

[COMMITTEE PRINT]

SECURITIES AND EXCHANGE COMMISSION
STAFF REPORT

ON

TRANSACTIONS IN SECURITIES OF THE
CITY OF NEW YORK

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

95th Congress, First Session



AUGUST 1977

Printed for the use of the
Committee on Banking, Finance and Urban Affairs

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WASHINGTON : 1977

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LETTERS OF TRANSMITTAL

AUGUST 29, 1977.

HON. HENRY S. REUSS,
*Chairman, Committee on Banking, Finance and Urban Affairs, U.S.
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: Enclosed for your consideration is a copy of a report entitled "Staff Report on Transactions in Securities of the City of New York," which was transmitted to me on August 26, 1977, by the Honorable Harold E. Williams, Chairman, Securities and Exchange Commission.

The report is the result of an investigation conducted by the staff of the Securities and Exchange Commission into events occurring during the period from October 1974 through April 1975, when New York City faced a fiscal crisis and issued large amounts of short-term securities.

The information and materials contained in the report will be most useful to the Members of the Subcommittee on Economic Stabilization in their oversight and legislative activities in connection with the New York City Seasonal Financing Act of 1975 (P.L. 94-143). Because of the importance of the issues raised in the report, it is suggested that the report be made available for the use of Members of the Committee on Banking, Finance and Urban Affairs and Members of Congress.

The views and conclusions presented in the report do not necessarily represent those of the Subcommittee on Economic Stabilization or of any individual Members.

Sincerely,

WILLIAM S. MOORHEAD,
Chairman, Subcommittee on Economic Stabilization.

(III)

SECURITIES AND EXCHANGE COMMISSION,
Washington, D.C., August 26, 1977.

HON. WILLIAM S. MOORHEAD,
*Chairman, Subcommittee on Economic Stabilization, Committee on
Banking, Finance and Urban Affairs, U.S. House of Representa-
tives, Washington, D.C.*

DEAR CONGRESSMAN MOORHEAD: I am pleased to transmit herewith
a report by the staff of the Commission, on Transactions in Securities
of the City of New York.

This report is submitted in accordance with your requests of Sep-
tember 7, 1976, and June 9, 1977, made in conjunction with the Sub-
committee's oversight responsibility for the New York City Seasonal
Financing Act of 1975.

With best wishes,
Sincerely,

HAROLD M. WILLIAMS,
Chairman.

(IV)



FOR RELEASE: 1 p.m. Friday, August 26

77-20

COMMISSION ISSUES STAFF REPORT ON
TRANSACTIONS IN NEW YORK CITY SECURITIES

The Commission transmitted to Congress today a Staff Report on Transactions in Securities of the City of New York. The Report is the product of a 19-month investigation and focuses on events which occurred during the period from October 1974 through April 1975, when the City faced a fiscal crisis and issued very large amounts of short-term securities.

The Report was transmitted to Congress at this time in response to requests from Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs; Congressman William S. Moorhead, Chairman of the House Banking Subcommittee on Economic Stabilization; and Congressman Benjamin Rosenthal, Chairman of the House Government Operations Subcommittee on Commerce, Consumer and Monetary Affairs. Senator Proxmire's Committee and Congressman Moorhead's Subcommittee are pursuing their oversight responsibilities with regard to the New York City Seasonal Financing Act of 1975, and Congressman Rosenthal's Subcommittee is examining activities of several New York Clearinghouse member banks and the Federal agencies that regulate them.

The investigation which underlies the Report, conducted by the New York Regional Office, was one of the most complex in the Commission's history and involved collection of more than 250,000 documents and over 12,000 pages of sworn testimony. It sought to --

(1) determine the nature and extent of the knowledge of City officials, underwriters, and bond counsel with respect to the steadily-worsening financial condition of the City; and

(2) compare the knowledge of these parties to the disclosures made to the public from October, 1974 through April, 1975 -- a period during which approximately \$4 billion worth of City short-term debt securities were sold to the public.

"The federal securities laws administered by the Securities and Exchange Commission have as their principal purpose the protection of public investors," the Report declares. "Accordingly, our inquiry has been to determine whether, in the offer, sale and distribution of the City's debt securities, under the circumstances, there was provided the measure of disclosure mandated under the federal securities laws in the interests of the investing public. We conclude that it was not."

The Report is accompanied by an Introduction and Summary and is divided into seven chapters as follows:

- (1) Chronology of Events;
- (2) Accounting Practices and Financial Reporting;
- (3) The Role of the City and Its Officials;

- (4) The Role of the Underwriters;
- (5) The Rating Agencies;
- (6) The Role of Bond Counsel; and
- (7) Analysis of Questionnaires Sent to Individual Investors, Syndicate Members and Managing Underwriters.

The Commission will, after receiving staff recommendations, consider what Commission action or legislative recommendations, if any, should follow.

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STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

INTRODUCTION AND SUMMARY

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

Introduction and Summary

Chronology of Events

October 1, 1974 - April 8, 1975 Chapter One

Report on Accounting Practices

and Financial Reporting Chapter Two

Report on the Role of the City

and Its Officials Chapter Three

Report on the Role of the Underwriters Chapter Four

Report on the Role of the Rating Agencies Chapter Five

Report on the Role of Bond Counsel Chapter Six

Analysis of Questionnaires Sent to

Individual Investors, Syndicate

Members and Managing Underwriters Chapter Seven

INTRODUCTION AND SUMMARY

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION STAFF REPORT ON
TRANSACTIONS IN SECURITIES OF THE CITY OF NEW YORK

INTRODUCTION AND SUMMARY

The last offer of securities by the City of New York to the general public was made in March, 1975. Since that time, the public debt market has been closed to the City. On November 15, 1975, the New York State Legislature enacted the Moratorium Act, which suspended the enforcement of the City's short-term debt, because the City was unable to meet its maturing obligations. Thousands of small investors had purchased a substantial part of the approximately \$4 billion of short-term securities sold during the six months preceding March 31, 1975. On November 5, 1975, ten days before the passage of the Moratorium Act, certain short-term notes actually traded at a 35 percent discount from their principal face amount. On December 31, 1975, after the Moratorium Act was passed, but before it was declared unconstitutional, prices of certain short-term notes had declined to a 45 percent discount from their principal face amount.

The Investigation

In January, 1976, the Commission commenced an investigation into transactions in securities of the City. The staff's inquiry principally focused on the period from October 1, 1974, to March 31, 1975 -- the period during which the City's reliance on short-term borrowing increased dramatically over prior comparable periods, and the period during which the City issued substantial amounts of certain debt instruments to the investing public that remained outstanding at the time of the passage of the Moratorium Act.

During its 19-month investigation, the staff obtained over 250,000 documents and compiled over 12,000 pages of investigative testimony.

The staff's Report is a distillation, analysis and evaluation of the evidence that has been obtained to date. The investigation, which is a continuing one, is in no sense an adjudicatory proceeding. Nor is the investigation or this Report a determination of the rights or liabilities of any person.

Background

For a number of years, the City was incurring increasing deficits in its operations. In order to finance these deficits, and to appear to comply with the legal requirement that it balance its operating budget, the City, among other things, increasingly resorted to the sale of "short-term" debt securities. 1/

On March 31, 1975, the City had outstanding debt in excess of \$14 billion, as follows:

\$ 7,887,733,170	Funded Debt
1,102,000,000	TANs
1,767,655,000	BANs
3,185,000,000	RANs
<u>107,610,000</u>	Other short-term debt
\$14,049,998,170	TOTAL <u>2/</u>

1/ The "short-term" debt securities offered by the City, with stated maturities of one year or less, included: Tax Anticipation Notes ("TANs"), issued by the City in anticipation of the collection of real estate taxes; Revenue Anticipation Notes ("RANs"), issued in anticipation of the collection of estimated taxes (other than real estate taxes), monies that were estimated to be received from the New York State and federal governments and certain other kinds of revenue; and Bond Anticipation Notes ("BANs"), issued in the anticipation of revenues from subsequent sales of bonds.

2/ Office of the Comptroller, City of New York. "Annual Report of the Comptroller of the City of New York for the Fiscal Year 1974-1975," October 31, 1975, parts 6-A and 6-C.

The City employed budgetary, accounting and financing practices which it knew distorted its true financial condition. These practices enabled the City to issue about \$4 billion of short-term securities during the six-month period preceding its preclusion from the Nation's securities markets. 1/ This record amount of securities was issued at the very time the City was on the brink of financial collapse.

In fact, the City dramatically increased its short-term debt six-fold -- from \$747 million to \$4.5 billion -- in the six years from 1969 to June 30, 1975. The New York State Charter Revision Commission primarily attributed this "enormous increase" in the City's debt to:

. . .the City's refusal to soundly finance its expense budget. Since 1970-71, every expense budget has been balanced with an array of gimmicks--revenue accruals, capitalization of expenses, raiding reserves, appropriation of illusory fund balances, suspension of payments, carry-forward of deficits and questionable receivables, and finally, the creation of a public benefit corporation whose purpose is to borrow funds to bail out the expense budget. 2/

These practices, it was concluded, did not "produce any cash in themselves; they simply enable[d] the City to borrow to pay current expenses." 3/

The June 30, 1975 deficit, as later adjusted by the City, exceeded \$5 billion. Reliable financial information was unavailable, and the adjusted deficit could only be estimated because, among other things, the City's internal accounting control system had been deficient in material respects.

1/ Id.

2/ Preliminary Recommendations of the State Charter Revision Commission for New York City, p. 33.

3/ Id.

The estimates of receivables, which formed the basis for the huge amount of RANs and TANs offered in the October, 1974 - March, 1975 period, were overstated by the accrual of revenues, including federal and New York State aid receivables and real estate and other local taxes which were unearned, uncollectible or non-existent. For example, on October 1, 1974, a consultant to City Comptroller Goldin prepared an internal memorandum, stating in part:

To balance the expense budget, the City employs a series of unsound budgeting and accounting practices including carrying forward bogus receivables, levying taxes on City-owned property. . . [and] overestimation of revenues. . . . The total amount of bad receivables which may have been rolled over exceed \$500 million. 1/

Subsequent reports of New York State and City officials disclosed yet additional, significant areas in which the City's actual financial condition during the October, 1974 - March, 1975 period was vastly different from that claimed by the City and its officials.

During this period, the City continued to issue debt securities to investors throughout the United States and in foreign countries.

1/ Graphic evidence of these practices was confirmed by two audit reports on New York City prepared by the New York State Comptroller in July and August 1975. Thus, for example, he estimated that "the \$502 million of real estate taxes receivable on the City's books at June 30, 1975 [was] overstated by approximately \$408 million. . . ." Similarly, the State Comptroller also found that receivables from New York State and the federal government, which formed a basis for the issuance of RANs, were "grossly overstated." In an examination of \$373.3 million out of \$434.2 million of such receivables, the Comptroller "found them to be overstated by \$324.6 million." Audit Reports Nos. NYC-3-76 and NYC-26-76.

As the City's financial plight worsened, it reduced the minimum face amount of the instruments it issued from \$100,000 to \$10,000, in order to penetrate the individual investor market more effectively. City securities were also placed with the City's pension funds and with a bond sinking fund — funds under the management of City officials, who were acting in fiduciary capacities on behalf of the beneficiaries of such funds.

The critical importance of adequate disclosure to public investors during this period is illustrated by a letter of April 1, 1975 by counsel involved in the distribution of the City's securities:

In view of the rapidity with which events are developing in connection with the City's finances, we feel it is appropriate to summarize for the Banks our views on what has come to be known as the question of "disclosure." You will recall that an attempt was made to address the problem in the form of the City's Report of Essential Facts dated March 13, 1975. While it may be possible by updating and supplementing that Report to satisfy the applicable legal requirements with respect to future underwritten offerings, we understand from our discussions with the banks that the adverse information which would be required in such a report, would in all likelihood render the City securities unsaleable. 1/

In a May 4, 1976, speech, 2/ the City's Comptroller, Harrison J. Goldin, sought "to describe some of the conditions which existed, with respect to accounting and budgeting at the start of the City's fiscal crisis" as follows:

1/ Letter of White & Case.

2/ Address of New York City Comptroller Harrison J. Goldin, at the Annual Conference of Municipal Finance Officers Association of the United States and Canada, San Francisco, California, May 4, 1976.

The City could not be sure of the amount of valid State and Federal receivables because agencies conducted their own negotiations on Federal and State grants, provided their own budgetary input on the amounts expected, spent the money long before the grants were received (if, indeed, they were ever received) and clung to a touching faith in the validity of receivables long after they had proved as unreliable as a politician's promise.

* * * *

The City could never count on receiving the full amount of real estate taxes budgeted in any particular year, because it insisted on budgeting 100 percent of the tax levy even though it was the invariable experience in New York - even in better times - that collections would run less than 95 percent of the tax levy. The difference in the case of tax levy of over three billion would obviously be somewhere around \$200 million.

* * * *

There was a broad feeling, I believe, that even though the City's accounting and budgeting had been revealed as a kind of Rube Goldberg conception - a system which defied understanding or control - it was better to leave it alone as long as it churned out enough money to meet the bills and pay the debts.

The functioning of the process by which City securities were brought to the market place depended not only upon the issuer, but also upon the principal underwriters, bond counsel and rating agencies. As is evident from the facts set forth in this Report, in varying degrees, they also failed to meet their responsibilities. Thus, public investors were denied the protections to which they were entitled.

The Report

This Report consists of seven chapters. Chapter One of the Report, the Chronology, describes the principal financial events during the critical period. It sets forth the meetings and other events participated in by

City officials, bond counsel, the underwriters of the City's securities, rating service officials and certain other persons. The Chronology, and the underlying evidence on which it was prepared, set forth, in large part, the factual basis for the succeeding Chapters which examine the roles of the various participants in the offer and sale of the City's securities to the investing public.

Chapter Two discusses certain of the City's unsound accounting and reporting practices, and the system of internal accounting control on which financial data of the City was based. These practices successfully obscured the City's real revenues, costs and financial position. Substantial weaknesses in the City's system of internal accounting control caused its financial information to be inherently unreliable. Many of the City's accounting practices were specifically designed to assist the City in its budget-balancing exercises by prematurely recognizing revenues and postponing expenses to unrelated future periods. The increase in revenue recognition was accomplished by the accrual of revenues, including federal and New York State aid receivables and real estate and other local taxes which were unearned, uncollectible or nonexistent. The essentially cash-basis accounting for City expenditures failed to recognize significant costs incurred but unpaid during the year, including millions of dollars annually in pension costs, which were calculated based on outdated actuarial assumptions and paid two years later. These were significant factors which contributed to the City's financial difficulties and enabled it to borrow funds from the public which could not be supported by its sources of revenue.

Chapter Three describes the role of the City and its officials in the events surrounding the City's fiscal crisis. It concludes that:

- (1) City officials were aware that there was an ever-growing disparity between revenues and expenses;
- (2) City officials employed certain unsound budgetary, accounting and financial reporting practices which created the appearance that revenues and expenses were in balance;
- (3) City officials prepared and published various reports which did not, individually or in the aggregate, clearly and accurately describe such practices or reveal the City's true financial condition; and
- (4) The Mayor and the Comptroller made numerous reassuring public statements concerning the City's financial condition and the safety of investments in the City's debt securities, which statements facilitated the sale of the City's securities, and which did not provide adequate disclosure of the facts.

In sum, the Mayor and the Comptroller misled public investors in the offer, sale and distribution of billions of dollars of the City's municipal securities from October, 1974, through at least March, 1975.

Chapter Four focuses upon the key role played by the underwriters in the distribution of the City's securities. It discusses the underwriters' knowledge of the financial crisis and the City's related problems, the inadequacies of their disclosure of materially adverse information regarding the budgetary and financial problems of the City, and their failure to fulfill their responsibilities to the investing public. It also discusses the realization of these underwriters, and their failure to disclose, that their capacity to distribute substantial additional quantities of securities successfully was significantly impaired because of the City's financial crisis and that the market had become saturated with City securities. As the City's fiscal crisis further deteriorated, the public was subjected

to a confusing and contradictory financial picture, with the result that public investors were misled.

Chapter Five discusses the role of the rating agencies. These agencies rate the creditworthiness of municipal obligations. Their ratings have a significant impact upon investment decisions and access by municipalities to the capital markets. The agencies appear to have failed, in a number of respects, to make either diligent inquiry into data which called for further investigation, or to adjust their ratings of the City's securities based on known data in a manner consistent with standards upon which prior ratings had been based.

Chapter Six examines the role of bond counsel. During October, 1974, through March, 1975, four firms issued opinions on the validity of the issuance of New York City securities. The Report examines the engagement of the firms and the procedures they used in providing their opinions. The Report also explores bond counsel's awareness of circumstances relating to the City's fiscal problems that affected matters basic to bond counsel's opinions. In addition, the Report examines the knowledge of bond counsel of other matters that should have been, but were not, disclosed to investors. The Report concludes that bond counsel, when on notice of circumstances that called into question matters basic to their opinions, should have conducted additional investigation. It also concludes that bond counsel, who continued with their engagement having knowledge of information material to investors, should, in view of the particular circumstances, have taken reasonable steps to satisfy themselves that such material facts were disclosed to the public.

Chapter Seven contains analyses of the responses received from questionnaires sent to individual investors, syndicate members and managing underwriters. The individual investor responses indicate that the majority had never invested in municipal securities before, and 90 percent responded that a factor in their investment was their belief that an investment in City securities was "safe and secure." The survey also found that, at the time they made their investments:

- 78 percent of the investors believed the City's bookkeeping and accounting practices to be excellent or good; and
- 79 percent of the investors believed that the City was in good or excellent financial condition.

Additional comments volunteered by a number of these individual investors concerning their experiences with these investments were overwhelmingly negative, and indicated quite clearly that, in their purchase of City securities, they had been "misled."

Epilogue

The Commission's mandate is to assure that investors in securities, whether issued by municipalities or others, receive the protections afforded by the federal securities laws. This Report concludes that investors in the securities of New York City did not receive those protections.

On a number of occasions, the key participants had a clear opportunity to prevent further serious damage to public investors. However, they did not do so. As the City's financial condition deteriorated, additional steps were taken to sell its notes to individual investors, thus unfairly and improperly shifting the inherent risks. At a minimum, before such a shifting of risk was attempted, the key participants had the duty to assure adequate disclosure upon which investment decisions could be predicated.

Depriving investors of their clearly defined rights cannot be justified by the need to provide vital services to New York's citizens. Rather than serving the salutary goals the City sought to effect, the failure to make meaningful disclosure prolonged the agony of the City's fiscal crisis, and delayed major necessary corrective efforts. This failure caused undue risks and substantial injury to investors in the City's securities. It also impaired the liquidity of a number of the City's major banks, which are leading financial institutions in the United States, and cast a pall on the capacity of municipalities generally to utilize the Nation's securities markets to fund their essential operations.

It is imperative that persons with responsibilities in the marketing of municipal securities reassess their roles to assure that, when required, they will meet the demands of such occasions. It is hoped that this Report will be studied by the various participants in municipal financing, and that they will commence a critical review of the facts as the first step in the development of a program designed to place into effect at the earliest possible time the necessary remedial measures, not only to prevent a recurrence of what took place in New York City, but also to install a system that will assure municipalities vital access to the Nation's securities markets and the protection of those who invest in municipal securities.

Chapter One



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**CHRONOLOGY OF EVENTS
OCTOBER 1, 1974 - APRIL 8, 1975**

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION

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TRANSACTIONS IN SECURITIES
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Chapter One

CHRONOLOGY OF EVENTS

OCTOBER 1, 1974 - APRIL 8, 1975

August 26, 1977

TUESDAY, OCTOBER 1, 1974

A memorandum to Harrison J. Goldin, Comptroller of the City of New York, from Steven Clifford, consultant to the Office of the Comptroller, examined "unsound budgeting and accounting practices" of the City of New York. The memorandum commenced:

To balance the expense budget, the City employs a series of unsound budgeting and accounting practices, including carrying forward bogus receivables, levying taxes on city-owned property, paying retroactive wage settlements from judgement and claims, postponing payments (or postponing the recognition of expenses), appropriating chemical [sic] balances, speeding up the recognition of revenue, overestimation of revenues, and underestimation of expenses.

These practices produce a supposedly balanced budget, at least at the start of the year. Unfortunately they do not generate any cash, and force [the] City to increase short term borrowings which currently total about \$4 billion. In addition to increasing debt service costs, these practices subvert the budgeting and taxation processes. By translating discretionary costs in one year to mandatory debt service costs in subsequent years, they deprive the taxpayers and voters of a choice between services and taxpayers [sic]. By allowing the City to increase expenses without an immediate increase in taxation, these practices encourage the City to over commit itself and disregard the future consequences.

The memorandum recommended "[a]udits of property taxes and other city receivables to be completed by October 15;" "[p]ublication of a white paper, about Jan. 15, documenting the effects of unsound accounting and budgeting on City debt service costs;" and "[i]nclusion of a five year forecast of revenues and expenditures in the Comptroller's Feb. 15 statement." 1/

1/ Memorandum, Steven Clifford to Harrison J. Goldin, October 1, 1974.

Indeed, as early as May 6, 1974, Jonathan Weiner, Special Advisor to the Comptroller, in a memorandum to Comptroller Goldin, noted that

(footnote continued)

WEDNESDAY, OCTOBER 2, 1974

The City announced the sale of \$420.4 million in Bond Anticipation Notes ("BANS") at an interest rate of 7.79%, the highest interest the City ever paid on BANS, and \$97.4 million in Urban Renewal Notes ("URNS") at a rate of 7.7%. The successful bidders were syndicates headed by Chemical Bank and by First National City Bank ("Citibank") and Chase Manhattan Bank ("Chase"). 1/ There was no public dissemination of an offering circular or comparable document.

MONDAY, OCTOBER 7, 1974

A monthly meeting was held of the Comptroller's Technical Debt Management Committee ("CTDM Committee"), a committee first established by Goldin's predecessor, Abraham D. Beame, to advise the Comptroller on debt issuance, the condition of the municipal securities markets and related matters. 2/

(continued)

Mayor Abraham Beame's proposed plan to meet the 1974-75 gap of \$1.5 billion consisted of (1) one-shot items totalling \$185.1 million, (2) phony savings and revenues totalling \$80 million, and (3) other less-than-sound fiscal practices totalling \$151 million, for a total of \$416.1 million. In addition, Weiner stated that the Mayor's plan accepted the Governor's "outrageous proposal" that the State accelerate its aid payments to the City totalling \$114 million. Weiner concluded:

"Hence, thus far \$530.1 million (at least) in budget balancing items for 1974-75 is gimmickry, a total which I believe surpasses most previous years excesses. Very seriously, of this total \$299.1 [million] is in one-shot ventures, and an additional \$80 million (at the very least) is phony. Beame is storing up a lot of trouble for himself. What in fact will be done next year? Borrow again?"

Weiner then urged Comptroller Goldin to "responsibly disassociate [himself] from some of these practices."

1/ News Release, Office of the Comptroller, 74-118, October 2, 1974.

2/ Testimony of Harrison J. Goldin (August 26, 1976) at 37. Hereinafter all testimony will be cited by the witness' name and the page(s) of the transcript of such witness' testimony. The testimony of several witnesses who testified on more than one occasion began on each occasion with page one. In those instances, the date of the person's testimony being cited will also be included.

All references to exhibits marked for identification during a witness' testimony will be referred to as " ____ Ex. ____".

Present at the meeting, besides Goldin, were Dr. Seymour Scher, First Deputy Comptroller; William T. Scott, Third Deputy Comptroller; Sol Lewis, Chief Accountant; and various other members of the Comptroller's staff. John Devine of Chase, Gedale D. Horowitz of Salomon Brothers, Richard F. Kezer and Paul S. Tracy, Jr. of Citibank, Zane Klein of Berlack, Israels & Liberman, Richard B. Nye of First Security Co., Wallace O. Sellers of Merrill Lynch, Pierce, Fenner & Smith ("Merrill Lynch"), Frank P. Smeal of Morgan Guaranty Trust Co. ("Morgan"), and James F. Trees of Fisher, Francis, Trees & Watts, Inc., all members of the CTDM Committee, were also present. 1/

At this meeting, the Comptroller announced various changes in the City's borrowing schedule, including changes to ensure compliance with the New York State Local Finance Law requirement that outstanding Revenue Anticipation Notes ("RANS") not exceed likely Federal and State receivables. Deep concern was expressed by CTDM Committee members about the potential saturation of the market because of the magnitude of the City's projected borrowings; that a point might be reached where the City would not be able to market its securities at any yields; and that difficulties might arise with the next scheduled bond offering on October 16th. The Comptroller and his staff were informed by CTDM Committee members that the volume of City securities being introduced into the market might bring a negative reaction from the municipal securities rating agencies and that, because of extreme market pressure, a negotiated sale might be more beneficial to the City than selling the securities through competitive bids. The Comptroller indicated that he also was extremely concerned about these matters and solicited assistance from the CTDM Committee. 2/

1/ Minutes of the CTDM Committee, October 7, 1974.

2/ Id.

The CTDM Committee requested a tentative schedule of proposed sales of City securities through June 30, 1975, including proposed sales of the obligations of the Stabilization Reserve Corporation ("SRC"). 1/ Lewis promised to provide such a schedule excluding proposed sales of the SRC which was under the control of a separate Board. 2/

TUESDAY, OCTOBER 8, 1974

A memorandum was addressed from Steven Clifford and Jonathan Weiner, Special Advisor to the Comptroller, to Seymour Scher and other members of the Office of the Comptroller, concerning the increasing frequency and amount of the City's issuance of short-term debt and the validity of the State and Federal receivables used to support the issuance of RANS. It was noted that end-of-year outstanding short-term debt had risen 241.1% from June 30, 1970 to June 30, 1974, whereas State and Federal aid in the expense budget had increased only 64.1% between the 1969-70 and 1973-74 fiscal years.

The memorandum noted that, as of June 30, 1974, all but \$75 million of the 1973-74 expense budget appropriations had been spent and there was a \$40 million negative balance of cash on hand. Clifford and Weiner observed that, "[H]ence, barring some as yet unknown revenue windfall or barring some accounting effort to charge expenditures already incurred to other fiscal years, we actually needed substantially all the borrowing we did on expense budget account." 3/

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- 1/ The SRC was one of several "moral obligation" financing entities utilized by the City to raise funds, outside constitutional debt limits, for various projects and purposes
- 2/ Minutes of the CTDM Committee, October 7, 1974.
- 3/ Memorandum, Steven Clifford and Jonathan Weiner to Seymour Scher, October 8, 1974.

The memorandum stated:

At this point we should have a very good idea as to whether the \$300 million borrowing for general fund revenues was appropriate (the expected revenues as of 6/30/74 should have come in during the July-September 1974 quarter). If not, we have a clear indication of over-estimation on these accounts.

Clifford and Weiner maintained that it was important to resolve the validity of State and Federal receivables as of June 30, 1974, and outlined the steps required to verify the receivables. They postulated, "[T]he amounts of RANS outstanding in . . . major accounts [totaling \$998.1 million] as of 6/30/74 at first blush suggests that the results of such an undertaking as outlined may be alarming." 1/ The authors added the following caveat:

... [A]t the macro budget-balancing level everything through one technique or another is fungible. Surpluses on one account in one fiscal year can be matched against deficits in another. 2/

The memorandum concluded with the following listing of "Suggested Tactics":

1. Engage in some relatively discrete and rapidly accomplished post audits perhaps of such items as the possibility that the City may be taxing its own property, some miscellaneous revenue accounts (e.g., limited profit housing) and one or more state and federal accounts, perhaps Elementary and Secondary school aid.
2. Undertake a more comprehensive set of audits.
3. Develop on-going procedures and policies as follows:
 - a. What evidence of validity would be sufficient for us to borrow?
 - b. What evidence (or cash collected) would be sufficient for us to approve vouchers? On items a & b we should develop rules flexible

1/ Id.

2/ Id.

enough to allow certain lags in receipt of information.

- c. What evidence do we need to credit receivables to a given fiscal year account?
- d. How should we write off bad receivables if such exist in large amounts?
- e. What reporting system do we want to develop in-house to track receivables through the billing, collection and credit procedures? 1/

* * *

Mayor Beame, by letter to Comptroller Goldin, elected to charge debt incurred for specified housing projects as housing or urban renewal indebtedness against the 2% limitation on such indebtedness rather than as long-term debt, which was legally limited, thereby allowing the City to incur additional long-term debt under the legal limitation. 2/

* * *

A memorandum of this date from Melvin N. Lechner, Director of the Budget for the City, to Mayor Beame, discussed the 1976 Capital Budget. Among other things, this memorandum proposed including at least \$390 million of expense items in the Capital Budget and raised the possibility of using capital funds to subsidize the transit system. In discussing ways in which to reduce an anticipated budget gap of up to \$648

1/ Id.

2/ Letter, Abraham D. Beame to Harrison J. Goldin, October 8, 1974.

This practice, also engaged in under the administration of Mayor John V. Lindsay, is treated separately in the "City" section of this Report.

million, Lechner made the following comments:

- (2) While there are a number of methods to reduce the "budget gap" -- use of TCF [Transit Construction Fund], use of Convention Center bonds, refusing to fund lower priority projects--a substantial problem would remain. Use of these devices might reduce the \$648 million gap mentioned above by as much as \$500 million, depending on the extent to which TCF can be used.
- (3) The remainder of the budget gap -- together with any increase in reserve that may be desired -- will require a combination of rescindments and reduction of new projects. I regard the size of the reserve as particularly important because of its effect on the City's credit rating and the marketability of our bonds. Marketability has become and will continue to be increasingly difficult for the following reasons:
 - (a) The size and frequency of bond and note offerings has increased.
 - (b) One of the two syndicates currently bidding on City debt -- headed by First National City -- may drop out of competition, leaving only one effective bidder.
 - (c) A rating change to BBB is entirely possible.
 - (d) There is a growing concern in the bond market with the City's fiscal condition, a concern which is amplified by the relatively "thin" market for City obligations.

In these circumstances, I believe public, affirmative action is important to demonstrate the City's willingness to acknowledge and deal with its fiscal problems. A reduction in the rate of capital spending, as exemplified by an increase in the reserve achieved by cancelling or deferring projects, would be the most dramatic demonstration.

- (4) While specific rescindments may not have to be identified at this time, I believe it important to communicate our intention to enforce budget stringency as early as possible. An indication of this intention will affect not only the bond community and rating agencies but also those interested in advancing City projects we may ultimately decide to delay

or eliminate. Currently, a number of lower priority projects have completed designs and are ready for bid; if we are to prevent commencement of this work, a clear signal will be required. 1/

WEDNESDAY, OCTOBER 9, 1974

A memorandum for internal circulation from James Carney of the Office of the Comptroller summarized discussions among himself, Scott and Lewis, concerning the current and proposed allocation of responsibility within that Office for debt management. The memorandum proposed that the Bureau of Accountancy continue to determine the need to issue debt, but not continue to make the policy decision as to how to incur the necessary debt, including the decisions as to maturity, the length and type of obligations issued and the timing of their sale. These decisions would be made by a standing committee, to be established, comprised of the Comptroller, the First and Third Deputy Comptrollers and the Chief Accountant, which would meet once a month prior to the meeting of the CTDM Committee and would determine the borrowing schedule and the form of the borrowing for the month. The implementation of debt issuance would continue to be handled by the Bureau of Investments. The memorandum stated that the debt redemption part of debt management was "in poor condition in terms of records, systems and procedures" and that an overhaul of the current system was necessary before the decision to transfer the debt redemption function to a banking institution could be made. 2/

1/ Memorandum, Melvin N. Lechner to Abraham D. Beame, October 8, 1974.

2/ Memorandum, James Carney to Harrison J. Goldin, Seymour Scher, William Scott and Sol Lewis, October 9, 1974.

THURSDAY, OCTOBER 10, 1974

On this date, Fitch Investors Service, Inc., ("Fitch") issued an update 1/ of its July 24 report. 2/ The earlier report was an analysis of the City and its debt, prepared by David M. Breen, Vice President of Fitch, pointing out the increasing reliance of the City, over the preceding five years, upon short term financing and upon the capital budget, as opposed to the expense budget, to finance recurring expense items. According to the report, almost half of the 1974-75 capital budget was being used to finance recurring expenses which equalled 5.68% of the City's total operating budget. Additionally, the report noted that the City had lost jobs, that its expenses continued to increase and that new or increased taxation would be required to fund the contributions to the City's pension funds. The report stated that speculative factors rather than investment characteristics might predominate unless the City took steps to halt the "recent course of financial debilitation." 3/

In its update, Fitch reduced the rating for New York City Bonds from "A" to "BBB" for maturities prior to January 1, 1980 and to "BB" for maturities January 1, 1980 and thereafter. The updated report was based upon a review of the Comptroller's Annual Report for the fiscal year ended June 30, 1974.

Among the items cited by the Fitch updated report were:

- (i) the increase in real estate tax delinquencies requiring more short-term borrowing at higher costs;

1/ "New York City -- Its Debt, Financial Structure (Financial Future?)-- An Analysis; An Update of July 24, 1974 Report," Fitch Investors Services, Inc., October 10, 1974 ("Fitch Update").

2/ "New York City -- Its Debt, Financial Structure (Financial Future?) -- An Analysis," Fitch Investors Services, Inc., July 24, 1974.

3/ Id.

- (ii) the City's waiver of the requirement to appropriate money for the Rainy Day Fund for seven successive years; ^{1/}
- (iii) the current deficit (disbursements over receipts) for the 1974 fiscal year of \$1.977 billion, an increase of 152% over the preceding fiscal year; and
- (iv) deferral of on-going maintenance and provision in the 1974-75 capital budget of only \$165 million for new construction. (The update stated that continual deferral of on-going maintenance would necessitate complete reconstruction of many City properties, a task likely requiring new or increased taxes.)

Referring to the constitutional "first lien" on city revenues for debt service, the update noted that funding for the "police power" function of government might have an equal or superior lien. A chart contained in the update showed that for the four years prior to fiscal 1974, the City maintained a year-end cash balance by utilizing borrowings and, despite such borrowings, had a deficit for fiscal 1974.

Fitch's reduction of the ratings for City bonds was based on "the predominance of speculative factors" as follows:

- (a) previous and continuing short-falls in realization of revenue projections;
- (b) continued reliance on short-term borrowing for cash flow purposes;
- (c) continued use of the Capital Budget for operating expenses which reduced the ability of the City to properly maintain its properties; and
- (d) reliance upon financing vehicles outside the City's debt limitations (Stabilization Reserve Corporation).

The Fitch report concluded that the City's failure to reverse these trends suggested that it might have "difficulty in meeting all its financial

^{1/} The Rainy Day Fund was a reserve fund which was supposed to be maintained for the purpose of helping the City through fiscal difficulties.

obligations, debt service as well as operating expenses." 1/

FRIDAY, OCTOBER 11, 1974

A memorandum written from Weiner to Goldin, Scher and Scott concerning the market for the City's short-term debt noted that major banks were finding it unprofitable to carry tax exempt debt for trading and holding purposes because other types of loans and leases had provided the banks with sufficient tax shelters for their purposes, thus eliminating the value of tax exempt obligations. The memorandum discussed a suggestion that the Federal Reserve "give commercial banks some differential credit against demand deposit reserve requirements depending on the average daily size of municipal debt held in their portfolios." It was noted that this proposal would avoid the criticism directed towards an earlier proposal in that the Federal Reserve "need not be called upon to support the debt of particular states or localities or operate with less than desirable anonymity in its open market program in what is, compared to the Treasury Bill market, a relatively thin sector." Commenting generally on market absorbability, the memorandum referred to attached tables that showed that City short-term issues, as a percentage of all municipal offerings, comprised 20.56% of all 1973 issues and 27.57% of all issues in the first half of 1974. It was indicated that both percentages would soon increase substantially as certain "project notes" backed by HUD were removed from the market. 2/

1/ Fitch Update.

2/ Memorandum, Jonathan Weiner to Harrison J. Goldin, Seymour Scher and William T. Scott, October 11, 1974.

TUESDAY, OCTOBER 15, 1974

Comptroller Goldin issued his required report on the proposed 1975-76 capital budget of the City and the capital program for the five succeeding fiscal years, as mandated by Section 212 of the City Charter, which directs that the report be submitted to the Mayor, the Board of Estimate, the City Council and the City Planning Commission, and that it be published in the City Record. In his report, the Comptroller stated that 53% of the contemplated capital budget would be used to pay for items usually considered to be expense items, noting that, as a result of this practice, the City's capital projects would not receive the attention they required and real estate taxes could increase. 1/

* * *

An internal report of Bankers Trust Company ("Bankers Trust") discussed the updated Fitch Report of October 10, and the October 15 Goldin report. The report noted that the City had \$5.33 billion in notes outstanding, with \$1.2 billion to be rolled over before December 31, 1974, and that there was a possibility of growing pressure on Moody's and Standard & Poor's to downgrade their "A" ratings of City securities. It concluded, however, that it was expected that the City would maintain its ability to meet its debt service obligations. 2/

1/ "Report Pursuant to Section 212 of the Charter with Respect to the 1975-1976 Capital Budget and the Capital Program for the Succeeding Five Years" Office of the Comptroller, October 15, 1974.

2/ "New York City's Credit," Bankers Trust Internal Report, October 15, 1975.

WEDNESDAY, OCTOBER 16, 1974

Messrs. O'Connor, Ranschburg and Jany of the Citizens Budget Commission, Inc. ("CBC"), an independent citizens' organization, met with Richard Adams, Senior Vice President of Chemical Bank, to discuss New York City finances and debt management. A memorandum from Richard Adams to William S. Renchard, Chairman of the CBC, and Donald Platten and Norborn Berkley, of the Chemical Bank, stated that the initial question raised by the CBC staff was whether the City could use the proceeds of a one-time \$500-700 million bond issue outside the capital budget to replenish operating funds and thereby reduce the amount under the Capital Budget which had to be used for current operations. The memorandum characterized this approach as a "gimmick" and noted that, during the meeting, Adams had stated that:

...two basic things must be done to improve the City's finances:

- (1) stop running budget deficits, balance receipts and expenditures, and
- (2) rationalize the financing operations of the City by regularizing market borrowings and by extending the average maturity of the City's debt.

According to the memorandum, the meeting ended with Adams agreeing to do some technical work on the November 8 presentation which the CBC was going to make to the Mayor's Council of Economic and Business Advisors. /

* * *

The City announced the sale of \$475.58 million in bonds at an average interest rate of 7.3318%. This was the largest sale of municipal bonds ever

/ Memorandum, R. V. Adams to W. S. Renchard, October 16, 1974.

conducted by the City up to that time. 1/

SATURDAY, OCTOBER 19, 1974

As reported in The New York Times, the Chairman of the State Charter Study Commission, State Senator Roy Goodman, issued a report that charged that the fiscal operations of the City involved the use of "a bewildering and perhaps questionable variety of devices to muddle through to the next year." In an accompanying statement, Senator Goodman described the expense and capital budgets as involving "an elaborate web of decision-making and, at times, conscious deception." 2/

TUESDAY, OCTOBER 22, 1974

Mayor Beame issued a press release stating that despite increasingly higher interest rates, New York City's credit position had improved considerably. The release stated, in part:

The Mayor emphasized that the City's credit position was "solid and strong," even though the national economy is under the stresses of both inflation and recession, and even though these inflationary-recessionary trends are "creating some budget balancing problems for the City."

The Mayor said, "There is absolutely no question about the City's ability to repay all of its debts on time, and that this ability has improved over the last fifteen years."

As proof, Mayor Beame cited three commonly accepted fiscal indicators in the October issue of the City's "Fiscal News-letter," issued by Finance Administrator Ivan E. Irizarry.

The Mayor stressed that these indicators of the City's sound credit position were over and above the absolute guarantee which the City's bondholders had under the State Constitution

1/ News Release, Office of the Comptroller, 74-122, October 16, 1974.

2/ The New York Times, "City Is Criticized On Budget-Making," October 20, 1974, p. 37.

that they would receive their scheduled interest and principal payments on time.

The indicators cited in the "Newsletter" were:

- * The full value of taxable real estate rose much faster than the City's net funded debt. The net debt was only 8.5% of the full value of real estate in 1973-74, compared with 11.8% in 1959-60.
- * Similarly, the City's revenues rose much faster than its debt service, that is, what the City has to spend in interest payments and bond and note redemptions. The significance of this lies in the fact that the State Constitution makes the City's debt service payments a first lien on all revenues not just revenue from real estate. Revenues were a full nine times more than debt service in 1973-74, compared with only 5.5 times in 1959-60.
- * Finally, a full 71.1% of the City's current debt will be repaid in ten years. And, 47.3% of the present debt — almost half — will be repaid in only five years — a better maturity schedule of its obligations than the schedules of eight other large cities. 1/

FRIDAY, OCTOBER 25, 1974

One of a series of periodic memoranda from Adams to Platten at Chemical Bank concerning the status of the dealer inventory in the various departments of the bank reported that most of Chemical Bank's municipal inventory was in City notes and that there was very little liquidity in the market for such notes. 2/

SATURDAY, OCTOBER 26, 1974

A memorandum from First Deputy Mayor James Cavanagh to Mayor Beame concerning the 1974-75 expense budget described the environment surrounding the budget, listed the causes of the budget problems, and outlined a series of

1/ News Release, Office of the Mayor, 529-74, October 22, 1974.

2/ Memorandum, R. V. Adams to D. C. Platten, October 25, 1974.

steps and solutions designed to meet the budget crisis. The causes cited in the memorandum were:

I. The environment

- New York City is in deep economic trouble (N. Y. Times)
- Mayor has warned of large deficit
- Mayor says (at Chamber of Commerce) "an even wider gap is opening"
- Broad range of fiscal authorities agree that crisis has arrived

II. The causes

- Inflation - increased costs
- Recession - depressed revenues, increased welfare and health costs
- Borrowing for day-to-day expenses
- Gimmicks - overstatement of revenues, understatement of expenses
- Depletion of reserves
- New York City economy has not been able to grow enough to meet government needs
- Difficulties of cutting the budget
- Heavy temporary borrowing

III. Solutions

- New and higher taxes - drive people and business from City
- Layoffs - add to unemployment
- Postponements - adds to general unemployment
- Reduced services - politically difficult 1/

1/ Memorandum, James A. Cavanagh to Abraham D. Beame, October 26, 1974.

SUNDAY, OCTOBER 27, 1974

In an article in The New York Times, the City was described by a group of fiscal authorities as being in deeper economic trouble than at any time since the Great Depression. "Fiscal crises are annual events in New York, and Mayors have cried wolf so often that Mr. Beame felt compelled to tell his audience that 'what I'm talking about is real -- it's not phony.'" The fiscal authorities cited the use of budget gimmicks and borrowing for day-to-day expenses as among the causes of the City's problems and the City was described as facing fiscal decisions that were unattractive both politically and economically. 1/

MONDAY, OCTOBER 28, 1974

Comptroller Goldin announced that on November 4, 1974 the City would sell \$500 million of Revenue Anticipation Notes ("RANS") and \$115 million of Tax Anticipation Notes ("TANS"). 2/ A Wall Street Journal article appearing the next day stated that, with this offering, the City would have placed \$2.5 billion of its notes in the market in 2 months, causing a dramatic increase in the yield on City notes while the yield on other short-term notes had been falling sharply. 3/

TUESDAY, OCTOBER 29, 1974

In a news wire entitled "New York City Bonds," Jean Rousseau 4/ stated, "We do not have any serious concern about the city's willingness and ability

1/ The New York Times, "Fiscal Experts See the City in Severe Financial Crisis". October 27, 1974.

2/ News Release, Office of the Comptroller, 74-125, October 28, 1974.

3/ Wall Street Journal, "Yields Rise on Notes of New York City as New Issue is Slated," October 29, 1974, p. 35.

4/ Mr. Rousseau was a vice president of Merrill Lynch and the manager of its Municipal Bond Department.

to pay the interest and principal on its debt, although we do believe that marketability has been affected by recent publicity." 1/

FRIDAY, NOVEMBER 1, 1974

The 1973-1974 Annual Report of the Comptroller was issued. 2/
The numerous omissions and misstatements of this document were largely the results of the City's innovative accounting and disclosure practices and lack of internal control. The more salient deficiencies included:

1. A failure to disclose the probable inaccuracies of cash balances. (As a result of the City's inadequate bank reconciliations, the City's cash balances later had to be reduced by some \$19 million.) 3/
2. Failure to disclose that payroll costs were based on a 364 day year, and the related cumulative [sic] unrecorded liability. In addition, there was no liability reflected for unpaid payroll and fringe benefit related costs, such as vacation pay. 4/
3. Failure to disclose the City's massive obligation for unfunded pension costs. 5/
4. Real estate taxes "receivable" of \$502 million of which \$408 million was later estimated to be uncollectible. 6/
5. Material Federal and State aid receivables recorded as if they were 100% collectible. 7/

1/ Merrill Lynch Newswire, October 29, 1974.

2/ News Release, Office of the Comptroller, 74-127, November 1, 1974.

3/ Annual Report of the Comptroller of the City of New York for the Fiscal Year 1975-1976, n. M, p. 25.

4/ See the section of this Report entitled "Accounting Practices and Financial Reporting" at 40-44.

5/ City of New York, Official Statement, May 20, 1977, p. 52.

6/ Audit Report of the New York State Comptroller, "Interim Report No. 2 - Uncollected Real Estate Taxes," Report No. NYC-26-76, August 4, 1975, p. 2.

7/ Audit Report of the New York State Comptroller, "Interim Report No. 1 - Prior Year Accounts Receivable," Report No. NYC3-76, July 1, 1975, Managerial Summary, at 3.

6. A non-existent "revenue" from the New York Stabilization Reserve Corporation ("SRC") (organized to issue debt for the City to meet its expenses and balance its budget). The debt was never issued and the SRC did not provide the needed funds. The report reflected \$150 million as a "Source of Revenue of the General Fund." 1/
7. A significant undisclosed cumulative deficit. 2/

MONDAY, NOVEMBER 4, 1974

The New York Times published an editorial entitled "Near-Bankrupt City," stating that the current deficit of the City could run to \$1 billion and that the "city is sliding into bankruptcy with dismaying speed." 3/

* * *

The City issued \$500 million of RANS and \$115 million of TANS, through a syndicate headed by Morgan Guaranty at an average interest rate of 8.3359%. 4/ No offering circular or comparable document was publicly disseminated.

1/ Audit Report of the New York State Comptroller, Interim Report No. 3 - Special and Miscellaneous Revenue Accounts, Report No. NYC-31-76, January 5, 1976, p. 3.

2/ Annual Report of the Comptroller of the City of New York For the Fiscal Year 1975-1976, pp. 4, 25; Municipal Assistance Corporation Press Release, August 29, 1975, at 2.

3/ The New York Times, Editorial, "Near-Bankrupt City," November 4, 1974, at 36.

4/ News Release, Office of the Comptroller, 74-128, November 4, 1974.

FRIDAY, NOVEMBER 8, 1974

The CBC made a presentation to Mayor Beame's Council of Economic and Business Advisors. William Renchard, Dr. Herbert Ranschburg and Roderic O'Connor of the CBC were present. Deputy Mayor Cavanagh represented the Mayor's office. The presentation was reduced to a typewritten report and sent to the members of the CBC with the notation "not for publication". The covering letter included a statement that Deputy Mayor Cavanagh had no argument with the CBC projections. 1/

The report stated that "[f]or the past eleven years, New York City's total budget expenditures have exceeded the City's expense budgets in increasing amounts," that "the gap between these two budgets has grown to \$1,486 million, equal to 13.4% of the expense budget," that "in 1974-75, \$722 million will be borrowed to cover 48.6% of that gap," and that the net debt of the City rose 72% from 1965 to 1974 while debt service rose 147%. It projected a minimum deficit of \$1 billion in the 1975-76 fiscal year.

The report recommended three basic approaches to the City's problems:

- (1) decrease expenditures and limit borrowing;
- (2) increase revenues - from City, State and Federal sources; and
- (3) seek legislative and/or constitutional reforms of certain fiscal practices.

1/ Letter, Roderic L. O'Connor to All CBC Subscribers, November 20, 1974; and attached "A Presentation to Mayor Beame's Council of Economic and Business Advisors by the Citizens Budget Commission," November 8, 1974.

After setting forth various ways of accomplishing these objectives the presentation ended with the CBC officers requesting the support of the members of the Council. _/

* * *

A memorandum concerning the City's finances was drafted for Alfred Brittain, III, Chairman of the Board of Bankers Trust, as background for a meeting with Goldin. This internal memorandum stated that the recently released City financial statement for the fiscal year ended June 30, 1974, showed that the City continued to deteriorate financially as evidenced by the following:

- (1) the excess of expenditures over revenues by nearly \$2 billion, with less than half of the difference to be made up eventually by planned state and federal payments;
- (2) the increase of short-term interest payments from \$62.5 million the preceding year to \$300 million the current year;
- (3) SRC was being used to retire budget notes that were refunded by revenue anticipation notes, leaving only some \$200 million to aid in balancing the more recent deficits. _/

The memorandum also stated that expense items accounted for 53% of the capital budget; that there had been a reduction of the ratings on City bonds by Fitch Investors Service to BBB and BB; that during the first half of 1974, New York City accounted for 27% of the nationwide tax exempt short-term borrowing; and that there was \$55 million of long-term bonds unsold from the last month's offerings. _/

_/ Id.

_/ Draft Memorandum to Alfred Brittain, III, November 8, 1974.

_/ Id.

Notes from the files of Bankers Trust also indicated that there was pressure on rating agencies to keep the ratings of City obligations above the point at which savings banks would be required to divest themselves of such obligations. 1/

SATURDAY, NOVEMBER 9, 1974

As reported by The New York Times, Mayor Beame ordered a \$330 million budgetary reduction consisting of pay reductions to City employees and reduced services to residents, in response to an emergency situation brought about by inflation and the recession. Mayor Beame stated, "for eight years John Lindsay cried 'wolf' and the public no longer believes -- they think it is just for Albany's sake . . . I want you to know this is not crying wolf." At his press conference, Mayor Beame said that the situation the City found itself in was no fault of the present administration and the bulk of the problem was inflation and recession. He stated, "I want you to understand that this has no relationship to the word 'bankruptcy.' Our bonds are good and secure. They will be paid." 2/

MONDAY, NOVEMBER 11, 1974

A letter from Mayor Beame and Comptroller Goldin to The New York Times, responding to an editorial of November 4, entitled "Nearly-Bankrupt City," appeared in the Times. The letter stated that the two officials agreed with the catalog of fiscal problems contained in the editorial, but took issue with the use of the word "bankrupt," on the basis that this word might create

1/ Handwritten notes received from Bankers Trust, November 8, 1974.

2/ The New York Times, November 9, 1974, pp. 1, 64.

"unwarranted fears for the safety of their investments among the city's bondholders." The letter stated that, under the State Constitution, City bonds and notes had a first lien on all revenues, and that "[o]ver and above the constitutional, legal and moral guarantees afforded to investors in New York City notes and bonds is the fact that they are investing in the world's wealthiest and soundest city as far as these obligations are concerned." They agreed that tough fiscal decisions and reforms had to be made and asserted that they would do what was necessary to protect the City "and to insure the continuing soundness of the City's obligations as an investment medium." ^{1/}

TUESDAY, NOVEMBER 12, 1974

At the monthly meeting of the CTDM Committee, Comptroller Goldin and members of his staff, including Scher, Scott, and Lewis, were in attendance, as well as John Devine and Thomas Labrecque of Chase; Mark Kessenich and Paul S. Tracy, Jr. of Citibank; Gedale Horowitz of Salomon Bros.; Zane Klein of Berlack, Israels & Liberman; Richard Nye of First Security Co.; Wallace Sellers of Merrill Lynch; and James Trees of Fisher, Francis, Trees & Watts, Inc.

At the meeting, a new borrowing schedule was distributed which added a January bond sale of \$500 million to those previously planned. The City reported that a cash projection computer program had been installed and was in the process of being brought up to date. The Comptroller

^{1/} Letter, Abraham D. Beame and Harrison J. Goldin to the Editor, The New York Times, dated November 7, 1974, published in The New York Times, November 11, 1974.

indicated a desire to reduce the minimum denomination of City notes to \$10,000 for the December 2 sale. Additionally, he drew the CTDM Committee's attention to a series of articles in The New York Times concerning City finances, indicated his hope that these articles would enhance the public's understanding of the City's problems, and announced that the letter he had written jointly with the Mayor, which had been published on November 11 in the Times, would be reprinted as a full-page advertisement paid for by a brokerage firm. 1/

* * *

A meeting was held in the Office of Comptroller Goldin between City officials and analysts of Standard & Poor's. This meeting had been requested by the analysts who had become concerned after having reviewed the City's Annual Report for the fiscal year ending June 30, 1974. At this meeting, the City officials present took the position that the City acknowledged the problems detailed in the Annual Report and was in the process of instituting cutbacks in expenditures and of improving management operations to remedy the situation. 2/ No rating change was effected by Standard & Poor's as a result of this meeting and it was ultimately decided that the City should be allowed time to implement its proposed solutions to its problems. 3/

THURSDAY, NOVEMBER 14, 1974

A meeting similar to the Standard & Poor's meeting was held between

1/ Minutes of the CTDM Committee, November 12, 1974.

2/ Margolies at 38-42.

3/ Id. at 38-46.

City officials and analysts of Moody's. 1/

* * *

The Comptroller issued a press release quoting the CBC as endorsing the joint effort by Mayor Beame and the Comptroller to "reassure investors concerning the City's basic financial strength while at the same time pledging Capital Budget reductions and other economies to close a looming budget gap." 2/

* * *

A four page document, prepared for a meeting with the agencies that rated the City's securities and captioned "City of New York Office of the Comptroller - Some Essential Facts About the City of New York's Debt Position," discussed several aspects of the City's debt and its financial situation, including the following:

- (1) with regard to outstanding long-term debt, as of June 30, 1974, the City had incurred debt (\$5 billion) totaling 68% of its debt incurring capacity (\$7.4 billion) under the 10% legal borrowing limit;
- (2) the City's full faith and credit is behind all its obligations;
- (3) net funded City debt had decreased as a percentage of full value of real property over the past decade and, from 1964-65 to 1973-74, net outstanding funded debt as a percentage of personal income generated in the City had also declined;
- (4) thirty percent of the total funded debt is either self-sustaining or guaranteed by the Sinking Funds' assets;
- (5) as of June 30, 1974, 21% of total outstanding debt was for transit, a service which few other cities pay for, and the remainder of the debt is proportionately comparable to other "Grade A" cities;

1/ Handwritten notes and diary page provided by Moody's, November 14, 1974.

2/ News Release, Office of the Comptroller, November 14, 1974.

- (6) the amount of City debt held by City pension systems and sinking funds had been reduced to maximize their earnings and minimize tax levy appropriations and, correspondingly, the percentage of City debt publicly held had increased;
- (7) the City's debt maturity schedule compared favorably with that of other major cities of the United States in that, as of November 30, 1974, 72.7% of the City's \$8.027 billion outstanding debt would mature within 10 years while 48.6% would mature within five years; and
- (8) with regard to outstanding short term debt, out of a total of \$3.416 billion, \$1 billion was for housing and was secured by mortgages and \$308 million stemmed from budget notes that had been issued in 1970-71 and redeemed on July 31, 1974. 1/

The document also discussed various aspects of debt service and taxing authority, stating, among other things:

- (1) debt service represented 16.2% of projected expense budget revenues in the 1974-75 budget which debt coverage ratio is "comfortable;"
- (2) although the City Real Estate Tax Levy for general purposes and for debt service had increased 120.7% for the decade ending in 1974-75, effective rates per \$100 of full value of taxable property had increased only 7.9% in that decade;
- (3) in the last five years, the assessed value of real estate had increased 12% and the full value had increased 28%; and
- (4) the City had not utilized all its taxing power within the 2-1/2% limit in the past two years. 2/

In a discussion of real estate tax delinquencies it was stated:

Although arrears of real estate taxes have gone up to 5.59 percent in 1973-74 from 4.94 percent in 1972-73, only 3.27 percent of the total real estate taxes for the past five years remained uncollected on 6/30/74. This relatively good collection record, plus the fact that 3 of the past 5 years resulted in expense budget surpluses, was reflected in the fact that no appropriation has been required for the Tax Deficiency Account to offset the accumulating cancellations of taxes. The most recent increase in arrears is in large part a reflection of high interest rates compared to the City's 9 percent penalty on late taxes. We expect this is a temporary phenomenon. 3/

1/ "Some Essential Facts About the City of New York's Debt Position," Office of the Comptroller, November 14, 1974.

2/ Id.

The document also pointed out that the ratio of current assets to current liabilities exceeded 100% for the second successive year, the welfare rolls in 1973-74 had declined by 6,000 persons per month, and the population of the City had been stable for more than 10 years.

The final section of the document dealt with steps already taken by the City to economize on its resources, stating that:

- (1) the Mayor's certificate for the 1975-76 capital budget, set aside a "true" reserve of \$225 million;
- (2) construction appropriations would be limited largely to renovations and modernizations instead of new projects;
- (3) by June 30, 1975, the City's work force would be reduced by 8,000 through an attrition program, in addition to the 2,500 provisional employees dismissed prior to the current fiscal year; and
- (4) high-cost programs would be eliminated as a result of an intensive review of facility utilization. ^{1/}

FRIDAY, NOVEMBER 15, 1974

Mayor Beame and Comptroller Goldin issued a joint statement, which closely paralleled their November 7, 1974 letter to The New York Times, directed against the "unwarranted fears" bondholders might have for the safety of their investments. The statement pointed out that "there is a distinction between the problems of balancing the budget and the basic ability of the City to meet its credit obligations." Budget problems were acknowledged by the two officials, but they asserted that the City's ability to meet its credit obligations was not affected in light of the facts that (1) New York City bonds and notes had a first lien on all City revenues, (2) the payment of

^{1/} Id.

interest and redemption of bonds had priority over any other obligations, and (3) both the Mayor and Comptroller would do what had to be done in order to preserve the City's economy and insure the soundness of its obligations. 1/

TUESDAY, NOVEMBER 19, 1974

The Comptroller's Office decided to use \$10,000 denomination certificates in connection with a December 2 offering of \$600 million of TANS and RANS. Citibank had suggested that 10 percent of the offering consist of \$10,000 denomination certificates while Chase felt that 40 percent of the issue should be in this denomination; the City compromised at 15%. 2/ The sale of such small denominations was initially resisted by the banks because it would increase costs and thus decrease profitability to the underwriters. 3/ In the course of the underwriting effort, additional amounts of \$10,000 notes were made available. 4/

1/ "Joint Statement by Mayor Abraham D. Beame and Comptroller Harrison J. Goldin," Office of the Mayor, November 15, 1974.

2/ Memorandum, Paul S. Tracy, Jr. to Richard F. Kezer and others, November 19, 1974.

3/ Charbonneau at 116-17.

4/ See page 29, infra.

WEDNESDAY, NOVEMBER 20, 1974

An article appeared in The Daily Bond Buyer quoting Mayor Beame and Comptroller Goldin as stating that the City was fully capable of meeting its obligations. These obligations were said to have a first lien on all revenues and would be repaid on time. "I'm not a rich man," the Mayor said, "but I've got a good portion of my assets in City bonds." Mayor Beame stated that one of the chief reasons for the City's heavy short-term borrowing was the tardiness of the State and Federal governments in transmitting their aid payments. Comptroller Goldin admitted the seriousness of the City's financial problems, but also referred to the City as a "superb investment." 1/

* * *

A memorandum to Merrill Lynch account executives advised them that New York City notes were then available in multiples of ten thousand dollars. The release emphasized that "this should open up a whole new market of potential tax-exempt note buyers. This should afford a great opportunity to open up new accounts and to bring in new funds." 2/

THURSDAY, NOVEMBER 21, 1974

In a memorandum to New York State Senator Roy Goodman, Chairman of the State Charter Revision Commission, Steven Clifford, then Consultant to the Comptroller, pointed out that the City's 1974-75 budget was out of balance by \$400 million and that the problems for fiscal year 1975-76 would be greater.

1/ The Daily Bond Buyer, November 20, 1974, pp. 1, 22, 23..

2/ Memorandum, John S. de Graffenried to Account Executives, November 20, 1974.

* * *

The Comptroller issued a press release announcing that City notes would be available in \$10,000 denominations beginning with the \$600 million offering of December 2 in order to achieve a broader market for the City's notes and possibly improve bids for the City's securities. He noted that the City did not sell securities directly to individual investors but stated that interested individuals should contact their banks or brokerage houses. The release stated: "The change to smaller denominations will permit additional private investors to obtain the good yields which are currently being offered on the City's short-term obligations." Although City bonds are issued in \$5,000 units, the City had not sold its notes in denominations as small as \$10,000 in over four years. ^{1/}

MONDAY, NOVEMBER 25, 1974

In an article in The New York Times, the City was depicted as facing four major problems:

- (1) its "A" credit rating was in serious jeopardy;
- (2) its demand for money -- already straining the market -- would be more difficult to meet;

^{2/} News Release, Office of the Comptroller, November 22, 1974.

- (3) its interest costs would soar well above market norms; and
- (4) the budget — already pinched — would be increasingly eroded by the cost of paying off the loans.

The remainder of the article quoted various municipal experts disagreeing about the City's fiscal problems and possible remedies. It was noted that the underwriting of City securities had become a dangerous profession, with huge amounts of unsold bonds still in syndicate hands from the October issue threatening the banks with substantial losses. 1/

TUESDAY, NOVEMBER 26, 1974

State Senator Goodman issued a press release based on the Steven Clifford memorandum of November 21, 1974. The release estimated a \$1.7 billion deficit for the next 19 months and stated that "[t]he City is a sick patient with a rapidly spreading form of financial cancer. The cancer is runaway short-term borrowing to cover huge expense budget deficits." The items in the Clifford memorandum were reiterated in this public release, including the statement that the banks might refuse to continue underwriting City short-term debt. 2/

* * *

The statement issued by Mayor Beame and Comptroller Goldin on November 15, 1974 was reprinted in The New York Times in the form of an advertisement paid for by Lebenthal & Company. The letter distinguished between the admitted fiscal problems of the City and the soundness of the City securities. 3/

1/ The New York Times, November 25, 1974, pp. 1, 48.

2/ News Release, State Senator Roy M. Goodman, November 26, 1974.

3/ The New York Times, November 26, 1974.

* * *

The Citizens Budget Commission issued a press release stating that the City had "serious problems, but they are not insoluble." "Neither do they warrant any concern regarding the City's ability to meet its credit obligations." The Mayor's efforts to respond to the fiscal crisis were endorsed. 1/

* * *

The New York Times printed an article concerning the City's budget deficit. The article discussed the size of the deficit, its origin and various approaches to eliminate it. Mayor Beame was quoted as saying that the deficit was caused by the dual problems of recession and inflation. 2/
WEDNESDAY, NOVEMBER 27, 1974

The Daily Bond Buyer published an article reporting over \$1 billion of unsold municipal securities (including those of New York City) in dealer accounts. There had been substantial price erosion of the City's October bonds and it was reported that "there was simply no market for the City bonds at the original price levels." When the October bonds were released from syndicate price restrictions, the prices of the bonds dropped dramatically. The article stated that City notes were reaching 8.33% in interest while rates on other short-term obligations were declining. 3/

1/ "Statement on New York City's Fiscal Crisis by William S. Renchard, Chairman of the Board," CBC, November 26, 1974.

2/ The New York Times, November 26, 1974.

3/ "New York City Prices Plummet 100 Basis Points in Free Market," The Daily Bond Buyer, November 27, 1974.

* * *

In a Merrill Lynch release to its account executives entitled, "Opportunity Knocks," they were advised that six hundred million dollars of New York City notes were available in minimum denominations of ten thousand dollars. Account executives were told not to "overlook the opportunity afforded here to call accounts and prospects who are normally precluded from buying tax-exempt notes because of the \$25,000 requirement", and to do their customers and themselves a favor by bringing this new issue to their attention. 1/

1/ Merrill Lynch Release, November 27, 1974.

FRIDAY, NOVEMBER 29, 1974

Comptroller Goldin sent a letter to Mayor Beame, which was publicly released on Sunday, December 1, 1974. In the letter, Comptroller Goldin stated that the budget deficit for the current fiscal year, 1974-75, would be \$650 million, \$250 million higher than projected by the Mayor. The budget deficit was calculated as being composed of \$250 million in revenue short-fall and \$400 million in expenditure over-runs. Goldin warned the Mayor that the deficit could be increased by adverse economic conditions, and that it must be closed in the remaining seven months of the fiscal year. He also stated: "As you know from my private and public statements starting as early as last February, I strongly support the policy of giving the public full and frank information on the City's serious fiscal problems, not only because the public has a right to know, but also because only an informed and concerned public can provide the support for difficult measures necessary to erase the deficit." As to solutions, Goldin said that it would not be possible to rely on the prospect of additional federal or state aid. He also ruled out higher taxes. With respect to additional borrowings, he stated: "I think it vital also that we say a clear and firm 'no' to any prospect of additional borrowing to close the budget gap." He stated that significant cuts in spending and a freeze on new capital commitments and newly announced commitments constituted the only sound solution, together with more federal or state aid, if obtainable. He concluded: "You know, far better than most, that the City's situation today is largely the result of a practice in previous years of getting through the present by mortgaging the future." 1/

1/ News Release, Office of the Comptroller, 74-138, December 1, 1974.

SATURDAY, NOVEMBER 30, 1974

The Mayor's office, through Deputy Mayor Cavanagh, issued an immediate rebuttal press release stating that the Comptroller's figures were incorrect and more than twice the deficit the Budget Bureau had projected, and that a cut of \$650 million in the budget would mandate at least 28,000 employee layoffs and unthinkable reductions in City services. The release indicated that the City did have fiscal problems, but far fewer than the Comptroller stated, and it was addressing those problems. 1/

SUNDAY, DECEMBER 1, 1974

Comptroller Goldin issued a press release containing the text of the letter sent to Mayor Beame on November 29, 1974. The current fiscal year deficit was said to be \$650 million, and Mr. Goldin contended that additional borrowing to cover this deficit would only worsen a serious situation. He stated, however, that the budget deficit "should not impair investor confidence in the essential soundness and safety of the City's obligations." 2/

MONDAY, DECEMBER 2, 1974

The Comptroller announced the sale of \$400 million of RANS and \$200 million of TANS to a combined syndicate led by Bankers Trust, which syndicate had submitted the only bid for the notes. Interest on the RANS was 9.5%, and on the TANS 9.4%, the highest rates ever paid by the City. The Comptroller, in his acceptance of the bid, stated that borrowing, both short-term and long-term, must be curtailed and put under rigid control. He also said, "[T]here

1/ News Release, Office of the Mayor, 585-74, November 30, 1974.

2/ News Release, Office of the Comptroller, 74-138, December 1, 1974.

is no question in the world that these borrowings will be repaid fully and on time" 1/

* * *

It was at one point planned that \$160 million of the RANS would be in \$100,000 denominations, \$180 million in \$25,000 denominations and \$60 million in \$10,000 denominations. 2/ Ultimately, however, only \$80 million of the notes were in \$100,000 denominations; \$140 million were in the relatively small \$10,000 denominations. 3/

* * *

The Wall Street Journal reported that the City had borrowed \$6.8 billion short-term since the beginning of the calendar year. Losses on the unsold October City bonds and inventory losses on City paper were said to have dramatically hurt the bidding ability of many dealers. 4/

* * *

Pursuant to a letter from Cavanagh, a meeting was scheduled for

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- 1/ News Release, Office of the Comptroller, 74-139A, December 2, 1974. The December RANS offering was the first offering of City securities which was not fully repaid in reliance on the Moratorium Act (\$249.6 million became subject to the Moratorium Act). (See Municipal Assistance Corporation exchange offer to holders of certain short-term notes of the City of New York, November 26, 1975.)
- 2/ Memorandum, Paul S. Tracy, Jr. to Richard F. Kezer and others, November 19, 1974.
- 3/ Certificate of Delivery and Payment for \$400 Million Revenue Anticipation Notes, signed by Harrison J. Goldin, December 13, 1974.
- 4/ Wall Street Journal, "New York City's \$600 Million Note Offer, Due Today, Is Hurt by Losses on Its Bonds", December 2, 1974, p. 25.

December 3 between members of the staffs of the Mayor and the Comptroller to review their differing budget estimates. 1/

TUESDAY, DECEMBER 3, 1974

A letter of this date on the letterhead of Richard L. Tauber, a Vice President of Morgan, addressed to a substantial client, advised on the status of New York City debt instruments. The letter indicated that the City's ability to pay its obligations was not in question, but the City was undergoing a financial crisis. The letter stated that although the author believed that the rating agencies would give the City the benefit of the doubt, a downgrading was very possible if the financial deterioration of the City continued; this would narrow the market for City securities. The letter recommended that the client reduce his holdings of City securities by not renewing maturing obligations and by tax loss trading. 2/

* * *

In a Merrill Lynch release to its office, account executives were told that the recent issue of New York City tax-exempt notes offered them an opportunity to call customers and prospects with "something interesting to talk about." The release went on to state that all the recent adverse publicity had "hurt the market for New York City bonds and notes." Branch offices were given "[u]p to 250 M [sic] notes firm overnight to work on a sales campaign." Salesmen were advised "[w]hy not make some calls this evening and discuss New York City notes with your customers or prospects." 3/

1/ Letter, James A. Cavanagh to Seymour Scher, December 2, 1974; letter, Seymour Scher to James A. Cavanagh, December 2, 1974.

2/ Letter, Richard L. Tauber to Corey R. Smith, December 3, 1974.

3/ Merrill Lynch Release entitled "Something to talk about," December 3, 1974.

WEDNESDAY, DECEMBER 4, 1974

The New York Times reported that aides to the Mayor and the Comptroller met for two hours on December 3, 1974 and, after arguing over their differing estimates of the size of the City's expense budget deficit, "agreed to disagree." 1/ The Times published an editorial attacking the practice of including expense items in the capital budget, thereby increasing their cost in the long run, by running up larger interest payments and reducing allocations for true capital projects. The editorial stated that the proposed capital budget listed \$780 million for expense items. 2/

The Wall Street Journal reported that individual investors, responding to the high interest rates on the recent offering, flooded dealers with purchase orders for notes in the new \$10,000 denomination. 3/

THURSDAY, DECEMBER 5, 1974

The New York Times reported that in spite of Mayor Beame's previously announced austerity program, 12,950 persons had been added to the City payroll over the preceding four months. 4/

FRIDAY, DECEMBER 6, 1974

A statement by the Mayor attacked the Times article of the previous day concerning the increase in City jobholders. It alleged that the story was "misleading" and used "raw payroll data" which was difficult to analyze.

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- 1/ The New York Times, "Aides to Beame and Goldin Disagree at Budget Deficit Parley," December 4, 1974.
 - 2/ The New York Times, Editorial, "Capital Loss," December 4, 1974.
 - 3/ Wall Street Journal, "Several Firms Put Off Offerings As Price Cuts Continue On Old Issues," December 4, 1974, p. 34.
 - 4/ The New York Times, "City Payroll Rose 12,950 in 4 Months," December 5, 1974, pp. 1, 52.

The statement cited Budget Bureau figures showing a net increase of 1,213 employees. 1/

MONDAY, DECEMBER 9, 1974

The CBC issued a press release calling for a total freeze on both City hiring and existing wages which it claimed would result in savings of over \$1 billion over a two-year period. 2/

TUESDAY, DECEMBER 10, 1974

Roderic O'Connor, President of the CBC, appeared before the City Planning Commission to discuss the proposed 1975-76 capital budget. O'Connor stated that this day was "the day the capital budget died." "This budget is a terminal case - murdered by a decade of fiscal mismanagement." Referring to the \$780 million of expense items in the draft capital budget, he stated that the CBC had warned repeatedly that such practices deplete the capital budget of money for capital needs, and accelerate the growth of future debt service payments in the expense budget. 3/ He called for a total job and wage freeze.

* * *

Comptroller Goldin appeared before the CBC and pledged his support to Mayor Beame to help close the projected budget gap. Goldin cited "basic areas of agreement with the Mayor," including the need for substantial cuts in City expenditures, renewed efforts to secure increased Federal and State aid, and a careful review of capital commitments. He acknowledged

1/ News Release, Office of the Mayor, 599-74, December 6, 1974.

2/ News Release, CBC, December 9, 1974.

3/ News Release, CEC, December 10, 1974.

It is clear that, under the above provisions regarding appropriation, New York City, as well as the other political subdivisions, must make appropriation for interest on all indebtedness and the maturing principal of bonds. However, as to revenue anticipation notes, tax anticipation notes, and bond anticipation notes, the above provisions apparently contemplate that repayment of principal may be accomplished by roll-overs of short term debt during a period limited to five years after the date of original issue. At the end of this period, the political subdivision must either (1) make appropriation for the payment of the unpaid principal of tax anticipation notes or revenue anticipation notes or (2) in the case of bond anticipation notes, sell the series of bonds in anticipation of which the notes were issued.

This memorandum also briefly discussed the question of hardship to a municipality as a defense to payment of indebtedness noting "[w]hether, in a case of extreme hardship, the court would require the payment of bondholder in full before any payment of municipal employees' salaries has never been decided." 1/

* * *

WEDNESDAY, DECEMBER 11, 1974

An internal Bankers Trust memorandum reported that during 1974 the City issued \$8 billion in short-term notes. 2/ It stated that the early

1/ Memorandum, Paul S. Tracy, Jr. to Salesmen and Traders, December 10, 1974.

2/ Memorandum, Truxton B. Pratt to William H. Moore, December 11, 1974.

December issue of \$600 million in notes was sold after only one bid had been submitted because of the following:

- (1) the market was overburdened with City paper;
- (2) the October bond sale had met a poor reception; and
- (3) there had been a public dispute, between the Mayor and Comptroller, over the size of the budget deficit.

The memorandum noted that it appeared there might be only one bid for future City underwritings resulting in high interest rates and that there might be some necessity for the Clearinghouse Association ^{1/} to respond to a plea for help by the City. The memorandum mentioned the "Bankers Agreement" of the 1930's, under which all short-term City financing was negotiated with New York City banks and noted that in 1970 Mayor Beame, then Comptroller, decided to use competitive bidding.

Noting that some projected City offerings to fund prior deficits would not be subject to the City's constitutional debt limit, including an SRC plan to offer \$500 million in bonds, the memorandum suggested that "the Clearing House should address this problem in advance of the next sale while the atmosphere is relatively cool and unemotional." ^{2/}

THURSDAY, DECEMBER 12, 1974

The New York Times reported that prices continued to move downward on the New York City bonds and that some dealers estimated that losses on some bonds were close to 20% on trades consummated at current prices. It was reported that many of the October bonds were still in dealers' hands and

^{1/} The New York City Clearinghouse is a voluntary association of New York banks.

^{2/} Memorandum, Truxton B. Pratt to William H. Moore, December 11, 1974.

would have to be sold if these dealers were to be capable of bidding on other issues. 1/

FRIDAY, DECEMBER 13, 1974

In an internal Morgan Guaranty memorandum, Amos T. Beason reported on the New York City situation to Frank Smeal, Executive Vice President. 2/ The memorandum stated that the City's financial problems were still solvable, but that City officials did not appear to comprehend the seriousness of the situation. It was asserted that, in the recent past, the City's problems were solved by more borrowings, budget gimmicks and increased Federal and State aid receivables. The reported attitude among dealers and investors was that the New York City financial institutions and the State and Federal governments would not permit the demise of the City to occur. However, investors were said to need concrete signs that the City's problems were being addressed by City officials and the financial institutions. The memorandum asserted that the bank's ability:

. . . to apply some financial discipline to the City's operation will be better accomplished while they can still fund themselves in the marketplace than when our vaults are loaded with nonmarketable City debt. Once the pattern becomes established of the City's not being able to sell debt and the City's financial institutions providing funds, we will find ourselves on a one way street.

1/ The New York Times, December 12, 1974, p. 73.

2/ Memorandum, Amos T. Beason to Frank P. Smeal, December 13, 1974.

The memorandum suggested that the banks require:

- (1) a substantial moratorium on capital expenditures;
- (2) a substantial cut in the City payroll;
- (3) a review of the City tax structure;
- (4) a termination of the public disagreements between Beame and Goldin;
- (5) "an honest certified assessment" of Federal and State receivables;
- (6) the development of "honest three-year plans" on revenues and expenses;
- (7) a solicitation of additional State relief; and
- (8) an analysis of the City's overall debt structure be conducted by officials of the City, State and City's business community with particular attention toward ameliorating the effects of the State's "phantom debt" requirements, i.e., the City's policy of repaying bond issues within half the useful life of the project for which debt has been incurred; the results of the study should include suggested remedial legislation.

In return for this program, the memorandum suggested that the City banks would take on substantial amounts of short-term City debt. The situation was said to require forthright discussion between the City officials and the bankers. 1/

* * *

One of a continuing series of internal memoranda from Richard Adams, Senior Vice President for the Bank Investment Division of Chemical Bank, to Donald Platten, Chairman of the Board and Chief Executive Officer of the Chemical Bank, reported on the status of Chemical's municipal dealer accounts.

1/ Id.

The memorandum stated the following: that the market for City securities was no longer viable, while the bond market was otherwise generally strong; the market was paralyzed with concern about the City's affairs and there were huge dealer inventories, which would not be sold except at heavy losses; the banks were forecasting a declining need for tax free bond income; the proposed purchase of City securities by the municipal employee pension funds would help the situation, but at least some of the contemplated financing would quite possibly have to be negotiated with New York City banks. 1/

* * *

The New York Times reported a statement by Mayor Beame urging the trustees of the City's five employee pension funds to purchase City bonds. 2/

MONDAY, DECEMBER 16, 1974

The New York Times reported that in recent weeks both banks and brokerage houses were suffering enormous underwriting losses on New York City bonds. Approximately \$200 million of the October bond offering was still unsold and losses on the bonds that had been sold approached \$40-50 million. The article stated that the possibility of future borrowing by the City had become increasingly uncertain and the market was described as a "disaster." The public bickering between the Mayor and the Comptroller was cited as a partial cause of the situation and several City

1/ Memorandum, Richard Adams to Donald Platten, December 13, 1974.

2/ The New York Times, December 13, 1974.

bankers were said to be planning to meet with the Comptroller to discuss the market problems. 1/

* * *

Karen Gerard, a researcher for Chase, wrote an internal memorandum entitled "The City's Fiscal Situation — The Budget Gap Is Real." 2/ It noted that a "'budget crisis'" was an annual event in New York City but unlike previous ones, this crisis was real. Ms. Gerard presented a general overview and analysis of the City's budget problems. She concluded that the City's economic base had been weakening at the same time that expenditures had grown at a more rapid rate than revenues, thus compounding the City's long-standing fiscal problems.

* * *

The CTDM Committee met at 5:00 P.M. at the Comptroller's office. Comptroller Goldin and eight members of his staff attended, along with Wallace Sellers of Merrill Lynch, Gedale Horowitz of Salomon Bros., Richard Nye of First Security Co., Richard Kezer of Citibank, Frank Smeal of Morgan, Thomas Labrecque and John Devine of Chase, James Trees of Fisher, Francis, Trees & Watts, Inc. and Zane Klein of Berlack, Israels and Liberman. The Comptroller distributed a new proposed borrowing schedule designed to stabilize the market by reducing the large quantities of City obligations and stated that his purpose in disclosing the magnitude of the developing

1/ The New York Times, December 16, 1974.

2/ Karen Gerard, Internal Memorandum for the Economics Group of the Chase Manhattan Bank, December 16, 1974.

deficit in the current budget was to refute rumors of a \$1 billion deficit estimate which had been circulating.

Members of the CTDM Committee expressed concern about the problems of rolling over short-term debt and the Comptroller stated that the current level of short-term borrowing would be continued at least through the first quarter of the next fiscal year. The CTDM Committee suggested that both the Mayor and Comptroller commence a public relations effort to inform the public of approaches that were being taken with respect to some of the City's problems. The serious nature of the market problems was discussed. The CTDM Committee indicated that pension purchases would provide only temporary relief and that this had to be told unequivocally to the Mayor. The meeting adjourned to reconvene at Gracie Mansion the next day at 8:00 A.M. 1/

TUESDAY, DECEMBER 17, 1974

The meeting of the CTDM Committee reconvened at Gracie Mansion. A memorandum by Frank Smeal indicates that Messrs. Beame, Goldin, Cavanagh and Lechner apparently caucused for approximately 15 minutes prior to the start of the meeting. 2/ At the reconvened meeting, Mr. Sellers of Merrill Lynch told the Mayor that the City securities market was a "total disaster" in recent weeks. 3/ Therefore, he stated, it was likely that there would be no bid on the January bonds. The CTDM Committee did not question the City's ability to pay its debt, but indicated that the market could not absorb offerings of the magnitude contemplated. The basic

1/ Minutes of the CTDM Committee, December 16, 1974.

2/ Memorandum, Frank Smeal to the File, December 17, 1974.

3/ Minutes of the Special Meeting of the CTDM Committee, December 17, 1974.

problem was said to be the size and frequency of the borrowings. He stated that purchases by the pension systems could afford only temporary relief and borrowing to finance deficits was no longer a viable procedure.

The Mayor disagreed with the CTDM Committee about the effect of the purchases by the pension funds, indicating that these purchases could continue as long as the rates of interest remained high. Furthermore, he asserted that it was the timing and not the size of the borrowing that was the problem and the banks should help "sell" the City and not just tell the City to reform. In addition, because of the ever-growing militancy of the municipal unions, Mr. Smeal indicated there were doubts as to whether City debt really had a first lien on revenues. Mr. Sellers stated that losses on the October bonds totalled nearly \$50 million and it was important to the City that the banks survive.

The Mayor stated that, with the exception of the borrowing by the SRC, all City borrowing was against expected revenues, as it always had been. He refused to commit himself to the elimination of deficit financing. The CTDM Committee indicated that the institutional market was closed to City securities and that the out-of-state banks were not buying these obligations. The Mayor stated that the City was borrowing against "firm receivables" and that the banks must "sell" the City to the rest of the country. The meeting concluded with the Mayor requesting, and the

CTDM Committee offering, support for attempts to obtain increased federal and state aid. 1/

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Following the meeting, the Comptroller issued a press release stating that the consensus of the CTDM Committee was that City obligations continued to offer absolute security to investors. In response to the market problem of oversupply, the City would reduce its borrowing and thus improve the supply-demand balance in the marketplace. The Comptroller explained that the reduction in public offerings would be chiefly accomplished by short-term limited investments of City pension fund and sinking fund money in City obligations. 2/

WEDNESDAY, DECEMBER 18, 1974

Bankers Trust generated an internal memorandum listing the maturity dates and amounts of all outstanding City notes and the reduced borrowing schedule for the City through June 1975. The memorandum demonstrated a cumulative increase in outstanding notes of over \$1.5 billion as of the end of June 1975. 3/

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The local newspapers, The New York Times, Daily News and The Daily Bond Buyer, printed stories to the effect that the City would reduce its borrowing for the rest of the fiscal year by \$1 billion. 4/ They reported

1/ Id.

2/ News Release, Office of the Comptroller, 74-141, December 17, 1974.

3/ Memorandum entitled "New York City Maturity Schedule of Outstanding Notes," December 18, 1974.

4/ The New York Times, Daily News, and The Daily Bond Buyer articles, December 18, 1974.

that the market reacted well to the news and the effective rates on City securities trading in the market declined.

THURSDAY, DECEMBER 19, 1974

An internal Citibank document addressed to Richard Kezer, Vice President, stated that the City still had a \$135 million deficit for fiscal year 1974-75 and, in order to balance the expense budget for 1975-76, the City would require more State and Federal aid as well as additional City taxes.^{1/}

* * *

Steven Clifford addressed a memorandum to the Comptroller and Seymour Scher, William Scott, Sol Lewis, Jonathan Weiner, Jerome Turk, James Carney and Richard Wells, all of the Comptroller's Office, regarding a proposal for a restructuring of City finances. Clifford characterized the City's accounting as "questionable," and identified the problem as two-fold: the City needed to issue \$7.3 billion in short and long-term debt during the next ten months in what was already a saturated market; and (2) unsound accounting and budgeting practices increased the need to issue debt while causing a decrease in investor confidence. He proposed that the City introduce various budgeting and accounting practices, including placing the City's general fund on a cash basis; putting the payroll and other payables on an accrual basis; establishing annual audits and certifications of receivables by an independent certified public accounting firm; removing City-owned property from the tax rolls; creating and maintaining three reserve funds, a general fund reserve, a debt service reserve

^{1/} Memorandum, John Berenyi to Richard Kezer, December 19, 1974.

and a social service reserve; recognizing reductions in real estate taxes due to delinquencies and reduced assessments in the current year; and repaying the prior year's deficits, i.e., \$520 million of stabilization notes and \$200 million of the 1974-75 deficit.

Mr. Clifford's memorandum indicated that federal legislation would be necessary to implement his proposal. In instituting the accounting reforms, the City would write off and retire \$2.7 billion short-term debt. The U.S. Treasury would lend the City the funds required at 8 1/2% interest and the City could repay the loan over 20 years.

Clifford cited the financial advantages of this proposal for both the City and the Treasury and noted that the sound practices established would also be advantageous. The final item on his list of advantages was: "Total collapse of city, capital markets and U.S. economy postponed for at least six months." 1/

Clifford urged that this proposal not be limited to aiding New York City but should be available for all states and municipalities that encountered deficits when they applied the sound accounting and budgeting practices. This would be the first step towards the regulation of the municipal market. It was also noted that maintenance of the accounting and budgeting standards should be covenants of the Treasury's loan and that, should the City violate them, it would be in default. 2/

1/ Memorandum, Steven Clifford to J. Goldin, B. Scott, S. Lewis, J. Weiner, J. Turk, J. Carney and R. Wells, December 19, 1974.

2/ Id.

FRIDAY, DECEMBER 20, 1974

Comptroller Goldin delivered a public address to the City Club of New York in which he discussed the fiscal problems of the City, with particular emphasis on the budget deficit. He stated:

New York's budget problems should be of only marginal interest to investors, who are protected by the State Constitutional guarantee making New York City bonds and notes a first lien on all revenues.

It would be a great disservice to investors and to the City if important fiscal information were withheld or manipulated. The City's bondholders and noteholders must have justified faith that government officials will be open and candid about the fiscal state of New York City.

Distrust is bred not by prompt public disclosure but by concealment of truth. 1/

MONDAY, DECEMBER 23, 1974

The Daily Bond Buyer reported that Standard & Poor's issued a report stating that they were retaining their "A" rating for New York City bonds, provided that the City continue its efforts to put its financial house in order. 2/

* * *

Mayor Beame issued a press release, commenting on the Standard & Poor's announcement, saying "It shows the proper awareness of the fact that the City's current budget balancing problems do not impair the City's ability to repay its debts...." 3/

1/ Remarks by Harrison J. Goldin at the City Club of New York, December 20, 1974.

2/ The Daily Bond Buyer, December 23, 1974.

3/ News Release, Office of the Mayor, 618-74, December 23, 1974.

THURSDAY, DECEMBER 26, 1974

In a memorandum to Amos T. Beason, Vice President of Morgan, Eric Altman, a researcher at Morgan, stated that the City was using short-term borrowing as an ordinary source of revenue. He asserted that the City had violated accredited accounting standards and was using gimmicks to achieve the appearance of a balanced budget; that the City had switched to an accrual basis for receivables while retaining a cash basis for payables; that the City budget assumed full collection of all revenues despite experience to the contrary; and that the City employed one-shot revenues to balance the budget. "By some estimates, restating the City's financial position in realistic terms according to accepted accounting principles will involve a write-off [of] \$2.7 billion at June 30, 1975." Altman contended that this write-off was too large for the banking community to finance and that the State could be [of] limited financial assistance because of its own fiscal difficulties. 1/

FRIDAY, DECEMBER 27, 1974

In another report to Donald Platten of Chemical Bank, Richard Adams, Senior Vice President for the Bank Investment Division, stated that the market for City securities was narrow and dependent on the New York City

1/ Memorandum, Eric Altman to Amos T. Beason, December 26, 1974.

banks. Problems in the 1976 fiscal year loomed large, with expenses outgrowing the economic base of the City. He declared that there was a need to reorganize the City's debt structure. 1/

MONDAY, DECEMBER 30, 1974

Moody's confirmed their "A" rating for New York City bonds in a detailed 19-page report. The City's fiscal situation was reviewed and the "A" rating was said to be confirmed because the City's debt was well-secured by a constitutional requirement for debt service, its internationally important economy and the prospects for administrative control of its financial difficulties. 2/

* * *

The Mayor issued a press release praising the action of Moody's and stating: "As Standard & Poor's did, Moody's also shows its awareness of the fact that the City's current budget-balancing problems do not impair the City's ability to repay its debts" 3/

TUESDAY, DECEMBER 31, 1974

The Comptroller's Office performed a review of the debt service accounts as of December 31, 1974. The memorandum summarizing this review

1/ Memorandum, Richard Adams to Donald C. Platten, December 27, 1974.

2/ Moody's Investors Service, Inc., Municipal Credit Report, December 31, 1974.

3/ News Release, Office of the Mayor, 624-74, December 30, 1974.

stated that over the years, the controls used in determining the liabilities in the various debt service accounts had been discontinued and bank reconciliations had not been effected. It was indicated that accurate data as to these accounts was not available on a timely basis. 1/

THURSDAY, JANUARY 2, 1975

In an internal Citibank document, David Gaston, investment officer, reported to Paul Collins, Senior Vice President, that Citibank held \$23 million par value in New York City obligations in accounts for which the bank had fiduciary responsibility. Mr. Gaston also reported that the bank was not purchasing City bonds for fiduciary accounts at the present time. 2/

MONDAY, JANUARY 6, 1975

In a letter to Comptroller Goldin, Mayor Beame directed that certain indebtedness incurred for loans to limited profit housing companies be excluded from the legally imposed two percent limitation on long-term debt with respect to housing and urban renewal and further instructed that certain other indebtedness incurred with respect to similar housing companies be charged against the two percent limitation. 3/

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- 1/ New York City Report of Debt Service Reconciliations as at December 31, 1974.
- 2/ Memorandum, David W. Gaston to Paul Collins, January 2, 1975.
- 3/ Letter, Abraham D. Beame to Harrison Goldin, January 6, 1975.

Marine Midland Municipals Co. sent a letter to its municipal customers informing them of the actions of Moody's and Standard & Poor's in confirming their "A" ratings for City bonds and stating that Marine Midland believed that the securities of New York City were a sound and attractive investment. The letter also included a copy of a Joint Statement by Mayor Beame and Comptroller Goldin dated November 15, 1974, that restated the constitutional, legal and moral guarantees afforded to investors in New York City notes and bonds.. 1/

TUESDAY, JANUARY 7, 1975

The Comptroller announced the sale of \$620 million of RANS to a syndicate headed by Chase and Citibank at an interest rate of 9.4%. The announcement was not made until 3:00 p.m. because the Comptroller had sought to determine whether there was any alternative to this bid. The Mayor and Comptroller each issued a press release attacking the 9.4% rate of interest. They stated that this rate was not reflective of the City's "A" rating and that they were going to meet with members of the financial community in order "to avoid a repetition of this unfair, unwarranted and outrageously high interest rate." 2/

1/ Letter, Marine Midland Municipals Co. to its clients, January 6, 1975, with attachment.

2/ News Release, Office of the Comptroller, 75-1, January 7, 1975.

WEDNESDAY, JANUARY 8, 1975

In an internal memorandum, Richard Adams of Chemical Bank reported to Donald Platten, Chairman of Chemical Bank, that there had been only one bid, at an interest rate of 9.4%, on the \$620 million RANS. The market was said to be improving and all of the notes had been sold; this was the second successive offering where a merged syndicate submitted the only bid on the notes. Adams said, "Support of the City of New York by the New York banks as 'lending institutions' has been enormous. Chemical Bank holds an amount of N.Y.C. obligations which far exceeds the amount it could or would lend to any other borrower, except the U.S. Treasury." 1/

Mr. Adams noted that the City may argue that the 9.4% interest rate was excessive, but that the following points, among others, might be made:

- (1) there was still an oversupply of City securities in the market;
- (2) there was much negative publicity about the City in the marketplace;

1/ Memorandum, Richard V. Adams to Donald C. Platten, January 8, 1975.

- (3) the market was continuing to narrow with several institutions withdrawing;
- (4) the real size of the City's deficit for fiscal 1975 was in doubt ("[w]e just don't know the facts."); and
- (5) figures between \$1 and \$2 billion had been discussed as the deficit for fiscal 1976. 1/

THURSDAY, JANUARY 9, 1975

The Mayor had requested that leaders of the financial community attend a meeting at Gracie Mansion at 8:00 A.M. Messrs. Beame, Goldin and Cavanagh, among others, represented the City. David Rockefeller and Thomas Labrecque represented Chase; Richard Kezer and William Spencer represented Citibank; Richard Adams and Donald Platten represented Chemical Bank; Ellmore Patterson and Frank Smeal represented Morgan; Charles Sanford and Alfred Brittain represented Bankers Trust; and John McGillicuddy and David Barry represented Manufacturers Hanover Trust Co. ("Manufacturers Hanover"). 2/

The primary topic of conversation was the 9.4% interest rate on the \$620 million RANS offering of January 7, 1975. The Mayor stated that the banks were not selling the City and its securities. He said that the 9.4% rate of interest forced upon the City by the single bid was not reflective of the City's financial strength, its substantial tax base,

1/ Id.

2/ The Daily Bond Buyer, January 10, 1975, pp. 1, 15.

and of the fact that City securities had a first lien on all City revenues. The mayor stated that the City was aware that it had problems, but he said that these were inherited from the previous administration, and there already had been great cuts in the budget. He claimed the financial community had been "bad mouthing" the City. 1/

The bank representatives responded by describing their views as to the status of the market for City securities. They said that there were serious doubts as to the market's capacity to absorb more City securities and that the clearing house banks did not have the capacity to take on all of the proposed City financing by themselves. They further stated that (1) the underwriters of the October bonds had incurred large losses, (2) the rate of 9.4% was not a rate set by the underwriters but one imposed by the marketplace, and (3) the market had reacted to the public dispute between the Mayor and the Comptroller over the size of the City's deficit and other fiscal problems. The bankers indicated that the City's investment community was willing to assist and work with the City to solve the market problems. 2/

The Mayor and the bank executives agreed that a committee would be established to work with the City to re-open the marketplace for City securities. Ellmore Patterson, then the head of the Clearing House Association and Chairman of Morgan, was to lead this committee which would become known as the Financial Community Liaison Group ("FCLG"). 3/

1/ E. Patterson at 23-24, 27.

2/ E. Patterson at 25, 28-29; Sanford at 22, 25.

3/ E. Patterson at 28-29; Memorandum, David A. Grossman to Willard C. Butcher, January 22, 1975.

* * *

In a briefing memorandum prepared for David Rockefeller by Thomas Labrecque prior to the meeting, it was reported (1) that the City would issue or refinance approximately \$7 billion in bonds and notes during calendar 1975, (2) out-of-state banks were withdrawing from the underwriting syndicates, (3) institutional investors were selling their City obligations, and (4) an estimated \$50 million was lost by the underwriters in the fourth quarter on City underwritings. 1/

* * *

The Mayor and Comptroller issued a joint press release after the meeting stating that, as a result of the meeting, "closer communications between the financial community and the City could provide potential investors with information that would strengthen confidence in the City as a sound investment." 2/

FRIDAY, JANUARY 10, 1975

In a speech delivered to the City Club of New York, David M. Breen, an analyst for Weeden & Co., formerly employed by Fitch, informed the

1/ Memorandum, Thomas Labrecque to David Rockefeller, January 8, 1975.

2/ Joint Statement from the Offices of the Mayor and the Comptroller, 18-75, January 9, 1975.

club members of particular City problems that were causing him concern. ^{1/} He stated that delinquent real estate taxes had increased from \$80 million to \$149 million in four years and; if the first quarter percentage delinquency continued, it appeared that \$190 million of such taxes would not be collected in the current fiscal year. He noted that, as the tax rate increased, the delinquency rate appeared to increase. Further, Breen asserted that the City had been in an economic slump since fiscal 1969-70 and the rate of abandonment of real property was considerable. He noted that the City had deferred, for the most part, its maintenance programs because little money was available in the Capital Budget, which was almost entirely being utilized for operating expenses. Eventually, he said, this practice "must mean complete reconstruction and/or replacement of the City's physical plant." The City's short-term borrowing was said to display its acute cash-flow problem. Mr. Breen claimed that (1) the City's deficit for the current fiscal year would be substantially larger than the Mayor's estimate and somewhat above that of the Comptroller and (2) the Rainy Day Fund had been depleted. He declared that:

The City, actually, has had deficits averaging \$1.1 billion annually for the past five years. The bottom line[s]... have shown cash balances only because of the City's ability to borrow for its cash flow needs.

Mr. Breen suggested three possible approaches to the City's problems:

- (1) mass firings of City workers;
- (2) a procedure whereby the financial institutions would manage the City's fiscal affairs, similar to what occurred in the 1930's; and

^{1/} Remarks by David M. Breen, Municipal Bond Analyst, Weeden & Co., before the City Club of New York, January 10, 1975.

(3) reorganization pursuant to Chapter IX of the Bankruptcy Act.

The City's fiscal problems were alleged to be the result of fiscal mismanagement and political expediency, exacerbated by the departure of the middle class from the City. 1/

* * *

The New York Daily News reported that the City was exploring the possibility of offering City bonds to its employees on a payroll deduction basis in the hope that \$250 million could be raised. 2/

* * *

A meeting was held among Richard Adams and Herman Charbonneau of Chemical Bank and David Grossman of Chase to discuss possible efforts by the clearing house banks to help improve the City's financial condition, including the organization of a financial committee to assist the City. Among the matters discussed were New York City debt management and financial reporting, the latter's quality being described as "poor." 3/

SATURDAY, JANUARY 11, 1975

The Mayor and Comptroller issued a joint press release attacking the speech by David Breen at the City Club, characterizing it as a call for bankruptcy. The press release stated that budget-balancing problems "have nothing to do with a city's ability, willingness and legal mandate to repay its debt." Mr. Breen was described, not by name, as irresponsible and as a person who

1/ Id.

2/ Daily News, January 10, 1975, p. 23.

3/ Memorandum, Herman R. Charbonneau to Richard V. Adams, January 14, 1975.

would yell "Fire" in a crowded theater when there was no fire. 1/

MONDAY, JANUARY 13, 1975

In a letter to Melvin Lechner, Director of the Budget, Comptroller Goldin stated that the estimated debt service for fiscal year 1975-76 would be \$2 billion, an increase of about 12% over the prior year. He estimated that the interest payments on temporary debt for the same period would show an increase of 160% from \$145 million to \$377 million because of the recent higher interest rates. The fact that the City had issued \$7 billion of short-term debt in fiscal 1973-74, an increase of \$3 billion over fiscal 1972-73, was said to be due to larger budgets and cash flow problems. 2/

* * *

Mayor Beame met with Ellmore Patterson and Frank Smeal and continued the discussion that began on January 9 at Gracie Mansion regarding the formation of a financial committee. They decided that the committee would work on financial planning and economic development for the City. 3/

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The New Yorker magazine published an article concerning the City's fiscal crisis with an emphasis on the job cuts ordered by Mayor Beame. The announced job reductions of Phases I, II and III, which totalled 7,935, were shown by the author to have actually resulted in the dismissal of

1/ Joint Statement by Mayor Abraham D. Beame and Comptroller Harrison J. Goldin, 20-75, January 11, 1975.

2/ Letter, Harrison J. Goldin to Melvin N. Lechner, January 13, 1975.

3/ E. Patterson at 31-32.

436 employees, none of whom was a member of a civil service union. The remainder of the job cuts were accomplished through attrition, retirement or the elimination of unfilled positions. 1/

* * *

Barron's, the financial weekly, printed an editorial stating that "[y]ou can't win on New York City bonds." The editorial discussed the problems of the City as well as the City officials' declaration that they would address these problems. The editorial noted, however, that despite highly publicized gestures toward economy the City's financial plight was growing worse with the City continuing to borrow and spend. It was asserted that the City's repeated assurance that its securities were sound "smacks of the repeated assurances of no devaluation which invariably precede a currency's debasement." 2/

TUESDAY, JANUARY 14, 1975

Alan Weeden, President of Weeden & Co., sent a letter to the Mayor in response to the Mayor's comments of January 11 on David Breen's speech to the City Club. Mr. Weeden wrote that Mr. Breen had not advocated bankruptcy for the City but had mentioned reorganization as an alternative approach to the City's fiscal problems. He further stated that Weeden & Co. was an active supporter of the market for City securities but it had sensed a concern in the marketplace over the rate of interest necessary

1/ New Yorker, January 13, 1975, p. 67.

2/ Barron's, January 13, 1975, p. 7.

to sell these securities. Weeden asserted that the City's fiscal problems should be discussed candidly and openly. 1/

* * *

Herman Charbonneau of Chemical Bank received a memorandum from Edward A. Rabson, also of the bank, regarding Chapter IX of the Bankruptcy Act as pertaining to New York City. Mr. Rabson outlined provisions of this Chapter and stated:

While we agree with Mr. Breen's charges of "fiscal mismanagement" and "political expediency" as adding to New York City's financial difficulties, we cannot, at this time, foresee a default on the City's general obligations, nor can we foresee the necessity of the City taking as drastic a step as filing a petition of insolvency under Chapter 9. [Emphasis in original]. 2/

* * *

Comptroller Goldin delivered an address to the Association for Corporate Growth in which he discussed the City's current financial difficulties. The City was said to be cutting back its expense budget spending, reviewing costly capital projects and sharply curtailing public borrowing. None of these efforts, he said, were reflected in the single bid by City underwriters of 9.4% on the last offering of City notes, which were sold out to yield 8-1/2 per cent and below. He asserted that such a yield was "an incredible bargain for investors." Mr. Goldin contended that the City was not being treated fairly by the lending institutions. He

1/ Letter, Alan N. Weeden to Abraham D. Beame, January 14, 1975.

2/ Memorandum, Edward A. Rabson to Herman R. Charbonneau, January 14, 1975.

admitted that the City was suffering from inflation and recession but he assured his audience that the Mayor and Comptroller would meet the economic challenge confronting the City. 1/

WEDNESDAY, JANUARY 15, 1975

Karen Gerard, of Chase Manhattan, prepared a memorandum for David Grossman entitled "A Note on the Relationship Between New York City's Immediate Debt Problems and the Longer Range Budget Situation." At the outset of the memorandum she noted that "it is generally claimed" that the City's "mushrooming of short-term debt" has expanded "with the growth of federal and state aid." However, she stated that the growth in short-term debt had increased more rapidly than the growth in aid. She provided figures to support her observation, e.g., in 1969 the City issued \$885 million in RANS and received \$2.57 billion in aid, but in 1974 the City issued \$4.51 billion in RANS and received only \$4.55 billion in aid. She noted that, "In fiscal 1974 alone, federal and state aid rose \$450 million while new issues of [RANS] for federal and state aid rose by \$2.8 billion." Gerard stated that the trend suggested "that one of three things has been happening. And a knowledge of which is primarily responsible is necessary if one is to judge whether the volume of temporary debt is a 'temporary' phenomenon or indicative of more deep-seated problems." The enumerated causes were:

- (1) ...[S]hifts in financing schedules, particularly at the state level...;

1/ Remarks by Harrison J. Goldin before Association for Corporate Growth, New York Chapter, January 14, 1975.

- (2) ...[W]orsening efficiency in the lag between city expenditures and reimbursements...;
- (3) The large volume of new issues could conceal a more serious problem of whether there is in fact anticipated aid behind the debt. If the latter were true, the consequences would be grave for both the short-term and the long-term municipal market.

She concluded that:

Because the impact is far different depending upon which factor is behind the rise, it is extremely important to have this question answered candidly. If there is no cause for long-term concern, it is easier to find pragmatic solutions and it would be well to advertise the fact that the short-term debt problem, at least, is temporary. If the issue is deeper, then it is essential to find out what the real situation is. 1/

THURSDAY, JANUARY 16, 1975

Minutes of a regular meeting of the Trust Investment Committee of the Trust Department of First National Bank of Boston indicated that:

A progress report on the Credit of the City of New York was presented for discussion. The previous improvement in the City's financial operations noted in August, 1974 has been deteriorating. The double adverse impact of inflation on operating costs and an increase in accounts receivable has produced a budget deficit gap requiring substantial short-term borrowing. A running controversy between the mayor's office and the comptroller on budget matters has damaged investor confidence.

Despite the possibility of some temporary improvement, it was felt the longer term prospects for the City's finances were not encouraging. Therefore, it was voted to discontinue approval for the purchase for general trust investment of all obligations of the City of New York, and sale should be considered on all issues maturing after August, 1975. 2/

FRIDAY, JANUARY 17, 1975

William Scott, Third Deputy Comptroller, addressed a memorandum to Sol Lewis, Chief of the Bureau of Accountancy, asking that certain analyses be performed with respect to BANS. This request was said to be pursuant to a conversation among Scott, Lewis, the Comptroller and Steven Clifford. Scott requested:

1/ D. Grossman Ex. 1.

2/ Minutes of Regular Meeting of Trust Investment Committee of the Trust Department of First National Bank of Boston, January 16, 1975

- (1) a listing of the amount, interest rate, and bond buyer index for each BAN issuance since July 1, 1967 as well as the same information on the RAN and/or TAN issues immediately preceding or following each BAN issue; and
- (2) a computation of the total interest charges on BANS for each fiscal year beginning with 1967-68 and the total amount of interest payments that the City received from projects funded by the BANS.

Additionally, the following two questions were posed in this memorandum:

1. Are these BANS a first lien on all City revenues?
2. Are they a first lien on the project properties themselves?
If yes, please calculate the assessed value of the projects.

Finally, Mr. Scott asked whether the City had ever converted housing BANS to funded debt and, if so, he requested the dates and the amounts involved. 1/

Early in January, Dr. Jackson Phillips, Executive Vice President of Moody's, met with the Comptroller and informed him that Moody's analysts were considering reducing its MIG-1 rating for the City's BANS to MIG-2. 2/ The Comptroller stressed the recent measures taken by the City to enforce budget cuts and asked that they be taken into consideration. He asked for and was granted time to prepare a presentation as to why the rating should not be reduced.

MONDAY, JANUARY 20, 1975

Comptroller Goldin gave an address to the New York City Treasurers Club in which he discussed the City's fiscal problems and its new computerized cash projection system. He stated that this system would enable the City to minimize interest costs and increase its return on short-term investments. With regard to the City's fiscal problems, Mr. Goldin asserted that the City was making the hard decisions that were required and was moving towards fiscal reform. 3/ He reported in part:

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- 1/ Memorandum, William T. Scott, Third Deputy Comptroller, to Sol Lewis, Chief, Bureau of Accountancy, January 17, 1975.
 - 2/ Memorandum, Freda Stern Ackerman to the files, January 17, 1975.
 - 3/ Remarks by Harrison J. Goldin before the New York City Treasurers Club, January 20, 1975.

The difficult and painful steps which New York is taking to meet the Challenges posed by the current economy, and to deal with the effects of past fiscal practices, are unmatched by any other municipal government in the country.

* * * *

Its not easy for a mayor to order mass lay-offs. The pressures mitigating against such cutbacks are far greater than those confronting a corporation president.

Its not easy to bring to a halt capital projects of great importance to the people of the City.

But these actions, and more to come, prove that the City means business in stressing economy, austerity, and improved fiscal planning.

In my office, we have developed, in line with a sharp curtailment of public borrowing for the remainder of the fiscal year, a regularized borrowing schedule, through the use of our new computerized cash projection system.

* * * *

For New York City to come out of the current economic crunch with renewed strength and a justified confidence in the future, the restraint and self-discipline, which have been forced upon the City by inflation and competing demands in the capital markets, must be adopted as conscious, long-term policy.

We can begin this year by ruling out any additional borrowing to close the budget gap. The issuance of Budget Notes obviously does not "solve" a deficit. It merely adds to future debt service. This year we are paying the price of the Budget Notes issued in Fiscal 1971 by repayment and, in fact, borrowing to make the repayment.

I am strongly opposed to any such "solution" this year.

* * * *

Next year's debt service, as I informed the Director of the Bureau of the Budget last week in the Comptroller's annual official estimate, will be in excess of \$2 billion.

This rising trend, the result of past fiscal practices, clearly must be reversed. And the only effective way to do it is to make a first consideration of how much the City can afford to

take away from the delivery of services, rather than how much it can get away with borrowing each year.

A percentage of the Expense Budget should be established which can reasonably be committed to debt service, then translated into dollars and the impact on tax rates determined. The amount of debt issued should be restricted to what the established level of debt service can sustain -- and no more.

Each year we should be narrowing the gap between redemption of debt and new debt commitments.

That is the first trend which must be reversed.

The second, which relates closely to the first, is the increasing load of current expense items which are charged to the Capital Budget.

More than half of the Capital Budget for the current fiscal year or \$724 million, is consumed by these items.

Next year, inflation could push that figure above \$800 million. With a combined estimated total of more than \$200 million going for transit and for judgments and claims, over a billion dollars would already be committed out of a Capital Budget debt-incurring capacity of \$1.36 billion.

Furthermore, I have recommended to the Mayor, who has concurred that an unencumbered margin of \$225 million must be held inviolate.

* * * *

But if the City is to renew itself, if it is even to build for essential purposes of health and safety, the trend of mounting expense items in the Capital Budget must be reversed.

The shifting of current expenses to the Capital Budget is akin to the back-door financing which has plagued Expense Budgets, increasingly over the past ten years, as quasi-independent authorities and public corporations have proliferated in New York State and throughout the nation, floating bond issues at great cost to the taxpayers but remaining unaccountable to public control.

There is a common theme running through all of these trends: the short-sighted approach of fiscal finagling which takes us one year at a time toward the day of reckoning.

Thus far, municipal governments have managed to survive from year to year on what appeared to be a limitless reservoir of mathematical ingenuity.

But the game is over. The stakes have grown higher and the clock has run out.

There is no possible way for cities, and even smaller communities, to maintain their viability unless stop-gaps and gimmicks are replaced by long-range fiscal planning which looks ahead not just to the close-out of a fiscal year, and not just to next year, but to five years ahead, and into the next decade.

I believe that New York City is beginning to take important steps in this direction.

It really has no choice.

My optimism is based on what I perceive to be a growing sense of realism in this City.

New York has a bright future precisely because it is beginning to face the urgent realities of the present, and to recognize the mistakes of the past.

The City is sadder but wiser today. It has experienced the same fiscal pains as every community in the nation, but magnified because of New York's size, its vitality, its influence, and its high visibility.

It is still the strongest and most creative city on earth. And it has in full the capacity and the will for the kind of tough fiscal planning which is the hallmark of successful management. 1/

TUESDAY, JANUARY 21, 1975

Steven Clifford provided the Comptroller with a background memorandum on the City's fiscal crisis. 2/ The memorandum reported that:

- 1) there had been a "massive increase" of \$5 billion in short-term debt over five years;

1/ Id.

2/ Memorandum, Steven Clifford to Harrison J. Goldin, January 21, 1975.

- 2) the increase could not be explained merely by delays in the receipt of Federal and State aid and such receivables had "not been audited" and may have been "seriously over-stated";
- 3) \$2.4 billion in short-term debt could be attributed to "budget gimmicks (i.e. disguised deficit financing) and recognized deficits," broken down as follows:

<u>Gimmicks</u>	<u>Amount of Current Short Term Debt Generated (\$ million)</u>
Accruals of revenue	\$ 440
Changing from cash to accrual on payables	239
Raiding reserves	136
Double use of fund balances	50
Excess stabilization borrowing	62
Subtotal	<u>\$ 927</u>
 <u>Recognized Deficits</u>	
70/71 Budget Notes	\$ 308
71/72 Receivable Writeoff	86
72/73 " "	180 (?)
73/74 " "	180 (?)
73/74 Stabilization Borrowing	150
74/75 Anticipated Deficit	600
Subtotal	<u>\$1,504</u>
Total Recognized Deficits and Gimmicks	\$2,431

- 4) the City had financed \$700 - \$1500 million of expense items through the capital budget since June 30, 1969;
- 5) in total the City had overspent its expense budget revenues by \$3.1 - \$3.9 [billion] since June 30, 1969;
- 6) the deficit for the 1974-75 fiscal year would be \$400-\$600 million and would reach \$1.2 to \$1.4 billion for fiscal 1975-76;
- 7) long-term debt had increased by \$3.3 billion since June 30, 1969;
- 8) the City would have to issue \$8 billion "plus" in new debt obligations in the next 12 months;

- 9) interest rates were at an all time high of 9.4% - 9.5% on the last City note issues, secondary trades were as high as 11.5%, and if City debt could not sell at these rates it could not sell at all; and
- 10) the market could collapse forcing a bankers' agreement or a moratorium on redemption of debt.

Mr. Clifford listed the following under the heading of "Solutions":

1. Restrictive Finances - term loan to Fund \$2 -- \$3 billion of debt.
2. Drop at least \$1 billion of City services - CUNY, Health & Hospitals, Welfare, etc.
3. Keep wage and salary increases in line with normal revenue growth - 4% - 5%. 1/

* * *

In an internal Bankers Trust document, it was reported that the Mayor had announced 11,985 job cuts but only 2,000 jobs had been eliminated to date. 2/

WEDNESDAY, JANUARY 22, 1975

G. C. McCarthy, a Vice President of Citibank, sent a memorandum to Paul Collins, Senior Vice President of the bank, stating that Citibank would not purchase City securities for any fiduciary account. The only exception to this policy would be where a client requested the purchase in writing and the securities sought had a maximum maturity of two years. 3/

1/ Id.

2/ Memorandum, Bankers Trust, "New York City Financial Update," January 21, 1975.

3/ Memorandum, G. C. McCarthy, Jr. to Paul J. Collins, January 22, 1975.

* * *

David Grossman, Senior Vice President of Chase, prepared a background memorandum for Willard C. Butcher, President of Chase, in preparation for a breakfast meeting with City officials to be held on January 24, 1975. The earlier meeting of January 9 with the Mayor and City bankers was reviewed. The memorandum stated that the City faced two serious fiscal problems, the debt situation and the budget situation. Mr. Grossman reported that there had been a rapid increase in the City's short and long-term borrowing which brought heavy pressures on the market. The City had issued \$7.3 billion in short-term debt in fiscal 1974 and over \$5 billion of City notes were outstanding. Further, the City planned to issue at least \$500 million of notes each month for the rest of the fiscal year and over \$600 million in bonds. The City's debt problems were seen as an outgrowth of its budget situation which could only be solved by bringing under control the imbalance between revenues and expenditures. Grossman reported that the City faced a current year deficit of \$450-650 million and \$1 billion for next year. Further complicating the problem was the fact that there were differences between City officials and commercial City banks as to the specific nature of the current problems that the City was encountering. 1/

THURSDAY, JANUARY 23, 1975

First National Bank of Boston offered for sale \$150 million of City RANS from their portfolio. Notes aggregating \$100 million were

1/ Memorandum, David A. Grossman to Willard C. Butcher, January 22, 1975.

dated September 30, 1974 to mature on August 22, 1975, and the remaining \$50 million in notes were dated September 16, 1974 to mature on September 15, 1975. A syndicate led by Chase, which included the joint managers of the two classical New York City note syndicates, purchased these notes for resale and investment purposes. This underwriting was completely sold by January 30 at a profit. 1/

* * *

George Roniger and C. E. Wainhouse, researchers for Citibank, addressed a memorandum to Peter Crawford, a Vice President of the bank, concerning the City's current fiscal difficulties. They stated that the City was faced with two types of problems: 1) an imbalance between revenues and expenditures; and 2) an imbalance between the issue of, and the demand for, City securities at other than premium rates of interest. These difficulties were said to be related inasmuch as concerns about the City's ability to meet budget requirements raised questions about its ability to service and refund its rapidly growing volume of debt. The memorandum states:

[T]he City's administration generally finds it to its own advantage to create the strongest possible impression of fiscal crisis. This strategy is pursued in order to improve its case for new State and Federal aid and for new taxes, and to prepare the public for a lower level of public services than demanded. It also serves the purpose of scaling down the demands of the administrators of City programs themselves and of municipal unions, and to prepare taxpayers for possible increases in taxation.

1/ Notes from files of Manufacturers Hanover, January 23, 1975.

The memorandum asserted that the City also employed a series of gimmicks in preparing the budget. Tables included in the memorandum demonstrated that over a five year period there had been a pattern of overestimates of City revenues. Additionally, short-term borrowing had been used to finance budget deficits and the SRC was created to provide borrowed funds to finance current expenses and to rollover debt incurred in 1971. Finally, the authors stated that the current recession had adversely affected New York's budgetary position, particularly causing a decline in "real" tax collections. The City's borrowing to pay for current expenses, characterized as a mortgaging of its future tax base, was alleged to be the greatest fiscal danger to the City and a risk to its long-term financial viability. 1/

FRIDAY, JANUARY 24, 1975

Mayor Beame, Comptroller Goldin, James Cavanagh, Melvin Lechner, Alfred Eisenpreis and other City officials met with leaders of the City's financial community for breakfast at Gracie Mansion. 2/
The following persons were also present, among others: 3/
Ellmore Patterson and Frank Smeal of Morgan, Alfred Brittain, III, and

1/ Memorandum, George Roniger and C.E. Wainhouse to Peter Crawford, January 23, 1975.

2/ News Release, Office of the Comptroller, January 24, 1975;
News Release, The City of New York, January 24, 1975.

3/ Letter, David A. Grossman to Paul Busse, Economic Development Council, January 24, 1975.

Truxton Pratt of Bankers, Willard Butcher and David Grossman of Chase, William Spencer and Richard Kezer of Citibank, Albert Gordon of Kidder, Peabody & Co., Inc. ("Kidder Peabody"), Donald Regan and Wallace Sellers of Merrill Lynch, Dr. John Fey of Equitable Life Insurance Co., George Jenkins of Metropolitan Life Insurance Co., Arthur Miles of Dime Savings Bank and Morris Crawford of Bowery Savings Bank. 1/

The meeting began with a distribution of documents and a presentation by Melvin Lechner, the Director of the Budget, as to the status of the 1974-75 budget, including the budget gap, the steps taken by the administration to eliminate it, the service reductions and cuts already accomplished, the additional cuts that had been planned, the deficits in tax levies and the programs designed to meet these problems. 2/

Mr. Alfred Eisenpreis, Economic Development Administrator for the City, also made a presentation 3/ on the City's general economic picture and the steps being taken to build the City's tax base and to stimulate business activity despite the nationwide recession. 4/

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- 1/ This was the first meeting of the FCLG which was to be chaired by Ellmore Patterson (E. Patterson at 32).
- 2/ D. Grossman at 28-29; E. Patterson at 32-33; Smeal at 46-48, 55-56; Letter, Ellmore C. Patterson to Donald T. Regan, January 27, 1975.
- 3/ Patterson at 33; Smeal at 46-47.
- 4/ In the days following the meeting, Patterson caused a working staff level of the FCLG to be formed (Letter, Patterson to Regan, January 27, 1975).

* * *

Mayor Beame testified before the State Commission on Tax Limitations, and asserted that the State had avoided its responsibility for the fiscal problems of the cities by permitting them to borrow for current expense items in order to avoid providing them with additional revenues. The Mayor reiterated his opposition to borrowing for expenses but acknowledged that economic circumstances had forced him to engage in it. 1/

* * *

John Fava, Deputy Finance Administrator of the City, addressed the New York Municipal Analysts Group on the City's fiscal base. 2/ Mr. Fava stated that the City provided more services than other cities in the country but that the recession had affected its capacity to finance those services. The large increase in short-term borrowing could be attributed, he said, to the manner in which budget gaps of the past several years had been closed. He said that one shot revenues would be put into a particular budget and anticipation notes would be issued against these receivables thereby increasing the debt. If the receivable proved to be overestimated, the City had four options: 1) the budget could be cut; 2) budget notes could be issued; 3) new notes against new receivables could be issued, or; 4) real estate taxes

1/ Statement by Abraham D. Beame before the Temporary State Commission to Study Constitutional Tax Limitations, January 24, 1975.

2/ The text of this address was printed in The Daily Bond Buyer, January 27, 1975.

could be increased. Mr. Fava ended his presentation with the thought that the City had the will to make budget cuts to solve its fiscal problems and was taking positive steps in that direction. 1/

MONDAY, JANUARY 27, 1975

William L. Wood, Jr., counsel to the Comptroller, addressed a memorandum to Comptroller Goldin concerning two important aspects of the City's 1975 legislative program. The first was a provision which would suspend the application of two sections of the Local Finance Law that established a maximum rate of interest of 5% per annum for City bonds or notes. These sections had been suspended yearly for the last several years and Mr. Wood noted, "[i]f the interest rate limitation is not suspended for this coming year, New York City obligation [sic] will become unmarketable." He also stated that if the Comptroller approved, Mr. Wood would seek the State Comptroller's support for the permanent removal of the interest rate limitations. The second proposal was an amendment to the City Charter that would repeal a section limiting the permissible investments of Sinking Fund monies. The section was characterized as precluding the City from "purchasing City obligations at par in many cases if such obligations are available in the market place at less than par." Wood stated that the section did not make good sense from an investment management perspective and greatly reduced the desired flexibility that the

1/ Remarks by John L. Fava, Deputy Finance Administrator, before the New York Municipal Analysts Group, January 24, 1975.

Comptroller should have in the continuing fiscal crisis of the City. The proposal was said to have been reviewed and approved by Ken Hartman of the Corporation Counsel's Office, the law firm of Wood, Dawson, Love & Sabatine, ("Wood Dawson"), Steven Clifford and Jon Weiner. Attached were texts of the proposed legislative enactments as well as texts of the proposed memoranda in support, prepared for the Comptroller's signature. ^{1/}

TUESDAY, JANUARY 28, 1975

The CTDM Committee held its monthly meeting; Comptroller Goldin, Dr. Seymour Scher, William Scott, Sol Lewis and other staff members represented the City. Gedale Horowitz of Salomon Bros., Richard Kezer of Citibank, Wallace Sellers of Merrill Lynch, Frank Smeal of Morgan, Zane Klein of Berlack, Israels & Liberman and Richard Nye of First Security Co. were also present. The Comptroller informed the Committee that Moody's was considering rescinding the MIG-1 rating assigned to the City's BANS. He stated that another meeting might be scheduled with Moody's to discuss the City's view of this change and a position paper was being prepared. The Comptroller then outlined the proposed February borrowing.

A discussion ensued as to the relationship between the FCLG and CTDM Committee. Various members of the latter described their views as to the role of the FCLG, and statements ranged from the FCLG being merely to "sell the City" to its being a financial and budgetary

^{1/} Memorandum, William L. Wood, Jr. to Harrison J. Goldin, January 27, 1975.

consultant. The Comptroller was concerned that the public might perceive that the financial affairs of the City were in the hands of the bankers. Mr. Horowitz and Mr. Sellers stated that the information presented at the January 24 meeting of the FCLG was too general and incomplete and had been heard many times before.

The Comptroller raised the question of alternative ways to market City securities, such as the City's plan to initially sell the securities to its employees. The meeting concluded with the Committee agreeing to provide Sol Lewis with thoughts on what the maximum interest rates would be for the February offerings. 1/

* * *

Comptroller Goldin, in a speech to the Harvard Business School Club on the fiscal plight of the City, pointed out that the City was suffering enormously from the nationwide recession which was putting great stress on the capital markets. He noted, for example, that the banks had committed more than 50% of their portfolios to municipal obligations.

Mr. Goldin stated that, in this time of high interest rates, some lending institutions had taken unfair advantage of the cities. The City was forced to pay 9.4% interest on an offering of City notes backed by an "A" rating and various legal and moral guarantees. Mr. Goldin conceded that the City had problems but he asserted that

1/ Minutes of CTDM Committee, January 28, 1975.

the City would "never default on the payment of its obligations, under any circumstances, barring the collapse of the entire economic system." He stated that the City recognized its fiscal problems and had the will and the capacity for the fiscal planning necessary to meet those problems and fulfill its responsibilities. 1/

THURSDAY, JANUARY 30, 1975

In the continuing series of memoranda from Richard Adams to Donald Platten, it was reported that Chemical's holdings of City securities in their dealer and portfolio accounts had decreased \$15.5 million since late December, after acquiring \$58 million of City securities from Security National Bank when that bank was acquired by Chemical. The market for City securities was said to have improved and it did not appear that Chemical would have to increase its holdings of City securities because of an inability to sell the forthcoming issues. Mr. Adams stated: "The syndicate pricing will be aimed squarely at prompt sales to investors." He also asserted:

[W]e continue to believe that the City will meet its obligations. The real new money financing pressure for the City is likely to occur after August of this year. By this time we will be in a position to assist the City if necessary since by then \$185.5 million of our holdings will have run off. Recommendation: that we do nothing precipitous with regard to reducing our holdings immediately, but let maturities do this for us. 2/

1/ Remarks of Harrison J. Goldin to Harvard Business School Club, January 28, 1975.

2/ Memorandum, Richard V. Adams to D.C. Platten, January 30, 1975.

* * *

Comptroller Goldin announced that, with the advice and participation of labor leaders and representatives of the financial community, the City would establish a procedure to sell City securities through a system of voluntary payroll deductions. 1/

FRIDAY, JANUARY 31, 1975

The Mayor submitted the Executive Capital Budget for 1975-1976 to the City Council and Board of Estimate. Expense items which were to be funded by the Capital Budget were set forth for the first time in a separate schedule "in the interest," in the Mayor's words, "of greater accountability and disclosure." 2/

* * *

In January, members of the staff of the Office of the Comptroller prepared a number of drafts of a proposed letter to the Queens Community Board #10 regarding the draft capital budget. In one such draft, dated January 29, 1975, it was suggested that the Comptroller state that although the Mayor and he projected that more than \$1.3 billion would be potentially available to be borrowed for long-term capital purposes, after the deduction of a \$225 million reserve, almost \$800 million would have to be set aside for the sale of bonds to finance current and recurring expenditures, \$109 million was being allocated for judgments and claims and \$70 million would be used to subsidize the 35 cent transit fare. The draft letter indicated

1/ News Release, Office of the Comptroller, 75-9, January 30, 1975.

2/ Letter, Office of the Mayor to City Council and Board of Estimate, January 1, 1975, accompanying Executive Capital Budget for 1975-1976.

that there was virtually no money available for new capital priorities, and stated:

We must start the process of freeing up bonding capacity for true capital purposes. Otherwise we run the risk of repetitions of the West Side Highway collapse and the perpetuation of the virtual standstill in capital renewal that we are now experiencing.

The draft letter further stated that the formulation of the Capital Budget "appears to be little more than an exercise in futility" and was in danger of becoming a "charade." 1/

Victor Marrero, a staff member of the Comptroller's Office, in a memorandum dated January 31, 1975 to the Comptroller, stated that the draft letter contained terms "that may be unnecessarily blunt," could be misinterpreted, might incur the ill-will of the Board of Estimate and City Council, and might attract newspaper headlines focusing on the words "charade" and "exercise in futility." 2/

SUNDAY, FEBRUARY 2, 1975

A New York Times article contrasted the views of the Mayor with those of "others" with regard to the causes of the City's fiscal crisis. According to the article, since September, when the Mayor first announced the City's troubles, he had blamed forces out of his control, i.e., inflation and recession, which created greater costs and produced lower revenues than anticipated. Others, such as the CBC, criticized the use of "soft" figures in the Mayor's budget and "the budgetary

1/ Draft letter, Office of the Comptroller to William Fells, Chairman, Queens Community Board #10, January 29, 1975.

2/ Memorandum, Victor Marrero to Harrison J. Goldin, January 31, 1975.

gimmicks of past administrations," some of which Mayor Beame had continued. Mayor Beame, the article stated, placed his hope in a federal takeover of the costs of welfare and a State takeover of the costs of the educational and court systems, but the Times stated that "in view of the budgetary problems at the Federal and state levels, the prospect of a huge infusion from the outside seems unlikely." Rather, it was indicated, the City would have to put its house in order on its own through service and employee reductions or higher taxes. 1/

MONDAY, FEBRUARY 3, 1975

J. Chester Johnson, an assistant Vice-President of Morgan, addressed a memorandum concerning the City to Amos T. Beason, a Vice-President of the bank. Reacting to a David Grossman memorandum on the fiscal problems of the City, dated January 28, 1975, Mr. Johnson stated that the memorandum offered virtually no opportunity for analyzing the City's "structural problems." Johnson contended that for the FCLG to offer the City more than its image of a "patching" plan, it would have to study, in addition to the agenda in the Grossman memorandum, the City's inadequate budgetary controls, the impact of "phantom debt" and "down payments" on the expense budget, the historic trend of the City's short and long-term debt load and the erosion of the City's economic base. 2/

1/ The New York Times, "Just How Did New York City's Finances Come to This?", February 3, 1975.

2/ Memorandum, J. Chester Johnson to Amos T. Beason, February 3, 1975.

TUESDAY, FEBRUARY 4, 1975

The Comptroller announced the sale by the City of \$290 million in RANS, at an interest rate of 7.55%, to a syndicate headed by Morgan and the Bank of America. Other bids on this issue were received from a syndicate headed by Citibank/Chase and from the European-American Bank & Trust Company. 1/

* * *

In a memorandum to David Rockefeller of Chase, David Grossman stated that, after a review of the potential areas of involvement by Chase in

1/ News Release, Office of the Comptroller , 75-12, February 4, 1974 [sic].

City affairs in 1975, he recommended that he (Grossman) concentrate on the following items: the City budget problem; the subway system, primarily the Second Avenue Subway; the economic development of lower Manhattan; and strengthening municipal productivity and manpower utilization. 1/

THURSDAY, FEBRUARY 6, 1975

Moody's announced that it was retaining its "A" Rating for General Obligation Bonds of the City, as well as its "MIG 1" rating on City BANS and its "MIG 2" rating for other notes. Moody's stated: "New York City has a revenue problem, a systemic difficulty in raising additional revenues to keep up with expanding needs." 2/

* * *

Mayor Beame, in a letter to Ellmore Patterson, amplifying a prior telephone conversation, complained about the interest rate of 7.55% on the \$290 million of RANS sold on February 4th. The Mayor pointed to several concurrent developments in the money market which, he stated, showed that 7.55% was an unwarranted rate: these RANS had sold so briskly that the yield had dropped to 7%; local Public Housing Agencies, through HUD, had sold \$680 million of tax exempt notes recently at an average rate of 3.485%, the lowest rate in two years;

1/ Memorandum, David A. Grossman to David Rockefeller, February 4, 1975.

2/ Munifacts, February 6, 1975.

notes of other governmental units, including taxable notes, were being sold at rates substantially lower than those for tax-exempt City notes; and the Federal Reserve had lowered its discount rate for member banks on February 4 from 7.25% to 6.75%, signalling the coming of easier credit. Accordingly, the Mayor could not understand how taxable notes could be sold at yields less than tax-exempt City notes. The Mayor also stated:

There have been disturbing reports of brokers advising clients not to invest in New York City bonds and notes because of the "risk" involved. I cannot believe that persons peddling this kind of destructive advice are ignorant of the tremendous legal, constitutional and moral guarantees of repayment which back our obligations. I can only conclude that the peddlers of this nonsense are being malicious, and it is unfortunate that the investing public is so impressionable that false and misleading information can sweep the investing public like a prairie fire and this kind of sabotage and disloyalty among financial institutions tends to reduplicate itself.

The financial community's leading institutions themselves not only feed on this kind of unjustified fright, but they contribute to it when they submit bids for City obligations which are wholly out of line both with the basic strength of our obligations and the actual current market developments.

The Mayor reiterated his concern for the pricing of City notes at higher yields than comparable taxable Treasury bills, and further stated:

I think it is up to the financial community to turn this topsy-turvy situation right side up again. As I said at our meetings, I believe the financial community has a selling job to do to make the investing public see the financial strengths of our obligations.

We in the City government are doing everything in our power to deal with the budget problems which the national recession - inflation created, and I believe the general public supports what the City Administration is doing. 1/

1/ Letter, Abraham D. Beame to Ellmore C. Patterson, February 6, 1975.

FRIDAY, FEBRUARY 7, 1975

David Grossman requested comments on his outline of the City's problems, which he enclosed in a letter to Frank Smeal of Morgan. 1/ The outline, labelled "draft", stated that the City's budget had increased between 10% and 15% in each of the last three years because of the wide range of services provided by the City, and not provided by other municipal governments; the rapidly increasing welfare costs (which had risen six fold in 10 years); rapid increases in wage and benefit costs of city workers; and the rapid rise in debt service. 2/ The outline stated that this growth in expenditures had been only partially balanced by growth in revenues, and that the growing gap between revenues and expenditures had been made up by short and long-term borrowing. Grossman noted that "[a]n increasing portion" of the short-term borrowing, such as over \$400 million in TANS to finance uncollected real estate taxes, appeared to represent "'permanent' temporary debt, rolled over from year to year," and that "budget-balancing 'gimmicks,'" such as requiring advance payment of water and sewer charges, had resulted in an additional \$150 million in rolled-over short-term debt. Also utilized since 1964 was the practice of borrowing against general fund receipts due in June of each year but not collected until after the end of the fiscal year. Mr. Grossman noted that, since Fiscal Year 1969-70, the cash gap had ranged from \$92 million to \$986 million, and that the gap had largely been made up by an increase in short-term debt. The outline stated that

1/ Letter, David A. Grossman to Frank P. Smeal, February 7, 1975.

2/ Draft, "An Outline Discussion of New York City's Budget Problems," February, 1975.

City borrowing for other than operating purposes also had increased greatly in recent years, and further stated:

The City has also developed a number of means to issue additional debt not subject to Constitutional limitations through various public benefit corporations authorized by the State Legislature.

These included the Educational Construction Fund, the City University Construction Fund, the Housing Development Corporation, the Stabilization Reserve Corporation, and the Transit Construction Fund. While some of this debt was said to be for self-supporting projects, the back-up was the City's expense or capital budgets and claims on State aid to the City. It was also asserted that the current year budget was badly out of balance.

Grossman's outline continued:

-- The City's plans to meet its next year problem -- which have been kept secret until now -- will almost certainly involve efforts to obtain major amounts of aid from the State. In light of the Governor's own budget statements, success does not appear likely.

The outline concluded that, in light of the absence of State aid and the limited capacity to cut City expenditures, the City would "almost certainly" seek to increase taxes and look toward more borrowing to meet its 1975-76 budget gap. 1/

1/ Id.

MONDAY, FEBRUARY 10, 1975

In a memorandum to David Rockefeller, copies of which were addressed to Messrs. Bergford, Labrecque, Elliott and Reed, dated February 10, 1975, Grossman stated that he anticipated a budget gap for the next year of over \$1 billion, and stated that his own analysis showed a "'hard core' gap of around \$900 million - 'a very difficult problem to meet.'" Grossman also stated that the City would be discussing the 1975-76 budget gap for the first time with State officials on February 12, and that Deputy Mayor Cavanagh had agreed to provide Grossman with copies of certain materials the next day. 1/

* * *

The Comptroller announced that the SRC had postponed the sale of \$260 million of its BANS scheduled for February 13, because a lawsuit had been filed challenging the constitutionality of the SRC Act. 2/ The news release stated that the Corporation Counsel had advised that the suit was without merit, but that the SRC had decided to postpone the offering because of the possible adverse effect on interest rates that this suit may have had. It further stated that the suit alleged that the City had exceeded its

1/ Memorandum, David A. Grossman to David Rockefeller, "Progress Report — New York City," February 10, 1975.

2/ New Release, Office of the Comptroller, 75-15, February 10, 1975.

The officials of the SRC (and their City affiliation), as shown in the official sale statement, were: James D. Carroll, Chairman, James A. Cavanagh, Vice-Chairman (First Deputy Mayor), Melvin N. Lechner, Executive Director (Director of the Budget), W. Bernard Richland, Attorney and Counsel *ex officio* (Corporation Counsel), Kenneth F. Hartman, Secretary and General Counsel (Assistant Corporation Counsel), Dennis C. Daring, Treasurer (Analyst, Bureau of the Budget), and Alexandra Altman, Assistant Secretary and Deputy General Counsel (Attorney, Bureau of the Budget). SRC, Official Statement and Notice of Sale, January 31, 1975.

constitutional debt limit, but the Comptroller's computations showed a remaining constitutional debt capacity of \$1.97 billion, and that the City intended to sell \$141.44 million of bonds on February 11. 1/

TUESDAY, FEBRUARY 11, 1975

The staff committee of the FCLG met at the Chase Bank at 3:00 P.M. 2/ Present, in addition to David Grossman of Chase, were Jac Friedgut of Citibank, William Fish of Bankers Trust, Amos T. Beason of Morgan, Gene Crowley of Salomon Bros., Jean Rousseau of Merrill Lynch, Duncan Gray of Kidder Peabody, Elmer Harmon of Bowery Savings, Francis Schott of Equitable Life, Karen Gerard of Chase and William Solari of Donaldson, Lufkin & Jenrette. 3/ The meeting was opened by David Grossman, who distributed a memorandum he had prepared entitled "Areas for Analysis - the New York City Budget." The memorandum stated that the current year's budget deficit was between \$400 and \$600 million and the budget gap for the following year (1975-76) was estimated at between \$1 and \$1.5 billion. 4/

1/ News Release, Office of the Comptroller, 75-15, February 10, 1975.

2/ "Meeting of Technical Advisory Staff of Mayor's Financial Liaison Committee," attached to Memorandum, Jean J. Rousseau to Donald Regan, February 12, 1975 ("Rousseau Memorandum").

3/ Id.

4/ "Areas for Analysis - The New York City Budget," attached to letter of David A. Grossman to Ellmore Patterson, February 13, 1975.

The basic discussion at the meeting concerned what the scope of the Staff Committee's activities should be. 1/ It was agreed that the Staff Committee would begin an analysis of the City's budget problems and borrowing practices, 2/ and would work toward development of a long-range plan for the City's financial management. 3/ William Solari stated that there had been a serious lack of adequate information about New York City, and suggested that the Staff Committee consider assembling a data book of information or working on an Official Statement, disclosing information concerning the City's fiscal condition, for City debt offerings. 4/ There was a discussion of how to improve the investing public's understanding of the City's problems. Gene Crowley raised the question of whether all of the participants at the meeting, the principal underwriters in the City, would become "insiders." 5/

Francis Schott stated that the Mayor should be told to cut the 1975-76 budget gap by \$1 billion, and that the participants at the meeting would help the Mayor at the federal and state level. 6/ It was decided that the "crunch"

1/ Rousseau Memorandum.

2/ Letter, David A. Grossman to Ellmore Patterson, February 13, 1975.

3/ Rousseau Memorandum.

4/ Id.; See also, Memorandum, Duncan C. Gray to Albert H. Gordon, February 13, 1975 ("Duncan Memorandum").

5/ Crowley at 38-39.

6/ Duncan Memorandum.

would come with the 1975-76 budget gap of \$1.5 billion, which needed the most immediate attention, after which the long-term could be addressed. 1/

The members agreed to collect a "library" of useful working papers already available in-house and circulate a bibliography to the Committee.

The next meeting of the group was scheduled for February 25 at 3:30 P.M. 2/

Ellmore Patterson wrote a letter to Alfred Brittain, III, apprising him of a letter received from Mayor Beame and the telephone call that had preceded it, complaining about the rate of interest on the last City offering. 3/

* * *

Comptroller Goldin announced the sale by the City of \$141.44 million of serial bonds, at an average interest rate of 7.169%, to a syndicate headed by Chase. In the news release announcing the sale, Goldin was quoted as saying that the interest rate "does not adequately reflect the security and quality of the City's tax-exempt obligations." 4/

* * *

In the evening, the Comptroller delivered an address to the National Secretaries Association. Mr. Goldin stated:

1/ Id.; Handwritten notes marked "2/11 N.Y.C. meeting."

2/ Rousseau Memorandum.

3/ Letter, Ellmore C. Patterson to Alfred Brittain, III, February 11, 1975.

4/ News Release, Office of the Comptroller, 75-16 February 11, 1975.

... I would say that budgets are conceived in illusion and dedicated to the proposition that the hand is quicker than the eye.

* * * *

But budget-making is serious business. It has become habitual with government to over-estimate certain revenues and under-estimate certain expenditures as a matter of routine.

It's a game of numbers, in order to meet the statutory requirement of a Balanced Budget. 1/

WEDNESDAY, FEBRUARY 12, 1975

The Comptroller announced that the City would sell \$260 million of TANS on February 19, 1975, and that the proceeds of this sale would replace the funds which the City had expected to receive from the sale of SRC BANS, postponed on February 10, 1975. 2/

* * *

The Comptroller issued another news release which contained the text of his speech to the National Secretaries Association delivered the previous evening. 3/

1/ Address by Harrison J. Goldin, National Secretaries Association Dinner Meeting, February 11, 1975.

2/ News Release, Office of the Comptroller, 75-18, February 12, 1975.

3/ News Release, Office of the Comptroller, 75-17, February 12, 1975.

THURSDAY, FEBRUARY 13, 1975

In a statement before the Board of Estimate and City Council Finance Committee, the Citizens Budget Commission warned that the City's physical plant was deteriorating because of the fiscal practice of using capital budget funds to pay for operating expenses. 1/ It noted:

The rescindment process has made more construction money available for high priority projects necessary for the maintenance of the city's capital stock. However, the continued diversion of capital funds to the operating budget has resulted in a level of true capital funding too low to prevent the city's infrastructure from deteriorating at a rate faster than it is being replaced. For example, the rate of water main replacement indicated in this proposed budget implies that the pipes are expected to last 145 years! Street resurfacing is done at a rate still 30 percent short of what is necessary to stay even! This same problem exists in varying degrees for all the other public facilities: parks, sewers, and so on. This may soon present a hazard to the city's very economic base.

The city has two options. It can either continue to use the capital budget as an escape route for operating expenses and in so doing further damage the infrastructure of the city, accelerate the growth of future debt service payments in the expense budget, and add some 15 percent to the cost of operating expense financed this way. Alternatively, City Hall can slow the growth of the capital and expense budgets and begin to recover from our past fiscal excesses. The capital budget will have to be kept low for a number of years in order to produce savings in debt service paid from future expense budgets. The Mayor has rightly kept the proposed debt incurred below the constitutional limit. But the city must go further by phasing out such borrowing over a five-year period. The city then could use part of the borrowing power thus freed for capital construction purposes.

SATURDAY, FEBRUARY 15, 1975

The Mayor announced that after the receipt of increased revenues and other final measures, the City would have a budget gap for fiscal 1975-1976 of \$883.9 million. "This gap," stated the Mayor, "is the

1/ Statement of Roderick L. O'Connor, President CBC, to the Board of Estimate and Finance Committee of the City Council on the Executive 1975-76 Capital Budget, February 13, 1975.

result of a carry-over of part of the inherited \$1.5 billion gap which was not closed by recurring revenues last year, of the inflation and recession of 1974-1975 and of new requirements for 1975-1976." He asserted that "increased revenue from existing and anticipated sources and other fiscal measures will produce \$800.6 million," leaving an \$883.9 million gap, which he proposed to fill by additional federal and state aid. 1/

SUNDAY, FEBRUARY 16, 1975

The Comptroller issued a report addressed to the Mayor, the Board of Estimate and the City Council, and a news release stating that two reserve funds (the tax deficiency account and the Rainy Day Fund), maintained for the purpose of helping the City through fiscal difficulties, had been depleted and would require an allocation of \$123 million in the next budget. In the same report, he stated that in the next expense budget the City would be required to provide over \$2 billion for debt service, an increase of \$212 million over the amount appropriated for the current fiscal year. 2/

* * *

An article in The New York Times on the Mayor's report of the previous day reported that various legislative sources had expressed "skepticism mixed with caution" as to whether the City would receive

1/ News Release, Office of the Mayor, 74-75, February 16, 1975.

2/ Report of the Comptroller, City of New York, February 15, 1975;
News Release, Office of the Comptroller, 75-19, February 16, 1975.

the aid it desired from Albany and Washington. 1/

TUESDAY, FEBRUARY 18, 1975

In a press release, the City's Finance Administrator, Ivan Irizarry, said that printed reports of the City's real estate tax arrears, appearing over the past weekend, tended to be misleading and needed clarification. Of the reported \$460 million in real estate tax arrears, \$356 million was chargeable to prior fiscal years, \$43 million was an error and \$61 million represented the true amount due and uncollected on the first half of the current year's total levy.

Mr. Irizarry stated:

Experience has shown that at the end of the fourth year, arrears of taxes due and uncollected are only about one percent of the levy, so the amounts needed for redemption of any outstanding tax anticipation notes out of future budgets has been minimal.

Of the prior year's delinquencies of \$356 million, late collections continue to reduce that figure. Frequently owners pay up when In Rem foreclosure proceedings are started.

For the quarterly payments due in January 1975, figures as of February 10, 1975, show that collections are running about 85.8 percent of the quarterly levy, or 2.8% behind last year's levels for the same period. Additional payments for this quarter, as well as for the first two quarters, continue to come in during the balance of the fiscal year. 2/

1/ The New York Times, "1.68 - Billion Gap Projected in City Expense Budget," February 16, 1975.

2/ News Release, Finance Administrator, February 18, 1975.

* * *

Roderic O'Connor, President of the CBC, issued a press release stating that the \$1.68 billion expense budget gap projected by the Mayor for 1975-1976 was due to "a decade-old policy of spending in excess of revenues." In addition, he asserted, the proposed increase in the real estate tax rate was a "brutal imposition on what is a very sick sector of the city's economy." The CBC supported the Mayor in his attempt to obtain additional Federal and State aid, but did not agree with the Mayor's contention that the only alternatives to additional State or Federal aid were deep service cuts or sharply higher taxes. The Mayor must freeze wages and city jobs, argued the CBC. The future of the City was said to be at stake. 1/

* * *

The New York Times published an editorial entitled, "City Hall Fantasia," directed towards the Mayor's announcement of a \$1.68 billion deficit for fiscal 1975-76. The City was described as facing "a fiscal crisis from which there can be no escape without drastic cuts in personnel and services and substantial increases in taxes."

The editorial continued:

Incredibly, there is little indication in the Mayor's budget presentation so far that Mr. Beame, once widely hailed as a tough fiscal expert, is prepared at last to grapple with these hard realities. His plan for closing an anticipated \$1.68 billion deficit with the help of nearly \$900 million in hypothetical new state and Federal aid leaves knowledgeable observers gasping in disbelief.

* * *

1/ News Release, CBC, February 18, 1975.

It is time the Mayor and his aides came down to earth and offered the citizens of New York a realistic budget, a budget that reflects the still substantial capacity of this city to support a reasonable level of city services, a budget that begins to reverse the long-term reliance on borrowing, and hocus-pocus, that have reduced the city to its present plight. 1/

WEDNESDAY, FEBRUARY 19, 1975

Comptroller Goldin announced the sale by the City of \$260 million of TANS at an average interest rate of 7.0783%, the lowest rate on City short-term notes in eight months. A syndicate headed by Bankers Trust purchased \$100 million of the TANS at 6.455%, while the remaining \$160 million were purchased by a syndicate headed by Chase at 7.18%. 2/

THURSDAY, FEBRUARY 20, 1975

The New York Times reported that the Office of the Comptroller was seeking an amendment to the City Charter to obtain \$245 million for an imminent "cash flow emergency." The amendment would permit the City's sinking funds to purchase \$200 million in City securities originally purchased by the municipal pension funds the preceding January. The pension funds would then use the money, augmented by \$45 million in cash, to purchase \$245 million in new City securities. 3/

* * *

Representatives of the FCLG and its staff attended a meeting with City officials including Mayor Beame, James Cavanagh and Melvin Lechner. The meeting began, as noted by Jean Rousseau of Merrill Lynch, 4/ with a presentation by Melvin Lechner

1/ The New York Times, Editorial, "City Hall Fantasia," February 18, 1975.

2/ News Release, Office of the Comptroller, 75-20, February 19, 1975.

3/ The New York Times, "Rate on City's Notes Drops to the Level of 8 Months Ago," February 20, 1975.

4/ Memorandum, Jean J. Rousseau to Donald T. Regan, February 27, 1975.

concerning the 1975-76 budget. He estimated that a net gap of \$883.9 million would remain after the Mayor completed economies totalling \$714 million. The Mayor then described his plans to organize a national lobby to urge the assumption of the welfare burden by the Federal Government. He also indicated that he anticipated meeting with 25 groups to explain to them the problems encountered with the budget. Mr. Beame expressed a distaste for additional short-term borrowing to meet the aforementioned budget gap, stated his unwillingness to engage in this practice, and said he expected to close the gap with Federal and State assistance alone. Finally, he described various positive aspects of the City's financial outlook.

Ellmore Patterson raised the question of the interest rate on City borrowings and Mr. Beame again accused the underwriters of unfair treatment. The Mayor agreed to work towards attaining a more favorable rate by improving the flow of information to the banks. Mr. Spencer 1/ mentioned the rising curve of New York City expenditures as opposed to the much slower growth of revenues and the recent tendency to close the growing gap through short-term borrowing, and cited this as having much to do with the City's higher interest rates because of investor concern. The Mayor asked the attendees for help in selling the City's story to the investing public. 2/

1/ Mr. Spencer was the President of Citibank.

2/ Memorandum, Jean J. Rousseau to Donald Regan, February 27, 1975.

Jean Rousseau of Merrill Lynch, in his notes of the meeting,
wrote:

As forthcoming and open as it [the meeting] was, the Mayor
and his aides didn't mention the City's prospective one
day cash shortfall and the legislative amendment then in
process to let them close it by having the Sinking Fund
invest in additional City notes. 1/

* * *

David Grossman sent a letter to the members of the FCLG Staff
Committee. Enclosed was a copy of a letter and attachments he had
previously sent to Ellmore Patterson apprising him of the Staff
Committee's activities and seeking guidance as to the direction that
this Committee should take. This letter to Patterson had attached
a copy of Grossman's "Areas for Analysis" memorandum and a membership
list of the Staff Committee. A review of the November 8, 1974 presenta-
tion of the Citizens Budget Commission to the Mayor's Council of
Economic and Business Advisors was included in this package as was a
copy of the Mayor's recently issued statement with regard to the
budget gap for fiscal year 1976. 2/

* * *

In a Citibank memorandum concerning New York City's financial
difficulties, 3/ it was reported that, over a 5 year period, a persistent
pattern of overestimates of budget revenues had developed, particularly

1/ Id.

2/ Letter, David Grossman to Members of the Budget Committee,
FCLG, February 20, 1975.

3/ Friedgut Ex. 2.

as to the sales tax, OTB revenues and business tax collections. In fiscal 1973-74 the budget had been balance by some \$300 million of borrowed funds, in part through RAN issuances and from a waiver of a legally-required City payment to its Stabilization Reserve Fund. The memorandum stated: "In the long run, the City's tax base should expand only modestly." The memorandum noted that:

The City has exhausted a significant portion of its potential financial flexibility. One example is the "Tax Appropriation and General Fund Stabilization Fund," commonly referred to as the "Rainy-Day Fund," which is supposed to be financed by annual appropriations of roughly one half of one per cent of the Expense Budget. In the best of circumstances, the maximum funded level provided for — roughly \$500 million, today — probably is inadequate as a source of meeting budget gaps. However, even this buffer is now gone — the consequence of seven years during which the requirement for replenishment has been waived as one means of closed Expense Budget gaps.

A second potential means of filling these gaps is through long-term borrowing. The State constitution limits such borrowing to financing items with long-term durability and usefulness. Technically, this excludes long-term borrowing as a way of meeting Expense Budget shortfalls. The City has not directly circumvented this constraint. However, it has secured a stretching of definitions. This includes outlays for such items as textbooks and vocational training. This device has allowed a shifting of some \$700 million of current expenses to the capital accounts in fiscal 1975. This increases future debt-service charges and reduces the City's ability to finance genuine capital projects.

A principal device to meet shortfalls in recent years is short-term borrowing in anticipation of Federal and state aid funds and borrowing in anticipation of future tax receipts.

* * * *

The issuance of debt for reasons other than capital projects puts the City in an increasingly vulnerable position. This type of debt forces the City to enter the capital markets repeatedly and regardless of market conditions, for funds which are required immediately. Additionally, this type of debt is used to make immediate current outlays based on future revenue inflows. The City's future is being mortgaged off.

The memorandum restated the Mayor's estimate of a \$900 million gap for fiscal 1976 and concluded by stating:

The Mayor is opening a new round of an old game - projecting a substantial gap in the forthcoming budget. As this game is usually played, the City Administration forecasts conservative increases in revenues and liberal growth in expenditures. This strategy is designed to improve the City's case for new state and federal aid and for higher taxes, as well as to prepare the public for a lower level of public services than many people are demanding. It also helps to scale down demands of program administrators and municipal unions. Thus, none of the Mayor's 1976 numbers should be taken too seriously at this point. They are the opening notes of the 1976 budget waltz. 1/

* * *

Members of the Economic Development Council, George Champion, Walter Wriston, Richard Shinn, and Robert Hatfield, met with Mayor Beame to discuss the City's financial crisis. Wriston subsequently told Jac Friedgut, a Citibank Vice President, who in turn reported to William Spencer that, at the meeting, the Mayor was told that "today was the day that the money ran out." 2/ Friedgut also reported to Spencer that, at the same meeting, the Mayor was told that the City's adoption of a five year plan was "absolutely essential." 3/ Mr. Champion suggested that the City put managers in place, give them authority and make them accountable. The Mayor said he wished to discuss the matter further. 4/

FRIDAY, FEBRUARY 21, 1975

A New York Post article reported that the City Council was expected to approve a bill permitting the City's sinking funds to acquire \$200 million in City securities from the municipal employee's pension funds. The pension funds would then add \$45 million in cash to the \$200 million and purchase newly issued City securities. The article stated that this money was needed by the

1/ Friedgut Ex. 2.

2/ Friedgut Ex. 1; Friedgut at 42.

3/ Friedgut Ex. 1; Friedgut at 43.

4/ Memorandum, William G. Herbster to Walter B. Wriston, February 20, 1975.

City to meet its payroll the following week. 1/

* * *

Comptroller Goldin testified before the City Council Legislation Committee in support of an amendment to the City Charter which would permit the City's sinking funds to purchase City securities at par. Goldin told the Committee that he and the Mayor had conferred on the matter of using sinking fund assets to purchase new offerings of City securities and that the Mayor had originally proposed the City Charter amendment when the Mayor was Comptroller. Goldin asserted that in purchasing City securities for the sinking funds he would meet his "fiduciary responsibilities" to the sinking funds and at the same time save money for the City.2/ (Ten days before Goldin's testimony, William Scott, Third Deputy Comptroller, directed John Reilly, Principal Investment Officer (Bonds), to sell \$200 million of RANS from the City's pension funds to the City's sinking funds.) 3/

MONDAY, FEBRUARY 24, 1975

The clearing house banks negotiated a "bridge loan" of \$170 million with the City in the form of RANS at a 6.5% rate of interest. 4/ The clearing house banks, acting as a syndicate, sustained a loss in connection with the transaction. 5/ These RANS were dated February 24, 1975 to mature on February 28, 1975 but were called by the City on February 25, 1975. 6/ A legal opinion as to the validity of the notes was issued by Wood Dawson. 7/

1/ New York Post, "City Needs Payroll Cash," February 21, 1975.

2/ Statement of Comptroller Harrison J. Goldin to the City Council State Legislation Committee, February 21, 1975.

3/ Memorandum, William Scott to John Reilly, February 11, 1975.

4/ Letter, Abraham D. Beame and Harrison J. Goldin to Chase Manhattan Bank et al., undated.

5/ Letter, Anthony J. Botti to Joseph Isolano, December 5, 1975.

6/ Letter, Anthony J. Botti to Joseph Isolano, October 14, 1975.

7/ Letter, Wood Dawson to Chase Manhattan Bank et al., February 24, 1975.

* * *

By memorandum dated February 20, 1975, William G. Herbster of Citibank advised Walter B. Wriston, Chairman of Citibank, of the points which should be made to the Mayor at the meeting on February 24, 1975 of the Council of Business and Economic Advisers. 1/ Herbster stated that the Mayor should be told that the "market is trying to tell the city something," and that the recent more favorable rates of interest had been a reflection of confidence brought about by the formation of the FCLG, the lessening of the public debate between Goldin and Beame and the beginning of efforts by the City to cut costs. The memorandum also stated that the high rates of interest for City securities reflected the deficit for fiscal 1976, the absence of a strong move towards economies, and the potential effect of possible increased taxes on the tax base and revenues.

The memorandum suggested that Mayor Beame be advised to reduce the budget gap to nil over a 3 to 5 year period, to bring in the "best" people in key management positions, to reduce significantly the amount of expense items in the capital budget, and to create a "Hoover Commission" for City government. It was additionally recommended that the members of the Council advise the Mayor to:

- (1) reduce the number of City workers;
- (2) increase productivity;
- (3) institute certain service cutbacks, such as the elimination of costly unproductive training programs;
- (4) institute certain changes to bring these charges closer to the actual cost of the services, e.g. increase the subway fare; and
- (5) make major reductions in capital expenditures which mandate future operating costs e.g. the CUNY building program. 2/

1/ Memorandum, William G. Herbster to Walter B. Wriston, February 24, 1975.

2/ Id.

TUESDAY, FEBRUARY 25, 1975

The Daily News, The Daily Bond Buyer and The New York Times reported an address given by Comptroller Goldin to the Queens Chamber of Commerce on Monday, February 24. The articles stated that Goldin warned against relying on massive new Federal and State aid to fill an \$880 million gap which the Mayor expected in the 1975-76 expense budget. 1/ The Comptroller was quoted as saying:

We cannot continue to depend on massive Federal and State assistance to erase next year's deficit, when all indicators point clearly toward something considerable [sic] less. We must get on with the task of effecting the stringent economies in operation which are as essential as they are painful. 2/

* * *

In preparation for a luncheon meeting with Mr. Beame, Jac Friedgut of Citibank prepared a "crib sheet" for use by Mr. William Spencer, President of Citibank. Mr. Friedgut pointed out the growth of the City's expense budget in the past 15 years, showing that City expenditures for social services had increased nine-fold in this period while the total budget had increased five-fold. The cost of education was said to have increased six-fold despite a decrease in public school enrollment. The growth in debt service was due, to some extent, to interest and amortization payments on a steadily rising list of operating expenses in the capital budget. 3/

1/ Daily News, February 25, 1975, p. 26; The New York Times, February 25, 1975, p. 39; The Daily Bond Buyer, February 25, 1975, p. 23.

2/ The Daily Bond Buyer, p. 23.

3/ Friedgut Ex. 4. (Memorandum, Jac Friedgut to William Spencer, February 25, 1975).

The conclusion drawn in the memorandum was that a tough program of holding down expenditures was a necessity for the City. Five immediate and specific suggestions included in this document were:

- (1) an intensive review of all City programs and a cutback in low priority items;
- (2) a freeze on jobs;
- (3) a joint effort by the City and the business community to convince the Federal and State governments to assume more of the expense burden;
- (4) an increase in productivity; and
- (5) a reduction of debt and an immediate termination of the issuance of debt for operating expenses.

Mr. Friedgut concluded:

These proposals will, not surprisingly, be unpopular with the Mayor. He will complain that he has no authority over such leviathans as the municipal unions, the Board of Education, the hospitals corporation, and other quasi-independent agencies. Such a defense is both true and not true. If the situation is critical enough (which it is) and if the Mayor is tough enough (which he might be) many things can be done even if they are technically not possible. The time is now. 1/

The Staff Committee of the FCLG met at Chase. The agenda for the meeting indicated, among other items, that the following matters would be discussed: (1) a report on the status of policy guidelines for the Committee; (2) the City budget gap for fiscal 1976, including the probable timing of the budget cycle, a preliminary estimate of the budget, and the nature and difficulty of the budget problem; and (3) possible work projects for the Committee, including the market outlook for municipal

1/ Id.

debt in general and City debt in particular. 1/

At the meeting, the discussion concerned, among other things, the fiscal problems of the City, the preparation of an official statement and prospectus, the general municipal debt issue and the fact that there were a large number of City short term securities in the market. 2/ The judgment of the Committee was that the City's expense budget for 1975-76 might be \$12.9 billion. 3/ In a memorandum from Friedgut of Citibank to Spencer, the former reported that it was the feeling of various members of the Committee that: "the Mayor's emphasis on presenting the 1975-76 budget gap rather than the actual dimensions of the budget itself, shows that he wanted to get people thinking about how to close the gap rather than the more basic issue of why the City insists on living beyond its means." 4/ Frank Schott of Equitable, Karen Gerard of Chase and Friedgut insisted that the real issue was the need for the City to reduce expenditures. Mr. Grossman did not disagree but felt that such an issue was the province of the policy level committee of the FCLG. Friedgut ended his memorandum on the meeting by stating that the staff committee and the CBC should work in concert "to prepare a unified analysis which would

1/ Memorandum entitled Tentative Agenda for Staff Committee, February 25, 1975.

2/ Solari at 29; D. Grossman at 55, 57.

3/ Friedgut Ex. 3.

4/ Id.

clearly demonstrate the absolute inviability of the City if it continued on its present course." 1/

* * *

BANS in the amount of \$248,980,000 were purchased by New York City pension funds at a rate of 6.455%. 2/ Emergency legislation, passed the previous day, permitted certain City sinking funds to purchase \$200 million in outstanding City obligations from the pension funds, thereby providing the money necessary to purchase the BANS. Prior to passage of the legislation, Section 275(b) of the Local Finance Law precluded such a purchase by the sinking funds if sinking fund obligations were available at a price below par. With respect to the Transit Unification Sinking Fund, Wood Dawson advised the City that the requirement that the fund not purchase City obligations when transit unification obligations were available at less than par, was a part of the contract with holders of the obligations and the change in the legislation would not affect this covenant. 3/

1/ Id.

2/ As noted above at p. 101, the bridge loan of \$170 million made by the banks on February 24, 1975 was repaid on February 25, 1975.

3/ As noted in the section of this report entitled "Role of Bond Counsel" at p.23, of approximately 100 City bond offerings since the 1930's, Wood Dawson has acted as bond counsel with respect to all but two or three.

WEDNESDAY, FEBRUARY 26, 1975

David Grossman mailed an updated copy of a memorandum entitled "Areas for Analysis" to Ellmore Patterson stating that it represented a reasonable work program for the Staff Committee of the FCLG to undertake. 1/

* * *

The Daily News printed an editorial entitled "Fiscal Folderol" concerning passage of the emergency law permitting the purchase of City securities by the City's sinking funds. The editorial stated:

This is just the latest in a series of financial gimmicks City Hall has concocted to plug the deficits created by its inability to curb spending.

We have reached the sad state where the municipal administration is reduced to budget-making based on wishful thinking - looking to Washington and Albany for a \$900 million aid windfall.

Comptroller Harrison Goldin warns that those expectations are pure pipe dreams, and urges that the City awake to the reality that drastic expense cutbacks are required.

That may be the most painful answer, but in the long run it is the only one that will enable New York to haul itself out of the hole the politicians have dug for us. 2/

Bankers Trust representatives informed members of their syndicate that White & Case, bond counsel, had discovered a problem with regard to the February 19 sale of \$260 million of TANS which was to have had a closing date of February 28. 3/ The February 19 sale had been

1/ Memorandum entitled "Areas for Analysis," February 26, 1975.

2/ Daily News, February 26, 1975, p. 41.

3/ Eide Ex. 3

to two syndicates, one headed by Chase and one by Bankers Trust. Chase had retained the law firm of Wood Dawson as bond counsel while Bankers Trust had retained White & Case to act in that capacity. 1/ This was the first City underwriting in which White & Case had been engaged as bond counsel. 2/

The members of the managerial level of the Bankers Trust syndicate were told by Bankers Trust that, based on figures provided to White & Case by an "accountant from NYC," it appeared that the City had exceeded its debt limit for TANS by approximately \$112 million. 3/ The managers were further informed that White & Case was not willing to give a clean legal opinion for the issue at that time, but that several possible solutions were being discussed, including the possibility of the City buying back \$112 million worth of notes from the Street. 4/ The problem was that White & Case had been offered documentation as to the outstanding real estate taxes as of January 30, 1975, but the firm desired more current figures. 5/

1/ Altman at 88.

2/ Epley at 24.

3/ Eide Ex. 3.

4/ Eide Ex. 3.

5/ Epley at 115-16.

Lawyers from Wood Dawson met with lawyers from White & Case at the office of Wood Dawson. During at least part of this meeting, City officials from the Office of the Comptroller were present. 1/ The problem with which White & Case was concerned was discussed. 2/

1/ Love at 199.

2/ Love at 197-200.

THURSDAY, FEBRUARY 27, 1975

On February 27th, a meeting of the Bankers Trust syndicate occurred. In attendance were representatives from Bankers Trust, Chemical, Morgan, Merrill Lynch, Bank of America and Salomon Bros. Marion J. Epley of White & Case was also present. 1/ Epley reported the problems encountered in trying to issue a clean legal opinion for the February 19 TANS offering. The first set of figures provided by the City through Sol Lewis, the City's Chief Accountant, indicated that the City did not have receivables to cover \$112 million of the proposed TANS and would be exceeding its debt limit. 2/

On this day, however, the Comptroller's office provided Bankers Trust with a second set of figures which indicated that there were sufficient revenues to support the TANS and that the previous figures were not authorized. 3/ Advised of this information, White & Case informed the syndicate that they were willing to issue a clean legal opinion if the City would (1) certify the accuracy of the second set of figures and (2) establish two closings with the Bankers Trust syndicate closing first. 4/ (The latter requirement related to the fact that the Bankers Trust syndicate had purchased \$100 million of the \$260 million TANS offering. Since coverage of only \$112 million of the offering was then in doubt, there appeared to be

1/ Sanford at 45-50; Eide Ex. 2.

2/ Eide Ex. 2; Eide Ex. 3; Sanford at 49-50.

3/ Eide Ex. 3.

4/ Id.

sufficient receivables to cover the Bankers Trust portion of the offering, provided they received the first \$100 million of TANS and closed before the Chase syndicate.) 1/

During this period of time, Mr. Sabatine advised Mr. Epley that Wood Dawson would issue a clean opinion with respect to the TANS offering based on information current as of January 30. 2/ Indeed, Sabatine took the position that Wood Dawson affirmatively did not want any information more current than January 30. Further, according to a memorandum written by Epley summarizing a telephone conversation later on February 27 with Mr. Sabatine, the latter observed that:

(1) In municipal financings, everything is always "'OK unless you ask questions.'"

(2) Failures to analyze statutes or obtain documentation are not significant in municipal financings since there is "generally plenty of fat all over the place." 3/

The Bankers Trust syndicate held a second meeting later on the afternoon of February 27 to bring the joint managers up to date on White & Case's progress in seeking to obtain more current information on the amount of outstanding real estate taxes. 4/ In response to questions from White & Case, Comptroller Goldin had previously stated that he would provide a "cold comfort" letter to White & Case indicating that the \$100 million issue bought

1/ Eide Ex. 2 and 3.

2/ Epley at 116.

3/ Memorandum, White & Case, February 28, 1975 ("Epley Memorandum").

4/ Sanford at 49-54.

by the Bankers Trust syndicate was within the legal limits. Mr. Goldin also indicated that he would send a copy of the letter to Wood Dawson, counsel to the Chase note syndicate. A representative of Wood Dawson told Mr. Epley that if Wood Dawson were to receive such a "cold comfort" letter, they would be unable to issue a clean legal opinion. In the absence of such a letter, they would issue a clean legal opinion based on their interpretation of the Local Finance Law and the practice for several years of accepting figures that were several weeks old. 1/

Charles Sanford of Bankers Trust chaired the syndicate meeting and polled the syndicate members as to whether they wished to use White & Case or Wood Dawson as bond counsel. The syndicate members voted to continue with White & Case. The syndicate members also instructed Mr. Sanford to inform the Chase syndicate that at this time, the Bankers Trust syndicate would not proceed to accept delivery of the notes. 2/ Mr. Sanford then contacted Thomas Labrecque of Chase who was chairing the Chase syndicate meeting and advised him of the Bankers Trust syndicate decision. Sanford also contacted Comptroller Goldin and relayed the same information to him. Goldin asked Sanford and Labrecque to come to a meeting at the Comptroller's office at 9:30 that evening. 3/

1/ Eide Ex. 2.

2/ Id.

3/ Id., Epley Memorandum at 5.

A log of the Comptroller's incoming telephone calls indicates that Mr. Goldin spoke with Mr. Sanford at 3:15, 3:40, 5:25 and 6:25, and with Mr. Labrecque at 6:40. 1/

Mr. Sanford went to the meeting that evening with the Comptroller with the impression that the meeting would be on an informal basis with few people present. 2/ Instead, in addition to Goldin, W. Bernard Richland (the City's Corporation Counsel), James Greilsheimer (Chief Litigating Attorney of the Corporation Counsel's office), William Wood (counsel to the Comptroller), Sidney Scher, William Scott, Sol Lewis, and several others from the Comptroller's office were present. In addition, Steven O'Grady of Bankers Trust, John Devine of Chase, and Leroy Love of Wood Dawson were in attendance. 3/

The meeting began with Goldin stating that the City was prepared to go forward with the offering. Epley responded by saying that based on figures provided by Sol Lewis, and his firm's reading of the statute (Section 24 of the Local Finance Law which relates to the requirement of a sufficient amount of tax receivables) "in order to render a clean legal opinion, it would be necessary to obtain reasonable satisfaction as to the amount of tax collections subsequent to January 30." 4/ The Comptroller answered that he could only certify figures

1/ Comptroller's Telephone Log, February 27, 1975.

2/ Sanford at 60.

3/ Love at 208; Epley at 92; Lewis at 132-33; Epley Memorandum at 5.

4/ Epley Memorandum at 6.

that were available, rather than estimates, but that the books of the City were open to examination by White & Case. 1/ The main question, according to Epley, was whether there were sufficient uncollected taxes to cover this issue of \$260 million of TANS. 2/ Leo Sabatine suggested that White & Case examine the J-73's (the daily postings of tax receipts); Goldin and Sol Lewis stated that this information was highly unreliable, and Lewis said that he did not know how current the information was. Goldin stated that he would attempt to learn the current status of the postings. 3/

The Comptroller and the City Corporation Counsel stated that this request for more current information by White & Case was unprecedented. 4/ In response, concern was expressed that, in view of the recent default of the Urban Development Corporation ("UDC") on its debt securities, underwriters should be reviewing new and different types of information than had been previously requested. 5/

The Corporation Counsel, Mr. Richland, stated that this request by White & Case represented a change in procedure and there was a possibility of suit by the City against the underwriters for breach of contract if they should refuse to go through with the sale. 6/ Mr. Epley responded that the firm was hesitant to provide a clean legal opinion absent reasonable

1/ Goldin at 55, 60-61, 111-12; Lewis at 132; Eide Ex. 2.

2/ Epley Memorandum.

3/ Id. at 7-8.

4/ Id. at 8.

5/ Goldin (August 28, 1976) at 58.

6/ Sanford at 60-61; Epley Memorandum at 6.

satisfaction as to the amount of tax collections which would occur after January 30. 1/ If the data provided by the City would adequately answer the question posed by this requirement, White & Case would issue their opinion. 2/

A recess was called at 11:20 P.M. after which the meeting continued. It was agreed that at 9:00 the following morning, representatives of White & Case would go to the Comptroller's office to examine the J-73's. 3/

During the day, there were also several conversations between representatives of the firms of White & Case and Wood Dawson concerning the problem of issuing a clean legal opinion for the notes purchased by the Bankers Trust syndicate. 4/

* * *

The Comptroller announced in a press release that the City would sell two issues of BANS, totaling \$537,270,000, on Thursday, March 6, 1975. 5/
FRIDAY, FEBRUARY 28, 1975

The next morning, representatives from White & Case went to the Comptroller's office to examine the J-73 forms. After some delay, J-73's were

1/ Epley Memorandum at 6.

2/ Id. at 7.

3/ Eide Ex. 2.

4/ Epley Memorandum.

5/ News Release, Office of the Comptroller, 75-22, February 27, 1975.

shown to the representatives and they proceeded to examine the available records. 1/

The Bankers Trust syndicate assembled in the early morning and discussed the events of the prior evening. Mr. Epley related to the syndicate the difficulties in acquiring the requested information at the Comptroller's office. He stated that the City was now prepared to certify figures as of February 6, 1975, but this was still not sufficiently current. White & Case was said to have decided not to issue their legal opinion because they were unable to state that, according to City documents, there were adequate uncollected taxes to cover the issuance of these TANS. 2/

It was unclear what course of action would be taken by the Chase syndicate. 3/ The Bankers Trust syndicate agreed not to accept delivery of the notes based on the lack of a legal opinion by White & Case and then discussed how to handle this decision when it was made public. It was agreed that a statement would be made only in reaction to statements by the City. If the City persisted in the charge that the syndicate breached a legal contract, the syndicate would respond by stating that the City was unable to demonstrate that the notes did not exceed legal limits for this type of borrowing. 4/ Charles Sanford of Bankers Trust telephoned the Comptroller and informed him that the syndicate would not take delivery of the notes.

1/ Lewis at 139-40.

2/ Id.; Eide Ex. 2.

3/ Labrecque at 206.

4/ Eide Ex. 2.

Similarly, the Chase syndicate advised the Comptroller that they, too, would not accept delivery of the notes. 1/

* * *

In the interim, the Comptroller, through a spokesman, issued a press release stating:

Contrary to inaccurate reports which have been circulated, there is no question concerning the sufficiency of City tax revenues to meet all obligations including the February 19th offering. The certainty of repayment is in no way an issue in the deliberations now taking place. 2/

* * *

During conversations between Sanford, Labrecque, Goldin and other City officials, it was discussed that if the \$260 million TANS offering did not go through, the City would require an alternative source of cash. 3/ The City and the clearing house banks agreed that the banks, acting as a syndicate, would purchase \$140 million of RANS, dated March 4 and maturing on March 20, 1975, as a bridge loan. 4/

* * *

The log of the Comptroller's incoming telephone calls indicates that at 9:30 A.M., the Comptroller spoke with Mr. Labrecque of Chase and with Mr. Sanford of Bankers Trust. Mr. Sanford also spoke to Mr. Goldin at 10:15 A.M. and 1:25, 1:45 and 5:45 P.M. Mr. Labrecque spoke to Mr. Goldin at 1:40 and 5:35 P.M. 5/

* * *

1/ Id.; Labrecque at 206.

2/ News Release, Office of Comptroller, 75-23, February 28, 1975.

3/ Labrecque at 207-08; Eide Ex. 2.

4/ Eide Ex. 2.

5/ Comptroller's Telephone Log, February 28, 1975

The Comptroller published Notices of Sale with respect to two issues of BANS totaling \$537.27 million. 1/ The Notices of Sale contained the following language:

Notes will be general obligations of The City, all the taxable real property within which will be subject to the levy of ad valorem taxes to pay the said Notes and the interest thereon, without limitation as to rate or amount. Payment of debt service shall be the first lien on all The City's revenues. The State Constitution requires The City to pledge its faith and credit for the payment of the Principal of the Notes and the interest thereon.

SATURDAY, MARCH 1, 1975

Articles appeared in The New York Times, the New York Post, and the Daily News, among other newspapers, concerning the cancellation of the sale of \$260 million in TANS. In the Times article, Comptroller Goldin was quoted as saying that the cancellation came about because of "a sudden demand by the underwriters, unprecedented in the history of the city, for data that could not physically be compiled, checked and verified in the short time available." Representatives of Chase and Bankers Trust were quoted as stating that the cancellation was the result of the City's failure to demonstrate that the contemplated borrowing was within its borrowing limits. The Comptroller estimated that, through January 31, 1975, \$409 million in real estate taxes were uncollected. In the same article, Finance Administrator Ivan Irizarry was reported as stating that most of that money [\$409 million] was from past fiscal years and that current uncollected real estate taxes were only about \$60 million. The article quoted the Comptroller as stating:

It is completely inaccurate to report or imply that there's any question concerning the sufficiency of tax revenues to meet all obligations, including the notes which are the subject of today's report [February 28]. 2/

1/ Notices of Sale, with respect to \$387,270,000 and \$150,000,000 of Bond Anticipation Notes, February 28, 1975.

2/ The New York Times, March 1, 1975, p. 29.

In the Post article, Mayor Beame and Comptroller Goldin were reported to have stated that the City had no immediate cash problems and that future contemplated borrowings would be more than sufficient to meet New York's obligations on its upcoming March 14 payroll. 1/ The Daily News article reported that the offering was cancelled by Goldin after Bankers Trust had refused to take delivery of the notes and that Chase had taken no action before Goldin cancelled the entire sale. 2/

SUNDAY, MARCH 2, 1975

A Sunday New York Times article, entitled "Fiscal Adversity Makes Beame and Goldin Strange Bedfellows," reported that Comptroller Goldin had revised his budget deficit figure for 1974-75 twice since his December estimate, but the Comptroller had refused to make his latest estimate public in an attempt to avoid a confrontation with Mayor Beame. The cooperation between the Mayor and the Comptroller was described as resulting from the deteriorating fiscal foundation of the City and their view of the banks as the common adversary because the banks had extracted high interest rates from the City and challenged the soundness of the City's notes. 3/

MONDAY, MARCH 3, 1975

The Daily Bond Buyer printed an article on the TANS cancellation which began:

1/ New York Post, March 1, 1975, pp. 3, 10.

2/ Daily News, March 1, 1975, p. 5.

3/ The New York Times, March 2, 1975.

Responding to reports that New York City may have exceeded its borrowing limit for tax anticipation notes when it sold \$260 million tax anticipation notes on February 19, Comptroller Harrison J. Goldin late Friday announced that the sale has been cancelled. 1/

Mr. Goldin was reported to have stated that the sale was cancelled because of a sudden unprecedented request for information which could not be collected before Friday's settlement date. The article stated that the underwriters had requested the amount of real estate taxes collected for February as well as the amount of such taxes due but uncollected. The aborted TANS offering was described as being a replacement for an offering of a similar amount of notes of the SRC that was to have taken place on February 13 but which had been postponed. 2/

* * *

Moody's revoked its rating on the aborted TANS issue. 3/

* * *

Jean Rousseau of Merrill Lynch addressed a memorandum to Roger Birk, President of Merrill Lynch, concerning the City's short-term financings. Rousseau reported that the sale of \$260 million of SRC notes had been prevented by a lawsuit in early February. He said that the City then obtained legislation permitting its sinking funds to buy outstanding City notes from the City's pension funds and that the pension funds subsequently purchased a new issue of City notes, which replaced the cancelled SRC offering. Rousseau also reported that the closing on the \$260 million TANS offering of

1/ The Daily Bond Buyer, March 3, 1975, p. 1.

2/ Id.

3/ Moody's Municipal Credit Report, March 3, 1975.

February had been cancelled because the City had only \$140 million in uncollected taxes, net of \$800 million TANS outstanding and, therefore, could not issue TANS in excess of that amount. According to Rousseau, the City was said to be planning to sell \$536 million of BANS in early March, for which there would be only one bid; Merrill Lynch was to participate to the extent of \$35 million of the issue. 1/

* * *

Jac Friedgut, 2/ in a memorandum to William Spencer entitled "The City Budget Mess," noted:

The basic problem, in plain English, is that the City's expenditures chronically rise more rapidly than its income, and the deficit has been financed by a combination of long-term borrowing (behind the fiction that specified current expenditures can justifiably be put in the capital budget) and short-term borrowing against subsequent income to close budgetary gaps.

The current year (1974-75) deficit was said to be about \$200 million and the deficit for 1975-76 was estimated at \$884 million. Friedgut asserted that the size of the City's deficit increases yearly and a growing percentage of income anticipated during each forthcoming year must be applied to pay off the borrowings from the preceding year. Thus, he stated, since the public sees a technically balanced budget each year end, the City's fiscal erosion is not understood by the taxpayers and voters. According to the memorandum, there existed a "floating temporary debt" of \$5 billion and a long-term debt of \$8 billion which placed a heavy demand on the obligation markets and caused "staggering" increases in the debt service portion

1/ Memorandum, Jean Rousseau to Roger Birk, March 3, 1975.

2/ Mr. Friedgut was a vice president of Citibank.

of the expense budget, and that, in the current year alone, debt service had risen 26% to \$1.435 billion. 1/

Friedgut stated that the City needed an assured supply of short-term credit at reasonable cost to finance the 1976 deficit, to slow the growth of expenditures and to reduce anticipatory borrowing. In return for such an undertaking by the financial community, the City would be required to reduce its expenditures, end the financing of expense items through the capital budget, and "undertake a solemn obligation to desist from any further quasi-legal procedures such a overestimates of revenues, underestimates of expenditures, advance collection of revenues, changing accounting practices in midstream, etc." Friedgut also recommended that the City impose a freeze on its total labor costs.

In conclusion, Friedgut stated:

The UDC crisis and the well publicized cash problems of the MTA have now given rise to fears that the City might be next. Legal litanies citing constitutional protection for the City's creditors are not enough, as shown by the questions raised about the validity of recent anticipatory borrowing. Immediate action on a new City-bankers agreement is needed to change the City's fiscal outlook. 2/

David Grossman mailed to the Staff Committee of the FCLG a corrected copy of the preliminary budget estimate discussed in the preceding meeting of the group. He also included a copy of a paper on the City's fiscal problems, prepared by Grossman, which was being distributed by Ellmore Patterson to the policy committee of the FCLG.

1/ Friedgut Ex. 6.

2/ Id.

The revised preliminary budget estimate indicated that the City's budget gap for 1975-76 would be \$884 million. 1/ The paper prepared by Grossman noted that the City's budget had grown rapidly over the last 10 years and this growth had been only partially balanced by a growth of revenues. 2/ The expanding gap between revenues and expenditures had been bridged by short and long-term borrowing. The City was also said to have developed agencies such as the Educational Construction Fund ("ECF"), the Housing Development Corporation ("HDC"), the SRC and the Transit Construction Fund ("TCF"), to issue "off-budget" debt not subject to the City's constitutional debt limits. The rapid increase in the level of City debt had placed much pressure on the markets for tax exempt debt and it appeared that the City would require additional borrowing for the current and succeeding years. 3/

* * *

A series of notes, memoranda, drafts and other documents prepared by the Comptroller's Office advocated dealing with the problems presented during the pendency of the Wein litigation by taking the position that, if all the indebtedness incurred by public benefit corporations (off balance sheet financing entities such as the ECF, HDC, SRC, and TCF) was added to the long-term debt of the City, the City would still be within its constitutional debt limits. 4/

1/ Memorandum, David Grossman to Staff Committee FCLG, March 3, 1975, with attachments.

2/ Id.

3/ Id.

4/ Comptroller's Office Memoranda, March 3, 1975, with attachments.

In a draft letter dated March 2, 1975 to be signed by the Mayor and the Comptroller and sent to the heads of public benefit corporations, the following language appeared:

As you may know, the City and its undersigned Mayor and Comptroller are now defendants in the case of Wein v. The City of New York, et al., in which the plaintiff alleges that the City's debt limit has been exceeded by virtue of sales of City obligations during last February, and in which the plaintiff demands that the City be enjoined from selling bonds in excess of its debt limit — despite the fact that the City's borrowing margin within its debt limits was roughly \$1.76 billion after all such February sales.

The underwriters of the City's bonds (and bond anticipation notes, which are also chargeable against the City's debt limit) have advised us, through their counsel, that the City will be required to furnish them with certifications regarding all public benefit corporations with obligations outstanding or authorized to be issued for City-related purposes, where the City is by statute or agreement made responsible for debt service on such obligations. The purpose of such certifications — which must be furnished at the closing of each sale by the City of its bonds (or bond anticipation notes) during the pendency of the Wein case — is to show that even if all such obligations were treated as City debt, the City would nonetheless have sufficient debt-incurring capacity to issue its bonds (or bond anticipation notes). 1/

TUESDAY, MARCH 4, 1975

A meeting of the Comptroller's Technical Debt Advisory Committee ("CTDA Committee") commenced at 8:00 A.M. in the Comptroller's office. Mr. Goldin, Dr. Scher, Mr. Scott, Mr. Lewis and others represented the Comptroller's office. Gedale Horowitz, Richard

1/ Id.

Kezer, Zane Klein, Thomas Labrecque, Richard Nye, Frank Smeal and James Trees also attended. 1/

The Comptroller requested, in connection with the pending BANS sale, that any requests by bond counsel for special or "'never-before-requested'" information be made sufficiently in advance of closing to enable the City to supply the information. Mr. Horowitz requested a financing schedule for the remainder of the fiscal year and the Comptroller responded that the only change contemplated was the addition of an interim bridge loan, in the form of \$140 million in RANS, to be offered to the clearing house banks on March 5. A permanent replacement for the cancelled SRC offering had not yet been developed. Mr. Kezer and Mr. Horowitz pointed out that, because of the UDC bond anticipation note problems, the City might encounter difficulties with its BANS offering the following Thursday. Mr. Labrecque stated that he would talk with bond counsel, who wanted to ensure City compliance with the laws pertaining to City borrowings. Mr. Kezer inquired why the \$140 million bridge loan was in the form of a sale of RANS rather than TANS; Mr. Goldin replied that this was done to avoid the problems encountered with the \$260 million TANS sale. The Comptroller ended the meeting by stating that, as a matter of prudence, he would confer later in the day with prospective syndicate managers on any possible problems that might arise with regard to the upcoming BANS sale. 2/

1/ Minutes of CTDA Committee, March 4, 1975.

2/ Id.

* * *

A Chase Manhattan syndicate pricing sheet on the negotiated \$140 million RANS sale, purchased by ten New York City banks headed by Chase, reported that the maturity date of the offering was March 20, 1975, the notes were not reoffered, and the syndicate account closed out at a loss of \$6,717.40. This amount represented the fee for legal services but did not take into account the interest that the purchasers would receive on the RANS. 1/

* * *

Comptroller Goldin, addressing a luncheon meeting of the New York Financial Writers' Association, explained the cancellation of the \$260 million TANS offering stating that the underwriters at the last moment had requested information never before required in connection with such an offering. According to Goldin, this data could not be physically gathered within the time demanded and, as a result, the sale was cancelled. 2/

The Comptroller asserted that City obligations "are not now and never have been a credit or security risk." Moreover, the City, according to the Comptroller, was beginning to take the difficult and painful steps necessary to overcome its fiscal problems. The acid test for the City

1/ Chase Manhattan Syndicate Pricing Sheet, March 4, 1975.

2/ The Daily Bond Buyer, March 5, 1975.

would be how it proceeded to meet the current year's budget gap and prevent future deficits. 1/

It means abandoning the game of numbers which has been played by municipalities throughout the country in which revenues are routinely overestimated and expenditures underestimated in order to meet artificially the statutory requirement for a balanced budget. 2/

* * *

In an internal memorandum to Comptroller Goldin and First Deputy Comptroller Scher on the City's borrowing needs for the remainder of the fiscal year, Sol Lewis, Chief Accountant, reported that he, Steven Clifford and Jonathan Weiner had a meeting with John Lanigan of the Bureau of the Budget on March 3, 1975. 3/ According to Lewis, the latter advised Lanigan that the projected cash needs of the City for the remainder of the fiscal year would require short-term borrowing of \$2.025 billion and that a compilation of all available borrowing authority indicated a limit of \$1.122 billion. Thus, the City would be short \$903 million of needed borrowing authority. Mr. Lanigan took the position that \$520 million of this total related to the inability of the SRC to sell obligations and that he had no answers to this problem. As to the balance of \$380 million, he suggested that the City might (1) increase Federal and State receivables, or (2) borrow ahead for expense items included in the Capital Budget in excess of actual expenditures but based on authorizations to provide the required cash.

1/ Id.

2/ Dow Jones Broad Tape, March 4, 1975.

3/ Memorandum, Sol Lewis to Harrison Goldin and Seymour Scher, March 3, 1975.

Mr. Lewis stated:

...we have traditionally borrowed long term only to the extent of actual expenditures for capital projects. Borrowing long term to finance cash flow needs engendered by Expense Budget deficits would, in my opinion, be a questionable practice.... In addition, any sale that would involve additional charges to our legal borrowing capacity would come up against the problems raised by the filing of the Wene [sic] case. 1/

WEDNESDAY, MARCH 5, 1975

The initial merged syndicate meeting of the managers interested in the City's \$537 million BANS offering began at 9:30 a.m. at Chemical. The lead member of the merged syndicate, Chemical, was represented by Herman Charbonneau and Richard Adams. Representatives were also present from Chase, Citibank, Morgan Guaranty, Bankers Trust, Manufacturers Hanover, Salomon Bros., A.G., Becker, Bear Stearns, Merrill Lynch, Weeden & Co., First Pennco, and Ehrlich-Bober. Included among those present were attorneys from White & Case, Wood Dawson, and Davis, Polk and Wardwell. 2/ Later in the day, Bank of America and First National Bank of Boston were in telephone contact with the meeting. 3/

The first portion of the syndicate meeting was dominated by discussion of bond counsel's problems with the wording of the legal opinion. Both White & Case and Wood Dawson were working on this particular offering and the syndicate would have to decide what role each law firm would play. The form

1/ Id.

2/ Isolano at 60-1; Rousseau (April 14, 1976) at 42-43; Ehrlich at 64, 66-7; Epley Ex. 15; D. Coleman at 58-60; Brophy at 14-16.

3/ Charbonneau at 161; D. Coleman at 68; Epley at 203.

of the opinion was also discussed. 1/ The status of the Wein litigation and its effect on the offering were discussed. Counsel felt generally that Professor Wein did not have a strong case. 2/ During the day it was stated that this City offering was one for which there would be only a single bid. 3/ There was also a discussion regarding preliminary thoughts on pricing. 4/

The meeting broke into a series of smaller discussions among various groups of underwriters and attorneys. 5/ Various City officials, including the Comptroller, were in touch with the underwriters and their attorneys throughout the progress of the meeting. 6/

Late in the afternoon, the various groupings of individuals converged for a large meeting. The purpose of this meeting was to define problems concerning disclosure and to discuss marketing the issue, the level of participation of each firm and the interest rate. 7/

1/ Eide at 50-51; Love (March 30, 1976) at 223.

2/ Epley Ex. 15; Love (March 30, 1976) at 223.

3/ Charbonneau at 156-57; Love (March 30, 1976) at 246.

4/ Eide at 45.

5/ D. Coleman at 64, 78-80; Love at 225.

6/ Rousseau (March 26, 1976) at 76; Epley at 215; Ehrlich at 69-70; Love at 227-28.

7/ Charbonneau at 160.

White & Case indicated that they could issue a clean legal opinion on the notes provided that certain conditions were met. 1/ One condition was that the Attorney General of the State of New York and the City's Corporation Counsel provide an opinion to the effect that the City had the legal authority to issue these notes. 2/ Wood Dawson adopted the position that they would proceed with the note offering in the same manner as they had handled prior note offerings. 3/ In addition, assurances that the proceeds would be used properly and that the City figures were as accurate as possible would be requested. 4/ After a discussion about the potential differences in language between the opinions of White & Case and Wood Dawson, it was suggested that the group would proceed with both counsel working on the matter, inasmuch as various parties favored one firm over the other. 5/

An ensuing discussion concerned Rule 10b-5 promulgated under the Securities Exchange Act of 1934. In this context, a memorandum of the meeting stated: "Into the 10b-5 aspects of whether foreseeing that City is up against its limit and may be handicapped in future borrowings and thus lack funds to pay off notes as they become due." 6/

1/ Epley Ex. 15; Isolano 70.

2/ Epley Ex. 15.

3/ Isolano at 60-61.

4/ Epley Ex. 15; Moos at 92.

5/ Epley Ex. 15; Eide at 50-51.

6/ Epley Ex. 15.

The discussion generally revolved around the obligation of an underwriter of City securities to disclose facts within his knowledge about the limits on the City's issuance of debt. The question of whether an underwriter must issue a disclosure sheet or prospectus was raised. 1/ Mr. Epley of White & Case stated that, at this stage, his firm intended to insert a paragraph in its opinion as to the borrowing situation and the opinion itself would be based on the opinions of the Attorney General and Corporation Counsel. 2/

A poll was taken to ascertain whether the institutions wished to proceed with this public offering and what each institution wanted to do about the problem of disclosure. Chase indicated it wanted to proceed with the sale with full disclosure. The Bank of America, which was participating in the meeting by phone, indicated they were withdrawing from the syndicate but indicated a preference for full disclosure. Chemical Bank expressed the desire to participate but was unsure about full disclosure, commenting that perhaps a brief but comprehensive statement would suffice. Citibank was unsure whether it wanted to participate but thought a disclosure statement would raise additional issues. Questions were raised by Citibank as to whether disclosure would be modeled on a Securities Act of 1933 registration statement; what should or should not be included; and whether the fact that the notes would be backed

1/ Epley Ex. 15; Isolano at 63.

2/ Epley Ex. 15; Epley at 428.

by unlimited ad valorem taxes would satisfy all problems. 1/

Manufacturers Hanover seemed to prefer full disclosure of the City's problems but suggested that the offering be done on a limited liability basis. Bankers Trust wanted to participate but noted that there was a marketability problem. 2/ Weeden wished to drop out. Salomon Bros. desired to participate in a limited fashion with full disclosure and was willing to listen to all views. Bear, Stearns did not wish to participate because of the marketing problems that would be caused by a posture of full disclosure. Merrill Lynch favored not having a disclosure statement. Merrill Lynch also indicated that it would participate in the underwriting without disclosure. 3/ A.G. Becker wished to drop out but believed full disclosure to be the proper approach. 4/ First National Bank of Boston, in touch with the meeting by phone, decided to withdraw from the syndicate. 5/

1/ Epley Ex. 15.

2/ Id.

3/ Epley Ex. 15; Charbonneau Ex. 19.

4/ Epley Ex. 15.

5/ Id.

In the evening there were conference calls between Herman Charbonneau of Chemical, John Hamill, in-house counsel to Chemical, Richard Simmons of Cravath, Swaine & Moore, outside counsel to Chemical, and Richard Kezer and Mark Kessenich of Citibank during which there were discussions concerning what disclosures would have to be made with respect to the BANs offering. The discussions included how they could possibly, in the time allotted, put together an adequate disclosure statement and what would constitute such a statement. 1/

* * *

In an internal memorandum entitled "The Banks and New York City," 2/ Jac Friedgut of Citibank stated, "[t]he primary role of banks in the Municipals market is not to buy and hold the paper, but to underwrite/syndicate/distribute it." He asserted that the banks were being attacked because of high interest rates, but that the reason for the high rates was that something was "seriously amiss within the budget."

Friedgut stated that, in recent years, the City's expense budget balancing had involved some "phony" practices including: use of the capital budget for operating purposes; use of "special budget notes;" issuance of short-term debt "under the guise of TAN's, RAN's or BAN's but the taxes, revenues or bonds being anticipated are further into the future and less certain than they should be;" and the depletion and postponement of replenishment of the Rainy Day Fund. Friedgut also said that short-term borrowing by the City had expanded

1/ Charbonneau at 164-66.

/ Friedgut Ex. 7.

from \$1.3 billion in June 1970 to approximately \$5 billion currently and that the City "is now on a debt treadmill (averaging \$500 million per month of short-term and \$500 million every six months of long-term)." 1/ He contended that the City's expenses had rapidly risen with welfare, personnel costs, free or discounted citizen services (such as free higher education) and debt service.

According to Friedgut's draft memorandum, the Mayor claimed that he could effect additional economies and obtain moderate revenue increases but would still have an \$884 million budget gap for 1975-76 without additional revenues. Additional taxes would be counterproductive and huge aid infusions were highly unlikely. Unless there was some decrease in this figure of \$884 million, "[t]he City's fiscal situation would simply not be viable, and investors would probably be uncomfortable about buying N.Y.C. paper regardless of interest rate." 2/ The City debt "overhang" and cash flow problems were so acute that they could not be solved overnight. The Friedgut memorandum contained a section entitled "Biting the Bullet" which contained a series of recommendations, including reducing expenditures by freezing labor costs and decreasing services. This section went on to state:

Even with all these sacrifices, the "debt overhang" will be slightly worse in June 1976 than at present. For the entire program to be effective in saving the City, therefore, planning has to be done concurrently to moderate budgetary increases subsequent to June 1976 also, to phase out capital borrowing for operating purposes, to establish integrity through the City's budget-making process, and generally to live within our means.

1/ Id.

2/ Id.

As a practical matter, the huge volume of short-term debt outstanding may not be reducible to any significant extent even with the City's best efforts. A basic restructuring of the inter-governmental program burdens and funds flows [sic] will be necessary. 1/

* * *

In a Daily Bond Buyer article of March 5, 1977, Comptroller Goldin was reported to have blamed the banks involved for the \$260 million TANS cancellation and was emphatic in asserting that the banks had been "unfair" in seeking what he called "unprecedented" information on what he considered too short notice. Mr. Goldin further "insisted that the unusual action had nothing to do with the City's fiscal health." The Comptroller was also reported to have stated that the City at no time had exceeded its legal borrowing capacity in selling the TANS. In the same article, Tom Parisi, a spokesman for Bankers Trust, was reported to have stated that: "Counsel for all the banks and investment houses involved concurred that the City had failed to comply with the law which mandates that the tax receivables information be as of the last of the current month" and that "[t]his was the sole reason for refusal to consummate the sale." 2/

1/ Id.

2/ The Daily Bond Buyer, "Goldin Blames Cancellation of TANS on Banks Involved," March 5, 1975.

On March 5, 1975, in a negotiated sale, a group of banks headed by Chase purchased \$140 million of RANS with a 15 day maturity at an interest rate of 7.25%. 1/

THURSDAY, MARCH 6, 1975

The prior day's meeting was reconvened at 9:00 A.M. at Chemical and was chaired by Herman Charbonneau and Richard Adams of that bank. They were assisted by John Hamill, in-house counsel to Chemical, Peter Tufts, John Devine, James O'Sullivan and Frank Puleo (of Milbank Tweed Hadley & McCloy) who at various times represented Chase. 2/ Richard Kezer, Mark Kessenich and Joseph Doyle (of Shearman and Sterling) represented Citibank. 3/ Steven O'Grady and Marion J. Epley (of White & Case) represented Bankers Trust. 4/ Gedale Horowitz and counsel (from Cleary, Gottlieb, Steen and Hamilton) represented Salomon Bros., 5/ Steven Kenney and Ralph Jones (of Brown, Wood, Ivey, Mitchell & Petty) and Jean Rousseau represented Merrill Lynch. 6/ Giles Brophy represented First Pennco, Joseph Isolano represented Manufacturers Hanover and Robert Moos represented Weeden & Co. 7/ Ehrlich-Bober was represented by Fred Ehrlich. 8/ Richard Eide and John Clark (of Davis, Polk and Wardwell) represented Morgan Guaranty. 9/ Dennis Coleman

1/ News Release, Office of the Comptroller, 75-28, March 6, 1975.

2/ Labrecque at 209; Moos at 98, 100; Charbonneau at 203-04.

3/ Charbonneau at 204; Horowitz at 72.

4/ Charbonneau at 204.

5/ Horowitz at 80.

6/ Charbonneau at 205-07; Rousseau (April 14, 1976) at 58.

7/ Brophy at 18; Charbonneau at 204.

8/ Moos at 122; Charbonneau at 204.

9/ Eide at 61-62.

represented Bear Stearns. 1/ Leo Sabatine of Wood Dawson also attended the meeting. 2/ The Bank of America and First National Bank of Boston were in contact with the meeting by conference phone. 3/

Various conference rooms were again being used and several meetings were being held at different times. 4/

The same general problems of the previous day continued to be discussed -- whether the syndicate was interested in purchasing the \$537 million of BANS and what disclosure was necessary to accomplish the sale. 5/ Again the Wein litigation and its effect on the ability of the City to issue notes was discussed. 6/ White & Case now appeared to be acting as both bond counsel and counsel to the underwriters. 7/ Wood Dawson, at Chase's request, was "hanging in there," providing assistance to White & Case in their attempt to form an opinion. 8/

1/ D. Coleman at 63.

2/ G. Horowitz at 78.

3/ Moos at 122.

4/ Charbonneau at 203; Isolano at 61-62.

5/ Labrecque at 212-13; Charbonneau at 205-06; D. Coleman at 63-64.

6/ Moos at 123-124, 138; Horowitz at 78-79.

7/ Rousseau (April 14, 1976) at 67-68.

8/ Love (March 30, 1976) at 221-22.

Additionally, Chemical Bank, as lead underwriter, was in telephone communication with the Comptroller and the Mayor. 1/ Individual members of the merged syndicate were also in contact with City officials. 2/ Thomas Labrecque of Chase had several phone conversations with Comptroller Goldin during the period of the syndicate meetings and discussed the progress of the sale. 3/

The syndicate again discussed the possibility of purchasing the BANS as a private placement among the clearing house banks. 4/ Rather than a private placement, however, it was discussed that if the public offering went through, the syndicate account would be divided. This represented a departure from the previous practice of having an undivided participation by all members of the underwriting syndicate. Some felt the acceptance of the limited liability approach was preferable because some

1/ Charbonneau at 308-09; Goldin (August 29, 1975) at 125; Adams at 92-93; Kezor at 114.

2/ Goldin Exhibit 72.

3/ Id.

4/ Eide at 56-57.

of the banks could place the securities in their investment accounts. 1/

With regard to the Wein litigation, the lawyers felt that although the suit was not frivolous, it should ultimately be dismissed. 2/ This part of the discussion produced more requests for information from the City concerning its constitutional debt limit. 3/

For the second time the members of the merged syndicate were polled as to their willingness to participate and their feelings as to the disclosure issue. 4/ The responses generally remained the same, with the syndicate leaning towards some type of disclosure. 5/ There were remarks that full disclosure would limit the marketability of the notes. 6/

During these discussions, Mayor Beame and Deputy Mayor Cavanagh met privately with the Chairman (Donald Platten) and the President (Norborn Berkley) of Chemical Bank, the lead underwriter of the syndicate and Frank Smeal of Morgan Guaranty, David Rockefeller of Chase and Walter Wriston of Citibank. 7/ The problems with underwriting

1/ Brophy at 24, 25; Moos at 144; Adams at 90-92.

2/ Document entitled, "Excerpt from White & Case Opinion," dated March 5, 1975.

3/ Moos at 126.

4/ Epley Ex. 15; Brophy at 19; Moos at 130-131; Rousseau (April 14, 1976) at 88-89.

5/ Rousseau (April 14, 1976) at 89; Rousseau Ex. 3.

6/ Rousseau (April 15, 1976) at 95; Charbonneau at 237; Charbonneau Ex. 19.

7/ Memorandum, Jac Friedgut to William Spencer, March 14, 1975. Five page handwritten notes entitled "3/6 Chemical."

the BANS were discussed, including the interest rate. Mayor Beame indicated that he "expected [the] banks to take [the BANS] into their portfolio there-fore [making the] marketability problem moot." The Mayor also expressed concern that the "rate would trigger investigation." 1/ Walter Wriston of Citibank stated that the banks must have access to a public marketplace and that there was "no way [the banks] will stuff" the notes into their portfolio accounts. 2/ Frank Smeal of Morgan Guaranty stated that "there is no market for \$537 million [BANS]." 3/

Several times throughout the day, the deadline, originally 11:00 A.M., for submission of bids was extended. 4/ In the late afternoon, the syndicate decided to submit a bid for the BANS provided five conditions were met. 5/ Those conditions were:

- (1) The disclosure statement prepared by the underwriters must be issued as a press release by the City at the time the announcement of the award of the Notes is made...
- (2) The City must furnish the underwriters with a "STATEMENT OF ESSENTIAL FACTS" as of January 30, 1975.
- (3) The legal opinion of White and Case must be unqualified.

1/ Five page handwritten notes entitled "3/6 Chemical."

2/ Id.

3/ Id.

4/ Kezer at 115; Love (March 30, 1976) at 229.

5/ Moos at 140-41.

- (4) The New York City Corporation Counsel must issue an opinion declaring that, in his opinion, the Wein Suit is without merit.
- (5) The Attorney General of the State of New York must issue an opinion to the same effect as that of the Corporation Counsel. 1/

At the conclusion of the meeting, the single bid, with its conditions, was agreed upon. 2/ The interest rate the syndicate decided upon was approximately 8.69%. 3/ The lawyers present at the meeting prepared drafts of the release to be issued by the Comptroller. 4/ The bid was submitted to City officials and the City rejected it. 5/

During the course of the day, the following people spoke by telephone to the Comptroller: Richard Adams of Chemical (six times), Herman Charbonneau of Chemical (two times), Thomas Labrecque of Chase (four times), and Gedale Horowitz of Salomon Brothers (one time). 6/

* * *

On March 6, 1975, the New York Post printed an article reporting that the City was preparing to sell \$537 million in BANS. The article further stated that the City had \$176 million in cash and that on

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- 1/ Charbonneau Ex. 11
 - 2/ Horowitz at 97; Charbonneau at 310.
 - 3/ Document marked "Draft 3/6/75."
 - 4/ Horowitz at 96.
 - 5/ Horowitz at 99-100; Charbonneau at 310.
 - 6/ Goldin Ex. 72.

March 14 it would need \$427 million to redeem maturing City notes and meet a payroll that averaged between \$180 to \$200 million. 1/

FRIDAY, MARCH 7, 1975

Another meeting took place at Chemical Bank. On this occasion, senior officials and syndicate representatives from the largest banks and broker-dealers in New York met to review the City's financial situation. Donald Platten chaired the meeting and Richard Adams presented an updated report on the proceedings of the previous day. Among those present were Walter Wriston of Citibank, Walter Page and Frank Smeal and Richard Eide of Morgan Guaranty, David Rockefeller, David Grossman and Thomas Labrecque of Chase, and Jean Rousseau of Merrill Lynch. 2/

The group discussed the same issues treated during the preceding two days at the syndicate meetings. Once again, the possibility of doing the offering as a private placement among the clearing house banks was discussed. Several of the bankers present stated that the banks currently had too much of their equity in City paper and that it just was not feasible to keep taking such paper into inventory. 3/ Frank Smeal spoke in favor of a private placement. 4/ The City's cash needs and the seriousness of its fiscal difficulties were discussed. 5/

1/ New York Post, March 6, 1975.

2/ Charbonneau Ex. 21; Charbonneau at 331; Labrecque at 220; Smeal at 95, 104-105; Adams at 98.

3/ Smeal at 107-11.

4/ Id. at 109.

5/ Charbonneau Ex. 21.

It was decided that the FCLG would work with the City to help in the preparation for future borrowings and to develop a Statement of Essential Facts. 1/

After the bid was resubmitted and the City decided to accept it, a joint press release was issued by the Mayor and the Comptroller announcing the sale of the \$537 million in BANS at a negotiated rate of 8.69%. 2/ They described this rate as very high and as a result of the UDC crisis. 3/ The press release also stated:

We are most unhappy with the rate negotiated today, but it was the best we were able to do under the circumstances. The City needs the money immediately, in order to provide an adequate cash flow. 4/

* * *

The Comptroller also issued a separate press release regarding the BANS sale, in which he termed the 8.69% rate of interest a "relatively high rate." 5/ He stated that this rate was a result of, among other things, the Wein litigation which attacked the proposed borrowing as beyond the City's constitutional debt limit. Comptroller Goldin's release concluded with the following statements:

1/ Rousseau (April 14, 1976) at 97-98.

2/ News Release, Office of the Comptroller, 75-30, March 7, 1975.

3/ Id.

4/ Id.

5/ News Release, Office of the Comptroller, 75-31, March 7, 1975.

Other factors contributing to this high rate of interest are the recent negative occurrences in the municipal credit markets, adverse economic conditions and the City's ever increasing cash needs which have necessitated extraordinary borrowings by the City and every expectancy of a continuing need for high borrowings. While solution of the City's fiscal problems is not an easy matter, Comptroller Goldin expressed his confidence that the City would, when the time comes, be in a satisfactory legal and fiscal position to sell Bonds to fund these Notes. 1/

In contrast, the earlier draft of this release, which had been prepared by lawyers present at the syndicate meeting of March 6, stated:

Economic conditions and cash needs of the City have necessitated an extraordinary amount of borrowings by the City in the municipal credit markets in recent years and the need for such borrowings will remain large in the near future. Past and prospective borrowings are causing the City to approach its constitutional debt limit. These conditions adversely affect the City's access to the municipal credit markets, to which the City must look for the financing it deems necessary to meet expenses and maturing obligations. Thus, the interest rates on the Notes awarded today reflect the risk inherent in the City's present financial condition. While solving the City's fiscal problems is not an easy matter, we shall nevertheless make every effort to sell bonds to fund these notes when the time comes, and I am confident it can be done. [Emphasis added] 2/

* * *

The Comptroller delivered an address at a luncheon of the New York Society of Security Analysts where he announced the sale of the BANS. He also commented upon the UDC crisis and its negative impact on the sale of City securities. He stated that it was necessary for the City to bring its budget under control and advocated a five part program to accomplish

1/ Id.

2/ Document marked "Draft - 3/6/75"; Horowitz at 96.

this task: (1) that the City stop borrowing to close budget gaps; (2) that expense items be eliminated from the capital budget; (3) that the unencumbered margin in the capital budget be increased; (4) that the amount of debt service the City could afford be given first consideration in the expense budget and the debt issued be restricted to that amount; and (5) that the City, ultimately, not issue any new long-term debt except to the extent that old debt is retired. 1/

* * *

The Comptroller announced in a press release that the City would sell \$375 million in RANS on Thursday, March 13, 1975. 2/ The Notice of Sale for this issue indicated that of these RANS, \$150 million were to be sold in \$100,000 denominations, \$168.75 million in \$25,000 denominations and \$56.25 million in \$10,000 denominations. 3/

* * *

In the afternoon, the Grossman committee of the FCLG met at Chase. 4/ The Committee meeting also attracted a number of people who were not official members of the FCLG. 5/ The meeting was chaired by David Grossman of Chase. At the meeting were Thomas Labrecque, Walter Carroll and

1/ Remarks by New York City Comptroller Harrison J. Goldin at Luncheon Meeting of the New York Society of Security Analysts, Friday, March 7, 1975, 1:00 P.M., 15 William Street, New York City.

2/ News Release, Office of Comptroller, 75-32, March 7, 1975.

3/ Notice of Sale for Issue of RANS on March 13, 1975.

4/ Labrecque at 222.

5/ D. Grossman at 97.

James O'Sullivan of Chase, Herman Charbonneau of Chemical, Jac Friedgut of Citibank, Ross Mathews of Morgan Guaranty, Jean Rousseau of Merrill Lynch and William Solari of Donaldson, Lufkin & Jenrette. Messrs. Fenton of Kidder Peabody, Thomson of W. H. Morton and Co., Harmon of Bowery Savings, Vatter of Metropolitan Life, Schott of Equitable Life, Anderes of Bankers Trust and Crowley of Solomon Bros. were present. Leroy Love and Leo Sabatine of Wood Dawson, Marion J. Epley and John Osnato of White & Case and Frank Puleo of Milbank, Tweed, also attended. 1/

It was stated that despite the sale of \$537 million BANS, there were still problems. It was said that the City needed \$350 million currently and \$1 billion in each succeeding month, for a total of approximately \$2.5 billion by June. It was further stated that the clearing house banks could not handle this volume by themselves and therefore the public market had to be kept open. The complication appeared to be that this sum was probably in excess of the City's borrowing capability; it was uncertain whether the City had the legal authority to incur this additional debt. 2/

1/ D. Grossman Ex. 7A.

2/ D. Grossman Ex. 4; Charbonneau at 316.

It was felt that the City needed a definite plan and the Committee agreed to assist the City in the preparation of the Statement of Essential Facts. 1/ The Committee decided to examine the repayment schedule of City notes maturing prior to June 30, 1975 and the revenue estimates through June 30, 1975, to see what portion of this revenue had already been pledged for outstanding debt and what part was available for the issuance of new debt. The City's expenditure estimates through June 30, 1975 were to be reviewed and evaluated. The Committee would also examine the statutory borrowing authority for the proposed City bonds and notes to be issued, in light of the Wein litigation. Finally, the Committee would assess the marketability of the proposed City borrowing schedule in terms of volume and timing. 2/

The Committee then turned to the legal problems raised by the Wein suit. Wood Dawson suggested a technical amendment to the SRC legislation allowing the City to borrow in anticipation of the SRC borrowing which was now blocked by the lawsuit. It was said that Wein apparently had no direct effect on the upcoming RANS. There were outstanding unresolved legal issues with regard to TANS and BANS but as to the RANS, Wood Dawson believed that as long as the City maintained that it had authority to borrow, underwriters had no reason to look behind the City's statements, unless they had some definite reason to suspect "hanky-panky." The question arose whether the group should review in depth the City's basis for present and future RANS and whether repayment of specific issues of RANS were legally tied to specific Federal, State or other revenues. It was noted that this review

1/ D. Grossman Ex. 4; Labrecque at 221-22.

2/ Charbonneau Ex. 21; Charbonneau at 331.

could raise problems for the next Wednesday's proposed sale of RANS. If this review indicated that the City was over-anticipating its receivables, there would be a potential disclosure issue. If a disclosure problem arose in this review, White & Case believed that a possible "due-diligence" question would then arise, Wood Dawson and Milbank Tweed did not believe that a due diligence issue existed. 1/

Alternative means of meeting the large cash needs of the City were discussed. Suggestions included additional Federal and State aid and Federal loans or purchases of City securities. Possible methods of helping the market absorb the huge amount of debt included a public airing of the City's fiscal and legal situation, a resolution of the UDC crisis and an attempt to balance the budget (which appeared to be out of balance for the following year by \$2 billion). The subject of the budget brought about a discussion of the City's accounting problems and the "gimmicks" used by the City which had led to the existing cash crisis. 2/

The Committee established a task force to work on some of these problems and to help with the sale of the RANS. This task force would meet the next day at Chase at 9:00 A.M. 3/

* * *

1/ Id.

2/ Id.

3/ D. Grossman Ex. 4.

An article in The New York Times reported the events of the previous day, Thursday, March 6, from their start at 8:30 A.M. until 9:30 P.M. The article reported:

The lawyers for the banking community demanded legal evidence that the city was empowered to sell the long-term bonds required to pay off yesterday's issue. A spokesman for Mr. Goldin said that the information requested was 'unprecedented.' 1/

* * *

In a New York Post article on the contemplated BANS sale it was reported:

The difficulties apparently revolved around a request by the Chemical Bank syndicate that Goldin provide an absolute guarantee that the city has the legal ability to back up the notes it is offering. 2/

SATURDAY, MARCH 8, 1975

There was a meeting of the FCLG task force at 9:00 A.M. at Chase. This was the group that had been created the previous day at the Grossman Committee meeting. David Grossman chaired the meeting. James O'Sullivan and Walter Carroll of Chase attended. Chester Johnson of Morgan Guaranty, Jac Freidgut of Citibank, Roy Anderes of Bankers Trust, William Solari of Donaldson, Lufkin & Jenrette, and John Thompson of W. H. Morton also were present. Willis MacDonald and John Osnato of White & Case and Leroy Love and Leo Sabatine of Wood Dawson were there as well. 3/

1/ The New York Times, March 7, 1975 p. 1.

2/ New York Post, March 7, 1975, p. 1.

3/ D. Grossman at 96-97 and 103-04; D. Grossman Ex. 4; Love Ex. 15; Love at 273-74; Solari at 39.

The purpose of the meeting was to discuss the type of information for disclosure purposes which might be useful in aiding the City in its future offering of notes. 1/

The concept of creating a disclosure document began to take shape during the meeting "roughly simultaneously" as the group developed increasingly serious questions as to the credit and the fiscal condition of the City. Due diligence and disclosure problems were discussed. Mr. Osnato reported discussions along these lines to Mr. Epley of White & Case that day.

Moreover, the group discussed the applicability of the 1933 and 1934 Federal securities acts as well as inside information problems. 2/

1/ D. Grossman at 98, 100; Epley at 274-75.

2/ Position Paper of White & Case, "In the Matter of Transactions In Securities of the City of New York" at 33-34; D. Grossman at 108; Epley at 249-50.

MONDAY, MARCH 10, 1975

The task force of the Grossman Committee met with representatives of the Bureau of the Budget and the Comptroller's Office. Also present were representatives of the Corporation Counsel's Office. David Grossman, James O'Sullivan and Walter Carroll represented Chase, John Thompson represented W. H. Morton, Chester Johnson represented Morgan Guaranty, William Solari represented Donaldson, Lufkin & Jenrette and Roy Anderes represented Bankers Trust. Steven Clifford, Sol Lewis, Seymour Scher and William Scott were there from the Comptroller's Office and John Lanigan, Alexandra Altman and Eugene Keilen represented the Bureau of the Budget. 1/

The meeting concerned the banks' request to secure from the City information concerning (1) the cash flow requirements of the City through June 30, 1975, (2) the debt service requirements of the City, and (3) the sources of the City's funds to service those debt requirements, including

1/ Two page document, with second page on letterhead of Office of the Comptroller, March 10, 1975; D. Grossman at 130-132.

the issuance of notes. 1/ The information was needed quickly, so that it could be submitted to the underwriters or their counsel, in connection with the next issuance of BANS and the forthcoming issuance of RANS. 2/ It was agreed that the requested information would be provided within two days. 3/ The City provided the Grossman Committee with a list of new short-term borrowings scheduled through June 30, 1975, totalling \$2.045 billion, not including \$249 million in BANS held by the City's Pension Fund, to be rolled over, and \$500 million in capital construction bonds scheduled to be issued in April. 4/ The City was requested to provide the Committee with a detailed day-by-day schedule of revenues and expenditures through June 30; a balance sheet as of June 30, 1975; a schedule of debt maturing prior to June 30; materials concerning the City's legal authority for existing and prospective borrowings through June 30 and similar data. 5/ The Corporation Counsel was said to expect the issues raised by the Wein suit, to be cleared up in six to eight weeks. If not, the City expected to ask the State legislature to permit new BANS issues in anticipation of issuing SRC

1/ Solari at 44; D. Grossman Ex. 32.

2/ D. Grossman at 137.

3/ Thompson Ex. 10.

4/ Id.; D. Grossman Ex. 32.

5/ Id.; Thompson at 68.

notes or bonds, 1/ and the City would have to look for alternatives by mid-April in that event. 2/ The City was said to need all of its planned short-term borrowing of over \$2 billion by June 11, but that there was a small amount of flexibility in the borrowing schedule. 3/ During the same period, the City was scheduled to redeem at least \$1.8 billion of its obligations. 4/ The City officials stated that the Comptroller's Office would be able to provide the basis for the City's legal authority for the proposed and outstanding issues within a day. 5/

It was disclosed that the then current outstanding level of City short-term borrowings was \$5.8 billion, plus about \$310 million net in BANS issued the last week for roll-over purposes, resulting in a grand total of just over \$6 billion. 6/

David Grossman of Chase prepared a memorandum concerning this meeting meeting, which indicated that copies were provided to several officers of Chase, including David Rockefeller. Attached to the memorandum was a listing of the City's borrowing needs through June 30. 7/

1/ Thompson Ex. 10; D. Grossman Ex. 32.

2/ Six pages of handwritten notes and accompanying material, entitled "3/10 at Scher's Office."

3/ Thompson Ex. 10; D. Grossman at 277-78; D. Grossman Ex. 32.

4/ Document entitled "Statement of Essential Facts" at 5; D. Grossman Ex. 32.

5/ D. Grossman Ex. 32.

6/ Thompson Ex. 10; D. Grossman Ex. 32.

7/ Thompson Ex. 10.

At 4:00 P.M., the FCLG, under the chairmanship of Ellmore Patterson 1/ met at Morgan Guaranty. The general topic of the meeting was a review of the financial status and financing plans of the City. 2/ Frank Smeal of Morgan Guaranty; Alfred Brittain and Truxton Pratt of Bankers Trust; George Roeder and David Grossman of Chase; Richard Kezer of Citibank; Albert Gordon and Duncan Gray of Kidder Peabody; Donald Regan of Merrill Lynch; William Salomon and Gedale Horowitz of Salomon Bros.; Francis Schott of Equitable Life; Charles Mueller of Metropolitan Life; Gordon Braislin of Dime Savings; John Larsen of Bowery Savings; John McGillicuddy and David Barry of Manufacturers Hanover; Donald Platten of Chemical; Leroy Love and Leo Sabatine of Wood Dawson; and Roger Blough, Marion Epley, John Osnato and Willis McDonald of White & Case, among others, attended the meeting. 3/

The meeting was called, in part, to prepare for the following day's meeting with the Mayor and the Comptroller. 4/ Patterson called the meeting after he had been brought up to date on the problems with the previous week's underwriting. Discussion ensued regarding the fact that the issue was not selling well. 5/ David Grossman provided a report on the status of his Committee's work with the City to develop information concerning the two debt offerings scheduled for Thursday and Friday. 6/ It was also

1/ Epley at 285, 295-296; D. Grossman Ex. 9.

2/ Epley at 295.

3/ Love Ex. 22; Epley at 285.

4/ D. Grossman at 143.

5/ E. Patterson at 56-57.

6/ D. Grossman at 140.

stated that the underwriters should tell the City they must start "shaping up and get their budget in balance" to show the public that the City was "focusing on the problem." 1/ A discussion then developed on the legal issues surrounding City offerings, including those issues raised in the Wein litigation. 2/

Patterson questioned whether the same disclosure problem existed with respect to the Thursday issuance as existed with respect to the past issues. The response was that the lawyers would consider that issue after Grossman developed more information. 3/

Frank Smeal stated that the City was preparing figures as of February 1975, and that the lawyers would have to see the figures before deciding whether a legal opinion would be needed to accompany the new notes, and, if so, what type of legal opinion. It was further stated that the information requested by the Grossman Committee at the meeting was due the next afternoon. 4/

Frank Smeal expressed doubt about the marketability of the upcoming \$375 million RANS issuance, despite the relative size of the offering and short-term maturity, if disclosure were necessary. Alfred Brittain and

1/ Patterson at 56-57.

2/ Five pages of handwritten notes, March 10, 1975.

3/ Id.

4/ Id.

George Roeder agreed with Smeal. William Salomon agreed that it would be hard to sell the new issue. It was stated that there was not much of a market for City bonds at that time. A point mentioned in favor of the upcoming RANS offering was that it was easier to issue a clean legal opinion concerning RANS than BANS. Patterson noted that the parties present must be prepared to discuss with the Mayor on the next day the issue of marketability. 1/

It was asserted during the meeting that positive signs were also present in the City's fiscal crisis. Examples were that the City's revenues were holding despite the recession; the level of uncollected real estate taxes was as good or better than in most cities; the tax base was found to be elastic enough to rebound at a fast rate; the real property tax base was increasing; the City was trying to keep the welfare rolls under control and increases occurring at a slower rate than in other major cities; school reading scores were increasing; and the heroin plague was decreasing. 2/

It was stated that the City's current problems were the result of two phony budgets, 1973-74 and 1974-75. In addition, it was stated that the State and Federal governments had not helped, and that the recession had hurt the City. 3/ Patterson contended that this news was not helping the bond sales. It appeared to him that the Mayor could not understand why the notes

1/ Id.

2/ Id.

3/ Id.

and bonds were not selling, and was refusing to recognize the "confidence factor." It was stated that the budget gap would continue because wage negotiations were outrunning revenue increases. Smeal advised the underwriters of the following week's RANS to concentrate on the topic of disclosure at the next day's meeting with the Mayor. 1/

It was decided that the banks' holdings of City securities be quantified to support the banks' statement to the City that the banks were unable to absorb "the whole problem." 2/

Each bank anonymously wrote down their approximate holdings of City securities. The total was between \$1.2 and \$1.3 billion. Patterson compared this total to a listing of the banks' equity and found that it represented 20% of all the banks' equity. 3/

* * *

An advertisement appeared in the Wall Street Journal on March 10, 1975 relating to a new issuance of \$537.27 million of BANS dated March 14, 1975, in denominations of \$100,000, \$25,000 and \$10,000, and listing Chemical, Chase, Morgan Guaranty, Citibank, Bankers Trust, Manufacturers Hanover, Salomon Brothers, and Merrill Lynch as underwriters. 4/

1/ Id.

2/ Patterson at 57-58.

3/ Id.

4/ Advertisement, Wall Street Journal, March 10, 1975.

* * *

Paul Collins, Senior Vice President of Citibank, addressed a memorandum and attachment to G. C. McCarthy, Jr., a Vice President of Citibank, which reported that Citibank held \$23 million in bonds and \$6.8 million in notes in its fiduciary accounts, and that, as of December 1974, New York City bonds were not being bought for fiduciary accounts. Collins asked that these numbers be updated. 1/

* * *

A private investor addressed a letter to Francis J. Rogers of the Chemical Bank Municipal Bond Department inquiring about any possible difference in the quality of City BANS, TANS, RANS and bonds. He asked whether all City debt securities had a "first priority" (i.e. would security holders be paid before city employees?). 2/

TUESDAY, MARCH 11, 1975

David Grossman sent copies of a package of materials he had received from the Comptroller's Office at 3:00 P.M., to James O'Sullivan of Chase, Roy Anderes of Bankers Trust, William Solari of Donaldson, Lufkin & Jenrette, John Thompson of W. H. Morton and Chester Johnson of Morgan Guaranty. He also scheduled a meeting of the task force for Wednesday, March 12, at 10:00 A.M. at Chase. The materials included schedules listed as

- (1) Short-term debt -- Issues and Redemptions--3/10 to 6/30/75;
- (2) TANS to be rolled over 6/11/75 and receivables for same;
- (3) short-term debt outstanding as of 3/5/75;
- (4) short-term debt outstanding 3/5/75 and receivables for same;

1/ Memorandum Paul J. Collins to G. C. McCarthy, Jr., March 10, 1975, with attachment.

2/ Letter to Francis J. Rogers, March 10, 1975.

- 5) required short-term borrowing 3/20 - 6/30/75;
- 6) short-term debt outstanding 6/30/75 and authorization for same;
- 7) detailed cash forecast to 6/30/75;
- 8) summary cash forecast to 6/30/75; and
- 9) estimated general fund accrual. 1/

The schedules estimated: that the City would issue \$2.5823 billion of various notes and redeem \$2.6219 billion of various notes between March 10, 1975 and June 30, 1975; that revenue to the end of the fiscal year would be \$1.2304 billion and estimated collections would be \$872 million, leaving a balance of unreceived revenues of \$358.4 million; and that the City also intended to roll-over \$230 million of TANS. Cash flow projections also demonstrated that despite the proposed City borrowing through the end of the fiscal year, the City would still be in a substantial negative cash position as of June 30, 1975. 2/

* * *

Frank Smeal addressed a memorandum entitled "Random thoughts on New York City" to Messrs. Patterson and Page. Mr. Smeal stated in his memorandum that the Wein lawsuit had challenged the legal capacity of the City to issue additional debt and was not regarded by lawyers to be totally without merit. As part of Mr. Smeal's description of the "environment," he reported that: the State of New York was in default on \$100 million bond anticipation notes; it appeared the City had to use pension funds and special borrowing to meet payrolls; purchasers of City BANS had to wait nearly 24 hours because

1/ D. Grossman Ex. 33.

2/ Id.

of the delay in the \$537 million issue; and that distributors of City securities were advised by lawyers that they had to disclose explicitly both the legal and economic difficulties of the City to potential investors. Lawyers as well as financial analysts were said to be concerned about the size of the unfunded short-term debt. Additionally, the long-term market appeared to be closed to the City. 1/

As to the \$537 million of BANS issued the previous week, it was suggested that the short maturities of this issue, i.e. the notes coming due in September 1975, had been placed, but that there was less investor interest in the longer one year maturities. 2/ The six underwriting banks were said to hold, at that time, about \$1.25 billion of City securities in their accounts. The banks alone could no longer underwrite borrowings of the size and frequency required by the City. Mr. Smeal noted that only two investment bankers, Merrill Lynch and Salomon Bros., participated in the \$537 million BANS offering and that they only participated in a nominal amount. 3/

Mr. Smeal indicated that the City, as well as other cities, could not operate without access to the credit market and that a total effort of all parties concerned must be directed to maintaining such access. Other sources of credit, such as the Federal Government, had to be actively explored. He continued:

Many investors feel that the City is in deep financial trouble. Revenue shortfalls way in excess of expenditure

1/ Smeal Ex. 11.

2/ Id.

3/ Id.

reductions, weak and weakening economy, high unemployment, loss of industry, high tax rates, changing profile of population, enormous pension burdens, out-of-line wage and salary levels, exhausted tax and revenue sources, are all cited to document that concern.

The problems of UDC merely focused attention on the problems of the City and accelerated the City's financial crisis.

Because of these factors, it is no longer enough to cite the strong legal claim that holders of the City's general obligation debt have on gross revenues of the City. Although the claims of the unpaid holders of UDC BAN's are vastly different from this claim, investors [sic] confidence in legal claims of bondholders generally were not reassured when the State legislature elected to pay contractors and construction workers while a \$100 [million] BAN went and goes unpaid. 1/

Mr. Smeal asserted that the City must do or seek to do something dramatic, such as a wage freeze, to restore investor confidence and that the Wein litigation must be quickly resolved. He stated that:

The serious allegations of that suit going as it does to the very capacity of the heaviest borrower to borrow is [sic] deadly serious. 2/

As to the issue of disclosure, Mr. Smeal reported:

It is imperative that the City open its books totally and not seen [sic] to be hiding anything. Claims that the information has never been sought before and delays in supplying data on City finances only aggravate a very nervous market. 3/

He further contended that the City's ability to borrow in the market was severely limited and that the Mayor could only fall back on the clearing house banks. Taking into consideration that at least one bank was unwilling to place additional City securities in its portfolio and other

1/ Id.

2/ Id.

3/ Id.

banks were either unable or unwilling to underwrite their share of City securities, the City might have no solution to its borrowing problem. 1/

The memorandum concluded:

I suspect they will try to get through Thursday by claiming the issue, because they are RANs and short and may be sold with more limited disclosure, can be underwritten. If this is so, and it may be, we defer the confrontation until mid-April.

If not, I would like to determine whether or not City Bank [sic] would participate in a Clearing House loan to the City of the kind that will be paid off by the RAN's to be sold this Thursday. 2/

* * *

In a memorandum to William Spencer of Citibank, Jac Friedgut set forth some past quotes of Mayor Beame. Mr. Friedgut reported:

On January 20, 1970, in decrying the fact that the City did not have an A rating at that time, he said: "The City originally lost its A rating because the rating agencies were concerned we were using borrowed money to pay for some day-to-day expenses." He then indicated that such practices had ceased. Unfortunately, as we all know only too well, the combination of capital budget borrowing for operating expenses and the sizeable "permanent floating" short-term debt strongly suggest that the City is now right back where it was when it had lost its A rating. 3/

* * *

A memorandum captioned "New York City Problem" stated that, in the calendar year 1975, the City must borrow \$500 million to \$1 billion, "or more", in addition to amounts that had to be borrowed to roll over maturing short-term obligations. If the City were to lose access to the public market, its needs would be approximately \$6 billion because of these maturities.

1/ Id.

2/ Id.

3/ Memorandum, Jac Friedgut to William Spencer and others, entitled "Past Quotes from Mr. Beame," March 11, 1975.

The public market was alleged to be closing to the City due to the apprehension among investors caused by the City's deficit, the "sheer magnitude" of its borrowing and the UDC situation. It was asserted that the public market could only be revitalized if: the City publicly acknowledged its problems and announced tough measures to meet those problems; the banking community (including prominent dealers) adopted the position that City debt was sound; and the Federal and State Government assured the public that they would assist the City when necessary. The memorandum concluded:

The time available for the above steps is extremely limited - weeks, not months. The Thursday sale of \$375 million RAN's can probably be effected because of their very short maturity, but a great deal will have to be accomplished before an April note sale will be feasible. In any event, we are very dubious of the prospects for a large bond sale in April. 1/

* * *

The FCLG held a meeting with City officials. Ellmore Patterson, Walter Page and Frank Smeal represented Morgan Guaranty; Alfred Brittain and Truxton Pratt represented Bankers Trust; George Roeder, David Grossman and Thomas Labrecque represented Chase; Donald Platten and Richard Adams represented Chemical Bank; William Spencer, Richard Kezer and Jac Friedgut represented Citibank; Albert Gordon and Duncan Gray represented Kidder Peabody; Donald Regan represented Merrill Lynch; William Salomon and Gedale Horowitz represented Salomon Bros.; John Fey represented Equitable Life; Charles Mueller represented Metropolitan Life; John Larsen and Elmer Harmon represented Bowery Savings; and John McGillicuddy and David Barry represented Manufacturers. Leroy Love and Leo Sabatine of Wood Dawson; Roger Blough, Marion Epley, Willis McDonald and John Osnato from White &

1/ Memorandum entitled "New York City Problem," March 11, 1975.

Case; and Richard Smith of Davis, Polk & Wardwell were also present. 1/

Prior to the arrival of the City representatives, members of the FCLG discussed the general financial condition of the City and the need for the members of the FCLG as underwriters and representatives of major institutions to help the City. 2/ Subsequently, Mayor Beame, Deputy Mayor Cavanagh, Comptroller Goldin, and other City representatives arrived at the meeting. 3/

Mr. Patterson reviewed the history behind the formation of the Committee and stated that its purposes were to improve the reception of the market to New York City securities, to reduce the interest cost to the City and to provide it with advice in financial matters. 4/ He then noted that the group's initial approach was long-range, but the focus had shifted to the City's immediate problems with the issuance of short-term debt, in part because of the publicity the City was receiving concerning its budget and cash problems. 5/ He pointed out that the banks represented at the meeting held \$1.2 billion of City securities in their own portfolios and that this sum represented 20% of their net capital. Given this fact, Mr. Patterson asserted, it was absolutely vital that the public market be kept open to the City because the banks themselves could not "take on the amount of City paper necessary" unless the City's securities could be sold publicly. 6/ Mr. Patterson noted that only one half of the \$537 million BANS sale was sold in the market. Richard Kezer indicated that the syndicate was optimistic about

1/ Schott Ex. 10.

2/ D. Grossman at 147.

3/ D. Grossman at 146-47.

4/ Rousseau Ex. 15.

5/ Id.; E. Patterson Ex. 4.

6/ Rousseau Ex. 15; E. Patterson Ex. 4

underwriting the sale of the \$375 million of RANS to be issued shortly if the disclosure problems could be settled beforehand. 1/

The Mayor responded that the City's fiscal problems were not unique and cities throughout the country were also experiencing similar problems. The Mayor indicated that the Governor and the State Legislature had told the City to resort to short-term borrowing to close the budget gap. He stated that the City had taken austerity measures totaling hundreds of millions of dollars and that the 1976 budget gap of \$889 million would be met with help from the Federal and State Governments. Mr. Beame reiterated his need for help from the banks in selling the "City story" and its debt to the public. He noted that the City was improving its information flow to the public through the CTDM Committee and claimed that short-term borrowing had not increased dramatically because such borrowing was against anticipated revenue due to the City. 2/

Mr. Patterson commented that the City's attacks on the interest rates ultimately hurt the City by generating adverse publicity. William Spencer stated that the public had lost confidence that the City could restrain its budget increases and did not believe the City would live within its means. 3/

Mr. Friedgut cited Mayor Beame's warnings, when he was Comptroller, that the City's budget was increasing at a rate that could not be sustained. The Mayor replied that the rate of increase was diminishing. 4/

Messrs. Rousseau, Smeal and Spencer remarked that the sheer size of the City's rolled over short-term debt was becoming almost impossible to handle; and the mere assertion of the constitutional priority of the City's debt would no longer suffice to persuade the public to buy City

1/ Rousseau Ex. 15.

2/ Id.

3/ Id.

4/ Id.

securities. Rather, Rousseau said, the City must publicly describe the specific steps it was taking to face its budget problems and meet its obligations, in a manner which the banks could endorse. The Mayor replied that he had made, and would continue to make, this information public. 1/

Thomas Labrecque indicated that a general apprehensiveness due to the Wein litigation had caused the members of the FCLG to ask questions and seek further information from the City. The Mayor responded that he was disturbed because the timing of these requests unfairly put the City in a bad light. The Mayor reiterated the City's willingness to work with the FCLG to resolve any problems and indicated that, in his opinion, the Wein suit would be dismissed before June 30th. 2/

Mr. Spencer expressed concern that the underwriting syndicate would not be able to sell any additional City notes or bonds unless the City could better demonstrate its ability to control its expenses and/or increase its non-borrowed revenues. He complimented the Mayor on the steps already taken in dealing with the unions but indicated that much more was necessary. The Mayor described the limited range of the budget over which he had direct control and indicated savings of \$600 million which he stated indicated his determination to control City expenses. 3/

Jean Rousseau stated that the market for City securities was disappearing rapidly and the City must come forward with affirmative programs to meet its fiscal crisis and thereby improve the market situation. Mayor Beame said that the City had reduced expenses, had sought increased Federal and State aid and would be raising taxes in a concerted effort to gain control over its fiscal problem. 4/

1/ Id.

2/ Id.

3/ Id.

4/ Goldin Ex. 76.

Gedale Horowitz stated that, despite the institution of a regular borrowing schedule by the City, the number of purchasers of City securities was dwindling, causing the April bond issue to be in jeopardy. Comptroller Goldin contended that the City's cash needs were rigid through June and that the borrowing must go forward. 1/

Patterson concluded the meeting by stating that dialogue between the investment community and the City was in the interests of both groups, and was absolutely essential, to keep the public market open. 2/

* * *

Copies of a Wood Dawson memorandum were sent to various members of the FCLG. The memorandum discussed the large amount of permanent short-term City debt and suggested a means to refinance this debt over a longer period of time. It reported that the City's constitutional debt incurring power was close to being exhausted and recommended that a public corporation be established to borrow money to pay over to the City and, effectively stretch out this debt. The corporation would be similar to the SRC but would be used to establish fiscal discipline for the City. It would issue securities only if the City ceased borrowing for recurring operating expenses, stopped establishing or increasing off-balance sheet financing, ended bonding to finance leases, avoided budget balancing "gimmicks" such as anticipating revenues from water and sewer charges in

1/ Id.

2/ Id.

advance, and anticipating the receipt of questionable revenues. Furthermore, such a corporation might serve to effect a "quick settlement" of any Wein - type litigation. 1/

WEDNESDAY, MARCH 12, 1975

At 10:00 A.M., the Grossman task force met with representatives of White & Case; Milbank Tweed and others at Chase. 2/ Materials provided by the City were reviewed. 3/ The group discussed the problems of cash flow and receivables and the preparation of a document to reflect the City's financial condition. In addition, William Solari and other members of the group had a discussion about problems of the City's cash flow. There was also a discussion concerning the Statement of Essential Facts being prepared by White & Case. 4/

* * *

At 2:00 P.M., the task force met with members of the Bureau of the Budget and the Comptroller's Office in the office of the First Deputy Comptroller, Seymour Scher. Representatives of White & Case also were present. 5/ A first draft of a Statement of Essential

1/ Memorandum, Wood Dawson, March 11, 1975, entitled "A Proposal for Providing One of the Essential Elements in Finding A Long Range Solution for the Current Financial Difficulties of New York City."

2/ D. Grossman at 152; Solari at 47.

3/ D. Grossman at 153.

4/ Id. Solari at 47-48; D. Grossman at 153.

5/ D. Grossman at 154.

Facts had been prepared by White & Case based on the materials provided by the City to the task force. 1/ Deputy Comptroller Scher added a separate sheet, entitled "Cash Flow Projections," to the package of materials already given to the task force. This sheet contained a paragraph which stated that the cash flow chart was produced on March 9, 1975 and that future borrowings and projected revenues "will be both necessary and sufficient to meet the City's cash needs through June 30, 1975, including the redemption of maturing debt. The City requires continuing access to the capital markets in the approximate amounts listed . . . in order to meet its cash needs through June 30, 1975." 2/

* * *

White & Case sent a letter to the prospective members of the bidding syndicate for the \$375 million of RANS asking for their comments on the enclosed first draft of the Report of Essential Facts, and advising the members to have their counsel contact White & Case prior to 3:00 P.M. that day with any comments or questions. The letter also indicated that a draft of the White & Case legal opinion as to the RANS was enclosed. A copy of the letter produced by Morgan Guaranty contained a handwritten note: "Smith if borrowing is essential, must point out — i.e. 'large amounts of borrowing required, no assurance can borrow.' Typical corp disclosure." 3/

1/ Altman at 107; D. Grossman Exs. 33, 34 and 41.

2/ Document entitled "Cash Flow Projections," on the letterhead of Seymour Scher, March 12, 1975.

3/ Letter, White & Case, "to Prospective Members of the Bidding Syndicate for RANS to be Offered on March 14, 1975," March 12, 1975.

* * *
Marion J. Epley, of White & Case, addressed a letter to William Scott, Third Deputy Comptroller, stating that the Report of Essential Facts being developed should be identified as the document referred to in the Notice of Sale for the \$375 million of RANS. 1/

* * *
The March 12 draft of the Report of Essential Facts included a cover sheet stating:

Attached is certain information prepared by The City of New York with respect to its financial position and certain other matters which may be of interest to purchasers of the Revenue Anticipation Notes of the City to be issued on March 20, 1975 and to mature on June 30, 1975. The Underwriters of the Revenue Anticipation Notes have not attempted to verify independently the material prepared by the City. However, based upon discussions with representatives of the City, the Underwriters have no reason to believe that such information is not correct. 2/

This draft contained a schedule of anticipated short-term borrowings, a summary cash forecast to July 29, 1975, a schedule of RANS outstanding as of March 11, 1975, a statement of debt outstanding at February 28, 1975, and other information. 3/

* * *
The first meeting of the merged syndicate, led by Citibank, which would submit the only bid for the \$375 million RANS issue, met at Citibank to discuss the offering. 4/ Representatives from

1/ Letter, Marion J. Epley to William Scott, March 12, 1975.

2/ Report of Essential Facts, Draft of March 12, 1975.

3/ Id.

4/ This meeting continued on March 13, 1975. All references herein are to either or both meetings.

Citibank, Chase, Morgan Bank, Bank of America, Bankers Trust, Chemical, Manufacturers Hanover, Salomon Bros., Merrill Lynch, Weeden & Co., A. G. Becker, Bear Stearns, Ehrlich-Bober, First Pennco, and First National Bank of Boston were represented at this meeting, either in person or by individual counsel. White & Case, represented by Marion J. Epley, attended the meeting and again appeared to be acting as both bond counsel and counsel to the underwriters. 1/

This offering was designed to replace the cancelled \$260 million TANS issue of February. As had been the case with the BANS of the preceding week, a poll was taken of the entities as to whether the securities could be sold and also as to their willingness to participate in the underwriting. The majority of the banks and broker-dealers believed that the issue could be marketed provided the disclosure problems were resolved by the Statement of Essential Facts and the opinions of White & Case, the State Attorney General and the City Corporation Counsel. Another factor favoring a successful marketing was the short maturity date of the issue. Again, there was a discussion of the possibility of effecting the offering as a private placement among the clearing house banks, but the overwhelming majority of the underwriters were in favor of a public underwriting in order to maintain the public market. 2/

1/ Rousseau Ex. 3; Smeal Ex. 15.

2/ Smeal 182-83; Rousseau Ex. 3; Eide at 68.

The effect of the Wein litigation to City borrowing was discussed, which led to a further discussion of the work being done to develop a Statement of Essential Facts by the Grossman task force, White & Case, and City officials. It was reported that the Statement of Essential Facts would be available the following day and that the Notice of Sale for the RANS would refer to it. Additional comments and suggestions were sought as to what should be included in the Statement. It was contemplated that this document would be sent to purchasers with confirmation slips and would contain information regarding the financial position of the City, including projections of maturities and borrowings through June 30 and a schedule of outstanding City RANS as of March 11. 1/

It was stated that the underwriters would not be verifying the figures supplied by the City but, the underwriters would be representing that they had no reason to believe that these figures were incorrect. Attorneys present discussed the participants' obligations with regard to the notes to be sold. There was some agreement that the participants' obligation was to provide rather than to verify the information. 2/

1/ Smeal at 183; Rousseau Ex. 3; Eide at 71;
D. Grossman Ex. 9.

2/ Rousseau Ex. 3.

Notes taken at the meeting by Jean Rousseau of Merrill Lynch reported that there was some discussion about "poss[ible] criminal liability if we participate." 1/

There were various proposals as to what income must or could be "earmarked" to pay off the notes. One proposal was that State Comptroller Arthur Levitt would advance fiscal year 1976 welfare payments (due in the fall of 1975) and the City would use these funds to help pay off the RANS when they matured on June 30, 1975. The conversation expanded to include proposals of raising and "earmarking" additional funds for the City . 2/

The City officials and other parties present wanted the RANS offering to proceed in the same manner as had the original City RANS offerings. 3/

* * *

A New York Post article reported that major banks had demanded and received from Comptroller Goldin "written assurance that the city will be able to pay off its latest loan even if it loses a lawsuit challenging its authority to borrow more money." The statement was described as a condition of the sale of \$537 million

1/ Rousseau Ex. 4A.

2/ Id.

3/ Id.

in BANS and was reported to have been the subject of substantial negotiations. The \$537 million BANS sold the previous week were scheduled to be paid off by the issuance of bonds. Goldin was quoted as telling the banks that the Wein lawsuit would "hamper" the bond sale, but that the City will be "in satisfactory [sic] legal and fiscal position to sell bonds" to pay off the money borrowed the previous week. Goldin was quoted as stating that he did not know if the borrowing would have gone through without that assurance. He emphasized that the City's ability to repay the BANS was "never in question" and further stated that the BANS were full faith and credit obligations and that the City was pledged to pay off those notes. Goldin said that the banks were distributing his press release on Friday, March 7, to dealers as a "disclosure," a term with which he did not disagree. The article also reported that the sale of the BANS was going poorly with only one-half sold. 1/

THURSDAY, MARCH 13, 1975

David Grossman met with officers of the Federal Reserve Bank of New York. The purpose of this luncheon meeting was to allow

1/ New York Post, March 12, 1975.

Mr. Grossman to detail for them the City's problems. Grossman outlined the City's current year deficit as well as the outlook for the next fiscal year. The fact that the rate of increase in City expenditures tended to exceed the growth of revenues was discussed, as that phenomenon related to the growth of both short and long-term debt. 1/

* * *

The Comptroller issued a press release announcing the sale of the \$375 million of RANS by the City at an interest rate of 8% with a premium of \$13,625 resulting in an effective rate of 7.9870%. The release noted that there was only a single bid by the merged syndicate led by Citibank. The Comptroller also stated:

The rate the City is paying today is still a very high one but is more acceptable than the rate paid last week and earlier this year. I am pleased that we were able to avoid the long and difficult negotiations which took place on our sale last week.

One new development in the situation is the establishment of a process by which data on the City's fiscal condition is made regularly available to a committee of financial community representatives. Through this process we hope to avoid the circulation of inaccurate information and also to prevent a reoccurrence [sic] of the events which forced a cancellation of a sale when information, demanded at the last minute, could not be immediately supplied. 2/

1/ D. Grossman at 178-80.

2/ News Release, Office of the Comptroller, 75-33, March 13, 1975.

In a Merrill Lynch document, Jean Rousseau directed that a copy of the Report of Essential Facts be distributed to purchasers of the BANS and RANS of March 1975. 1/

* * *

Marion J. Epley, wrote a letter to Kenneth Hartman, Assistant Corporation Counsel, stating:

This will confirm our advice to Bill Scott yesterday afternoon and to you last evening that receipt by us of the opinions of the Attorney General and of the Corporation Counsel to be delivered as a condition of the issuance of our opinion at the closing tomorrow will also constitute a condition to the delivery of our opinion with respect to the RANS being offered today.

Copies of the letter were sent to William Scott, Third Deputy Comptroller, and Richard Kezer of Citibank. 2/

* * *

David Gaston of Citibank, updating his prior report in a memorandum to Paul Collins, a Senior Vice President, stated that the bank's fiduciary accounts held \$22 million in bonds of the City and \$6.5 million in notes of the City. 3/

* * *

An internal Salomon Brothers document stated:

1/ Memorandum, Jean Rousseau to Marcus Cuevas, March 13, 1975.

2/ Letter, Marion J. Epley to Kenneth Hartman, March 13, 1975.

3/ Memorandum, David Gaston to Paul Collins, March 13, 1975, entitled "Re: New York City."

The following memorandum has been prepared to assist investors in the credit evaluation of New York City obligations. All of the statistics contained herein have been taken from various reports by the Comptroller of the City of New York.

Each sheet of this document bears a legend which reads "FOR INTERNAL DISTRIBUTION ONLY NOT TO BE SENT OUT." 1/

The memorandum stated that City bonds were secured by the full faith and credit of the City and the unlimited taxing power of the City. In addition, real estate tax levies could not be limited by the State or local legislature and, if the City failed to pay debt service, State law provided that a sufficient sum must be set aside from the first revenues available. 2/

There were a series of tables in this document. Table #1 stated that as of August 1974, the City's net funded debt was \$6.818 billion. Temporary debt (BANS, RANS and TANS) was listed as \$3.767 billion as of December 1974. In 1968, the temporary debt had been \$686 million. Table #2 traced the trend in real estate tax delinquencies. In 1963-64, the amount of tax delinquencies was \$45.8 million, a rate of 3.65%. In 1973-74 the amount was \$148.6 million, a 5.59% rate. Table #3 reported on the ratio of receipts to debt service. In 1963-64, debt service was \$439 million with a ratio of receipts to debt service of 7.1%. In 1973-74, debt service was \$1.141 billion

1/ Memorandum, Salomon Brothers, entitled "Memorandum Re: The City of New York," undated.

2/ Id.

with a ratio of 9.0%. Table #4 compared the bond maturity schedule of New York City with those of other large cities. Within 5 years, 47.3% of bond principal would be due and, in 10 years, 71.1% would be due. Table #5 demonstrated that net debt as a percentage of full value of taxable real estate declined from 9.8% in 1963-64 to 8.5% in 1973-74. Table #6 indicated that during this same period, net debt as a percentage of assessed value of taxable real estate increased from 12.9% to 17.3%. 1/

The memorandum also reviewed budget information about the City, listed the income and expenses of the 1973-74 fiscal year and described the general fund revenue shortfall of \$237 million for that fiscal year. The report concluded with a description of the SRC, indicating that the \$520 million to be borrowed by that entity would be used for budget note redemption and filling budget gaps for 1973-74 and 1974-75. 2/

* * *

David Grossman distributed the Report of Essential Facts to the Staff Committee of the FCLG. His covering letter stated:

Development of the statement involved a high degree of cooperation among staff of the Office of the Comptroller the Bureau of the Budget, White & Case (bond counsel to the underwriters) and a task force made up of members of the staff committee including: Roy Anderes, Banker's Trust; William Solari, Donaldson, Lufkin; Chester Johnson, Morgan Guaranty; John Thompson, W.H. Morton; Jac Friedgut, Citibank; and Jim O'Sullivan and Walter Carroll, Chase. 3/

1/ Id.

2/ Id.

3/ Epley Ex. 10.

A covering page, affixed to the final version of the Report stated:

Attached is the report of essential facts referred to in the Notice of Sale by the City of New York with respect to Revenue Anticipation Notes of the City offered for sale on March 13, 1975. Harrison J. Goldin, Comptroller, City of New York. 1/

In place of the summary cash forecast through July 29, 1975, which had been contained in an earlier draft of the Report of Essential Facts, the final version contained a statement entitled "Statement With Respect to Cash Flow Projections." It said:

New York maintains a computerized cash flow forecasting system to project cash receipts and disbursements. Projections produced by this system on March 9 indicate that the future borrowing listed on Page 3, together with projected City revenues, will be both necessary and sufficient to meet the City's cash needs through June 30, 1975, including the redemption of maturing debt. The City requires continuing access to the capital markets in the approximate amounts listed on Page 3 in order to meet its cash needs through June 30, 1975. 2/

In this final version, two charts were added. The first showed short-term debt outstanding as of March 6, 1975, maturing prior to June 30, 1975 and totaling \$2.496 million. The second was a schedule of maturities of long term (funded) debt to be paid in the period March 6, 1975 to June 30, 1975, totaling \$191.729 million. The schedule of anticipated short-term borrowings contained a footnote stating:

1/ Id.

2/ Id.

The validity of the Stabilization Reserve Corporation and its power to issue bonds and notes is presently being challenged by a lawsuit in a New York State court. The complaint in this lawsuit has been dismissed, but such dismissal may be appealed. The sale of such bonds or notes is subject to the successful final disposition of such suit.

The final version of the Report of Essential Facts also contained a schedule of RANS outstanding as of March 11, 1975, a statement of debt outstanding as of February 28, 1975, supplemental information with respect to the City's debt incurring power as of February 28, 1975 and other related matters. 1/

* * *

The Mayor issued a press release reporting that the State Supreme Court had upheld the right of the SRC to sell \$520 million of bonds or notes to help finance municipal services in New York City. Mr. Beame stated:

While the case has no legal bearing on the City's own bonds and notes, some people in the investment community have not understood this fact.

* * *

Professor Wein has asserted that bonds and notes of the Corporation would be City debt chargeable against the City's constitutional debt limit and that the 1974 State law creating the Stabilization Reserve Corporation was unconstitutional. Judge Korn ruled against him on both points. 2/

* * *

Comptroller Goldin issued a press release stating:

1/ Id.

2/ News Release, Office of the Mayor, 101-75, March 13, 1975.

As I stated earlier, the Wein case did not, in actuality, pose a threat to the security of City obligations, but it may have contributed to an unhelpful climate in which to market City debt. 1/

* * *

In a New York Times article, the Comptroller was quoted as saying that the City's bankers (the FCLG) were receiving a daily "continuous flow of information" on municipal receipts and expenses. The information flow was said to be an attempt by the City to avoid "repetitions of the cancellation of a recent note sale [the February 28 cancellation of the \$260 million TANS offering]." 2/
FRIDAY, MARCH 14, 1975

The CTDM Committee met at the Comptroller's office at the suggestion of Ellmore Patterson and Frank Smeal in order to discuss the City's financing schedule for the balance of the fiscal year ending June 30, 1975. 3/

In a memorandum from Mr. Smeal to Mr. Patterson, it was reported that the meeting opened with a discussion of what amount of money, if any, could be raised by the City through the sale of long-term debt. Opinions ranged from \$100-\$250 million, depending on the method of sale. Mr. Smeal took the position at the meeting that the City's banks were at or close to saturation with respect to City securities and further noted that the problems encountered with the most recent City issues indicated that "the credit markets were

1/ News Release, Office of the Comptroller, 75-34, March 13, 1975.

2/ The New York Times, March 13, 1975.

3/ Memorandum, Frank Smeal to Ellmore Patterson, March 14, 1975.

closing on the City." 1/ He suggested that the Committee should concern itself with the problems of the \$550 million needed by the City on April 14, 1975 and recommended that other sources of funds, such as savings banks, insurance companies, City pension funds and State, Federal and Federal Reserve sources, be explored. He pointed out that the budget gap for the current year was so great that some substantial amount of additional borrowing was necessary and that financing plans for July, August and the rest of the calendar year were required as soon as possible. 2/

Smeal advised Patterson:

Daily flow of fund schedules disclosed, of course, that the city absolutely had to have the proceeds of a \$500 MM long term bond issue and was depending on raising \$520 MM under Stabilization Reserve Corporation authority. I had serious doubts about the City's ability to do either of these things.

In the meantime, initial optimistic expectations that the \$375 MM RAN's might be readily placed and at the same time create some movement in the unsold BAN's were not realized. This, in spite of the fact, that we had a clean legal and a thoroughly acceptable "record of essential facts" as a substitute for a very damaging disclosure statement. As I write this, late Friday morning, only \$57 MM (15%) of the \$375 MM RAN's had been placed, leaving a balance of \$318 MM. \$240 MM, roughly half, of the BAN's are still in underwriters [sic] hands, leaving an overhang of New York City paper of \$558 MM on the market. 3/

The memorandum further stated:

The credibility of repeated assertions by the Mayor that the budget will be balanced, is now about zero. Analysts, bankers and very soon the world at large believe that this has been done only by the use of gimmicks and meaningless numbers adding up, after at least 2 years of phoney budgets, to an enormous floating debt of as much as \$3 or \$4 billion.

1/ Id.

2/ Id.

3/ Id.

Furthermore, we do not know how to raise revenues or cut expenditures so as to produce honestly balanced budgets, certainly not under prevailing economic conditions. We cannot identify the substantive areas, transit fare, pension payments, where the problems can be solved. The City has to set its own social balance sheet and decide where to tax and where to spend. We can only ask that it be done honestly.

The members of the Controller's Committee, including Chase, City Bank [sic], Salomon Brothers, all agree with this view and told the Controller that they were "scared." This message was transmitted to the Mayor at 10:40 this morning by the Controller so that he will not be completely surprised by any message you deliver on Monday.

There is only one place I know of where one can go for the hundreds of millions of dollars, if not billions, that may be required to keep the City running. I haven't the slightest idea whether they, the Fed, have the authority or the willingness to do so. 1/

* * *

Copies of the final version of the Report of Essential Facts, dated March 13, 1975, were sent to Comptroller Goldin, Sol Lewis, William Wood, William Scott, Melvin Lechner, Eugene Keilen, Kenneth Hartman, Steven Clifford and James Greilsheimer. 2/

* * *

Wood Dawson submitted a bill for legal services to Chemical Bank with reference to the \$537 million BANS. The cover letter of the bill stated that Chase Bank had instructed the firm to bill Chemical as manager of the merged syndicate. 3/ The bill itself indicated that the fee was for, among other things:

1/ Id.

2/ Memorandum to Harrison Goldin, Sol Lewis, William Wood, and William Scott, March 14, 1975.

3/ Letter, Wood Dawson to Herman Charbonneau, March 14, 1975, with enclosure.

[E]xamination of certificates of the Comptroller authorizing the issuance of the Notes, debt statements of the City and a Report of Essential Facts; attending meetings of the merged underwriting accounts on March 5 and 6, and advising The Chase Manhattan Bank account with respect to various matters, including the form of legal opinion to be rendered by designated bond counsel and the form of statement for release by the City Comptroller used in connection with marketing the Notes ...1/

* * *

In a New York Times article, it was reported that the City Council and Board of Estimate had agreed the preceding day to a \$1.9 billion capital budget. Of this total, only \$5.1 million was allocated for new projects. The rest of the budget, it was reported, was to be used for maintenance and rehabilitation of existing City facilities. 2/

* * *

In another New York Times article, the sale of the \$375 million in RANS was reported. The article stated that the City had pledged to the banking community that both City Corporation Counsel Bernard Richland and State Attorney General Louis J. Lefkowitz would guarantee in writing that the City was not exceeding its borrowing authority. The sale of the RANS was said to have been contingent upon the delivery of the two opinions. The article commented that a provision of the State Attorney General's letter "forb[ade] the banks [from using] the opinion to resell the notes." Chemical Bank was reportedly concerned about the effect that a pending lawsuit

1/ Id.

2/ The New York Times, March 14, 1975.

challenging the constitutionality of the SRC might have on the two sales. 1/ In addition, the Comptroller was quoted as saying that data about the City's fiscal health was being supplied "regularly and continuously to a committee of financial community representatives." The Comptroller noted that \$140 million of the RANS issue plus \$417,000 in interest would be paid to Chase for a \$140 million short-term loan the bank had given to the City on March 5; the Comptroller also pointed out that "[m]uch of the city's borrowing simply pays off previous borrowing." 2/

* * *

The Daily Bond Buyer reported: (a) the City sold \$375 million of RANS immediately after the Wein lawsuit, was dismissed by a state court; (b) the sale was accomplished by a single bid, from a merged underwriting syndicate; (c) sales to the public were reported to be proceeding only at a fair rate, at best; and (d) investors were still not purchasing the unsold \$245 million of BANS of the previous week still available in the market. 3/

1/ The New York Times, March 14, 1975.

2/ Id.

3/ The Daily Bond Buyer, March 14, 1975, p. 1, 3.

* * *

In a letter to one of its clients, Morgan Guaranty recommended that the client sell "New York City holdings" and reinvest the proceeds in "high grade notes." 1/

MONDAY, MARCH 17, 1975

Early in the morning, at Gracie Mansion, Mayor Beame met with David Rockefeller of Chase, Ellmore Patterson of Morgan Guaranty, William Spencer of Citibank and other individuals. 2/ The meeting came about as the result of a desire by several bankers to communicate the serious nature of the City's financial problems to the Mayor, in a group smaller than the FCLG. 3/

1/ Letter, Walter B. Terry to a client, March 14, 1975.

2/ Rockefeller at 45.

3/ Smeal at 191.

A memorandum written in preparation for this meeting stated:

Knowledge of the participants, purpose and the message of this meeting could trigger a real panic in the market for New York City securities and have a serious impact on markets, world-wide, because of the extensive ownership of the billions of dollars of New York City securities and especially because of the concentration of that ownership among the large New York City banks. Because of this, it is important that some advance thought be given to the presence of the press and the explanations that might have to be made about the presence of these three distinguished bankers. It was generally agreed at breakfast that no effort to conceal the fact of the meeting should be made but that the visit should be related to the continuing effort of the liaison group to help the City solve its problems. 1/

The memorandum indicated that at the time there was an overhang of \$558 million in unsold City notes on the market and that the City would require \$1.7 billion in short-term funds and \$500 million in long-term funds through the end of fiscal year 1975. Further, about half of the projected short-term borrowing was to take the form of BANS or SRC issues, both of which were "tarnished in the market." According to the memorandum it was doubtful that any significant portion of the City's short or long-term borrowing could be obtained through traditional sources because: the City banks had already invested between 1/5 and 1/4 of their capital in City securities and their ability to supply additional money was virtually exhausted; the market for City securities appeared saturated, as evidenced by its inability to absorb even one half of the prior week's offerings; and the proposed borrowings will occur at a time when the City's "borrowing needs are greatest and budget problems most visible." 2/

1/ Memorandum entitled "Proposed Statement to Mayor Beame by the Messrs. Patterson, Rockefeller, Spencer, on March 17, 1975." (E. Patterson Ex. 7).

2/ Id.

The memorandum continued:

The market will not be reassured by assertions of balanced budgets when balance is achieved by further borrowings or gimmicks or shifting accounts or a general overstatement of revenues and understatement of expenses. Somehow, a large part, billions perhaps, of the floating debt must be "funded."

We see no way of achieving this through the market in the prevailing environment. 1/

The reference in the memorandum to "gimmicks" used to balance the City's budget, was explained as meaning any of the following:

- (1) capitalizing expense items;
- (2) deferring expenses until the next year;
- (3) switching the City's books from an accrual to a cash basis for certain items;
- (4) suspending required payments;
- (5) changing billing dates;
- (6) overestimating Federal and State receivables;
- (7) adjusting the timing of estimated payments; and
- (8) suspending payments to reserve funds. 2/

The memorandum further stated that it was not alleged that these "gimmicks" were illegal, but rather, that they had become standard operating procedures for the City over the years.

The memorandum asserted that the City was "out of credit and credibility," that events such as the weak national economy, the Wein litigation and the UDC default, perhaps, aggravated the problem and accelerated the present crisis,

1/ Id.

2/ Id.

but that the root cause of the problem was that the City had been living way beyond its means. It urged that other non-market sources of funds be found and that the magnitude of the City's needs are such that they could only be supplied by the Federal Government. The memorandum concluded with the comment that the rating agencies might be reviewing their rating for City notes, a potential "time bomb in the market." It was asserted that the confidence of the banks and the underwriters must be restored before attempts could be made to restore the confidence of the marketplace. 1/

Mr. Patterson stated that the general topics covered by the memorandum were discussed with the Mayor when he and Messrs. Rockefeller and Spencer met with the Mayor on March 17, 1975. The bankers indicated to the Mayor that things were getting tighter and something positive in the way of fiscal improvement had to be demonstrated. 2/

1/ Id.

2/ E. Patterson at 78-79.

The meeting ended with the bankers relating to the Mayor that he must quickly take dramatic actions. They stated: (a) there was little or no time left; (b) any future borrowing was doubtful; and (c) the City had to reach out to the State, the Federal Reserve Bank and the Federal Government. 1/

* * *

David Grossman of Chase prepared a memorandum entitled "Part II Toward a Solution" which he later sent to Ellmore Patterson for consideration by the FCLG. 2/

In his memorandum, Mr. Grossman stated that "[w]hile the City's budget and borrowing problems are very serious they have not yet seriously sapped its basic economic strength" and quoted various statistics to show this strength. He contended that the budget must be balanced and borrowing reduced. 3/

The total amount of outstanding short-term borrowing at the end of the current fiscal year (both City and Stabilization Reserve Corporation) will be in excess of \$6 billion, compared to \$3.4 billion at the end of the previous fiscal year and only \$1.3 billion five years ago. 4/

1/ E. Patterson at 78; E. Patterson Ex. 7.

2/ Smeal Ex. 20.

3/ Id.

4/ Id.

The true budget imbalance for the current fiscal year was indicated to be approximately \$2 billion. 1/ He also asserted that the City must cut expenditures and consider a \$1 billion increase in taxes. 2/

Mr. Grossman said that the City had a "permanent" component of short-term debt of \$3 to \$4 billion, including \$1 billion for Mitchell-Lama housing, \$400 million in TANS issued against real estate taxes uncollected during the past 5 years; \$450 million in budget notes from 1970-71 and 1973-74 which were to be re-issued as SRC notes; year-end accrual borrowing against the next year's receipts of over \$300 million; and notes issued against a sizeable portion of State and Federal receivables. In order to fund this debt over the long-term, Mr. Grossman noted, the State could establish an authority to issue long-term debt and the proceeds could be used to retire the temporary debt. In addition to the funding accomplished by this agency, it would also have to ensure that this situation did not arise again in the future. Additionally, a Federal financing agency might purchase City debt.

Mr. Grossman stated that there would be difficult political problems involved in balancing the budget because the City would not welcome any intervention by outside governmental or private groups and the municipal unions and other interest groups would not welcome any interference with the funds and services they received through the City budget. 3/

1/ Id.

2/ Id.

3/ Id.

* * *

David Grossman addressed a letter to Ellmore Patterson enclosing his proposed outline of an "Investor's Data Book" on New York City. 1/ He stated that the outline, dated March 13, 1975, was in response to a request of one Mayor and that "[t]he purpose of the data book would be to provide a consolidated, comprehensive and factual statement on the City and its finances." Grossman suggested that it was appropriate to determine whether the Comptroller would be interested in such a document and, if so, whether personnel from the Mayor's and Comptroller's offices, in cooperation with members of the Staff Committee of the FCLG, would work on a rough draft and hopefully develop something within four to six weeks. 2/

* * *

Frank Smeal of Morgan was in Washington for a meeting of a Treasury financing committee. While in Washington, Mr. Smeal met with William Simon, Secretary of the Treasury, to discuss matters other than those involving the City. However, the subject of the City arose and a short conversation ensued. Mr. Simon suggested that Mr. Smeal discuss the situation with Under-Secretary of the Treasury, John Bennett, and attempt to provide him with a general overview of the City and its fiscal problems. 3/

1/ Letter, D. Grossman to E. Patterson, March 17, 1975.

2/ Id.

3/ Smeal at 173-74, 192.

TUESDAY, MARCH 18, 1975

In Washington, D.C., Jac Friedgut of Citibank made a presentation on the City's financial condition to the Congressional delegation from New York City. He explained that the City had two budgets, expense and capital, with total expenditures of \$13 billion. The City was said to use various types of short-term borrowing to realize its income stream. Its expense budget was growing at the compound rate of 13% per year and there was a growing disparity between revenues and expenditures which could not be eliminated by the Rainy Day Fund because that fund had become depleted. The City had closed gaps over the past several years "by various techniques, such as the issuance of special 'budget notes' or else the 'stretching' of TANS, RANS, and BANS, involving borrowings against revenues which were not always collected in the amounts anticipated." 1/

Mr. Friedgut reported: (a) the City had financed large amounts of expense items through the capital budget, including \$722 million in the current fiscal year; (b) the City's short-term debt had grown to approximately \$6 billion, equalling 25% of the total outstanding tax-exempt short-term debt in the country; (c) "New York City is now on a debt 'treadmill' which appears to average more than \$500 million per month of short-term debt in addition to its long-term debt offerings;" and (d) the City's expenditure level had been rapidly rising, e.g., welfare and related payments had experienced a six-fold increase over the preceding

1/ Jac Friedgut, Presentation to New York City Congressional Delegation entitled, "New York City's Financial Situation," March 18, 1975.

10 years to the current level of \$2.4 billion and City employee salaries and benefits had tripled in 10 years to over \$6.5 billion for the current fiscal year. It was said that municipal wages exceeded those in the private sector by 25%. Additionally, the City was said to support a high level of free or discount services, such as higher education, mass transit and hospitals, and the City could not afford all of them. Finally, debt services had greatly expanded, putting additional burdens on the expense budget.

The City's revenues were also rising, but at a slower rate than its expenses. Although Federal and State aid had eased the situation, this aid had recently diminished. Friedgut stated that the budget gap for the current fiscal year would approach \$120-\$200 million, and the City was facing an \$884 million gap for 1975-76. Additional taxes probably would be counterproductive as they might tend to drive more businesses and people out of the city. Expectations of large scale additional Federal and State aid were unrealistic. The only alternative was to cut the expense budget. "Unless something 'gives,' the City fiscal situation might not be viable and New York City paper would then be suspect, regardless of interest rate." ^{1/}

Friedgut concluded that the City had a substantial borrowing schedule which depended on investor confidence, and could only be maintained if the City was perceived as being determined to live within a balanced budget.

^{1/} Id.

Layoffs would be avoided, if possible, but wages would have to be frozen for at least a year. Also, a comprehensive package, including additional Federal and State aid and soundly conceived taxes, would have to be instituted. 1/

Mayor Beame and Deputy Mayor Cavanagh received copies of the materials, prepared by Friedgut, were disturbed by their contents, and considered arranging a counter-meeting to discuss the situation with the City's congressional delegation. 2/

* * *

City officials James Cavanagh, Sidney Frigand, Eugene Keilen and Richard Bing accompanied Mayor Beame to Washington, D.C., to discuss possible legislation to help reduce City borrowing costs. This group met with Chairman Ullman of the House Ways and Means Committee, Senator Harrison Williams of the Senate Banking, Housing and Urban Affairs Committee and Senator James Buckley of New York. City officials suggested that the Federal Financing Bank Act be amended to allow the U.S. Treasury to purchase municipal securities. All of the legislators were

1/ Id.

2/ Memorandum, Richard Bing to Melvin Lechner and John Lanigan, March 19, 1975.

interested in the City's problems and were informed of the high rates of interest the City was paying on its debt. The City promised to send the legislators drafts of suggested legislation. 1/

* * *

Eugene Keilen, Bruce Kirschenbaum and Richard Bing met with Under-Secretary of the Treasury John Bennett to discuss possible legislation which would permit the Treasury to purchase municipal securities. Mr. Bennett, and several associates present, asked a series of questions about the City offerings. Mr. Bennett had been assigned by Secretary Simon to work on New York City fiscal problems and requested the name of a City official who would be capable of providing information to the Treasury Department. 2/

James Cavanagh called the Comptroller and briefed him on the various meetings that had occurred in Washington. 3/

The City officials also hosted a luncheon for the presidents of major labor unions in the United States to obtain their support for a variety of federal revenue measures for the City. A joint business-labor-City lobby effort was to be arranged. 4/

1/ Id.

2/ Id.

3/ Id.

4/ Id.

* * *

A New York Times article reported that the New York State Pension Commission had stated that the City's \$6.7 billion employee pension funds "have been dangerously depleted by a decade of budget 'gimmickry'." The article stated that in a report to Governor Carey, the Pension Commission had written that "[t]he financial soundness of the New York City public employee [sic] pension systems is in jeopardy unless corrective action is taken immediately." The Pension Commission's report stated: (a) the City had chosen to use pension underfunding as one method of balancing its operating budget; (b) the gimmickry had started during the Lindsay administration and had mounted during the Beame administration; and (c) the underfunding between 1967 and 1975 totalled \$2 billion. The article reported that the Mayor had stated that he had not had the opportunity to study the report, and quoted the Comptroller as stating, "The Kinzel commission report highlights deeply troublesome questions relating to the adequacy of the assets base on which the city has historically counted for generating pension payments." 1/

* * *

Irving Shapiro of the Comptroller's Office wrote a memorandum to Jerome Turk, also of that office, concerning the "Validity of Real Estate Taxes Receivable as Basis for Outstanding Tax Anticipation Notes." 2/ This memorandum contained figures showing that as of June 30, 1974 the amount

1/ The New York Times, March 18, 1975.

2/ At the bottom of the first page, the memorandum said, "TO: SOL LEWIS, STEVE CLIFFORD PLEASE LET ME HAVE YOUR COMMENTS 3/19 SS."

of uncollected real estate taxes for all prior years (including 1973-74) totaled \$408 million. As of the same date, there were TANS outstanding in the amount of \$317 million. The memorandum included a chart which stated the percentage of real estate taxes receivable as of June 30 of a particular year that was in fact collected in the subsequent year. The memorandum concluded: "It is apparent that payment for the above outstanding Tax Anticipation Notes payable during the 1974/75 year will have to be met from current revenues and not from the collection of Real Estate Taxes Receivable as of 6/30/74." 1/

* * *

Thomas Labrecque addressed a memorandum to William Butcher, concerning the "New York City Financing Picture." Labrecque reported that, at that time, Chase held \$212 million of City obligations in its portfolio account and \$133.7 million in its dealer account. The memorandum continued:

Of the total of 95.7 million in Notes in the Dealer account, \$78.5 million were the result of the two Note financings in the last two weeks. Our original liability was \$127.8 million and we have sold \$49.3 million to date. In addition, \$31.1 million of the portfolio's \$56.8 million in Notes were our share of the negotiated 15 day loan which matures on Thursday, March 20th.

In calendar 1975, New York City projects it will need to issue approximately \$7 billion in Notes and Bonds. They need \$2,150 million from now to the end of the fiscal year, June 30th, as follows:

1/ Clifford Ex. 20.

	<u>Notes</u>	<u>Bonds</u>
APRIL	\$550 million	\$500 million
MAY	550 million	-
JUNE	550 million	-

Given the sales performance of New York City obligations over the last two weeks, the City's ability to float this amount of debt is tenuous at best. While this picture could be helped by a significant budget cut on the Expense side, the probability of this happening over the short run is minimal, if in fact, there is a chance at all. 1/

1/ Memorandum, Thomas Labrecque to William Butcher, March 18, 1975.

WEDNESDAY, MARCH 19, 1975

An Investors' Conference Committee meeting, organized by Deputy Mayor James Cavanagh and chaired by Ivan Irizarry, the Finance Administrator of the City, was held. Present were Frank Smeal and Ross Mathews of Morgan Guaranty, William Beahan of Lebenthal & Co., John Devine of Chase, Gedale Horowitz of Salomon Bros., Richard Kezer of Citibank, Jean Rousseau of Merrill Lynch, John Thompson of W. H. Morton and City officials. 1/

It was strongly recommended that the Investors' Conference Committee meeting previously scheduled for May would be cancelled because of concern about the City's budget gaps, the UDC situation and a judgment by the Committee "that New York City does not at this time have effective answers to the questions and criticisms that have been raised about the City fiscal procedures" 2/ The following points were made:

- (1) the UDC problem had to be resolved;
- (2) the City should consider issuing a sinking fund bond;
- (3) the City should consider issuing near term bonds at discount;
- (4) the City should set up segregated accounts for payment of debt service;
- (5) the City should improve, expand and standardize fiscal reporting;
and

1/ Memorandum, Jean J. Rousseau to Donald T. Regan, March 20, 1975;
Memorandum, Ivan Irizarry to James Cavanagh, March 21, 1975.

2/ Memorandum, Ivan Irizarry to James Cavanagh, March 21, 1975.

- (6) the City should "take strong action to restore belief that the City administration was not just 'doing what it can' but actually, 'doing what is necessary,' however distasteful, to fundamentally improve its fiscal position." 1/

* * *

Jean Rousseau's March 20, 1975 memorandum concerning this meeting indicated that everyone had agreed that the best and only practical plan was to postpone any decision on accelerating the next Institutional Investors Tour until after the close of the fiscal year. He continued:

We then had a more general discussion of how the marketing of the City's debt could be improved. I presented the thought that I had previously expressed; to wit, [sic] it is first necessary for the City to develop detailed plans to resolve its budget and financial crisis and then attempt to revive confidence in the investment community and buyer enthusiasm with the institutional and retail buying public. In this view, marketing and "image" become subordinate concerns for the City, as they presently ought to be. Bill Beahan, President of Lebenthal, then added that the public attitude toward the City's debt has swung sharply to the negative in recent months and that it is rapidly becoming impossible for his firm to distribute City issues. He said that concrete positive steps; budget cutting, staff cutting, or whatever, were necessary to restore investor acceptance. (You may recall that at the March 11 meeting, the Mayor beat us all over the head with Lebenthal and the superior marketing job they have done on the City issues. I think that Bill's remarks are all the more significant as coming from a fresh source and one that has previously been very constructive about New York City issues). 2/

* * *

1/ Id.

2/ Memorandum, Jean Rousseau to Donald T. Regan, March 20, 1975.

Undersecretary of the Treasury John Bennett called Frank Smeal and inquired about people in the banking community familiar with the City's financial crisis. Smeal provided Bennett with the name of David Grossman, who had previously been employed by the City as a high official in the Bureau of the Budget. Bennett then called Grossman and invited him to a meeting in Washington the following day. 1/

A meeting was held at Comptroller Goldin's office between officials of that office and City officials from the Bureau of the Budget. The purpose of this meeting was to assemble material for delivery to the Treasury pursuant to the request from the Treasury the preceding day. 2/

The Comptroller called Governor Carey to advise him of the City's situation and of the meetings between City officials and the Treasury. 3/

* * *

David Grossman, as Chairman of the FCLG, continued his practice of distributing memoranda and materials to all members of the FCLG and its staff. On this day, he distributed a document captioned "Part II Toward a Solution", discussed previously under date of March 17. 4/

* * *

1/ D. Grossman at 7; Memorandum of Interview of John Bennett, April 19, 1976 ("Bennett Interview").

2/ Goldin Ex. 77.

3/ Id.

4/ Memorandum, David Grossman to John Thompson, March 19, 1975.

In a statement issued by the Citizens Budget Commission, the City was described as facing a deficit for 1974-75 of \$200 million, a prospective deficit for 1975-76 of \$884 million and a chronic cash flow problem requiring annual short-term borrowing of \$7 billion. 1/ The statement reported:

City officials maintain that the City is not going to default on its obligations because of the full faith and credit backing of the City's debt, and because the annual revenues of the City far exceed the debt service due each year. This statement is correct.

It fails, however, to deal with the fact that the costs of current operations can no longer be met by the City out of current revenues. Nor can cash flows be sufficiently accelerated through anticipatory borrowings to mask any longer the basic deficit situation in which the City finds itself. 2/

The following steps were said by the CBC to be necessary:

- (1) reduce expenditures by \$800 million;
- (2) end the financing of expense items in the capital budget; and
- (3) desist from further "gimmicks" such as overestimates of revenue, underestimates of expenditures, advance collection of revenues, postponed payments, and changing accounting practices in midstream. 3/

It was also asserted that the City's labor costs had to be frozen by job attrition, deferment of wage increases, pay cuts, payless furloughs, and

1/ "Statement by the Citizens Budget Commission on New York City Fiscal Situation," March 1975, p. 1.

2/ Id.

3/ Id.

stretching out contract time periods. 1/ The statement ends with the admonition:

In conclusion, it must be emphasized that legal litanies citing constitutional protection for the City's creditors are not enough. The recent high borrowing costs to the City indicate that the City's fiscal reputation is slipping. Immediate deficit-cutting action by the City is needed to reverse the City's present critical fiscal outlook. Anything less spells fiscal disaster. 2/

* * *

Jac Friedgut of Citibank gave a presentation to senior Citibank officials on the City's fiscal situation. This presentation was somewhat similar to the one he had given to the New York City Congressional delegation. 3/

* * *

David Grossman, in a memorandum to David Rockefeller concerning the "City Problems in April," stated that if the City were unable to sell its scheduled debt for April, it would be in a cash deficit position of over \$400 million on Monday, April 14. 4/ He explained that although the City appeared to be able to meet its payroll of April 11, only \$68 million would then remain to redeem \$600 million in TANS maturing on Monday, April 14. The then-current City debt schedule called for bids for a note issue on April 2 or 3 with a settlement

1/ Id., p. 3.

2/ Id., p. 4.

3/ Friedgut at 69.

4/ D. Grossman Ex. 44.

date of April 14. Mr. Grossman concluded his memorandum with the comment that there was very little time available to develop viable alternatives. 1/

THURSDAY, MARCH 20, 1975

Undersecretary of the Treasury John Bennett met with David Grossman of Chase and others at the Treasury in Washington. 2/ This meeting was intended to prepare Bennett for his scheduled meeting with City officials in the afternoon. 3/ During the meeting Grossman outlined, in general terms, the New York City financial problem. 4/

Bennett and the other Treasury officials offered very little advice to Grossman, but Bennett noted the potential legal exposure under Rule 10b-5 under the Securities Exchange Act of 1934 if facts were withheld from the investing public. 5/

* * *

1/ Id.

2/ D. Grossman at 190.

3/ Bennett Interview.

4/ D. Grossman at 190.

5/ D. Grossman at 191; Bennett Interview.

After the meeting, David Grossman called David Rockefeller in New York and briefed him on the meeting with the Treasury officials. 1/

* * *

In the afternoon, Bennett and other Treasury officials met with Comptroller Goldin; Melvin Lechner, Director of the Budget; Eugene Keilin, General Counsel to the Bureau of the Budget; and Bruce Kirschenbaum, the City's Washington lobbyist. Joining this group were Messrs. Oltman and Sandburg of the Federal Reserve System. Comptroller Goldin did not present a specific proposal to the Treasury officials but requested assistance in whatever form it could be obtained. 2/

The question was also raised as to whether the Federal government would accelerate revenue sharing payments. Bennett questioned Keilin as to whether the City had reviewed the procedures to be followed in declaring bankruptcy since, based solely upon the information he had received from Grossman that morning, Bennett felt that this was a real possibility. Keilin expressed some familiarity with such procedures but acknowledged that the matter had not been researched fully. He indicated his belief that a court would not enforce the first lien on City revenues available to bond or noteholders. 3/.

1/ D. Grossman at 196-98.

2/ Bennett Interview.

3/ Id.

Bennett looked into some federal payments that the City officials alleged were in arrears, but later found that those payments were current. 1/

* * *

In an internal memorandum, Roy Anderes, Vice President of the Portfolio Management Group for Bankers Trust, wrote to Edward Sibert and William Lutz of Bankers Trust concerning New York City notes and bonds. Mr. Anderes stated:

Recent events in the tax-exempt note market have emphasized and accentuated the selectivity and nervousness of that market. The market is steeply discounting lesser credits so that the spread between prime paper and lesser credits is historically wide, reflecting in part investor preference for quality.

New York City is highly dependent upon the short-term market to remain financially viable or solvent. Recently the City has found access to this market increasingly difficult. Although the City's budget problems as well as their other well publicized financial problems have contributed to these difficulties, events beyond the sphere of the City's management, such as the New York State Urban Development Corporation default on its notes, have also had their impact.

In view of New York City's high degree of reliance on the note market as well as the increasing budget deficits being experienced by the City, we no longer feel this credit suitable for retention. We suggest an orderly selling program such as we are doing with the port bonds but perhaps at a more accelerated rate.

For internal purposes we are changing New York City's rating from 3B to 4. 2/

* * *

1/ Id.

2/ Anderes Ex. 3.

Mayor Beame issued a press release stating:

I am confident that the City will be able to meet both its payrolls and its debt service payments in April.

The "scare" talk by some persons in the banking community does the City a severe disservice, since it does make it more difficult for the City to market its new short-term obligations.

I want to reassure the general public, city employees and the investing public that the City will meet its payrolls and debt service if the banks cooperate and stop casting unwarranted suspicion on the City's ability and willingness to pay all of its obligations on time. 1/

* * *

In a speech made by Comptroller Goldin to the New York Fraternal Congress, he stated, "[W]ith apologies to Abraham Lincoln, I would say that by and large, budgets are conceived in illusion and dedicated to the proposition that the hand is quicker than the eye." Mr. Goldin also stated:

It has become habitual with government to overestimate certain revenues and underestimate certain expenditures as a matter of routine.

It's a game of numbers, in order to meet the statutory requirement of a balanced budget.

When it finally becomes apparent to everyone that a budget is not going to balance, one technique is to balance it by pushing the onus over onto the next administration. 2/

* * *

1/ Statement by Mayor Abraham D. Beame, March 20, 1975.

2/ Remarks by New York City Comptroller Harrison J. Goldin, Annual Meeting of the New York Fraternal Congress, Statler-Hilton Hotel, Seventh Avenue, 33rd Street, N.Y.C., 1 P.M., Thursday, March 20, 1975.

A New York Times article described Jac Friedgut's March 18 briefing of the New York City Congressional Delegation. Mr. Friedgut was reported to have said that his bank (Citibank) would not buy City securities because it could not sell them due to the fact that investors were convinced that, if the City's money ran out, the City would pay its employees and default on its bank obligations. The article quoted Mayor Beame as responding: "If he made that statement its outrageous." A spokesman for Mr. Friedgut said that Mr. Friedgut definitely did not say what was reported. Mr. Friedgut had told the Congressional Delegation that "[i]t is becoming difficult to market New York City issues." The spokesman noted that as much as half of the two most recent offerings were unsold but that Citibank "is in the market." 1/

Mr. Goldin was reported to be considering a cancellation of the next scheduled RANS sale (\$550 million on April 14, 1975) and the banks were said to be "grumbling" that they could not participate in a City offering in a market in which they could not resell City securities. Deputy Mayor James Cavanagh was asked about the possibility of bankruptcy for the City and he replied: "Nonsense, the banks and us are in a community of interests. If we go down, they go down." 2/

* * *

1/ The New York Times, March 20, 1975, p. 43.

2/ Id.

FRIDAY, MARCH 21, 1975

David Grossman of Chase met with Roy C. Haberkern of Milbank Tweed, counsel to Chase, and discussed his (Grossman's) meeting of the previous day with John Bennett of the Treasury Department. 1/

* * *

Mayor Beame and Comptroller Goldin met for most of the morning to review information that had been sought by the Treasury at their meeting of March 20. They were also preparing for the meeting with Treasury officials scheduled for the afternoon. They discussed the advice of the Treasury officials to reduce the amount of City short-term borrowing in fiscal year 1975-76 as compared to fiscal year 1974-75. 2/

* * *

In a March 24, 1975 Merrill Lynch wire flash, authorized by Jean Rousseau, it was reported that "On Friday [March 21, 1975], apparently because of a number of alarming press reports concerning New York City's budget crisis,

1/ D. Grossman at 199-202.

2/ Goldin Ex. 21.

the Street experienced a heavy influx of sell orders in city notes and bonds." 1/

A meeting commenced at 3:00 P.M. in the Comptroller's Office between officials of the City, the Treasury and the Federal Reserve Bank. John Bennett, Mayor Beame, Comptroller Goldin, Deputy Mayor Cavanagh, Budget Director Lechner and other representatives of the City attended this meeting. Bennett asserted that the City officials apparently were not communicating properly with investors and pointed out as one example of this the fact that the City referred to its own "balanced budget." Bennett offered to arrange a meeting in Washington with nationwide representation to assist the City in understanding what had to be done to obtain investor confidence. 2/

The Comptroller later briefed Governor Carey on both the meeting with the Treasury officials and on the present status of the City's fiscal crisis. 3/

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The Comptroller and Deputy Mayor Cavanagh met and discussed certain fiscal steps that the Mayor planned to announce publicly on Sunday, March 23. 4/

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1/ Merrill Lynch Wire Flash, March 24, 1975, 9:35 A.M.

2/ Bennett Interview; Goldin Ex. 77.

3/ Goldin Ex. 77.

4/ Id.

The New York Times reported that the CBC had issued a warning that the City must cut its expense budget by \$800 million through a total freeze of its labor costs in order to insure a sound credit position. According to the Times, the CBC advocated job attrition, deferment of wage increases, pay cuts, payless furloughs and stretching out of contract time periods. The Mayor reportedly responded by stating that there was "nothing new in what they're saying." 1/

The article described the previous day's meeting with Comptroller Goldin and Undersecretary of the Treasury Bennett as a meeting to discuss ways of getting large amounts of money for the City. "Discussed, according to participants, was Mayor Beame's proposal to create a Federal municipal-finance agency that could issue bonds and buy city note issues at low rates of interest...." The possibility of loans from the Federal Reserve System was also reported to have been a topic of conversation. 2/

The article also reported that the CBC stated that the City was not going to default on its obligations, as some had suggested, but could no longer meet the cost of current operations out of current revenues because of the constant need to borrow to finance the City's business as well as to pay off prior indebtedness. 3/

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1/ The New York Times March 21, 1975, p. 31.

2/ Id.

3/ Id.

In a New York Post article it was reported that the City would need nearly \$1 billion in April to meet a payroll and redeem two note issues maturing during that month. The City had planned to borrow \$1 billion in April but the Comptroller's Office declined to say whether this borrowing would proceed as scheduled. It was reported that State Attorney General Louis Lefkowitz had issued a legal opinion indicating that the City had the legal authority to issue long term bonds. Lefkowitz said, "I concluded that default was a possibility if the opinion wasn't rendered." 1/

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The Daily News reported that the Office of the Comptroller stated that the City's cash needs between April 14 and 18 would be less than \$1 billion rather than the \$1.5 billion estimated in a CBC report. The amounts required were \$745.7 million for the redemption of notes, \$50.5 million for the redemption of bonds and about \$200 million for a payroll. A spokesman for the Comptroller denied that the City would be unable to meet these cash needs. 2/

1/ New York Post, March 21, 1975.

2/ Daily News, March 21, 1975, p. 5.

SATURDAY, MARCH 22, 1975

Mayor Beame called Ellmore Patterson, Chairman of the FCLG and Chairman of the Board of Morgan Guaranty, and stated that he planned to announce a ten point reform program for the City on television. Mr. Beame asked if Mr. Patterson would make a statement in response to the Mayor's announcement. Patterson stated that he would need some time to prepare a response. The phone call was very brief and the parties did not discuss in depth the substance of the planned speech or the accompanying press release. Mayor Beame did, however, read the ten points of the program to Mr. Patterson. 1/

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A New York Times article reported the meeting the previous day between City, Treasury and Federal Reserve officials. The request by the City for a massive amount of cash to meet the City's needs was mentioned. According to the article, estimates of the City's cash requirements for the month of April -- to help pay maturing bonds and notes and two City payrolls -- ranged from \$250 million to \$750 million. City budget officials were reported to have said that a lack of cash could mean that the City might have to delay meeting its payrolls or repaying its maturing debts. 2/

It was also reported that, in the afternoon, the Mayor announced that he had called a press conference for noon the following day at Gracie

1/ E. Patterson at 84-85.

2/ The New York Times, March 23, 1975, article entitled "City Asks For Federal Aid To Get Cash in 30 Days."

Mansion to "reassure the public and those who buy and deal in New York City securities and give them confidence in their investments." The Mayor said he was "concerned with the unwarranted stories concerning the City's fiscal strengths." He said his press conference would involve the City's borrowings, the next year's budget and other steps the City would take to reassure the public. 1/

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In a Daily News article concerning the meeting between City, Treasury and Federal Reserve officials, it was reported that, in April, the City had to retire \$50.4 million of bonds; \$633 million of TANS; and \$111 million of urban-renewal notes. In addition, the City would have to meet two payrolls, each of about \$200 million, on April 11 and April 25, as well as other cash expenses which might arise during the month. The City planned to borrow \$550 million in April and a similar amount was scheduled to be borrowed in May. In the latter month, the City had to repay \$220 million of notes and \$69 million of bonds and had to meet three payrolls. 2/

/ Id.

/ Daily News, March 22, 1975, article entitled "City Seeking Help from Washington."

SUNDAY, MARCH 23, 1975

The Mayor held a press conference. According to the official text of his statement, Mayor Beame stated the following:

I have called this press conference to announce a series of major steps designed to ease the City's borrowing and fiscal problems in the years ahead.

I am calling on the State and Federal governments, on the banking community, on the business community, on organized labor and on the general public for cooperation and for support of the program I am announcing today.

I also wish to clear the air of some misconceptions and misunderstandings which, if left unchallenged, could seriously damage the City's economy and its position in the short-term and long-term money markets.

I want to stress the City's ability and willingness to meet all of its obligations on time. I also want to stress my determination to meet the City's expense budget problems without resorting to deficit financing.

We will pay all interest and redemption costs on time.

We will meet our payrolls.

We will not lose our basic fiscal strengths.

By no stretch of the imagination can this great City, with its unparalleled assets, sink under the weight of the current wave of unwarranted negative publicity attributed to certain segments of the financial community.

The economic strengths of this city are unparalleled. Our business activities, alone, generate more than \$100 billion a year. Our taxable real estate exceeds \$80 billion in value. The City government is capable of raising \$7 billion in revenues annually.

Our total revenues are six-fold greater than annual cost of debt service. The City provides constitutional and legal guarantees of repayment for our note holders and our bond holders.

The underwriters of our obligations know this and they know our assets better than most others, and that is why I cannot understand the 'scare' statements regarding the City, its assets and its obligations.

It is true that as a result of the abnormal economy, the City of New York has been adversely affected - more so than most other cities - because of New York's unique concentration of fiscal responsibilities.

No City in the nation - or the world - is called upon to provide so many functions and services. New York, in effect, is a City-State - as large in population as Sweden and with a budget greater than India's - and which is, nevertheless, without the sovereign powers to raise funds or regulate its own economy.

Despite this paradox, the city functions as well in terms of the services it must provide for its citizens ranging from basic housekeeping which cities pay for out of taxes - to courts, welfare, medicaid, correctional facilities, education, parks, and recreation - which, combined, no city except New York City, pays for out of its own resources.

Accordingly, the City of New York needs a large, continuing cash flow to maintain these services. This is achieved by short-term borrowing on a monthly schedule from the financial community in anticipation of tax revenues and Federal and State aid.

During the current national inflation and depression - with tight money and runaway interest rates - the City, and the market in which it must function - have been adversely impacted. Further, the City's budget has been affected because revenues have fallen below projections - as a result of the depressed economy - and expenditures have skyrocketed, because of inflation, increased energy costs and the rapid rise in welfare rolls.

The City was among the first in the nation to call attention publicly to these problems. It was also among the first to take bold steps to deal with them.

We have acted quickly to institute an unprecedented fiscal austerity program which will significantly reduce the number of jobs on the city payroll by the end of the fiscal year; which has placed a freeze on hirings; and which steps up revenue and fee collections. As a result, we will have reduced by more than 10% the operational cost of running the City.

In addition to these actions, I am announcing the following programs:

- (1) We expect to reduce the volume of next year's temporary borrowing by \$2 billion for the following reasons:
 - (A) With the cooperation of the Federal and State governments, there will be a more timely transmission of Federal and State aid payments to the City including revenue sharing funds and education aid. This will also be accomplished through expediting claims to the Federal and State governments for reimbursements. The City will also install an improved system of monitoring charges to funds other than tax levies, thus reducing the need further for temporary borrowings.
 - (B) A continuation of the recent practice of short-term borrowing, on a regularized basis, for long periods during the year.
- (2) As a result of the above actions, we expect to reduce year-end balances of outstanding short-term borrowings by about a half-billion dollars.
- (3) Total long and short-term debt outstanding at the end of the 1975-76 fiscal year will increase by about \$800 million as compared to an increase of \$3 billion at the end of the current fiscal year. This is further evidence of our determination to reduce our debt.
- (4) A new borrowing schedule will be instituted for the rest of this fiscal year, reducing the April borrowing from the \$1.05 billion previously scheduled to \$450 million. This will allow for additional time in working on immediate-range and long-range programs with the Federal and State governments.
- (5) We are developing a joint cooperative State-City approach to our fiscal and borrowing problems.

I have submitted legislation to create a joint State-City Fiscal Commission. Such a Commission would be in constant session throughout the year, studying the needs and revenues of both the City and State.

Furthermore, it would study approaches to the ever-present problem of lowering the cost of government in the City and in the State, such as through transferring functions to that level of government which is best equipped to perform such service, at the lowest cost.

It would also help develop a full partnership with the Federal government on urban problems.

- (6) This year, for the first time, we are instituting a program of accrual deductions of the expense budget items funded in the capital budget. So far this year, we have already taken \$25 million of expense items out of the new capital budget.

This is a first step in a continuing program to reduce the impact on the capital budget and to move towards having these charges reflected in the expense budget.

- (7) The \$135 million of economies in the next year's budget which I announced recently will mean drastic cutbacks in such services as:

- * Reduced cleaning and collection services by the Department of Sanitation.
- * Reduced services by the Police Department, such as emergency services, traffic control and harbor control.
- * Elimination of some fire companies and transferring firemen now performing certain non-fire fighting duties to fire-fighting duties.
- * Closing of some day care centers and consolidation of staffs.
- * Increased class sizes in the schools.
- * Increased teaching hours at City University.
- * Continuation of the hiring freeze.
- * Continuation of forced retirement after age 65.

As indicated above, these reductions in services and other economies will result in a direct saving of tax levy funds of \$135 million. Combined with the \$478.6 million already achieved, the savings will total \$613.6 million within two fiscal years. The economies will also mean a reduction of about 30,000 City positions in the same period.

- (8) I am determined to balance next year's budget by recurring revenues in order to avoid further borrowing.

This will require the cooperation of Congress, the State legislature, the City Council and the executive branches of all three levels.

Next year's budget gap is basically the unresolved part of the \$1.5 billion gap which this administration inherited when it took office.

- (9) We are in process of developing a national coalition of labor leaders and businessmen, who along with the country's mayors, will press the Federal government for an emergency assistance program for local governments, welfare reform, a loan fund for municipalities and massive public works and public employment programs to relieve the country of its severe unemployment problem.
- (10) Finally, it is my intention to institute a study of the continuing and future requirements of the City, and the fiscal revenues necessary for these needs, and to develop a realistic program of action.

I will review this with the Mayor's Council of Business and Economic Advisors with the intention of getting the study underway rapidly.

Despite all of the self-help efforts by the City, it is clear that we will need the cooperation of the State and Federal governments, and, of course, the financial community. I have been deeply involved in constructive discussions with all of these interests and I am confident that their cooperation will be forthcoming. 1/

* * *

It was reported that the Mayor also stated that, some weeks ago, he had invested in City securities to indicate his confidence in these obligations, and noted that, despite the banks' and brokers' contention that there was no demand for City securities, he nevertheless had to pay a premium to purchase his notes. 2/

1/ News Release, Office of the Mayor, 111-75, March 23, 1975.

2/ The New York Times, March 24, 1975, articles entitled "Beame Outlines Plan to Reduce City Borrowing" and "Beame Purchase Backs His Confidence in City."

The Mayor reportedly stated:

Nothing I've presented today is as a result of bankers' suggestions. We asked them for suggestions, but at no time did they offer anything specifically. And let me say this: Nobody's going to tell me how to run the city. I'm going to try to run it in the best interests of the people. We're always open for suggestions. But we got none. 1/

The Mayor continued, stating that one bank in particular was irresponsible, naming the Citibank, and asserted that Citibank had sent a representative to Washington, D.C. who had told the City's congressional delegation that investing in City securities was risky. "He could at least have had the courtesy of letting us know he was going." 2/

Mr. Beame reportedly further stated:

I think the banks have to exercise the responsibility to let the public know that New York securities are good investments, to restore confidence in their investors. I think our program should be a strong catalyst to restore confidence, because we're trying to do things to reduce our need to go into the market as often as we do now. 3/

The Mayor also said, "We're dealing with a condition, not a theory. The cash will be there to pay our bills. How? Possibly the Federal government. Perhaps an advance against cash owed us. I'm not worried. I'm not concerned. I'm not concerned about our ability to meet expenses." The Mayor was then asked if the Comptroller was cooperating with him on this program and responded: "We're completely cooperative, aren't we, Jay?" The Comptroller nodded. "You have to realize that I've been dealing

1/ The New York Times, March 24, 1975, article entitled "Beame Outlines Plan to Reduce City Borrowing."

2/ Id.

3/ Id.

with some of these bankers for a long time, since I was Comptroller. So I make inquiries. The Comptroller makes his inquiries. But if something happens, it's the Mayor's neck." 1/

MONDAY, MARCH 24, 1975

A meeting commenced at 8:00 A.M. in the Comptroller's Office to discuss the borrowing needs of the City. Present at the meeting were Comptroller Goldin, Richard Kezer of Citibank, Thomas Labrecque of Chase, Frank Smeal of Morgan Guaranty, Gedale Horowitz of Salomon Bros., Herman Charbonneau of Chemical, and others from the Comptroller's Office and the investment community. 2/

The Comptroller stated that the City needed \$2.3 billion to get through June, the end of the fiscal year. 3/ Several parties responded that with the full participation of the clearing house banks, the maximum that could be underwritten in April was between \$100 and \$200 million. Other parties stated that there was no marketplace for City securities at all. It was suggested that the underwriting picture would improve if the City were to make real cuts in its labor costs and remove expense items from the capital budget. 4/

1/ Id. The New York Times also reported that Messrs. Goldin, Cavanagh and Lechner, among others, were present during the news conference.

2/ One-page document produced by Chemical Bank.

3/ Id.

4/ Id.

The Comptroller pointed out that the City had to meet a payroll on April 11 and redeem maturing notes on April 14, and therefore required several hundred million dollars. He asserted that there were difficulties in seeking relief directly from the Federal Government. The Treasury Department had indicated that the City should come to it only after having first sought the funds from New York State. A second problem mentioned was that it would be difficult for Congress to act to aid the City before the Easter recess. A Chemical internal document describing this meeting included the notation "Stop Payment on NYC checks." 1/

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Ellmore C. Patterson issued a press release the day following the Mayor's press conference, stating:

Mayor Beame is to be commended for his determination to take steps to improve the city's fiscal position. The program he has outlined - particularly the balancing of the budget in the next fiscal year - is certainly moving in the right direction. When the program is implemented it should be beneficial to the city. Meanwhile the Financial Community Liaison Group continues to work with the city officials to help wherever it can. 2/

* * *

Various City newspapers reported the Mayor's March 23 press conference. 3/ Endorsements from various civic, business and financial

1/ Id.

2/ One page E. Patterson press release, dated March 24, 1975.

3/ The New York Times, March 24, 1975, article entitled "Beame Outlines Plan To Reduce City Borrowing;" New York Post, March 24, 1975, article entitled "New Beame Cuts: Mixed Reaction."

leaders were cited. 1/ Leaders of the municipal unions, however, expressed opposition and concern with regard to further budget cuts in the areas of City services in which the members of their unions were employed. 2/ It was also separately reported that sources had confirmed that Mayor Beame had purchased \$50,000 in City notes and that other members of the Board of Estimate were expected to make "symbolic purchases" of such securities. 3/

The New York Times published an article reporting that the City had recently discovered a \$33 million deficit resulting from the previous fiscal year's budget. According to statements attributed to Deputy Budget Director John Lanigan, the deficit occurred because the City's cash shortage forced it to undertake greater amounts of short-term borrowing at increasing interest rates. 4/ The continuing disagreement between the Mayor and the Comptroller over the size of the current deficit was also reported. Mayor Beame reportedly had maintained that the 1974-75 budget deficit originally had been \$430 million, but had been reduced through dismissals, economies and new sources of revenue to \$120 million. Mr. Goldin had estimated the original deficit to be \$650 million, which estimate was reduced to \$340 million in consideration of the Mayor's economies. Mr. Lanigan was reported to have

1/ New York Post, March 24, 1975, article entitled "New Beame Cuts: Mixed Reaction."

2/ Id.

3/ The New York Times, March 24, 1975, article entitled "Beame Purchase Backs His Confidence in City."

4/ The New York Times, March 24, 1975, article entitled "City Finds A Leftover \$33 Million Deficit."

stated that the City's total cost of borrowing had declined. However, an official in the Comptroller's office reportedly disagreed, stating such costs would remain at the previous year's levels. 1/

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Steven Clifford addressed a memorandum to Comptroller Goldin and Seymour Scher regarding the Mayor's plan to reduce borrowing. Clifford indicated that the major objectives of the Mayor's plan were to:

- (1) Decrease short term debt outstanding by \$500 million from 6/30/75 to 6/30/76.
- (2) Decrease short term debt issuances by \$2 billion in F.Y. '75-'76 from F.Y. '74-75 level.
- (3) Limit total debt increase in '75-'76 to \$800 million. 2/

Clifford further observed:

It should be noted that the Mayor's plan is not based on budgetary and fiscal restraint. In fact, it assumes that real and/or disguised deficits for '75-'76 will remain at present levels, and an additional \$700 million of short term debt will be generated by budget balancing gimmicks or outright deficit financing. [Emphasis in original.] 3/

1/ Id.

2/ Memorandum, Steven Clifford to Harrison Goldin and Seymour Scher, March 24, 1975.

3/ Id.

TUESDAY, MARCH 25, 1975

A meeting was held in Washington, D.C. at the Treasury Building to discuss the New York City fiscal crisis. This meeting was arranged by John Bennett, Undersecretary of the Treasury, to help to clear the air on the City crisis and to reassure the investment community as to the soundness of the City's securities. 1/ The meeting was attended by Arthur Levitt, Comptroller, and Peter Goldmark, Budget Director, of the State of New York. Messrs. Goldin, Cavanagh, Lechner, Keilin, Kerschenbaum and Marcesi represented the City. Members of the financial community included Amos T. Beason, Edward Bennett of Hartford Life & Casualty Co. ("Hartford Life"), Robert Bethke of the Discount Corporation of America, Richard Doyle of Supervised Investor Services, Gedale Horowitz, Richard Kezer, Thomas Labrecque, Thomas Masterson of Underwood Neuhaus Inc., Leland Prussia and Arthur Toupin of Bank of America, Robert Rivel of Union Dime Savings Bank and David Taylor of Continental Illinois National Bank. Representing the Federal Reserve System were J. Charles Partee and Richard Puckett. The Federal Reserve Bank of New York was represented by Richard Debs and Peter Sternlight. John Bennett, Edward Snyder, Robert Gerard and David Stoughton represented the Treasury Department. 2/

1/ Bennett Interview; Memorandum of New York City Meeting on March 25, 1975 in Room 4121 of the U.S. Treasury; Lechner at 349.

2/ Bennett Interview; Memorandum of New York City Meeting on March 25, 1975 in Room 4121 of the U.S. Treasury.

John Bennett opened the meeting by stating that, at times, the City's fiscal crisis looked like a "game of chicken" between the City, the State, the Federal Government, and the banks. Fortunately, he indicated, the Mayor's press release of Sunday [March 23] appeared to be a move away from such a confrontation and a stride towards cooperation. Comptroller Goldin pointed out that the Mayor had said that the City's budget would be balanced by receiving additional revenues and not by borrowing. Budget Director Lechner stated that the City's fiscal crisis was the result of the ravages of inflation and recession. The State was said to be encountering the same problems. The City had to borrow \$2.3 billion to get through the fiscal year ending in June and would be repaying over \$1 billion in maturing TANS in that period. It was noted, however, that there was some flexibility as to the precise time that the City needed all of this money. Deputy Mayor Cavanagh then stated that, in general, TANS could be rolled over for a period of five years and then could be redeemed with normal revenues. David Taylor asserted that this fiscal crisis was a crisis of confidence, adding that the City needed the endorsement of its banks in order to foster confidence. 1/

John Bennett wanted to know what could be done to make the City saleable and asked what the alternative was if this were not possible. The City was said to need access to the short-term market for an increasing number of millions of dollars. Richard Kezer stated that \$500 million in unsold City notes were currently in the marketplace. John Bennett reported

1/ Id.

that the Federal Government was not in a position to guarantee City securities, indicating that this was an issue for the Congress to explore. 1/

Comptroller Goldin stated that because of the problems with the SRC and the magnitude of City receivables, the City had to issue increasing amounts of short-term debt. Robert Rivel, of Union Dime Savings, suggested that the size of the short-term borrowing should be explained to the investing public, including the life insurance companies and the savings institutions. Gedale Horowitz stated that the City had been living beyond its means for several years, thereby impairing its ability to repay its obligations. He said that investors were concerned about repayment and that the City had lost its old buyers and was not getting new ones. 2/

Edward Bennett of Hartford Life wanted Cavanagh to provide "hard copy" on the City's financial plan but it was pointed out that there were only two weeks before the City had to raise new funds. Several parties suggested that various institutions in the City must stand by the City and that this included purchasing City securities. Thomas Masterson pointed out that the City's past acts of gimmickry had now come back to haunt the City. Amos Beason mentioned the rating agencies and

1/ Id.

2/ Id.

questioned the fact that the City still had an "A" rating while it was close to not meeting its bills. There was a general discussion about the cause of the City's crisis. Although there were some differences of opinion, the general consensus was that the crisis was not caused by the UDC difficulties, the total debt outstanding, or by the volume of future borrowings. Rather, the crisis could be attributed to a basic lack of confidence in the eventual repayment by the City of its obligations. 1/

Arthur Levitt indicated that the State was exploring a type of back-up bond for City financings but noted that he was pessimistic. He pointed out that unlike UDC obligations, New York City's obligations were full faith and credit securities. Robert Rivel asked Levitt why the State could not assist the City on a short-term basis. John Bennett asked whether or not the New York Federal Reserve Bank could help by buying City securities. Richard Debs responded that the Federal Reserve statutes would not permit such activity by the Bank. 2/

Thomas Labrecque stated that a short-term solution would not help because the City's fiscal crisis was a chronic, long-term problem. John Bennett stated that everybody, including the Federal and State governments, was examining the situation. In the meantime, Bennett said, the Federal Government would be examining the schedule of payments of Federal receivables to the City. No decisions were reached at this meeting but most parties

1/ Id.

2/ Id.

agreed that the unsold City paper on the market had to be cleared up. 1/

Participants at the meeting described Mayor Beame's television speech of Sunday, March 23, as a disaster for its failure to consider reality. Additionally, it was stated that James Cavanagh had chosen to filibuster and had ignored the intended purpose of the gathering; Cavanagh blamed everything on the banks and refused to consider the City's problems. 2/

1/ Id.

2/ Id.

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An internal Citibank document addressed to Paul Collins, Senior Vice President, by Philip Heston, a Vice President, reported that Citibank held over \$34 million of City bonds and notes in its fiduciary accounts. The document also noted that the bank held \$286 million of New York City debt on a custody basis. 1/

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In mid or late March, Herman Charbonneau, a Vice President of Chemical Bank, and another Chemical Bank official had lunch with a member of the Comptroller's staff. During this lunch, the City's fiscal problems were discussed at length. The City employee, who worked on the City's finances, told Charbonneau that a substantial amount of Federal and State aid receivables being carried on the City's fiscal books were "fabricated." 2/

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David Grossman addressed a memorandum to David Rockefeller entitled "Progress Report (4)", which was also sent to several members of the FCLG. Grossman's report stated that the Treasury Department apparently had been designated as the Federal agency to coordinate any Federal action on the City's borrowing problems. Further, there had been a series of meetings with various Federal officials and meetings between City and Treasury officials. Grossman also noted that the staff committee of the FCLG would be meeting the following day and that Evan Davis of the law

1/ Memorandum, Philip W. Heston to Paul Collins, March 25, 1975.

2/ Charbonneau at 351-54.

firm of Cleary, Gottlieb, Steen & Hamilton, formerly general counsel to the Budget Bureau, was being added to the group. 1/

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In a Daily News article, it was reported that State Attorney General Louis J. Lefkowitz had replied to six questions posed by bankers before they would agree to underwrite the most recent issue of City BANS (the \$537 million issue). The Attorney General specifically ruled that bonds of public benefit corporations, City contracts, and contributions to retirement funds were not subject to the City's constitutional debt limit and that short-term City debt also was excluded from that limit. 2/

WEDNESDAY, MARCH 26, 1975

The Staff Advisory Committee of the FCLG held a meeting which was conducted by David Grossman. 3/ He reported on the task force that had worked with the City in preparing the Statement of Essential Facts in its present form. Grossman described the various meetings in Washington concerning the City's situation and indicated that there was no present prospect that the federal government would provide money to solve the City's problems. He characterized the Mayor's speech of Sunday, March 23, as encouraging, but noted that there was nothing new from the numbers previously

1/ Memorandum, D. Grossman to Rockefeller, March 25, 1975.

2/ Daily News, March 25, 1975.

3/ Memorandum of Staff Advisory Committee Meeting, March 26, 1975; Rousseau (April 14, 1976) at 139.

presented to the Committee except for changes in the April borrowing schedule (reducing the note sale from \$550 million to \$450 million and deferring of a bond sale to May or June). 1/

When the discussion turned to the budget gap, Grossman stated that if various expedients were eliminated ("one time shots," the financing of current expenses in the capital budget, the overestimating of revenues, etc.), the true budget gap would be \$2 billion. Grossman stated that if the City doubled its income tax and fully applied it to all commuters and also effected a 1% increase in the City sales tax, \$1 billion would be raised. Additionally, he pointed out that a total wage and benefit freeze would save \$300 million. 2/

Grossman asked Jean Rousseau of Merrill Lynch to present his views on the public market for City securities. Rousseau stated that the market for City securities was now "crippled" and, although able to limp along, it was very unlikely to absorb another note issue without more encouragement. Rousseau observed that "we are, in effect, letting Mayor Beame do our advertising and not taking an affirmative stand ourselves," and that the Mayor had not been very persuasive with the public, lately. Rousseau further observed that the market has become more and more sensitive to bad publicity and, consequently, unless revitalized, it probably will simply "expire whenever the next rude shock occurs." 3/ Rousseau suggested that, to restore the market, it would be necessary for the banks and dealers to advertise that

1/ Id.

2/ Id.

3/ Id.

the City was doing and would do what was necessary and sufficient to resolve the City's problems. The reaction to the suggestion was divided. Some thought the Federal and State governments must step in to help and direct the City; others wanted the City to commit itself to some requirements before "we could go out on a limb." 1/ Mr. Rousseau suggested that any requirements proposed to the City be presented as coming, in effect, from the investing public and necessary to reassure the investors, rather than as coming from "the Banks" for their own selfish and/or reactionary purposes. Grossman said that he would discuss the matter with the FCLG. 2/

The Staff Committee then set up three "task forces." The first would work on a "Data Book" describing the City in full economic detail, to be maintained on a current basis. The second would study the feasibility of separating water and sewer revenues and expenses from the general fund and then issuing water and sewer revenue bonds which presumably would be better rated and/or more saleable than City general obligation securities. The third task force would study major elements of the City budget, including pension costs and an analysis of City revenues and expenditures. 3/

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Representatives of six banks of the Clearing House Association met at Morgan Guaranty to discuss the City's financial condition. Present, in addition to those of Morgan Guaranty, were representatives of Chase, Citibank,

1/ Id.

2/ Id.

3/ Id.

Manufacturers Hanover, Bankers Trust and Chemical. The immediacy of the City's cash needs was discussed with particular emphasis on the redemption of \$400 million of City notes due on April 14, 1975. Because of this large maturity and the inability of the City to go to the public market, the possibility of default was discussed. At approximately this time, White & Case, as counsel to the FCLG, and Davis, Polk & Wardwell, as counsel to Morgan Guaranty, were exploring various procedural and legal implications of a municipal default and bankruptcy. 1/

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John Lanigan, First Deputy Director of the Budget, in a memorandum to First Deputy Mayor James Cavanagh concerning cash flow projections, reported that the City would need to borrow \$1.6 billion in notes and \$500 million in bonds by the end of the fiscal year (June 1975). Lanigan stated, "If we ignored the legal need to place cash in escrow for revenue anticipation notes our actual cash borrowing needs could be reduced by \$250 million for the fiscal year." 2/

* * *

On March 5, 1975, Mayor Beame and Comptroller Goldin wrote a letter to Jack Poses of the City University Construction Fund ("CUCF"). They requested that the CUCF furnish at the closing of each sale of its securities a certification which would show that even if certain "City-related" obligations

1/ Chronological Narrative of the Participation of Morgan Guaranty Trust Company of New York City in Matters Relating to New York City: December 1974 through March 1975, pp. 36-37.

2/ Memorandum, John J. Lanigan to James A. Cavanagh, March 26, 1975.

were treated as City debt, the City would nonetheless have sufficient debt incurring capacity to issue its notes or bonds. This information would be requested by the City during the pendency of the Wein litigation. By letter of March 26, 1975, Jack Poses recommended that the City reconsider following this procedure as it was his view that such City-related obligations were not legally to be treated as City debt. 1/

* * *

In a New York Times article covering the prior day's annual meeting of Citicorp, the parent of Citibank, Walter Wriston, Chairman, was quoted as saying that the City was "fortunate" to have a Mayor so "well equipped to read the numbers." 2/

* * *

In a Daily Bond Buyer article about the day-long meeting at the Treasury Department the preceding day, Jack E. Bennett, Deputy Undersecretary for Monetary Affairs, was reported to have said that New York City would not get any special federal grants but that revenue sharing payments and federal grants might be accelerated. 3/

* * *

A Long Island Press article about the same meeting quoted Deputy Mayor Cavanagh as saying: "I think we are going to be ok. Our big problem is April 14 and we are gearing everything now to meeting that deadline. We

1/ Letter, Jack Poses to Mayor Beame and Comptroller Goldin, March 26, 1975, with attachments.

2/ The New York Times, March 26, 1975, p. 55.

3/ The Daily Bond Buyer, March 26, 1975, p. 1.

think we can do it. First we take care of today and then we worry about tomorrow." 1/

THURSDAY, MARCH 27, 1975

Messrs. Patterson, Rockefeller and Spencer of the FCLG, together with Mr. Hayes of the Federal Reserve Bank of New York met with Mayor Beame, Comptroller Goldin and Deputy Mayor Cavanagh at Gracie Mansion. 2/ This meeting involved a long discussion of the City's fiscal problems, the lack of interest in the market for City securities, and the urgency of the City's cash needs, particularly the April 14 maturity. Mr. Hayes stated that there was no possibility that the Federal Reserve could loan money to the City. Given the exigency of the situation, it was decided to assemble representatives of all interested parties - the City, State, and Federal governments, and the financial community - to develop a specific program of fiscal reform to restore investor confidence. 3/

At the close of the meeting, the bankers indicated they wanted three things: (1) details on the City's cash position; (2) the financial plan relating thereto, especially for funding a portion of short-term debt that could not be supported under a cash system; and (3) details of the 1975-76 budget, including specific plans for cuts and for holding labor costs down. 4/

* * *

1/ Long Island Press, March 26, 1975, p. 1.

2/ Goldin Ex. 83.

3/ Rockefeller at 57-58; E. Patterson at 89-90; Beame at 189; Labrecque Ex. 22.

4/ Goldin Ex. 77.

David Grossman wrote a memorandum entitled "Possible Frameworks to Address the New York City Fiscal Situation." Grossman suggested a few alternatives to meet the immediate cash problem: (1) the City might borrow the money required and pledge a specific City revenue flow for repayment; (2) the underwriters could buy City obligations for the account of the Treasury or the Federal Reserve; (3) the State could buy City notes; or (4) the Treasury or Federal Reserve could buy City notes directly. 1/

As a long-term approach, Grossman suggested a corporation similar to the SRC to convert short-term debt into long-term debt. Other possibilities suggested were Federal insurance of City obligations and Federal and State purchases of these securities. 2/

Additionally, Grossman posed, as alternatives, that the City raise a number of taxes and cut City services. A fiscal reform package was described which included (a) limiting short-term borrowing, (b) eliminating expense items from the capital budget, (c) reforming various accounting practices, and (d) developing a three or five year fiscal plan for the City. 3/

1/ D. Grossman Ex. 47.

2/ Id.

3/ Id.

FRIDAY, MARCH 28, 1975

Various individuals met at Chase to develop a program to open the public market for New York City obligations. Representing the City were Messrs. Cavanagh, Lechner, Lanigan, Goldin and Clifford. New York State was represented by Peter Goldmark, Director of the Budget and Michael Diffley, also with the Division of the Budget. Robert Gerard represented the Treasury Department, Peter Sternlight represented the Federal Reserve Bank of New York, and the financial community was represented by David Grossman and Thomas Labrecque of Chase, Amos T. Beason and Frank Smeal of Morgan Guaranty, Gedale Horowitz of Salomon Bros., Charles Sanford of Bankers Trust, David Barry of Manufacturers Hanover, Jean Rousseau of Merrill Lynch, and Richard Kezer of Citibank. 1/

1/ Labrecque Exs. 21 and 22; Goldin Ex. 84; D. Grossman at 209.

According to a memorandum written by David Grossman, the immediate objective of the discussions was to determine what steps were necessary and what time schedule was appropriate to bring about adequate financing by April 14. 1/ The meeting lasted about five hours. 2/

A document dated March 28, 1975, apparently prepared to serve as a basis for discussion at this meeting, detailed a six-point program for fiscal improvement of the City. 3/ The elements of the plan were:

1. A program of revenue and expenditure changes to close the \$884 million budget gap for 1975-76.
2. Phase out the use of long-term borrowing to finance operating expenses over a 5 to 10 year period by amendments to the Local Finance Law. This should include requirements for disclosure of all such items now included in the capital budget or "outside the certificate."
3. Reduction of the City's short-term debt position in line with a plan for the next 12 to 18 months. This should include a program of improved advances/reimbursements of State and Federal aid.
4. Improvements in the City's financial accounting and reporting systems by means including:
 - Work toward adoption of MFOA principles and standards
 - Install improved accounting systems
5. Installation of a long-range fiscal planning process (3 to 5 years) for City expenditures and--insofar as feasible--revenues.
6. Establish a City-State fiscal commission to review aid programs, show financing of operating programs, etc. along the lines of the Mayor's proposal. 4/

1/ Labrecque Ex. 22; See also D. Grossman at 210.

2/ Labrecque Ex. 22.

3/ Goldin Ex. 84.

4/ Id.

Of immediate concern to the group was improvement of the
City's cash flow and balancing of the budget. 1/

1/ id.

* * * *

In a memorandum addressed to J.H. Fleiss, D.S. Howard, Senior Vice President for finance of Citibank, requested an update, as of March 31, of Citibank's total holdings of municipal securities. He specifically requested a listing of the maturity schedule for the municipal securities at par value held by Citibank on a month-by-month basis for 1975 and 1976 and by year thereafter. 1/

SATURDAY, MARCH 29, 1975

The meeting of the previous day reconvened. A second draft of the six point fiscal improvement program was discussed and several elements were tentatively agreed upon by the gathering. Among these was a commitment by the City to phase out carrying expense items in the capital budget over a five to ten-year period by seeking amendments to State legislation. Items in the capital budget that were of an expense nature would be disclosed annually "outside the certificate." Each year, for several years, the maximum amount of these expense type items permitted in the capital budget would be decreased. State law allowing the use of capital funds to make debt service payments would be amended or repealed, which would affect the Transit Facilities

1/ Memorandum, D.S. Howard to J.H. Fleiss, March 28, 1975.

Construction Fund, the City University Construction Fund, the State Health Facilities Corporation, UDC and other entities. 1/

It was decided that the City would embark upon a program to upgrade the quality of its financial reporting and accounting systems by adopting the standards of the MFOA, instituting modern accounting procedures for all City agencies, and preparing and issuing a comprehensive bond or note prospectus for each securities sale, in order to provide complete information on the financial organization, procedures and status of the City. 2/

The group also agreed that the State should establish a permanent commission composed of City officials, State officials, and members of the financial and business community, to study the fiscal relationship between the State and the City. This commission would examine the present responsibilities of each unit and determine whether there should be some adjustments. 3/

The last point tentatively agreed upon by the group was the enactment of a State law to establish multi-year fiscal planning for the City, including a three to five-year projection of anticipated expenditures and revenues. 4/

1/ Lanigan Ex. 20.

2/ Id.

3/ Id.

4/ Id.

MONDAY, MARCH 31, 1975

The working group established at the Friday and Saturday meetings continued their work at Chase. City and State officials did not attend these meetings. 1/

The meeting convened at approximately 2:00 p.m. Present were Thomas Labrecque, David Grossman, Palmer Turnheim and Lawrence Toal of Chase, Richard Adams and Herman Charbonneau of Chemical, Amos T. Beason of Morgan Guaranty, Richard Kezer and Jac Friedgut of Citibank, David Barry of Manufacturers Hanover, Charles Sanford of Bankers Trust and Peter Sternlight of the New York Federal Reserve Bank. Halliburton Fales and Marion J. Epley of White & Case were also present. 2/

The meeting began with with Mr. Labrecque's suggestion that the attorneys address the issue of possible anti-trust problems arising from the meetings among the banks and others. Mr. Fales emphasized that each bank must make an individual judgment in its own best interest and that cooperative action by the banks should preferably be taken at the request of the City officials. 3/

There was also a discussion about the possibility of underwriting City notes to be sold on April 14. Mr. Epley advised the group that any underwriting where notes were resold to the public would raise very serious disclosure problems and that the fiscal status of the City might make

1/ Memorandum, Marion J. Epley to the Files, March 31, 1975.

2/ Id.

3/ Id.

adequate disclosure impossible. He also expressed the opinion that the disclosure required would probably cause serious marketing problems for any City notes. 1/

Richard Kezer of Citibank raised a question about continued trading in outstanding City notes. Epley replied that White & Case had advised Bankers Trust that, in view of the developments since the issuance of the March notes, continued selling of those notes might give rise to "10b-5 liability" to a selling underwriter. 2/ Epley stated that he was giving the same advice to all those present and that the parties should consult their own counsel. 3/ Charles Sanford of Bankers Trust stated, and Thomas Labrecque of Chase agreed, that their banks might continue selling City notes with the understanding that if the City should default, the banks would repurchase the notes at the original sales price. 4/

Mr. Labrecque informed the group that City representatives had requested the group to make a review and clarify their proposals made to the City over the weekend. 5/ In addition, Mr. Labrecque stated that White & Case had been given two assignments. The first was to examine the effects of a City default if the City could not redeem the \$600 million of TANS due on April 14. Mr. Epley stated that work was continuing in this area and

1/ Id.

2/ Id.

3/ Id.

4/ Id.

5/ Id.

a report would be made to the banks as soon as possible. The second assignment was to study the possibility of setting up a "secured" City financing in April. 1/ Mr. Epley stated that it appeared that the most hopeful means of obtaining "security" would be to require, by contract, that the City comply with the Local Finance Law requiring the "earmarking" of certain types of tax and other revenues. 2/ There was further discussion of a "secured" offering. 3/

Mr. Friedgut then stated that the real issue was not securing an issue of City debt, but whether or not the City was willing to recognize the priority of debt repayment over such expenditures as salaries to police and payments to welfare recipients. Mr. Sanford agreed and said that the City still had not demonstrated its willingness to lay off City employees, if required, in order to balance the budget. 4/

The assemblage then considered the third draft of "Elements of a Fiscal Improvement Program for New York City". 5/ The principal focus of the discussion concerned balancing the budget without additional borrowing. It was agreed that if that point was satisfied, the other parts of the plan would probably be achieved. 6/

1/ Id.

2/ Id.

3/ Id.

4/ Id.

5/ Id.

6/ Id.

Mr. Labrecque described the Saturday meeting as ending with Deputy Mayor Cavanagh indicating his view that the banks had a "real problem" which he hoped they would be able to resolve. 1/ Mr. Beason pointed out that such statements meant that the City was still not listening to the comments expressed by the investment community. Mr. Friedgut observed that, in his view, Messrs. Beame and Goldin felt that they were being very successful in their negotiations with the banks and had no particular reason to yield on any points at this time. 2/

It was pointed out that, at the Saturday meeting, Steven Clifford had stated that the City needed only \$350 million to accommodate its needs through May 9, contradicting the figure of \$450 million which City officials had previously quoted. 3/

The conversation again returned to the third draft of "Elements of a Fiscal Improvement Program for New York City" and the means of insuring compliance by City officials with the points contained therein. There was a brief discussion about various federal officials who had stated that the City would not receive "one red cent" of additional aid. 4/ Other sources of financial aid for the City were discussed, including the receipt of Federal and State aid. 5/ The establishment of a committee of independent parties to "audit" the City's compliance with its budget was discussed

1/ Id.

2/ Id.

3/ Id.

4/ Id.

5/ Id.

and various potential participants were mentioned. 1/

White & Case was instructed to proceed with revision and expansion of the Report of Essential Facts used with an earlier offering of RANS. The possibility that adequate disclosure was impossible under the circumstances was discussed and acknowledged by the bankers present. 2/ The meeting ended with Peter Sternlight stating that although it remained disturbed about the City's problem, the Federal Reserve Bank was nevertheless unwilling to advance funds to the City. 3/

In an internal City document, meetings between City officials and banks were summarized. 4/ The banks were described as carrying a large inventory of City securities which they claimed were difficult to move. Consequently, they would not increase their holdings. The difficulty, according to the banks, was that the market had no confidence in the City because of the adverse climate created by the absence of a plan to solve the fiscal crisis, the growing annual amount of borrowing and the adverse experience with UDC.

The banks were characterized as wanting a fiscal plan, a reduction in expenses, a reduction in borrowing, the transfer of expense items out of the capital budget, the creation of a City-State fiscal relations committee,

1/ Id.

2/ Id.

3/ Id.

4/ Cavanagh Ex. 51.

the establishment of long range planning, and the development of improved financial reporting and accounting systems. 1/

It was asserted that if the banks refused to buy the \$350 million of notes, the City should proceed with, among other things, pension fund purchases of City notes and advances of aid from the State. The summary lists the alternatives available to the City in the event that it was unable to raise the necessary money; default was included on the list. 2/

* * *

The New York Post printed an article on the possibility of a City bankruptcy. Various City officials were asked their positions on this possibility. Comptroller Goldin reported stated: "The City is not on the verge of bankruptcy." An aide to Mayor Beame was asked for the Mayor's position on bankruptcy and replied: "No way." 3/

* * *

The Daily News reported that Mayor Beame and various City budget experts would participate in a budget "retreat" at the municipal building for three afternoons during the week to grapple with the current credit crunch and a projected \$800 million gap in the budget for the next fiscal year. It was also reported that, during a television interview, Comptroller

1/ Id.

2/ Id.

3/ New York Post, March 31, 1975.

Goldin expressed confidence that the City would be able to borrow \$450 million later in the month. 1/

* * *

John Thompson of W.H. Morton sent a memorandum to Frank Smeal and Amos T. Beason providing suggestions for resolving the City fiscal crisis. 2/

Mr. Thompson began his memorandum with the statement that he recognized that a solution to the City fiscal crisis was impossible before April 14. Thompson discussed the possibility of default by the City and provided details of some of the City fiscal problems. He reported that there was almost \$3 billion of outstanding RANS resulting from the City's practice of paying off RANS issued in previous years with the proceeds of even larger borrowings against new revenues. According to the memorandum, the deficits resulting from revenue shortfalls in several years "have in effect been folded into a cumulative balance of RANS outstanding." 3/

Thompson suggested that the investment community might consider filing an amicus curiae brief in the Wein litigation. He also asserted that the City, in conjunction with the investment community, should retain an independent accounting firm to help revise City accounts and reports "so that the records will be understandable in the future to all concerned." 4/

1/ Daily News, March 31, 1975, p. 10.

2/ Memorandum, John F. Thompson to Amos T. Beason and Frank P. Smeal, March 31, 1975 with attachment.

3/ Id.

4/ Id.

He also stated that the banking community could help the City in pressing the Federal and State governments for more timely payment of aid. He asserted that "many of us were late in sensing the adverse developments which have taken place," 1/ and continued:

I am convinced that the over-borrowing was all done legally, and in numerous cases was based on special amendments to the Finance Law adopted to permit it. Their significance in the issuance of debt was understood by bond counsel. If the rest of us had understood them better their significance in terms of credit, cash flow and marketing short term city debt would have been clearer to us. Some of us first learned certain of the disillusioning facts at early meetings of the Grossman subcommittee, when Leo Sabatine was addressing various of the problems of legal issuance. For that reason I believe we will need the continued cooperation of his firm, Wood Dawson, in order to be sure that we fully understand the implications of the way things have been done. 2/

TUESDAY, APRIL 1, 1975

A fourth draft of the City's six point fiscal improvement program was distributed by David Grossman to the FCLG. The initial item required the City to balance its budget without increased reliance on borrowing and required City officials to commit themselves to this objective by April 14, 1975. 3/

The second item called for the development of a program to accelerate the payment of State and Federal aid and advances against expenditure reimbursements. Other items indicated that the City would end the use of the capital budget to finance expense items, improve

1/ Id.

2/ Id.

3/ Document entitled "A Fiscal Improvement Program for New York City" (Fourth Draft) prepared by D. Grossman, April 1, 1975.

its financial accounting and reporting, and establish a fiscal commission to study the City's financial problems and develop long-range fiscal planning. 1/

* * *

A letter dated April 1, 1975, written by Marion J. Epley of White & Case to Thomas Labrecque of Chase (with copies to Richard Kezer of Citibank, Herman Charbonneau of Chemical, David Barry of Manufacturers Hanover and Charles Sanford of Bankers Trust), discussed the disclosure question involving City securities. 2/ The text of the letter was as follows:

Dear Tom:

In view of the rapidity with which events are developing in connection with the City's finances, we feel it is appropriate to summarize for the Banks our views on what has come to be known as the question of "disclosure". You will recall that an attempt was made to address the problem in the form of the City's Report of Essential Facts dated March 13, 1975. While it may be possible by updating and supplementing that Report to satisfy the applicable legal requirements with respect to future underwritten offerings, we understand from our discussions with the Banks that the adverse information which would be required in such a Report would in all likelihood render the City securities unsaleable.

One of the suggestions which has evolved from various meetings over the last several days has been the preparation by the City of a comprehensive prospectus to be updated and circulated in connection with each sale of bonds or notes by the City. Preparation of such a prospectus would assume and reflect the taking of appropriate corrective actions by the City with respect to its Budget and finances. It is recognized by all involved that preparation of such a prospectus will be a massive undertaking, and in our view it could not be completed in less than four to six weeks.

1/ Id.

2/ Letter, Marion J. Epley to Thomas Labrecque, April 1, 1975.

Even to meet that time schedule, substantial effort by numerous City personnel, Bank representatives and counsel, as well as full cooperation and access to City records, will be required.

We understand that the Banks have tentatively determined, and we would concur, that the most desirable form of disclosure in connection with the traditional underwriting of City securities, in which resales are made to the public, would be through the use of such a comprehensive prospectus.

Regardless of the form which any ultimate disclosure document may take, we reemphasize our advice that public sales of New York City securities, in the absence of what may be agreed upon as full and meaningful written disclosure, would be contrary to the best interest of both the City and the Banks and could result in a substantial exposure to liability both to primary and secondary purchasers of the securities.

We believe that the Banks should be aware of our position in conducting further discussions with the City.

Sincerely,

/s/ Jay Epley 1/

WEDNESDAY, APRIL 2, 1975

Mr. Epley forwarded to Ellmore Patterson essentially the same letter that had been written to Thomas Labrecque the previous day. 2/ Copies were again sent to Messrs. Labrecque, Kezer, Charbonneau, Sanford and Barry. The text of the two letters differed only in the last sentence

1/ Id.

2/ Charbonneau Ex. 15.

of the first paragraph.

The first letter stated:

While it may be possible by updating and supplementing that Report [of Essential Facts dated March 13, 1975] to satisfy the applicable legal requirements with respect to future underwritten offerings, we understand from our discussions with the Banks that the adverse information which would be required in such a Report would in all likelihood render the City securities unsaleable.

The corresponding sentence in the second letter began with the word "it" and ended with the word "offerings", entirely omitting the clause which stated that as a result of discussions with the banks it appeared that disclosure of "adverse information" would "render the City securities unsaleable." Additionally, while the April 1 letter had been signed by "Jay Epley," the April 2 letter was signed by "White & Case." 1/

Sometime during mid-April (according to White & Case) an associate at White & Case wrote a memorandum to the files with respect to conversations he had with City employees concerning anticipation notes and first lien. The text of the memorandum 2/ is as follows:

Clearing House Banks
re: NYC Financing Plan

I called Sandy Altman to discuss the "first lien" language in Article 8 Section 2 of the New York State Constitution. I told her that it appeared BANS were not covered in that Section and yet the Notice of Sale for the March issue contained the first lien language. Sandy was aware of the problem and stated that the Notice of Sale and advertisements contained "a lot of loose language". She said that the gap in Article 8 Section 2 may have been filled by the fact that the underlying bonds have a first lien. She also stated that the first

1/ Id.

2/ Undated Memorandum For the Files by John Osnato.

lien language had been dropped from the Notices of Sale for RANS and TANS at the request of either Hawkins, Delafield or Wood, Dawson. She stated that she was not the proper person in the City to get this information from and told me to call Ken Hartman.

I called Ken Hartman today and he was also aware of the problem. He agreed that it appeared the BANS were excluded from the first lien language. He stated that there were a lot of problems in Notices of Sale and with the use of the first lien language generally. He further stated that if the City continued to use the first lien language it could "get blown out of the water". He said he would do some further research in the area and get in touch with us (he said his research would concentrate on the Vanderzee case). 1/

Later in April, in a letter from White & Case to Citibank, as manager of the underwriting syndicate for a prior RANS issue, the basis for White & Case's fee was discussed. The letter referred to an earlier discussion between the parties regarding the fee, stating: "As I told you at the time, we feel that the traditional practice of so many 'cents per Note' may not be appropriate in the new environment for these municipal financings where, among other developments, efforts are being made for the first time to disseminate relevant information with respect to the City's financial condition." 2/

* * *

A Dow Jones Wire Service Release indicated that Standard & Poor's had suspended the City's "A" rating on general obligation bonds. 3/ It stated, in part:

1/ Id.

2/ Letter, White & Case to Richard Kezer, April 17, 1975.

3/ Dow Jones Wire Service Release, April 2, 1975.

...New York City's rapidly deteriorating ability to raise money in the capital markets places unusual strains on its cash position for the immediate future.

The possible "inability or unwillingness of the major underwriting banks to continue to purchase the City's note[s] and bonds" was cited by S & P as a primary contributing reason for the suspension.

* * * *

The City's present cash flow problems reflect not only its inability to meet operating expenses without resorting to borrowing but the same may hold true for the meeting of debt service requirements coming due shortly on long-term debt. 1/

Prior to the suspension [in March 1975] two Standard & Poor's analysts had been informed by New York State Budget personnel that the State could not afford to bail the City out. Sol Lewis, in response to questions from a Standard & Poor's representative, stated that "if the city could not borrow what it needed when it had to, it could go bankrupt and all sorts of lawsuits would follow." 2/ Standard & Poor's then suspended the City's "A" rating. Standard and Poor's stated that the City's "rapidly deteriorating ability to raise money in the capital market places unusual strains on its cash position for the immediate future." 3/

FRIDAY, APRIL 4, 1975

The major commercial banks and three non-bank underwriters met with State Comptroller Arthur Levitt at Morgan Guaranty Trust at 2:00 p.m., to discuss the proposed "advance" from New York State to New York City of approximately \$400 million. Comptroller Levitt stated that he did not know of the advance

1/ Id.

2/ Internal memorandum dated April 3, 1975 from H. Grossman to B. W. Harris (Standard & Poor's).

3/ Wall Street Journal, April 3, 1975; Standard & Poor's, The Fixed Income Investor, April 5, 1976, at 756.

prior to the Mayor's visit with the Governor. Levitt also said that Mayor Beame told Governor Carey that without assistance, the City would default on April 14th. The Mayor had stressed that he was not asking for new money, but rather an advance.

During the course of the meeting, Richard Kezer of Citibank, indicated that the lawyers had found a serious problem with Governor Carey's announcement of an "advance" to the City because the City had already issued the March RANs against the particular revenue sharing funds referred to by the Governor. The difficulty was said to be not in the State making the funds available to the City, but should the City receive an advance on the June revenue sharing, it would be compelled to place it in an escrow account against the March RANs. ^{1/}

TUESDAY, APRIL 8, 1975

In a report, Moody's confirmed its "A" rating for New York City bonds, its MIG-1 rating for RANS and its MIG-2 rating for all other notes.

The report states:

For half a century now, it has been widely known that New York City has a revenue problem, a systemic difficulty in raising additional revenues to keep up with expanding needs. It is also well known that revenue problems are aggravated by business recession and that liquidity is impaired in some proportion to declines in economic activity. But New York City's debt is secured by much more than its current liquidity position. The strong legal backing of the City's obligations and the City's unique position in the American economy provide a considerable amount of assurance to the creditor. These assets, managed by political leaders of even average competence, would represent adequate backing for any City's securities. In the case of New York City its securities become a good buy for investors seeking yield and willing to withstand adverse and often irrelevant publicity. The vulnerability of the City to cash stringencies, however, is the very reason the rating is not

^{1/} Document entitled "Meeting at Morgan Guaranty," April 4, 1975.

higher. Our ratings encompass all these and other considerations and simply cannot in fairness to the investor be changed capriciously. The bond rating of New York City's general obligation bonds remains A, the bond anticipation notes MIG 1 and all other notes MIG 2. 2/

EPILOGUE

Efforts by the City during May 1975 to market its short-term debt were unsuccessful. A proposed short-term debt sale of \$280 million was cancelled on May 19, 1975. During April and May 1975, the City received substantial advances from New York State, and certain sums from the federal government.

In June 1975, the Municipal Assistance Corporation for the City of New York ("MAC") was formed. MAC, another public benefit corporation, was an agency and instrumentality of New York State. Its purpose was to assist the City in providing "essential services to [the City's] inhabitants without interruption and [to create] investor confidence in the soundness of the obligations of the City." MAC was authorized to borrow up to three billion dollars and was initially supported by revenue streams derived from sales taxes and stock transfer taxes due the City. Standard & Poor's rated the MAC securities A+.

MAC sold \$1 billion of its securities to the public in June and July 1975. Additional sales aggregating approximately \$2 billion were made through October 1975.

On September 9, 1975, the State Legislature adopted the New York State Financial Emergency Act for the City of New York which,

among other things, created the Emergency Financial Control Board. One of the Control Board's primary functions was to develop a three-year financial plan for the City with a view to achieving a balanced expense budget for the City for its fiscal year ending June 30, 1978. The financial plan was to be prepared in accordance with accounting principles different from those previously employed by the City, which principles were intended to reflect more accurately the City's revenues and expenditures.

On November 15, 1975, the State Legislature enacted the Moratorium Act, which provided for suspension of the enforcement of short-term obligations of the City outstanding on November 15, 1975.

On January 5, 1976, the Commission commenced its investigation concerning transactions in the securities of the City and related matters. In its January 8, 1976 release announcing the investigation, the Commission stated, in part:

Securities issued by the City of New York or by any municipality are not required to be registered with the Commission. However, the Commission is authorized to conduct investigations and, where appropriate, seek remedial relief where violations of the Securities Act and/or the Exchange Act have occurred in the trading of such securities.

* * * *

The Commission notes that a major reason for its investigation is its desire to restore investor confidence in the municipal bond markets.

The Commission's investigation is also being undertaken to determine what, if any, additional legislation or rulemaking is necessary in light of the facts uncovered during the investigation to protect investors in municipal securities.

On November 19, 1976, the Moratorium Act was declared unconstitutional by the New York State Court of Appeals.

Chapter Two



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**ACCOUNTING PRACTICES
AND FINANCIAL REPORTING**

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

Introduction and Summary

Chronology of Events

October 1, 1974 - April 8, 1975 Chapter One

Report on Accounting Practices

and Financial Reporting Chapter Two

Report on the Role of the City

and Its Officials Chapter Three

Report on the Role of the Underwriters Chapter Four

Report on the Role of the Rating Agencies Chapter Five

Report on the Role of Bond Counsel Chapter Six

Analysis of Questionnaires Sent to
Individual Investors, Syndicate

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REPORT ON
ACCOUNTING PRACTICES AND
FINANCIAL REPORTING

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INTRODUCTION

Pursuant to the Securities and Exchange Commission's formal order of investigation, we have inquired into the accounting practices, systems and procedures employed by the City of New York prior to June 1975. As a result of that inquiry we believe that one of the fundamental factors underlying the City's financial difficulties was the use of budgetary, accounting and financing practices which enabled it to borrow funds from the public which could not be supported by its sources of revenue.

The results of our investigation indicate that New York City's accounting and reporting practices effectively served to obfuscate the City's real revenues, costs and financial position and that substantial weaknesses in the City's system of internal accounting control caused published financial information to be inherently unreliable. Both of these factors directly affected the materials used in connection with the sale of its securities. "Notices of Sale" were prepared in connection with the issuance of many of its debt obligations. A "Report of Essential Facts" was appended to the Notices which contained summary financial data indicating a balanced budget. This information was based on accounting principles employed by the City and was essentially a product of its defective system of internal accounting control.

Our analysis is based upon material obtained from a variety of sources, including the Comptroller General of the United States, the Office of the New York State Comptroller, the City of New York, the American Institute of Certified Public Accountants ("AICPA"), the Municipal Finance Officers Association of the United States and Canada ("Municipal Finance Officers Association"), various independent public accounting firms, testimony before the staff of the Commission's New York Regional Office as well as publications on file in various public libraries.

The staff has reviewed audit reports dealing with the City prepared by the Office of the New York State Comptroller and various independent public accounting firms; municipal accounting guidelines and other material prepared or issued by the Comptroller General of the United States, the Office of the New York State Comptroller, the AICPA, the Municipal Finance Officers Association, and others; public documents prepared by the City of New York, including statutory reports, press releases, proceedings of the City Council and various studies; nonpublic memoranda and other material obtained both pursuant to subpoena and voluntarily from the City and its Counsel; and other material, including legislative background materials, textbooks, professional journals, magazines, and newspapers.

I. NEW YORK CITY ACCOUNTING PRACTICES

A. Introduction

Many of the major problems inherent in New York City's accounting practices were succinctly summarized by City Comptroller Goldin:

"Whereas a prudent and conservative accounting system would allow the budgeting and spending only of revenues actually to be received during the fiscal year, New York City's system allowed the accrual each year of many millions of general fund revenues which would not be collected until the following year--if, indeed they were collectible at all. Real estate taxes were budgeted as if 100 percent of the tax levy would be collected, even though it was as certain as sunrise that a portion would still be outstanding at year's end.

"Since spending was keyed to the level of accrued revenues rather than revenues actually received, the result was heavy short-term borrowing.

"On the expense side, New York City maintained a cash basis for payables, carefully preserving the fiction that incurred expenses did not exist until the bills were paid. Payroll costs, for example, were not provided for in the year incurred but rather in the year in which paychecks were distributed—a system which resulted, not surprisingly, in teachers receiving much of their earnings for the latter part of the fiscal year out of borrowings against receivables in the following year." 1/

In the course of our inquiry we sought to determine the extent to which New York City's accounting practices obscured the City's true fiscal condition and enabled the City to ostensibly

1/ Unpublished document drafted by Harrison J. Goldin sometime subsequent to the formation of MAC; Harrison J. Goldin Exhibit 99 for identification ("Goldin Exhibit 99").

balance its budgets and prolong the precarious state of its finances until the Municipal Assistance Corporation ("MAC") enabling legislation and its mandated reforms in 1975.

Foremost among the critics of the City's accounting practices has been the MAC itself. On August 29, 1975, MAC published a document which exposed the cumulative effect of certain accounting practices utilized by New York City, indicating a deficit at June 30, 1975 of almost \$2.6 billion. The MAC analysis of the City's fiscal condition cautioned that "other audits and further examination of City records may require modification" of this deficit figure. ^{1/}

It was subsequently disclosed in the Fall of 1976 that in addition to this initial \$2.6 billion deficit, the City had accrued pension liabilities and other charges which increased the deficit estimate to an amount in excess of \$5 billion.

Although the accounting practices reviewed may not all have had a direct impact on the fiscal crisis, they did

^{1/} Municipal Assistance Corporation, August 29, 1975 press release.

clearly affect the City's ability to provide "complete and accurate financial information in proper form and on a timely basis." 1/

City Comptroller Harrison Goldin, in testimony before the staff stated that beginning in the fall of 1974:

"We were working intensively on developing a whole new formulation, one that would reform completely the City's accounting budgetary control and management information systems, one that would retranslate the way in which the principles had developed historically into approaches that would conform not with the historic legislatively mandated and sanctioned and customary accounting principles but with those that more closely approximated the principles articulated by the M.F.O.A. [Municipal Finance Officers Association]." 2/

Unfortunately, that "new formulation" of the City's information systems was begun too late to be of use during its fiscal crisis.

1/ National Committee on Governmental Accounting, Governmental Accounting, Auditing, and Financial Reporting (Chicago: MFOA, 1968) P 1. [Hereinafter referred to as "National Committee, Governmental Accounting."] The National Committee noted that, despite its unique character, this is the purpose of governmental accounting, as it is for accounting for other types of economic activities.

2/ Testimony of Harrison J. Goldin (26 August 1976) at pp. 134-35.

In order to put the relationship between the City's accounting practices and the massive deficit disclosed by MAC in proper perspective, we have reviewed the City's methods of revenue and expense recognition, fund accounting, capitalization of expenses, and other matters. This analysis includes a review of:

- 1) The basis of accounting, or the manner in which revenues and expenses were recorded in given fiscal years;
- 2) "Fund" accounting, or the format of the accounting system; and
- 3) The nature and amount of expenses financed through the capital budget.

Background material, including a brief history of municipal accounting and an overview of generally accepted accounting principles ("GAAP") applicable to municipalities, is included in Appendix A.

B. Basis of Accounting Utilized by New York City

In its investigation the staff found that the basis of accounting utilized by New York City substantially deviated from the basis of accounting regarded as generally accepted. These accounting methods were a substantial factor in the failure to set forth the huge cumulative General Fund deficit which existed as of June 30, 1975.

The accounting practices of New York City permitted the City to distort its financial position by overstating its assets and understating its liabilities and further failed to disclose a material cumulative operating deficit. The City's accounting methods recorded cash due in later years as a receivable (and as revenue) in a current fiscal year, but did not record liabilities of the same current year until a later year, when the cash was actually disbursed. Thus the recognition of revenues was advanced while the recognition of expenses was postponed, distorting both the City's financial position and its concept of a balanced budget.

A December 29, 1975 Arthur Andersen & Co. report sharply criticized this practice stating:

"The basic policy is to account for expenditures on a cash basis and revenue on an accrual basis, whether earned or not. This approach can be very distortive of financial position and has probably contributed to the present fiscal crisis. The accruing of unearned or unbillable revenue is not an acceptable accounting practice and could be manipulated to reflect a better financial

picture than actually exists. It seems particularly anomalous when combined with cash basis expense accounting, where liabilities are understated." 1/

Indeed, the City went beyond this by increasing from year to year the amounts of revenues and expenses so recorded. As the City from year to year increased its recognition of accrued revenues, it also increased from year to year its delay in the recognition of such expenses as pension fund payments and payroll. Thus, the imbalance increased, being expanded to new categories of revenues and expenses, in addition to the increased dollar amounts applicable to revenue and expense categories not newly introduced in a given year.

Our inquiry has included the City's treatment of revenues which were budgeted to be received from its three primary sources: (a) revenues from taxes of various types which the City recorded in its General Fund, (b) revenues from the State and Federal governments under various State and Federal aid programs, and (c) revenues from real estate taxes. We have also reviewed the City's method of recording expenses for personal services

1/ Arthur Andersen & Co., Report for the Secretary of the Treasury Regarding Information Relating to the Financing Requirements under the New York City Seasonal Financing Act of 1975, 29 December 1975 [Hereinafter referred to as "Arthur Andersen & Co., Report for the Secretary"].

and have briefly described certain other items such as reserve account transactions. The following pages relate the effects of what Comptroller Goldin has called "this least conservative of all possible accounting systems." 1/

1. General Fund Revenues 2/

The City receives tax revenue from a variety of sources such as the City sales tax, personal and corporate income taxes and stock transfer tax 3/, and, during the fiscal year, generally records revenue as it receives cash in payment of these taxes. Prior to 1975, however, at the end of a fiscal year, an estimate was made of certain tax revenue which would be received in cash in the following fiscal year and which was deemed applicable to the current fiscal year. The City then recorded this estimated revenue in the current fiscal year and to meet its cash needs, issued Revenue Anticipation Notes ("RANs").

1/ Goldin Exhibit 99, p. 4.

2/ The "General Fund" in the City accounting system differs substantially from the GAAP concept.

3/ For a complete list of taxes paid into the City's General Fund, see part 2-E of the Annual Report of the Comptroller of the City of New York for the Fiscal year 1974-1975.

Revenue recorded in this manner was commonly referred to as the "June accrual." According to MAC, this practice resulted in \$358 million of the cumulative deficit. 1/

The issuance of RANs in anticipation of the receipt of estimated revenue was permitted by a New York State Statute passed in 1965. Prior to 1965, the City was precluded from borrowing against taxes and fees unless they were due and payable during the fiscal year. 2/ The City issued no RANs at all in some years during the 1950's and early 1960's and when it did, they were nearly always paid off by year-end. The 1965 enactment permitted the City to borrow against certain taxes and fees which were not scheduled for receipt by the City prior to the end of the fiscal year.

1/ Municipal Assistance Corporation, August 29, 1975 press release.

2/ Legislative Memoranda: "New York City - Revenue Anticipation Notes" at 2064.

It appears that the City of New York viewed this bill as having only a limited effect on future budgets. In a memorandum issued by the City in 1965 in support of the bill, the City noted:

"This proposed change will enable the City to borrow approximately \$50,000,000 more in the current fiscal year, in anticipation of revenues to be collected in 1965-1966 which are attributable to activities occurring in 1964-1965. It will not increase the temporary borrowing power in subsequent fiscal years, but will merely change the anticipated revenue base to include the revenues attributed to activities occurring in the fiscal year in which the notes are issued." ^{1/} [Emphasis added].

It has been asserted that the City's continuing use of the June accrual was a necessary feature of the City's finances. This is apparently based on the premise that once the June accrual was introduced to help balance the City's budget in 1965, it had to be used in following years or there would be a "shortage" of revenue, since revenues received during that year would be applied to the previous year.

^{1/} Memorandum of City of New York on Chapter 441, 1965 N.Y. Laws.

This argument attempts to justify a continuation of the June accrual but does not explain why the City increased the size of the accrual from 1965 to 1974. The City did not merely remain on the treadmill, it increased the speed. Pursuant to the 1965 legislative authorization year-end balances of RANs grew to \$298.3 million by June 30, 1974 as follows:

<u>RANs Outstanding</u>	
REDEEMABLE FROM GENERAL FUND REVENUES	
<u>As of June 30</u>	<u>Millions</u>
1965	\$ 56.6
1966	45.0
1967	93.8
1968	93.8
1969	93.8
1970	116.7
1971	131.3
1972	150.0
1973	162.1
1974	298.3 <u>1/</u>

These increases in the June accrual aggravated the mismatching in the City's recognition of revenues and

1/ This data is taken from the Annual Report of the Comptroller of the City of New York ["Annual Report of the Comptroller"], Part 6-C, Statement 1 for the appropriate years.

expenses by annually boosting accrued revenues. This escalation included both the introduction of new categories of revenues and increases in dollar amounts applicable to revenue items accrued in prior years. The chart on the following page shows the components included from year to year in the June accrual.

City officials, in testimony before the staff, have maintained that the June accrual was imposed upon them by State statute. ^{1/} The 1965 legislation was permissive, not obligatory however, and related to allowable borrowings, not accounting practices per se. In addition, when the State legislature passed the bill, it appears to have viewed the related increased short term borrowing to be approximately \$50 million. In 1965 and 1966 the City borrowed approximately this amount, but in subsequent years it markedly and regularly increased borrowings.

^{1/} See, e.g., colloquy during the Testimony of Abraham D. Beame at p. 68.

JUNE ACCRUAL
DATA TAKEN FROM COMPTROLLER'S ANNUAL REPORT
FOR APPROPRIATE YEAR, PART 2-E, STATEMENT 6

<u>FOR</u>	<u>AS OF JUNE 30, (000's OMITTED)</u>						
	<u>1965</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
SALES TAX	\$ 35,100	\$ 36,100	\$ 42,500	\$ 45,000	\$ 45,400	\$ 56,700	\$ 79,400
UTILITY TAX	2,300	3,800	3,800	4,200	5,000	5,600	7,700
COMMERCIAL RENT AND OCCUPANCY TAX	6,800	8,500	11,000	12,000	13,700	17,100	19,600
GASOLINE AND MOTOR FUEL TAX	6,200	8,000	8,000	9,000	11,000	14,000	10,500
MORTGAGE TAX	3,000	1,200	1,000	2,000	2,500	700	500
WATER METER REVENUES	2,000						
WATER CHARGES		3,300	5,700	6,700	7,000	114,800	117,200
SEWER RENTS							25,000
COMPENSATING USE TAX	200						
AMUSEMENT TAX	400						
HORSE RACE ADMISSIONS TAX	200						
TAX ON CONVEYANCE OF REAL PROPERTY	400						
PERSONAL INCOME TAX				25,000	29,000	45,100	46,700
PERSONAL INCOME TAX AND UBT		13,200	16,700				
GENERAL CORPORATION TAX		34,000	34,000				
GENERAL CORPORATION AND UBT				34,800	37,000	36,600	40,000
CIGARETTE TAX		2,600	2,600	4,300	4,500	2,600	1,600
STOCK TRANSFER TAX		6,000	6,000	7,000	7,000	5,100	8,500
AUTO USE TAX							1,700
TOTALS	<u>\$ 56,600</u>	<u>\$116,700</u>	<u>\$131,300</u>	<u>\$150,000</u>	<u>\$162,100</u>	<u>\$298,300</u>	<u>\$358,400</u>

For instance, in June 1973 the City Council enacted a law, submitted by the Mayor, 1/ which permitted the City to budget eighteen months of water charge revenue in the twelve month 1973-1974 fiscal year, yielding an additional \$52.5 million in accrued revenues. Prior to the enactment of this law, the City billed such charges on the first day of each January for the following twelve calendar months. The City Council enactment revised this billing procedure as follows:

- "1. One-half of the annual charges for un-metered water shall become due and payable, in advance, on January 1, 1974, for the period January 1 to June 30, 1974.
- "2. Commencing on June 30, 1974, all annual water charges for un-metered water shall be due and payable in advance on June 30th of each year." 2/

As a result of this enactment, the City was permitted to boost water charge revenue budgeted for the 1973-74 fiscal year by including six months' revenues (January 1-June 30, 1975) in the 1973-1974 fiscal budget. The City issued RANs in anticipation of the receipt of those revenues estimated by the Mayor to be attributable to 1973-74 but still uncollected as of June 30, 1974. The related increase in RAN debt is reflected in the City's Expense Budgets and Annual Reports:

1/ Office of the Mayor, City of New York, Executive Budget, 1973-1974, Message of the Mayor, 15 May 1973, p. 2.

2/ Proceedings of the Council of the City of New York, June 19, 1973, p. 1241.

Fiscal Year Ended <u>June 30</u>	Budgeted Revenue <u>(Millions)</u>	RANS Outstanding at June 30 <u>(Millions)</u>
1973	\$185.0	\$ 7.0
1974	242.5	114.8
1975	180.9	117.2

In order for the 1974-1975 budget to reflect twelve months of water charge revenue, water charge revenue applicable to 1975-1976 was accrued. None of these "revenues" had been earned in the accounting sense, since the related services had yet to be rendered.

MAC wrote off the entire \$358.4 million June accrual to the June 30, 1975 cumulative deficit. Of that amount \$117.2 million was attributable to water charge revenue.

Another practice used by the City to inflate its budgeted revenue was its treatment of sewer rent revenue.

In May 1974, the City Council enacted legislation which permitted the City to budget additional sewer rent revenue in the 1974-1975 fiscal year. Prior to this enactment, sewer rents for a fiscal year ending June 30 were billed on January 1 during that particular fiscal year. The 1974 enactment permitted the City to advance its billings by six months, making sewer rents payable on June 30th in advance of the particular fiscal year to which the rents applied. Thus, sewer rents for fiscal 1975 were payable on June 30, 1974.

In recommending adoption of the law, the City Council's Committee on Finance reported that "the initial 6 month acceleration of sewer rent collections from January 1, 1975 to June 30, 1974 is estimated to yield approximately \$28 million in additional revenue in fiscal 1974-1975." ^{1/} The City's Expense Budgets reflected budgeted sewer rents of \$46.0 million in fiscal 1973-74, and \$73.0 million in fiscal 1974-75. The increase in 1974-75 reflects the early accrual of the 1975 sewer rents.

Following the change in collection dates, the City introduced sewer rents as part of the June accrual for fiscal 1975. MAC ascribed \$25 million of the June 30, 1975 write-off amount to accrued revenue for sewer rents. The MAC mandated adjustment appears to be proper, since these revenues were also unearned.

^{1/} Proceedings of the Council of the City of New York, May 23, 1974, p. 956.

2. Federal & State Aid Revenue

The City also accrued revenue for Federal and State aid and issued RANs in anticipation of the receipt of this revenue. This practice resulted in deficit financing to the extent that this accrued revenue was inflated.

Both the National Committee on Governmental Accounting ("National Committee") in 1968, and the American Institute of Certified Public Accountants ("AICPA") in 1974, have set similar criteria concerning the accrual of revenue by municipalities. 1/ The State Comptroller's MAC Directives 2/ are based for the most part on the promulgations of these two authoritative sources and have further delineated the criteria for the recognition of revenues from Federal and State aid as follows:

"To be recognized as a revenue and as a receivable, the related expenditure must be within statutory and regulatory limitations. Revenues and receivables should not be recognized to the extent that: (a) expenditures are not allowable by law or regulation; (b) expenditures exceed the dollar amount of available grants; (c) claimed expenditures are disallowed upon audit; and (d) past experience indicates that claimed expenditures will be disallowed upon audit." 3/

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- 1/ See Appendix A.
- 2/ The MAC legislation requires that the City adopt the New York State Comptroller's uniform system of accounts, as modified for New York City. These changes were issued in a series of "MAC Directives."
- 3/ Office of the New York State Comptroller, Division of Audits and Accounts, Accounting Systems Directive No. 1; Budgetary and Accounting Practices for State and Federal Receivables (19 September 1975): 2.

It appears that the City accrued its Federal and State aid revenue in a manner which was at variance with the recommendations of existing authoritative sources. The Office of the New York State Comptroller indicated in an audit report on the City dated July 1, 1975 that:

"...the City had included as accounts receivable substantial amounts that were not collectible or where the likelihood of collection was extremely remote - such as claims for reimbursement of disallowed costs, claims in excess of stipulated limitations, and claims that had been rejected but were on appeal." 1/

In August 1975, MAC attributed \$778 million of the cumulative deficit to uncollected Federal and State aid and other receivables.

In October 1976, in refining the MAC figures, the Office of the City Comptroller attributed \$963 million of the revised \$5.078 billion deficit to a revaluation of aid receivables (\$678 million) and to the establishment of a reserve for federal and state aid disallowances (\$285 million). 2/

The issuance of RANs in anticipation of the receipt of Federal and State aid is authorized by Section 25 of the Local Finance Law, which was amended in 1965 to expand the City's authority to issue RANs against Federal and State aid.

1/ Office of the New York State Comptroller, Prior Year Accounts Receivable, Managerial Summary, p. 3.

2/ Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1975-1976 p. 25, note M.

Prior to 1965, the City could issue RANs against uncollected Federal and State aid owed for a fiscal year, even if not paid until after the end of a fiscal year. However, the law required that RANs outstanding at the end of a fiscal year, when added to the receipts for the year, could not exceed the amount of aid actually collected in the preceding fiscal year. Thus, if a billion dollars in federal and state aid was received in fiscal 1963 and \$900 million in revenue had been received by the end of fiscal 1964, outstanding RANs could only total \$100 million. This was designed to assure that RANs issued in a given fiscal year were virtually repaid at year-end.

The new law changed this restriction, eliminating the requirement that borrowings against aid be tied to the prior year's collections. Instead, it permitted the City to borrow against the Mayor's estimate of Federal and State aid applicable to the current year's budget. The law was apparently intended to conform the temporary borrowing power in anticipation of revenues to the operations of the City budget and revenue collections. ^{1/} However, it left open the question of how the notes would be repaid if these estimates turned out to be overly optimistic.

^{1/} Memorandum of the City of New York on Chapter 441, 1965 N.Y. Laws.

RANs outstanding related to Federal and State aid at fiscal year ends 1963 through 1969 were as follows:

<u>As of June 30</u>	<u>RANs outstanding</u>	<u>Millions</u>
1963		\$ -0-
1964		40.0
1965		62.0
1966		-0-
1967		-0-
1968		-0-
1969		35.0 <u>1/</u>

As of June 30, 1970, year-end borrowings against Federal and State aid climbed to \$420 million.

The law pertaining to RANs was again changed in 1971 and the City was permitted to issue RANs in anticipation of the receipt of various revenues on an overall basis rather than by specific sources of revenue. This change was sponsored by then Comptroller Beame 2/ who argued that the restrictions of Section 25 of the Local Finance Law required "complicated and

1/ This data is taken from the Annual Report of the Comptroller, Part 6-C, Statement 1 for the appropriate year.

2/ Letter dated 28 June 1971 from Ronald E. Stringer, Law Secretary, Office of the Comptroller, The City of New York to Michael Whiteman, Counsel to the Governor.

unnecessary recordkeeping at local levels of government" which resulted from "the recent expansion of federal and state aid to finance local governmental activities, and because this aid is received pursuant to a plethora of assistance programs." 1/

Thereafter, the City's balances of RANs outstanding at year end related to Federal and State aid were as follows:

<u>As of June 30</u>	<u>RANs outstanding</u>	<u>Millions</u>
1970		\$ 420.0
1971		965.0
1972		1,030.0
1973		725.0
1974		1,500.0
1975		2,560.0 <u>2/</u>

The staff attempted to draw comparisons for corresponding years between these balances of RANs outstanding and balances of federal and state aid receivables against which the RANs were issued. In an effort to obtain the balances of these

1/ Undated Memorandum from Abraham D. Beame, Comptroller, The City of New York, in Support of Senate Act No. 3568, An Act to Amend the Local Finance Law, in Relation to Revenue Anticipation Notes.

2/ This data is taken from the Annual Report of the Comptroller, Part 6-C, Statement 1 for the appropriate year.

aid receivables, we reviewed financial data contained in the statement entitled "Part 1 - Consolidated Statements - Summary 2" in the Annual Report of the Comptroller for each year during the period 1970 to 1975. We were unable to identify such balances due to the lack of information as to the extent to which federal and state aid receivable balances were included in various accounts in this statement. For example, there is a statement on page 2 of the Comptroller's 1973-1974 Annual Report that reflects receivables due from federal and state aid, but also reflects cash and receivables due from "miscellaneous sources," from "various sources for prior reimbursable outlays by the City," and from the "Stabilization Reserve Corporation." There is no indication of the extent to which balances in such accounts support RAN balances. Aid receivable balances are set forth in the "Foreword" in each Annual Report, but these balances apparently refer only to aid receivables for current outlays without regard to receivables from prior years which may support the issuance of RANs.

Had sound accounting principles been used, the City would have been unable to show sufficient accrued revenue to support the outstanding RANs. To the extent that these aid receivables were uncollectible, the accrual represents a portion

of the City's cumulative deficit. As mentioned previously, in August 1975 MAC, using the State Comptroller's accrual criteria, attributed \$778-million of the cumulative deficit to potentially uncollectible federal and state aid and other receivables, and in October 1976, the City revised this estimate upwards to \$963 million.

Although approximately \$300 million of the \$778 million aid writeoff identified by MAC was attributable to aid claims which may have been in dispute, the City's financial reports should have given consideration to potentially uncollectible aid claims.

The National Committee recommends that an:

" . . . accrued receivable recorded on the books should be offset by an estimated allowance for amounts which will not be collected . . . This should be done for the same reasons that it is done in commercial accounting for accounts receivable namely, to present an accurate picture of resources which will actually be realized in the course of operations and to prevent an overstatement of assets and equity accounts on the periodic statements of financial position." 1/

1/ National Committee, Governmental Accounting, p. 12.

The effect of these deviations from GAAP was far more significant than a simple failure to adhere to accounting guidelines. As the Office of the New York State Comptroller noted:

"The significant overstatements of receivables also meant that revenue anticipation notes issued by the City and which were stated to be supported by Federal and State aid receivable were not so supported." 1/

The City's published financial reports consistently reflected these aid receivables as "resources," 2/ without indicating the questionable collectibility of this aid by either an offsetting allowance or footnote disclosure. For example, the Comptroller's Annual Report for the fiscal year 1973-1974 published on October 31, 1974, the last Annual Report published prior to the City's fiscal crisis, contained the following disclosure without mention of potential losses arising from either disputed claims or bookkeeping errors:

1/ Office of the New York State Comptroller, Division of Audits and Accounts, Audit Report on Review of New York City's Central Budgetary and Accounting Practices; Interim Report No. 1-Prior Year Accounts Receivable (Report No. NYC-3-76: I July 1975) Managerial Summary, p. 4. /Hereinafter referred to as "Office of the New York State Comptroller, Prior Year Accounts Receivable".

2/ See the Annual Report of the Comptroller of the City of New York for the Fiscal Year 1973-1974, Part 1, Consolidated Statements, Summary 2, p. 2.

"Federal and State funds of various kinds constituted 44.46 per cent of the 1973-1974 Expense Budget as compared to 44.64 per cent in preceeding year. The dollar amounts of such aid were \$4.557 billion in 1973-1974 and \$4.163 billion in 1972-1973.

"While such funds are urgently needed, the delays which occur between expenditures and reimbursements requires heavy borrowings with a consequent heavy burden of interest. This interest expense draws funds from other high priority needs. It is extremely necessary, therefore, that the other levels of government which supply the funds agree to a plan for advance installment payments.

"Unaudited State and Federal aid still receivable as of June 30, 1974 totaled \$998.1 million, an increase of \$55 million over the amount of such aid still receivable on the same date in 1973." ^{1/}

The National Committee published its accounting guidelines in 1968, followed by the AICPA's Audit Guide in 1974. Since its foreclosure from the credit markets in 1975 the City apparently has adopted procedures recommended by the State Comptroller for recording federal and state aid receivables.

^{1/} Ibid, p. viii. The Annual Report also stated that \$300 million in short-term debt outstanding as of June 30, 1974 represented RANS for aid receivables "for 1972-1973 and prior years." Ibid., p. vii. There is no explanation of the apparent anomaly between these receivables (totalling less than \$1.3 billion) and the \$1.5 billion of outstanding RANS related to State and Federal aid which were reported as outstanding at June 30, 1974.

3. Real Estate Tax Revenue

The City also accrued revenue for real estate taxes and issued tax anticipation notes ("TANs") in anticipation of the receipt of such accrued revenue. Similar to its practice in issuing RANs, the City's issuance of TANs resulted in a deficit to the extent that accrued real estate tax revenue was inflated.

GAAP permits the accrual of real estate tax revenue in certain instances. The National Committee recommended accrual of real estate tax revenue because:

"...the tax is levied pursuant to law as of a specific date, the amount of the tax is precisely determinable in advance, and an enforceable legal claim attaches to the properties and/or taxpayers subject to the tax." 1/

The AICPA, did not make specific recommendations regarding accrual of real estate tax revenue but instead outlined the following criteria:

"One major source of revenue which may or may not be accruable is property taxes. In many jurisdictions throughout the country, accounting for property taxes is on a cash basis because a portion or all of the payment is not due until the year following the year billed. Timing considerations and the availability of such revenues to meet expenditures in the related budget year should be considered in determining whether or not property taxes should be accrued." 2/

1/ National Committee, Governmental Accounting, p. 12.

2/ AICPA, Audit Guide, p. 15.

Where real estate tax revenue is accrued, GAAP requires that an allowance be established to provide for real estate taxes which are estimated to be uncollectible:

"Where this /accrual/ method of accounting is followed, the accrued receivable recorded on the books should be offset by an estimated allowance for amounts which will not be collected. For example, an Allowance For Uncollectible Taxes should be set up and shown as a deduction from the receivable account, Taxes Receivable Current, on the asset side of the fund balance sheet. This should be done for the same reasons that it is done in commercial accounting for accounts receivable, namely, to present an accurate picture of resources which will actually be realized in the course of operations and to prevent an overstatement of assets and equity accounts on the periodic statements of financial position" 1/ [Emphasis in Original].

Prior to the fiscal crisis, the City recorded real estate taxes at variance with these criteria by accruing real estate tax revenue without offsetting the accrual with an "Allowance for Uncollectible Taxes." The City then issued TANS in anticipation of receipt of the accrued revenue.

The following balances of real estate taxes receivable and TANS outstanding illustrates the extent to which these accrued outstanding receivables allegedly supported the City's issuance of TANS:

1/ National Committee, Governmental Accounting, p. 12.

<u>Millions</u>		
<u>As of June 30</u>	<u>TANs Outstanding</u>	<u>Taxes Receivable per Annual Report</u>
1963	\$ 63.1	\$ 94.2
1964	77.4	104.7
1965	88.8	115.9
1966	100.3	130.3
1967	136.5	168.8
1968	147.5	176.4
1969	155.5	187.5
1970	170.0	204.9
1971	206.0	241.9
1972	232.0	282.8
1973	265.0	337.5
1974	317.0	408.5
1975	380.0	502.2 <u>1/</u>

A major portion of amounts carried as receivable at June 30, 1975 were of questionable collectibility. In August 1975, the Office of the State Comptroller, in an audit report, concluded that over 80% of the real estate taxes listed by the City as receivable as of June 30, 1975 was neither collectible nor readily available. 2/

The State Comptroller's report was critical of the City's procedures as to internal accounting control of real estate taxes receivable, 3/ and outlined the problem created by the inflation of these receivables as follows:

1/ The data in column 2 was taken from "Part 6-C - Temporary Debt - Statement 1," and the data in column 3 was taken from "Part 1 - Consolidated Statements - Summary 2" of the Annual Report of the Comptroller for the appropriate year.

2/ Office of the New York State Comptroller Audit Report No. NYC-26-76, Uncollected Real Estate Taxes, p. 4.

3/ See discussion under "Internal Control," infra.

"The City's budgetary and accounting practices result in an inflated estimate of real estate taxes to be collected to balance the annual expense budget, and do not make adequate provision for taxes that will not be collected. The result has been that budgeted real estate tax amounts have not been realized; for the most part, the revenue shortfall has been met by continued borrowing.

* * *

"Two major causes for this shortfall are: (1) the City included properties in its tax rolls which were not subject to real estate taxes or for which taxes would not be collected, and (2) there has been insufficient provision for the increasing volume of defaulting taxpayers and tax cancellations and remissions." 1/

Taxes receivable which fall into the first category amount to \$282.6 million, and include real estate taxes receivable for publicly-owned property (\$126.6 million), 2/ diplomatic

1/ Office of the New York State Comptroller, Uncollected Real Estate Taxes, p. 4. In the "Managerial Summary", the theme of the first cited paragraph was stated as follows: "The City's Budgetary practices result in an inflated estimate of real estate taxes that it can reasonably expect to collect to balance the annual expense budget. Unless expenditures are reduced to make up the shortfall, the City's budget is automatically out of balance; borrowings thus become necessary to meet the cash flow deficiency." Office of the New York State Comptroller, Uncollected Real Estate Taxes, Managerial Summary, pp. 1-2.

2/ Examples include a high school, a public park, an urban renewal sight, abandoned City waterworks, a community college, City occupied office buildings, and Carnegie Hall. See Uncollected Real Estate Taxes, p. 7. The City's Tax Commission grants exemptions based upon the owner's and/or the parcel's use as defined by law. This procedure is contingent upon the owner filing an application for exemption with the Tax Commission. Barring submission of an application, there is no mechanism for the Finance Administration to exempt the property regardless of who owns the property or for what it is used.

"The absence of such a procedure has resulted in levying significant amounts of real estate taxes on properties from which taxes will not be collected....

"...the City is generating a built-in real estate tax collection shortfall by continuing the practice of including its own property on the tax rolls." Ibid, p. 8.

property (\$4.7 million); 1/ Mitchell-Lama property (\$53.0 million); 2/ "in rem" property (\$54.4 million); 3/

1/ "The need for some provision for uncollectible taxes is evident in the City's handling of diplomatic property. The City has on its tax rolls diplomatic properties whose status would be exempt if the proper filing for exemptions were instituted by the owners. Thus, 40 out of a total of 60 diplomatic properties have unpaid real estate taxes, with most of the taxes outstanding for extremely long periods....the City's ability to collect these taxes is limited, since diplomatic properties are exempt from in rem foreclosure proceedings." Ibid, pp. 8-9.

2/ Mitchell-Lama properties are properties which are permitted, by law, to apply for "shelter rent exemptions which in effect, are an abatement of real estate taxes." Real estate taxes were overbilled to these properties because "the tax was determined exclusive of tax abatements authorized under shelter rent exemptions" due to the "lack of communication between City departments." Ibid, pp. 9-10.

3/ "In rem properties are those in the process of being foreclosed because of nonpayment of real estate taxes. The City's procedures for accomplishing foreclosure are painfully slow....Although the City will ultimately realize some revenue from the sale of these properties, the amount that will ultimately be collected is uncertain. Meanwhile, the full amount of the receivables is included in the City's total of uncollected taxes." Ibid, pp. 9-10.

and for property belonging to Penn Central, a bankrupt corporation (\$43.9 million). 1/ Taxes receivable which the State auditors considered as uncollectible and which fall into the second category amount to an additional \$125.7 million. 2/ Thus, the State auditors noted that "out of a balance due of \$502.3 million, it is likely that only \$94 million will be collected and available within a reasonable period." 3/

As a result of these findings, the Office of the State Comptroller questioned the extent to which TANS issued by the City were, in fact, secured by real estate taxes, noting:

1/ "The Penn Central Corporation is in reorganization and the collectibility, in the foreseeable future, of outstanding real estate taxes is extremely doubtful." Although "the Finance Administration feels that Penn Central arrears should not be written off as uncollectible," the State auditor's report recommended that rather than writing off Penn Central arrears, the City should keep the arrears on the books and make a bookkeeping entry establishing a provision for uncollectibility. "Such a provision would be fiscally prudent, in that the central records would show the amounts of taxes readily available to meet expenditures; it would also prevent borrowing against taxes that either may never be collected or may not be collected in the foreseeable future." Ibid, pp. 10-12.

2/ The State auditors noted that this estimate was computed based upon "collection experience statistics for prior years," but did not disclose these statistics. Ibid. p. 4.

3/ Ibid.

"The City issued \$380 million of TAN's on June 11, 1975 secured by \$448 million of uncollected real estate taxes. We found that real estate taxes that could be reasonably construed as 'collectible' or 'available' would support less than one-third of these TAN's. According to our analysis, only \$106 million of \$448 million of uncollected real estate taxes were potentially collectible at June 10, 1975, leaving 72 percent or \$274 million of the TAN's unsupported. (Between June 10 and our later study as of June 30, 1975, a total of \$12 million was collected or cancelled)." 1/

The State Comptroller's report noted that in selling these TANs, the City Comptroller had issued: ". . . a certification as to the amount of real estate taxes uncollected and not cancelled as of June 10, 1975. However, the amount of potentially uncollectible real estate taxes was not determined and deducted from the certified amount." 2/ In an extension of his analysis of the annual patterns of TAN borrowings, the State Comptroller stated, "while the TAN's issued earlier in the fiscal year would be fully supported by collectible tax receivables, the year-end borrowings may not have been fully secured by collectible receivables. . . ." 3/

1/ Ibid., p. 20.

2/ Ibid., p. 22.

3/ Ibid., p. 22.

Although the Office of the State Comptroller estimated that approximately 20 percent, or \$94 million, of the June 30, 1975 receivable balance for real estate taxes would be "collected and available within a reasonable period," 1/ the August 29, 1975 MAC adjustment wrote off the entire \$502 million receivable. In March 1976, the Office of the New York State Comptroller issued a MAC Directive, which outlined budgetary and accounting practices to be followed by the City in budgeting and recording real property tax revenue. This directive required that the City record its real estate tax revenue on a cash basis, "giving recognition to uncollected real estate taxes so that expenditures will not be budgeted on the basis of revenues that will not be collected." 2/

1/ Ibid, p. 4.

2/ Office of the New York State Comptroller, Summary of Accounting Systems Directives for New York City, Managerial Summary, p. 2.

4. Stabilization Reserve Corporation Receivables

In 1974, the Stabilization Reserve Corporation ("SRC") (a corporate governmental agency of the State of New York) was formed for the purpose of "assisting the City of New York . . . in the provision of essential services to its citizens on a sound financial basis during a limited period of unprecedented fiscal crisis for the City: July 1, 1973 - June 30, 1975." 1/

SRC was established to assist the City in the management of short-term debt. Through the SRC, the City proposed to issue bonds and notes in an aggregate maximum amount of \$520 million. The bonds of the corporation were to be general obligations with maturities not greater than 10 years. Provisions for repayment of the principal and interest on the bonds were to be made in 10 approximately equal annual installments. A capital reserve fund would be created through which SRC bonds were to be redeemed. 2/

Through May 1975, the City was unable to issue any SRC debt due to the Wein litigation. 3/ On March 7 and March 8, 1975 it was suggested by Wood Dawson Love & Sabatine, the bond counsel who passed upon the legality of bonds issued by the City, that the City might issue anticipation notes for the SRC bonds in order to assist the City in its cash flow problems during the early part of 1975 even though the borrowing itself was delayed

1/ Official Statement of the New York City Stabilization Reserve Corporation, dated January 31, 1975, at p. 1.

2/ Official Statement of the New York City Stabilization Reserve Corporation, dated January 31, 1975, at pp. 1, 4.

3/ Preliminary Draft Official Statement of the City of New York, dated May 23, 1975, at pp. 41, 42-43.

by the Wein suit. In the Annual Report for fiscal year 1973-1974, the City included among its actual receipts \$150 million from SRC. The following language appears in the explanatory material prefacing a table in this report: "A receivable of \$150,000,000 was set up against the proposed borrowing by the New York City Stabilization Reserve Corporation established pursuant to Chapter 594 of the laws of 1974." 1/ Nothing more was said to justify this "receipt."

In the subsequent fiscal year (1974-75), there was a similar entry for \$370 million, again under the heading of actual receipts.

1/ Annual Report of the Comptroller for the Fiscal Year 1973-1974, at p. 175.

5. Expenses

In contrast to the City's method of accelerating recognition of revenue, the City delayed recognition of expenses.

This delay accounted for \$365 million of the City's recorded June 30, 1975 cumulative deficit. ^{1/} It was also revealed that correction of a two-year lag between the incurrence and payment of municipal employee pension expense would add an additional \$2.167 billion to the June 30, 1975 cumulative deficit. In placing expenses on an accrual basis, therefore, the City has so far recognized \$2.532 billion as part of its cumulative deficit as of June 30, 1975.

Both the National Committee and the AICPA recommend that under both the modified accrual and the full accrual bases, expenses be recognized at the time liabilities are incurred, (with certain exceptions not pertinent here.)

^{1/} Annual Report of the Comptroller, 1975-1976, p. 25, Note M.

The City, however, recorded its expenses in a manner which was at variance with these recommendations. Responding to a staff questionnaire, dated October 14, 1976, the City stated that it recognized expenditures against budgetary accounts as follows:

- "1. Personal Service (PS) - cash basis
- "2. Contracts - upon registration of a contract
- "3. Other OTPS [Other Than Personal Services] - largely upon receipt of a voucher." 1/

The Arthur Andersen report noted:

"Expenses should be recognized when incurred. The accounting presently recognizes expenses only when vouchers are processed for payment. Instances of significant delay in agency processing of vouchers have been cited so that there is not accounting of incurred expenses on a timely basis.

"While the Comptroller has a system for encumbering outside contracts, expense is still not recognized until vouchers are processed. Also, year-end payrolls have not been accrued." 2/

1/ City of New York, "Draft Response," October 14, 1976, p. 5. We have not requested that this response be finalized because we believe that information as to certain clarifications is available from other sources.

2/ Arthur Andersen & Co., Report for the Secretary, pp. 24-25.

The City Comptroller stated in the Annual Report of the Comptroller of the City of New York for the Fiscal Year 1974-1975 that in general, the City "employed a cash basis for recognizing expenses." 1/ Comptroller Goldin had noted earlier that "New York City maintained a cash basis for payables, carefully preserving the fiction that incurred expenses did not exist until the bills were paid." 2/

The August 1975 MAC adjustment included adjustments for \$105 million accrual of payroll expense, \$25 million accrual of overtime pay, and \$95 million of various other expenses incurred prior to June 30, 1975.3/

1/ Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1974-1975, Foreward, p. xiii.

2/ Goldin Exhibit 99, p. 4.

3/ Municipal Assistance Corporation, August 29, 1975 press release.

There is also evidence that in addition to utilizing the cash basis to delay recognition of expenses, the City increased from year to year the amount of expenses so delayed. Similar to the annual increments in the accrual of revenue, annual increments in delaying recognition of expenses aided the City in annually balancing its budget. Certain of these matters are discussed below.

(a) Payroll.

The City's treatment of payroll expense is illustrative of how the City's recognition of expenses on a cash basis served to defer expense recognition and to assist the City in annually balancing its expense budget.

In 1971, the City's Board of Education reported a deficit of \$40 million in its fiscal 1970-71 budget. To deal with this estimated deficit, City Comptroller Beame requested the Board to provide data to his Office in support of this reported deficit. The Comptroller denounced as "inexcusable" the "failure of the Board of Education to responsibly gauge its expenditures," and pending analysis of this supporting data, "urged the Board to defer implementing cutbacks in teaching personnel." ^{1/}

The Comptroller also offered an emergency proposal to "provide the funds " necessary to avoid the Board's planned cutbacks in teaching personnel. He noted that his proposal

^{1/} Office of the Comptroller, City of New York, Press Release (8 March 1971), p. 1.

would "not cost our taxpayers one penny in this or in next year's budget." Comptroller Beame outlined his proposal as follows:

"This is how my emergency proposal would work: Under present procedures, teachers are paid, at the end of the school year, by a single check on July 1st covering the second half of June and the month of July. This procedure will still continue.

"At present, the charge for this July 1st payment is split between the current budgetary year and the upcoming year. In other words, part is charged to June, and part to July.

"I propose, starting this year, to charge the entire July 1st check -- which, I said, includes June payroll -- to July, that is, the upcoming fiscal year. This new procedure would then continue each year thereafter.

"Thus, the projected education budget gap for this year, could be closed by relieving the current budget of this charge.

"It is estimated that about \$50 million of the education payroll paid out on July 1 is applicable to the month of June. Inasmuch as the Board of Education says \$25 million is needed to avoid any cutback in teaching personnel, . . . , about half of the \$50 million can be used to balance the current 1970-71 education budget. The remainder can be used to carry this cost into the new 1971-72 education budget year, so as to avoid any additional taxes next year for this purpose.

"If the Corporation Counsel thinks legislation is needed to make this plan effective, it should be introduced at once.

"I also want to point out that this same procedure could be used with respect to non-educational payrolls, where the last few days in June are paid in early July. This would make more than \$20 million available for 1971-72, and would reduce the need, to that extent, for additional taxes being suggested for the 1971-72 City budget, or can help meet our deficit for the current year. If legislation is required, as indicated above, this phase should also be included.

"I am making this proposal only because of the extraordinary crisis facing the City right now. In balance, I believe this is a reasonable resolution of a difficult problem." 1/

In a press release issued in response to this proposal, Mayor Lindsay sympathized with and shared the Comptroller's desire to seek an answer to the crisis. However, Mayor Lindsay labeled the device to defer recognition of payroll expense as "stopgap financial juggling", and emphasized that this should be understood:

"It merely puts off today's pain until tomorrow.

"It underscores the need for new City taxes, for it will not correct the overspending which produced the problem. It will not increase the City's ability to finance the growing burden of education. What it will do is mortgage the budget in the fiscal year 1972-73 by passing forward \$75 million in increased payments which we have no present means of financing. This is unsound fiscal practice." 2/ [Emphasis in Original]

1/ Ibid, pp. 1-2. The initial impact was subsequently revised upward by \$3.5 million by implementation of the same deferral procedure for per diem substitutes and administrative employees of the Board of Education.

2/ Office of the Mayor, City of New York, Press Release (8 March 1971): 1.

Comptroller Beame shortly thereafter announced that since the Office of the Corporation Counsel had determined that legislation was not required to implement his proposal, he would take all appropriate steps to implement the proposal to "provide funds" in the fiscal 1971 budget. 1/

Documents submitted to the staff by the City indicate that this procedure of recognizing payroll expense when paid assisted the City in reducing the recognition of payroll expense in fiscal years 1972, 1973, 1974 and 1975 as well. For each of those years, the procedure of recognizing payroll expense on a cash basis (when paid) enabled the City to record payroll expense for only 364 days. We believe this worked as follows: During the course of a fiscal year, the City issued 26 bi-weekly paychecks (one paycheck for every two weeks), each of which covered a 14 day period. Over the course of a 52 week year, the City disbursed monies for (and recognized payroll expense for) only 364 days' payroll (26 paychecks x 14 days per check).

1/ Office of the Comptroller, City of New York Press Release (10 March 1971). See also Office of the Comptroller, City of New York, Press Release (22 March 1971).

The unaccrued payroll liability was therefore growing by one day's payroll each year (two days payroll in leap years). One document publicly issued by the City Comptroller's Office indicates that the City's payroll for one day amounted to more than \$10 million. 1/ The initial benefit to the City resulting from implementation of the procedure set forth in Comptroller Beame's March 8, 1971 press release was \$70 million, while MAC's adjustment for payroll accrual amounted to \$130 million, 2/ a difference of \$60 million. Benefits realized in fiscal 1972, 1973, 1974 and 1975 resulting from the recognition of 364 days' payroll in those years appears to account for most of the \$60 million difference. One document notes that, "perhaps the most imaginative gimmick is the 364 day fiscal year, initiated a few years ago to exclude a payroll period from the budget." 3/

1/ June 17, 1975 Memorandum, "Restructuring the City's Accounting Services", written by Stephen Clifford.

2/ This amount consisted of \$105 million for the accrual of payroll and \$25 million for the accrual of police, fire, and correction overtime.

3/ May 15, 1974 memorandum from Stephen Clifford to the Commissioners of the Charter Revision Commission, appendix, p. 3.

However, excluding consideration of leap years, under the 364 day payroll year the City would have recognized 54 weeks' payroll expense every 14th year, requiring the City to issue 27 paychecks. This 27th pay period would have occurred, absent reforms as mandated by MAC, in fiscal 1978-79, representing an additional charge of approximately \$170 million in that fiscal year. 1/

(b) "Reserve" account transactions

Another procedure utilized by the City to reduce recorded expenses and assist in annually balancing its budget was by the recording of transactions in two accounts entitled the "Tax Deficiency Account," and the "Tax Appropriation and General Fund Stabilization Reserve Fund," the latter being commonly referred to as the "rainy day fund". These two accounts are maintained pursuant to Sections 127 and 128 of the City Charter, and were established to provide internal reserves to the City. The City had so depleted the reserves in these accounts that, in August 1975, MAC attributed \$100 million of

1/ June 11, 1975 memorandum from Stephen Clifford to Harrison J. Goldin.

the June 30, 1975 cumulative deficit to a shortage in these reserves. In October 1976, the City apparently increased this June 30, 1975 write off to \$119 million.

The City Charter stipulates that the tax deficiency account be charged (debited) with tax cancellations and remissions, and with discounts allowed for the prepayment of taxes. The account is increased (credited) with expense budget appropriations no longer required and certain other credits. The Charter provides that the City make an annual appropriation to this account equal to the amount that the debits exceed the credits as of February 1st of each year and sets forth limitations for this appropriation. Although required appropriations were apparently made to the Tax Deficiency Account, the appropriations failed to offset the increasing amounts of tax cancellations and remissions in recent years. As a result, the Tax Deficiency Account had a negative (debit) balance of \$141.9 million as of June 30, 1975. 1/

1/ Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1974-1975, (New York: New York City, 1975, Part 2-A-Expense Budget-Statement 10, p. 156.

All amounts stated hereafter in this subsection were taken from the City's various Annual Reports and Reports of the Comptroller Pursuant to Section 113 of the Charter.

The rainy day fund was also established to help stabilize the City's finances. Unlike a corporate "contingency reserve", the rainy day fund was designed to be "funded" in the cash sense by liquid assets including cash and mortgages. Assets in this account were intended to provide a ready internal reserve for the City to use during fiscal years when actual revenue fell short of budgeted revenue. The Charter also requires the City to make an annual appropriation to the rainy day fund until it reaches a certain level. 1/ Furthermore, the Charter requires that in addition to these normal annual appropriations, the City must also make appropriations pursuant to a mandated schedule to replenish the rainy day fund for any transfers from the fund to meet expense budget shortages. Thus, the rainy day fund was designed "to build up in 'good' years an amount which could be drawn on if revenue shortfalls were to occur in 'bad' years." 2/

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- 1/ The Charter provides that when the rainy day fund assets exceeded 30% of the real estate tax levy, those assets might be applied to the reduction of taxes. However, that level was neverreached.
- 2/ Office of the New York State Comptroller, Uncollected Real Estate Taxes, p. 2.

It appears that initially the rainy day fund served its intended purpose of helping to stabilize the City's finances. In fiscal years 1963 and 1964, pursuant to law passed by the City Council, the City made no appropriations to the rainy day fund. Instead, the City transferred \$81 million from the rainy day fund to the City expense budgets for those years, and transferred an additional \$11.9 million for fiscal 1965. During the late 1960's, in addition to making normal appropriations as required, the City appropriated \$39.4-million in partial repayment of the above transfers.

For each fiscal year beginning in 1969, the City Council passed legislation waiving the required appropriation. A Committee of the City Council reported in June 1968 that in waiving this appropriation, it considered that the rainy day fund had a substantial balance and that there were "many pressing demands to be met" in the fiscal 1968-69 budget. 1/ Since fiscal 1968, the City has failed to appropriate any funds to the remaining unreplenished balance of \$53.5 million attributable to fiscal 1963 through 1965.

In addition to not replenishing the earlier withdrawals, the City failed to make its required normal annual appropriations to the fund. Instead, the reverse occurred. The City has further depleted the rainy day fund by transferring \$35.1 million from that account to the General Fund for fiscal 1970 and \$42 million

1/ Proceedings of the Council of the City of New York, June 25, 1968, p. 2388.

for fiscal 1974 with concomitant offsets to the expense budget. Had the rainy day fund "been maintained and replenished as required by the Charter, it would have provided a cushion of over \$280 million at the point.../in 1975/ when the City faced a possible shutdown of operations for lack of cash." 1/ This cushion could not be provided because, as of June 30, 1975, the rainy day fund had a purported credit balance of only \$22.8 million. All that remained was \$10.5 million of mortgages receivable, \$13.8 million of taxes receivable for fiscal 1970 and prior years, and a cash overdraft of \$1.5 million.

(c) Accrued pension liability.

City employees are covered by five actuarial retirement systems: the New York City (1) Employees', (2) Teachers', and (3) Board of Education Retirement Systems, and the (4) Fire Department, and (5) Police Pension Funds.

Prior to 1971, four of these five systems traditionally had funded their retirement programs on a "two year lag" basis. On this basis, there was a two year delay between the time the City incurred pension costs for these systems and the time contributions were made to the systems. For example, monies paid into these four systems in fiscal 1971 actually represented liabilities arising during fiscal 1969. As was later noted:

1/ Office of the Comptroller, City of New York, "Report of the Comptroller Pursuant to Section 113 of the Charter with respect to the Proposed Expense Budget for 1976-1977," February 14, 1976, as quoted in the City Record, February 24, 1976, p. 500.

"The ostensible reason for the lag is that it facilitates the administration of the systems, since it gives all concerned a period of time after the close of the year in which to ascertain the exact number of employees and the amount of payrolls involved."^{1/}

During this same period, the fifth system, the Teachers' Retirement System, was financed on a current basis, i.e., contributions were being made in the year in which the liability was incurred.

In 1971, the New York State Legislature changed the law so that the Teachers' Retirement System was also placed on a two-year lag.^{2/} As a result, during the fiscal years 1971-72 and 1972-73 (the two fiscal years following the year of the change) the City's contributions to the Teachers' Retirement System were significantly smaller than amounts otherwise due under prior practice.

The impact on the expense budget is illustrated in the chart below.

^{1/} State of New York, Permanent Commission on Public Employee Pension and Retirement Systems, Otto Kinzel, Chairman, Financing the Public Pension Systems, Part I: Actuarial Assumptions and Funding Policies (New York: Permanent Commission, March 1975), p. 33. The Permanent Commission points out that with the single exception of the New York City Teachers' Retirement System, "all of the public retirement systems in the City and the State, . . . , have traditionally funded their programs on a 'two-year lag' basis." [Hereinafter referred to as "Permanent Commission, Financing the Public Pension Systems"].

^{2/} New York State Laws of 1971, Chapter 407.

Contributions to Teachers' Retirement Systems 1/
(Millions)

1	2	3	4
<u>Fiscal Year</u> <u>Ended June 30</u>	<u>Annual Reports of</u> <u>Teachers'</u> <u>Retirement System</u>	<u>Comptroller's</u> <u>Annual Report</u>	<u>Expense Budget</u>
1969	\$103	\$ 93	\$105
1970	102	102	101
1971	141	138	134
1972	33	40	26
1973	85	84	74
1974	258	258	283
1975	263	314	316

Although we were unable to reconcile differences among columns 2, 3 and 4 because of differences in descriptive captions and dollar amounts, the pattern plainly indicates that contributions made in 1972 and 1973 were materially curtailed.

1/ The data in column 2 is extracted from Pensions, City of New York, Mayor's Management Advisory Board, Richard R. Shinn, Chairman, (April 1976). The data in column 3 is extracted from expense codes 612-614 of Part 2-A, Statement 7 of the Annual Report of the Comptroller for the appropriate year. The data in column 4 is extracted from the Expense Budgets of the City as published in the subsequent year.

In a memorandum, dated December 1974, the Special Deputy Comptroller of the City, Steven Clifford, requested that research be undertaken concerning the postponement of payments to the Teacher's Retirement System. He hypothesized that this postponement amounted to \$70 million in fiscal 1972-1973 and \$17 million in fiscal 1973-1974. This is an apparent reference to the introduction in 1971 of the two year lag in postponing payments to the Teacher's Retirement System. 1/ The Permanent Commission on Public Employee Pension and Retirement Systems ("Permanent Commission") 2/ also noted the funding lag. Because the City recognized this expense on a cash basis, the change in the law clearly resulted in a reduction of the City's budgeted and actual expenditures in fiscal years 1971-72 and 1972-73.

The City recognized the effect of the two-year lag with respect to all five systems in allocating \$2.167 billion to the revised cumulative deficit as of June 30, 1975. 3/

1/ Division's Exhibit "Harrison J. Goldin No. 50 for Identification," p. 3.

2/ The Permanent Commission was created in 1971 by the Governor and Legislature of New York State and given authority to "examine into and make recommendations with respect to all aspects of public employee retirement benefits and systems in the City and State of New York, as a guide for State legislative and executive action." Permanent Commission, Financing the Public Pension Systems, p. 1.

3/ Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1975-1976, p. 25, note M.

Generally accepted accounting principles recognize the essential difference between the incurrence of the liability for a pension cost and the actual contribution to the pension fund. ^{1/} Legal requirements mandated the "two-year lag" for contribution purposes. It might also be argued that budgeting on this basis was similarly necessary. No basis appears to exist however, for the failure of the City to either record or disclose this massive liability.

The \$2.1 billion adjustment to correct for unrecorded pension costs resulting from the "two-year lag" was only a minor part of the total problem. Additional potential pension liabilities of about \$6 billion were subsequently identified, partly as a consequence of the City's use of outdated and unrealistic actuarial assumptions.

In an examination of the New York City Retirement Systems, the Permanent Commission noted that despite continuous annual statements by the City Actuary concerning the need to update actuarial assumptions, "the New York City systems' actuarial assumptions continue to be out of touch with reality." The Permanent Commission further noted:

"Amazingly, the assumptions used for the New York City Employees' Retirement Systems were prepared for a 1914-18 Commission on Pensions from the City's records of experience from 1908-14 -- more than a half-century ago.

^{1/} See, e.g. National Committee, Governmental Accounting, pp. 11-12 "Basis of Accounting" and Accounting Principles Board, APB Opinion No. 8; Accounting for the Cost of Pension Plans (New York: AICPA, 1966).

Data from the same period is used for the City Teachers' System. The Police and Fire Systems, created in 1940, use data based upon the same 1908-14 experience, with only slight modification. With the exception of some changes made in the 1940's with respect to mortality after retirement and interest credits, no changes have been made in the assumptions since these systems were first established.

"The latest experience data in the New York City systems show that continued use of unchanged assumptions leads to understatement of the true costs of retirement systems." ^{1/}

Specific criticisms of actuarial assumptions included:

Mortality Assumptions.

"Experience indicates that the City systems have consistently overestimated the death rate for regular service pensioners and their beneficiaries, disability pensioners, and active employees, thereby underestimating the total number of persons who will be alive and drawing benefits at various ages....

The following examples demonstrate the divergence between actual mortality experience and the official assumptions:

--Actual mortality among retired City firemen is approximately one-fifth of the assumed rate - an error of almost 500 percent....

--Actual mortality among disabled City firemen who are receiving pensions is about one-eighth of the assumed rate - an error of 800 percent....

--Actual mortality among currently employed women who are members of the City Employees' Retirement System is less than one-fifth of the assumed rate--an error of over 500 percent."

Turnover Assumptions.

"The rate at which employees terminate employment before earning a vested benefit is also an important determinant of pension costs. All other things being equal,

^{1/} Permanent Commission, Financing the Public Pension System, pp. 12-13.

the higher the turnover rate among a group of employees, the lower the cost of providing retirement benefits. Once again, there are glaring instances in some City systems where the assumed rate is substantially greater than actual experience would justify....For example, the turnover of members of the Fire system is about one-fifth of the assumed rate - an error of almost 500 percent...."

Disability Assumptions.

"...In the City systems, all but the City police rates lead to a substantial overestimation of non-service connected disability costs. In the case of the City Police system, the actual number of non-service disabilities is about 43 percent greater than the official assumptions predict...."

[T]he police and fire systems in New York City have many more service-connected disabilities than anticipated. Since service-connected disability benefits, or more accurately, "accidental" disability benefits, provide a retirement benefit of 75 percent of pay, a disproportionate number of such cases can have serious cost implications. (Table 6) demonstrates that accidental disability awards presently are running at least six times the assumed rate for City policemen, and at more than nine times the assumed rate for City firemen. Thus, the "official estimates" seriously underestimate the costs of these benefits, allowing the City to contribute less each year than is actually required to pay the full cost of the benefits."

Salary Rate Assumptions.

"The actuarial assumption which has the greatest impact on pension costs is the assumption for future salary increases. Unlike most other assumptions, even a slight understatement of projected salary increases will have a substantial effect on costs. (Table 9) illustrates substantial disparities between actual and assumed rates of salary increases for virtually all the public retirement systems. The disparity, and the resulting understatement of costs, is especially significant in the New York City systems." ^{1/}

^{1/} Ibid, pp. 13-29. (Referenced tables omitted)

The Permanent Commission concluded that "the actuarial assumptions used in the New York City retirement systems are highly inaccurate because they bear little or no resemblance to actual experience." 1/ A report by Arthur Andersen & Co. mirrored certain of these criticisms. 2/

APB Opinion No. 8 provided guidelines for accounting for the cost of deviations from actuarial assumptions and observed that "there is broad agreement that pension cost, including related administrative expense, should be accounted for on the accrual basis." 3/ APB Opinion No. 8 recommended that the annual provision for pension cost "be based on an accounting method that uses an acceptable actuarial cost method". 4/ An Appendix to the Opinion described acceptable actuarial cost methods, and noted that these methods must be based on actuarial assumptions which are reasonable. 5/

In estimating the cost of a pension plan to a business or governmental unit, actuarial assumptions are made regarding the return on pension assets invested, expenses of pension fund administration, the amounts and timing of benefits to be paid and other matters including "interest".

1/ Permanent Commission, Financing the Public Pension Systems, p. 13.

2/ Arthur Andersen & Co., Report for the Secretary of the Treasury Regarding Information Relating to the Financial Requirements Under the New York City Seasonal Financing Act of 1975, 29 December 1975, pp. 5-6.

3/ Accounting Principles Board, APB Opinion No. 8; Accounting for the Cost of Pension Plans (New York: AICPA, 1966), para. 11.

4/ Ibid, para. 17.

5/ Ibid, para. 24.

The importance of utilizing realistic assumptions was emphasized by the Permanent Commission:

"The accuracy of cost estimates and the degree to which the employer is paying the full cost of retirement liabilities as they accrue depend on just how close the actuarial assumptions come to actual experience.

* * * *

"If the actuarial assumptions used...are unrealistic, the result can be a serious understatement of the cost of the proposed benefits." 1/

One study published by the Mayor's Management Advisory Board, in April 1976, recommended the implementation of major changes in actuarial assumptions and funding methods, and estimated that these changes would result in an increase of \$208-million in pension contributions per year. 2/ In May 1977, the City estimated that as of June 30, 1974, there was an unfunded accrued liability of \$8.481 billion for the five major systems (using updated actuarial assumptions and eliminating the two-year lag in funding), and, as of June 30, 1975, approximately \$1.2 billion for the non-actuarial and supplemental pension plans. 3/ This supports the earlier observation by the Permanent Commission, which concluded that the City's failure to adopt realistic actuarial assumptions resulted in the failure to pay current pension costs and that the City had used "pension under-funding as one method of balancing its operating budget. The

1/ Permanent Commission, Financing the Public Pension Systems, p. 9.

2/ Mayor's Management Advisory Board, Pensions, p. 26.

3/ City of New York, Official Statement (New York: City of New York, 20 May 1977), p. 52. Unfunded accrued liability is the excess of the liability accrued for total future pension benefits on account of services already rendered less the value of the assets of the pension systems.

result has been a progressive deterioration in the financial adequacy of the City's retirement systems." 1/

The notes to the City's June 30, 1976 "Estimated Financial Statements" disclose that they are not prepared in accordance with GAAP and that with respect to pension costs:

"The amounts provided are not necessarily the amounts which would have to be provided under generally accepted accounting principles for municipalities. As a detailed study has not been made, such amounts are not determinable."

"In 1976, the Mayor's Management Advisory Board issued its report on pensions, which recommended, among other matters, that the actuarial assumptions be revised. Such revision would increase pension costs by \$208 million per year. A task force of the Board is currently continuing its study of the City's pension program. The ultimate result of such study cannot presently be predicted." 2/

The increased pension cost of \$208 million per year mentioned in the note is apparently based on a forty year amortization period for purposes of determining the required contribution necessary to eventually eliminate the unfunded accrued liability. Employees covered by these plans can generally retire after 20 to 25 years service, however. The average remaining working lives of covered employees is not known, but surely must be

1/ Permanent Commission, Financing the Public Pension Systems, p. 30

2/ City of New York, Official Statement (New York: City of New York 20 May 1977), p. 138.

considerably less than 40 years. 1/ Arthur Andersen & Co. recommended a 20 year amortization period. 2/ The City, however, proposes to spread its costs over a period substantially greater than that for which the related services are rendered and thereby perpetuate the process of deferring costs into unrelated future periods.

No estimate of the unfunded accrued liability is included in the notes to the financial statements, although the matter is discussed in some detail in the textual portion of the City's Official Statement.

The City has recorded only part of this liability as part of its cumulative deficit, noting that "unfunded accrued liabilities are generally amortized over a 20 to 40 year period." 3/ While this is true when such liabilities arise from underfunding pension costs otherwise properly calculated and recognized on an ongoing basis, there is considerable question as to whether such a "forward looking" adjustment is appropriate for accounting purposes in this situation.

1/ The Permanent Commission (Financing the Public Pension Systems p. 30) estimated, for instance, that the average remaining working lives of teachers covered by the state pension plan was approximately 15 years.

2/ Arthur Andersen & Co., Report for the Secretary of the Treasury Regarding Information Relating to the Financial Requirements Under the New York City Seasonal Financing Act of 1975 29 December 1975, p. 6.

3/ City of New York, Official Statement (New York: City of New York, 20 May 1977), page 52.

In the change to GAAP for its pension costs the City must recognize the essentially different nature of its funding of the pension plans and recognition of pension costs and related liabilities. The future funding of the unfunded accrued liability is designed to place the plans on a sound actuarial basis with minimum drain on the cash resources of the City. 1/ This has little to do with generally accepted accounting principles however. "Unfortunately, it is actual experience and not 'official estimates' which produces the real cost that must eventually be paid by the taxpayer." 2/ These very real costs and the related liability have continued to grow geometrically, due in large part to the City's historic failure to adjust for the facts as brought to its attention by the City Actuary. Thus the unfunded liability is also an unrecorded liability.

1/ Ibid.

2/ Permanent Commission, Financing The Public Pension Systems, p. 32 (Emphasis Added).

If the Permanent Commission's observations are accurate, the use of archaic actuarial assumptions was an error which should have been corrected many years ago. ^{1/} The correction for accounting purposes should be an additional substantial adjustment of the cumulative deficit, not continued postponement of liability recognition. ^{2/}

(d) Excess pension interest

In order to balance its budget for fiscal 1974-75, the City budgeted revenue for "excess pension interest". Authorized by state law, this accounting device permitted the City to credit three years of this "revenue" to the expense budget for fiscal 1974-75.

The Permanent Commission outlined the City's use of "excess" pension interest as a means to reduce recorded pension costs:

"In the past, the City had always made an additional contribution to the Systems when the interest earnings for the year fell below the statutory 3% assumption (now 4%). In the 1960's, interest earnings began to exceed the statutory assumption, and the excess interest earned during the year for which contributions were being made was used to reduce the current contribution.

^{1/} Arthur Andersen & Co. apparently would agree with the City's proposed treatment, however. In their Report for the Secretary of the Treasury (page 6) they assert that "...the understatement of costs in the past must be made up by added cost recognition in the future."

^{2/} For a more complete technical discussion of the application of the authoritative accounting literature see Appendix C.

Thus, in fiscal year 1970-71, for example, the City would be making the contribution for the pension costs attributable to the 1968-69 fiscal year. If the Retirement System had earned interest in excess of the 4% statutory rate during 1968-69, the excess interest would be used to reduce the contribution in 1970-71. This 'excess interest deduction' is improper from an actuarial viewpoint, since sound actuarial practice requires that any such excess (or, indeed, any loss, together with any other actuarial gains or losses) be spread over a realistic period. An even more serious objection to such 'interest deductions' is the fact that the City failed to consider unrealized appreciation or loss in determining whether there were any excess earnings. In short, the City would declare an interest 'excess' in a particular year even though the losses in value in its stock and other holdings far exceeded the entire interest earnings for the year." 1/

Under generally accepted accounting principles there is no such thing as "excess" interest. Earnings of pension fund investments which exceed the actuarially assumed "interest" rate are viewed only over a long term. If long term earnings exceed the assumption, the assumption is adjusted. The actuarial "gain" resulting from the use of an estimate is then spread over future years. 2/ In addition, it is difficult to differentiate between "earnings" on pension fund assets (dividends and interest) and gains and losses (both realized and unrealized) resulting from fluctuations in the value of pension fund investments. The true "earnings" of the pension fund should reflect both of these factors since both impact upon the value of fund assets available for payment of benefits. 3/

1/ Permanent Commission, Financing the Public Pension Systems, pp. 34-35.

2/ See Accounting Principles Board Opinion No. 8 for a detailed technical discussion.

3/ Permanent Commission, Financing the Public Pension Systems, p 36.

Current recognition of pension fund "excess interest" is clearly contrary to generally accepted principles of accounting. ^{1/} The law which permitted this practice for budgetary purposes did not change the City's true liabilities or costs with respect to its pension plans.

The Permanent Commission noted that the practice of crediting "excess" interest to reduce the City's pension contributions was originally done on a two year lag basis. In 1974 State legislation eliminated the two year lag, and permitted the City to credit "excess" interest earned over a three year period (fiscal 1972-73, 1973-74, and 1974-75) to the budget for one year, fiscal 1974-75.

An unaddressed memorandum contained within the Governor's Bill Jacket analyzing the issue presented by the 1974 legislation, noted that the bill was "the purest form of fiscal gimmickry." The memorandum nevertheless recommended the adoption of a "no objection" position on the bill "because the Governor agreed to this measure as part of the City's fiscal package, and because the bill will provide some much-needed fiscal relief to the City during 1974-75...." In reviewing possible objections to the bill, the memorandum observed, "in a very real sense, there

^{1/} See Accounting Principles Board, APB Opinion No. 8; "Accounting for the Cost of Pension Plans" (New York: AICPA, 1966), paragraphs 30 and 32.

is no 'excess income' in the City's retirement systems," and noted the adverse impact such treatment of "excess" pension interest would have on the budget in the next two fiscal years. 1/

The Permanent Commission described this change as follows:

"Despite the obvious objections to such interest deductions, the practice was actually expanded in 1974. Under Chapter 595 /of the New York State Laws of 1974/, the 1974-75 City contributions not only were reduced by the interest 'excess' in 1972-73 (pursuant to prior practice), but also for the 'excess' in 1973-74. Finally, the bill required the actuary to estimate the 'excess' which would be earned in 1974-75, and also allowed such 'estimated excess' to be used to reduce the 1974-75 appropriations. Thus, the City and contributing authorities reduced their 1974-75 contributions to the City retirement systems by approximately \$261 million - the alleged interest 'excesses' for a three-year period. During this approximate period, the City Employees' Retirement System and the Police Pension Fund lost approximately \$334 million in the value of their stock portfolio. This loss alone would have completely eliminated the alleged 'interest excess,' and would have actually produced an interest 'deficit' of approximately \$75 million. No fund, regardless of the valuation technique utilized, should claim and act upon an alleged earnings 'excess' without considering the value of its stock holdings." 2/ [Emphasis in Original]

The City credited "excess" interest to reduce pension contributions as follows: 1972: \$17.5 million; 1973: \$41.9 million; 1974: \$50.7 million; 1975: \$261.4 million.3/

The extent to which the change in the law affected the City's

1/ Richard E. Hegner, Examiner, Unaddressed Memorandum dated 14 May 1974.

2/ Permanent Commission, Financing the Public Pension Systems, pp. 35-36.

3/ City of New York, Official Statement, p. 32. note 8.

fiscal 1974-75 expense budget is uncertain as there is conflict among the documents reviewed. One document indicates a total credit to the budget of \$168 million for "excess" pension interest, of which \$125 million resulted from the change in the law, 1/ while other documents indicate a credit of \$261 million to the fiscal 1974-75 expense budget, 2/ but fail to reveal the impact of the change in the law. Resolution of this conflict, however, would not affect the validity of the basic conclusion that crediting three years' "excess" pension interest to the fiscal 1974-75 budget was a material and non-recurring element in "balancing" the budget for that fiscal year.

The crediting of one years' "excess" pension interest by the City in each fiscal year impacted favorably upon the City's expense budget over the years. The elimination of the "two year lag", however, permitted the City to record three years "excess" interest in fiscal 1975.

1/ Richard E. Hegner, Examiner, Unaddressed Memorandum dated 14 May 1974, in Governor's Bill Jacket.

2/ Permanent Commission, Financing the Public Pension Systems, p. 35. An analysis of the City's Expense Budget for the fiscal year 1974-75, as adopted, also indicates that the City credited \$261 million for "excess" pension interest in that year.

C. Capitalization of Expenses

Pursuant to the City Charter, the City operates under two budgets which are prepared for different purposes and are funded from different sources. The expense budget provides a plan for City operations of a current nature. It is financed largely by recurring revenue obtained from State and Federal aid, the real estate tax levy, and a variety of taxes accounted for within the so-called General Fund. These revenues are used to fund the departmental operations of the City, to provide current services in areas such as police and fire protection, education, health and social services, and debt service. The capital budget represents a plan of proposed expenditures for capital projects such as streets, parks, bridges, tunnels, property of a permanent nature, and physical public betterments or improvements. 1/ Except for that portion financed by the state and federal governments, the capital budget is financed by the sale of long term debt.

Increasingly, in recent years, the City utilized the capital budget to issue indebtedness to finance expense budget appropriations. One document, dated November 8, 1974, which was prepared by the Citizens Budget Commission, indicates that from 1965 to 1975 the City borrowed through its capital budget to finance appropriations in the expense budget as follows: 2/

1/ Charter of the City of New York, Section 211.

2/ Citizens Budget Commission, "A Presentation to Mayor Beame's Council of Economic and Business Advisors", November 8, 1974.

<u>Fiscal Year</u>	<u>Amounts (in millions)</u>
1965	\$ 26
1966	57
1967	68
1968	68
1969	84
1970	151
1971	195
1972	225
1973	274
1974	564
1975	722

Analyses of the City's expense budgets by the staff for the years 1973 to 1975, and by the Office of the State Comptroller for the years 1970 to 1975, basically confirm these figures. 1/

The escalating utilization of capital budget funds (totaling \$2.434 billion during this eleven year period) to meet expense budget needs has been recognized to have various effects, including:

- "1. Expenses of a current nature will be financed by revenues (primarily real estate taxes) obtained in later years.
- "2. Future years bear an added burden of paying interest on the borrowings - in effect compounding the original costs.

1/ Office of the New York State Comptroller, Report on the Debt Structure of the City of New York (Report No. NYC-42-74: 16 May 1974), p. 33 [Hereinafter referred to as "Office of the New York State Comptroller, Report on Debt Structure (1974)"]; Report on the Debt Structure of the City of New York (Report No. NYC-33-76: 27 February 1976), p. 43 [Hereinafter referred to as "Office of the New York State Comptroller, Report on Debt Structure (1976)"].

"3. This funding procedure significantly increases annual borrowings, expands outstanding debt, and lowers the City's debt incurring margin." 1/

The New York State Constitution and the Local Finance Law empower the City to incur long-term indebtedness under certain conditions. Article VIII of the State Constitution prohibits the issuance of indebtedness "for longer than the period of probable usefulness of the object or purpose for which such indebtedness is to be contracted," and section 11 of the Local Finance Law sets forth the "period of probable usefulness" for various items. In practice, the City included in its capital budget only those items to which the Local Finance Law assigned a period of probable usefulness.

The concept of "period of probable usefulness," according to the Office of the New York State Comptroller, has its origins in the New York State Constitutional Convention of 1915, when "...for the first time, the recommendation was made that the Constitution contain language directing the Legislature to fix maximum periods and that such determination shall be conclusive." 2/ These concepts were ultimately codified in 1918. 3/ Thus, "through the years the legislature has enacted numerous laws empowering municipalities to issue bonds for a multitude of objects and purposes having a 'period of probable usefulness.'" 4/

1/ Office of the New York State Comptroller, Report on Debt Structure (1974), p. 34.

2/ Ibid, p. 35.

3/ Ibid. p. 36.

4/ Ibid, p. 37.

However, the Office of the State Comptroller observed that laws assigning a "period of probable usefulness" have been receiving an ever broadening interpretation that has resulted in a dramatic increase in the issuance of debt to finance the City's expense budget. "Costs connected with ongoing functions of governmental service are being bonded; educational expenditures in increasing amounts and nature are being bonded; and even debt service is being met by the issuance of more debt." 1/ The State Comptroller considered that if such views were expanded to an extreme the concept of "period of probable usefulness" would permit local governments to bond virtually all expenditures, and questioned the practice of borrowing for recurring type expenditures:

"By its nature, certain governmental functions, such as education, social, physical and mental rehabilitation, environmental protection, etc., have 'periods of probable usefulness' extending far beyond the period in which the expenditure is made. Thus, carried to an extreme, the concept of 'period of probable usefulness' could conceivably be extended by the Legislature to permit local governments to bond virtually all its expenditures. While we don't suggest that only 'brick and mortar' expenditures should be bondable, we do question the practice of continuously borrowing for recurring-type expenditures. Such a practice permanently increases the cost of government." 2/

The 1975 MAC Law stipulates that the City eliminate from the capital budget over a ten year phase out period those operating

1/ Ibid, p. 37.

2/ Ibid.

expenses which properly belong in the expense budget. In February 1976, the State Comptroller issued a directive that set forth guidelines for the City to use in determining which expenses might properly be included in its capital budget. The major thrust of this directive was that "the capital budget should include only those expenditures which result in the construction or acquisition of major permanent facilities or additions having a relatively long life." 1/

D. Fund Accounting

The City, prior to 1975, utilized a "needlessly complex" fund structure that was used to effect budget-balancing 'gimmickry' through transfers of revenues and expenditures between fiscal years and funds. 2/

The inadequacy of the City's fund accounting structure has been acknowledged in such areas as the failure to conform to accepted practice regarding terminology, account titles, fund classifications, and financial statements; 3/ failure to maintain a "fund balance" account reflecting surpluses or deficits; 4/ the inability of

1/ Office of the New York State Comptroller, Audit Report on the Planned Elimination of Operating Expenses from New York City's Capital Budget (Report No. NYC-45-76: 27 April 1976), Managerial Summary, p. 1.

2/ June 17, 1975 memorandum "Restructuring the City's Accounting Services", written by Stephen Clifford.

3/ Donald W. Beatty, Executive Director, Municipal Finance Officers Association, Letter dated 27 March 1975 to Harrison J. Goldin, Comptroller, City of New York.

4/ Office of the New York State Comptroller, Summary of Accounting Systems Directives, p. 7.

the City's fund structure to control City expenditures; 1/ and the failure to appropriately classify hundreds of accounts representing a mixture of asset, liability, and capital transactions. 2/ The City's methods of fund accounting served to obfuscate rather than illuminate the City's financial activity.

As part of the investigation, the staff submitted a questionnaire to the City which dealt with certain aspects of the City's accounting and budgeting practices. The City's "draft response" to this questionnaire, reflected, among other things, that the City's fund account structure was analogous in certain respects to the fund structure under GAAP, and in other respects differed from a GAAP type fund structure. 3/

For example, the City maintained an "operating" fund which appears, in some respects, to be similar to a "General Fund" under GAAP. This "operating" fund was used to account for a variety of revenues and expenditures. Other "fund accounts"

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- 1/ June 17, 1975 memorandum, "Restructuring the City's Accounting Services", written by Stephen Clifford.
- 2/ Office of the New York State Comptroller, Division of Audits and Accounts, Audit Report on Review of New York City's Central Budgetary and Accounting Practices; Interim Report No. 3-Special and Miscellaneous Revenue Accounts (Report No. NYC-31-76 : 5 January 1976); p. 23. Hereinafter referred to as "Office of the New York State Comptroller, Special and Miscellaneous Revenue Accounts."
- 3/ See Appendix A for an explanation of fund accounting under generally accepted accounting principles.

maintained by the City which appear, in some respects, to have GAAP equivalents are "fund accounts" for capital improvements (GAAP: Capital Projects Fund), trust and agency (GAAP : Trust and Agency Fund), sinking funds (GAAP : Debt Service Fund), private enterprise housing (GAAP : Enterprise Fund), assessable improvements (GAAP : Special Assessments Fund), and long term debt (GAAP : General Long Term Debt Group of Accounts). "Fund accounts" maintained by the City which appear to have no GAAP equivalent are accounts for "specials." 1/

GAAP call for two additional types of funds, Special Revenue Funds and Intragovernmental Service Funds, and one additional group of accounts, the Fixed Assets Group of Accounts. Although the State Comptroller considered that there was no immediate need to establish a Special Revenue Fund, he recommended that the City establish, as of July 1, 1977, an Intragovernmental Service Fund. He also recommended the establishment of a Fixed Asset Group of Accounts. 2/

1/ It might be argued that "specials" should appropriately be placed within a GAAP "trust and agency fund". However, the New York State Comptroller's Office noted that "Many of the [special] accounts have been maintained as if they were agency or trust funds, even though neither situation existed." Office of the New York State Comptroller, Special and Miscellaneous Revenue Accounts, p. 5.

2/ Office of the New York State Comptroller, Accounting Systems Directive No. 5.

In reviewing the Annual Report of the Comptroller of the City of New York for the Fiscal Year 1973-1974, a representative of the Municipal Finance Officers Association remarked that "significant modification" would be required in "organization, terminology, account titles, classification of funds, combined statements, and statistical tables to conform the City's report to GAAFR. 1/ Another representative observed that it "could be a monumental task to review and criticize the report in the context of GAAFR" He considered that this was partly because the City performs a "vast range of services," and partly because of the format of the report. "Some balance sheets are prepared but since the City operates virtually on a single fund basis (General Fund) into which everything is tossed, considerable restructuring would be needed." 2/

On January 5, 1976, the State Comptroller's Office published a report on the City special accounts ("Special Accounts Fund") and so-called miscellaneous revenue accounts ("Miscellaneous Revenue Account Fund"), both of which the City maintained outside its regular operating and capital accounts. 3/ This report was highly critical of these two "funds" and recommended that they be discontinued.

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- 1/ Ray E. Anderson, Consultant, Municipal Finance Officers Association, Chicago, Unaddressed Memorandum dated 3 March 1975. "GAAFR" refers to the authoritative text Governmental Accounting, Auditing, and Financial Reporting.
- 2/ Robert L. Funk, Assistant Director, Municipal Finance Officers Association, Chicago, Letter dated 15 January 1975 to S.G. Fullerton, President, Municipal Finance Officers Association.
- 3/ Office of the New York State Comptroller, Special and Miscellaneous Revenue Accounts, p. 1.

The report observed that the City maintained "about 260 accounts involving almost all City Departments in the Special Accounts Fund, and 475 accounts involving about 60 City departments in the Miscellaneous Revenue Account Fund." 1/ The State auditors noted that "without analyzing each of the hundreds of accounts it is not possible to determine the true significance of each account's balance." 2/

The National Committee, the AICPA, and the Office of the New York State Comptroller each recommend that the "fund balance" for each fund be clearly revealed. The National Committee defines "fund balance" as:

"The excess of the assets of a fund over its liabilities and reserves except in the case of funds subject to budgetary accounting where, prior to the end of a fiscal period, it represents the excess of the fund's assets and estimated revenues for the period over its liabilities, reserves, and appropriations for the period." 3/

1/ Ibid, Managerial Summary, p. 1.

2/ Office of the New York State Comptroller, Special and Miscellaneous Revenue Accounts, p. 12.

3/ National Committee, Governmental Accounting, p. 161.

The City, however, failed to maintain a fund balance account within the General Fund. ^{1/} As a result, the use of the special and miscellaneous revenue funds served to mask the full extent of deficits. The Office of the State Comptroller stated that the City's use of these two funds (and the hundreds of accounts within them):

"...to record significant transactions affecting City operations, which in the absence of a general fund balance account (into which would be recorded the surplus or deficit from the year's operations), served to mask the full extent of the City's reported deficits. Since these Special and Miscellaneous Revenues Account funds were outside the City's expense budget, the City's financial reports did not clearly show the results of the City's operations." ^{2/}

In discussing the reasons for establishing these two funds, the State auditors turned to the Comptroller's Annual Report:

"The special accounts contain a group of non-operating accounts established to record the advances made to other funds and agencies, revolving funds, deposits received for specific purposes, and undistributed receipts which are subsequently distributed to appropriate accounts. Some of these accounts represent unneeded

^{1/} Office of the New York State Comptroller, Special and Miscellaneous Revenue Accounts, Managerial Summary, p. 1.

^{2/} Office of the New York State Comptroller, Summary of Accounting Systems Directives, p. 7.

balances which are used to finance the expense budget by transfer to the General Fund, while others are maintained for existing liabilities, capital accounts, the real property fund and transfers estimated in the expense budget as financing certain expenditures." 1/

* * *

"The miscellaneous revenue accounts reflect revenues received from various sources for special purposes that constitute part of the ordinary functions of the City government, such as certain state and federal aid, sewer rentals and parking meter revenue, but not included in the expense budget. These revenues, not required to be deposited in the general fund, are recorded in individual accounts and are not part of the supplementary revenues estimated in the expense budget except for certain transfers relative thereto." 2/

However, the State auditors also noted that Section 126 of the City Charter states:

"All revenues of the City...from whatsoever source except taxes on real estate, not required by law to be paid into any other fund or account shall be paid into...the general fund." 3/

1/ Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1973-1974, p. 403.

2/ Ibid, p. 145.

3/ Office of the New York State Comptroller, Special and Miscellaneous Revenue Accounts, pp. 4-5.

The State auditors concluded that through their long standing use of the Special Accounts, City officials had created both a form of discretionary reserve and a vehicle for recording non-realizable revenues. ^{1/} In emphasizing the "discretionary" nature of the availability to the expense budget of the balances in these two funds, the State auditors observed:

"...the City's Expense Budget includes lump sum amounts as an Expense Budget reduction and/or revenues, contemplating that such amounts will be transferred from Special and Miscellaneous Revenue Accounts. However, not until after budget adoption does the City Comptroller determine the composition of individual amounts and accounts to be transferred to support the Expense Budget."^{2/} [Emphasis Added]

* * * *

Specific examples include:

"In recent years, Special Accounts balances were used to meet City revenue shortfalls. For example, in addition to \$98 million from Special Accounts authorized to be used in support of the fiscal 1974

^{1/} Ibid, p. 5. The State auditors remarked, "By excluding Special Accounts from the normal budgetary process, City officials have created a form of discretionary reserve. This has been a long standing practice, as evidenced by our previous audit report on the same matter, issued approximately three years ago. On other occasions, an opposite effect was achieved: that is, transactions recording purported receivables served as the basis for including currently non-realizable cash in the revenues used to finance the Expense Budget. Many of the accounts have been maintained as if they were agency or trust funds, . . .even though neither situation existed."

They also noted, "Trust and Agency Fund Accounts are usually established to account for cash and other assets received or accepted in escrow and held by the governmental unit in the capacity of trustee, custodian or agency for subsequent distributions, transmittal or release to individual or other governmental entities or funds."

^{2/} Ibid, p. 12.

Expense Budget, \$23 million was transferred to make up a shortfall in General Fund revenues. During this period, another \$74 million was transferred to meet expense budget deficits of fiscal years 1969 through 1972. Thus, the City has belatedly used these Special Account fund balances to reduce the impact of previous year deficits." 1/

* * * *

"The City anticipated receiving \$520 million General Fund revenues from the New York City Stabilization Reserve Corporation during fiscal years 1974 and 1975. Although the Corporation was unable to provide the funds, the City recorded \$150 million as a General Fund "Source of Revenue" in 1974 and \$370 million in 1975, classifying the item as a receivable due the Miscellaneous Revenue Accounts Fund.

* * * *

"Repayments since 1971 of \$7.7 million by the Off-Track Betting Corporation for computer equipment purchased for them and paid for by the City out of capital funds were credited to a special account instead of being considered as a revenue in the year of receipt and used to offset debt service costs incurred in purchasing the equipment.

* * * *

"The City Comptroller set up a Miscellaneous Revenue receivable account for a \$98.7 million "Advance to make up revenue shortfall in 1974-75 General Fund," as a means of recording General Fund revenues, even though the revenues were not available in cash. There was no advance and no transfer, and the entry did not involve the receipt of cash. As a result, this aspect of the 1974-75 deficit was not readily apparent.

* * * *

"Real estate taxes of \$191.2 million for 1975-76 collected in advance were recorded as a special account credit. This obscured the true nature of these advance tax payments, which should have been recorded as a liability of the City in the year of receipt.

"Prior to June 30, 1975, the State advanced the City \$800 million in State aid applicable to the City's fiscal 1976 expense budget to help ease the City's cash shortage problem. Although the City could not incur the expenditures to earn these funds until fiscal 1976, the receipt was not shown as a liability of the City's General Fund at June 30, 1975. Instead, the \$800 million, less an incorrect adjustment, was recorded as a credit to the Miscellaneous Revenue Fund. Had it been recorded properly, its relationship to the City's deficit would have been evident." 1/

It is evident that the use of the special and miscellaneous revenue accounts:

"...permitted the City discretion to retain revenues as fund balances for extended periods, instead of including them as revenues in the year of receipt; to close or reduce account debit or credit balances by transferring all or a portion of the debit or credit balance to other accounts; and to make loans, advances and incur expenditures to or for other governmental units without express authorization through the City's budget and legislative mechanisms." 2/

In recommending discontinuance of the special and miscellaneous revenue accounts and establishment of a General Fund fund balance account, the State Comptroller observed that: "...the two funds and the accounts within them contributed significantly to the loss of budgetary and accounting discipline in New York City. The net effect was generally a failure to clearly and timely disclose the City's actual financial status." 3/

1/ Ibid, Managerial Summary, pp. 2-3.

2/ Ibid, p. 4.

3/ Ibid, emphasis supplied.

II. INTERNAL CONTROL

A. Introduction

Internal control encompasses organizational and accounting controls which are designed to provide reasonable assurance that financial records produce reliable information and that assets are safeguarded. An effective system of internal control is recognized as essential to an effective accounting system in providing reliable data. 1/

The inadequacies of New York City's system of internal control have been extensively described in publicly available documents. The inadequacy of such controls in providing reliable data, independently of certain City "accounting gimmicks", significantly hindered the City's capability to generate financial data which was reliable and accurate. As Comptroller Goldin noted in a speech before the Municipal Finance Officers Association in May 1976:

"There was a broad feeling, I believe, that even though the City's accounting and budgeting had been revealed as a kind of Rube Goldberg conception - a system which defied understanding or control - it was better to leave it alone as long as it churned out enough money to meet the bills and pay the debts." 2/

1/ For a brief overview of the attributes of an adequate internal control system and its relationship to municipal accounting, see Appendix B.

2/ Office of the Comptroller, City of New York, Press Release (4 May 1976): p. 2.

B. Audits Commissioned by City
Comptroller Goldin

On March 25, 1974, the City Comptroller's Office issued a press release stating that three accounting firms had been selected to "examine and independently verify some ten billion dollars in City securities, mortgages, and bank accounts". The Comptroller's Office had commissioned Peat, Marwick, Mitchell & Co. to audit securities and mortgages in the City employee retirement funds totaling approximately \$7.4 billion, S. D. Leidesdorf & Co. to audit trust funds of which the Comptroller was custodian amounting to \$88 million, and Clarence Rainess & Co. to audit general City Treasury funds of approximately \$1.5 billion. The release indicated that the three accounting firms were expected to comment upon any weaknesses in the City's internal control procedures. 1/

The three audit reports were transmitted to the Comptroller's Office in July, 1974 and

". . . confirmed each other in documenting a deplorable, chaotic condition within the Comptroller's Office with respect to record-keeping, condition of books, systems, controls, and the physical protection of hundreds of millions of dollars in securities." 2/

1/ Office of the Comptroller, City of New York, Press Release (25 March 1974): 1.

2/ Office of the Comptroller, City of New York, Press Release (5 August 1974): 1.

The Leidesdorf audit report, transmitted to Comptroller Goldin on July 12, 1974, found that \$5.4 million in securities were missing from the vault where the Comptroller's ledgers reflected they should have been. In addition, the report also noted that \$1.1 million in securities were found in the vault but were unrecorded in the Comptroller's ledgers. 1/ The audit report criticized the internal control over assets, and recommended that in order "to safeguard assets more effectively . . ." improved accounting procedures and strengthened control over operations would be necessary. 2/ Twenty-four recommendations for such improvements were made. 3/ The various internal control weaknesses, the Leidesdorf report noted, existed in 1974 notwithstanding the exposure of such weaknesses in a 1972 report by the City Comptroller's Bureau of Municipal Investigation and Statistics, Division of External Audit. 4/

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- 1/ A subsequent investigation into the missing \$5.4 million in securities traced "the discrepancy to sloppy bookkeeping in the Comptroller's office." New York Times, 1 August 1974, p. 1.
- 2/ S.D. Leidesdorf & Co., Report on Examination of Certain Funds and Securities Held by the Comptroller of the City of New York in a Trust or Fiduciary Capacity, July 1974, transmittal letter dated 12 July 1974. [Hereinafter referred to as "S.D. Leidesdorf & Co., Examination of Certain Funds."]
- 3/ Ibid., Section III, pp. 1-22.
- 4/ ". . . it is apparent that these conditions have existed for an extended period of time prior to March 31, 1974. We note, for example, that a report dated August 1972, issued by the Comptroller's Bureau of Municipal Investigation and Statistics, Division of External Audit, disclosed differences between book records and a physical count of securities as of December 31, 1971 and related weaknesses in the system of internal controls. Furthermore, various matters commented upon in such report still existed as of March 31, 1974." Ibid, Section III, p. 2.

The audit by Clarence Rainess & Co. dealing with City treasury funds reported unreconciled differences of approximately \$45 million between cash balances reflected in the Comptroller's general ledger and cash balances reported by outside depositories in response to confirmation requests, noting that "because of the lack of reliable documentation available the amount of discrepancy could differ substantially." 1/

Like the Leidesdorf report, the Rainess audit report criticized the City's internal control. 2/ Rainess noted that its documentation illustrated "the inadequacy of the Comptroller's records and the inaccuracies deriving therefrom." 3/ Additionally, the report reflected that its comments were:

1/ Division's Exhibit "Harrison J. Goldin No. 8 for Identification," p. 15.

The mayor was aware of the "problem of reconciling these accounts . . . since they had been under continuous scrutiny since the latter part of 1972 and through most of 1973." Comptroller Beame "directed the First Deputy Comptroller to undertake an intensive effort to rectify this matter," and "as a result . . . , the account balance was narrowed down to a \$6-million overage, as of June 30, 1973." Office of the Mayor, City of New York, Press Release (22 July 1974): 4. Clarence Rainess & Co. observed in its report that "the only recorded incomplete attempt to achieve a reconciliation of bank balances that came to our attention is for the period ending June 30, 1973." (Division's Exhibit "Harrison J. Goldin No. 8 for Identification," p. 15).

2/ Division's Exhibit "Harrison J. Goldin No. 8 for Identification," p. 13. The report stated that "present deficiencies relate to accounting, communications, and controls. Each of them is basic to the inadequacies of the total system."

3/ Ibid, p. 18.

". . . not designed to be critical of the personnel who can do little other than respond to the immediate needs of the Comptroller's Office. It was obvious from our discussions that they would like to improve their performance standards. In every instance, each individual with whom we discussed various problems recognized the inadequacies of the system, the need for change, and the lack of controls. Unfortunately, they have inherited an antiquated method for recording and reporting.

"Accountability enhances fiscal integrity. The impetus must come from leadership. Dedicated employees can then be given the opportunity to perform more effectively." 1/

On July 22, 1974, Peat, Marwick, Mitchell & Co. ("Peat Marwick") transmitted its audit report dealing with securities and mortgages in City employee retirement funds to Comptroller Goldin. Peat Marwick reported that while cash approximating \$310,000 was recorded on the Comptroller's books of account, there existed no corresponding bank balances for such funds. Peat Marwick's report noted that these accounts had not been reconciled for many years. In addition, Peat Marwick criticized internal control relative to the various retirement and pension systems, and stated that "due to the absence of adequate internal control procedures and security over the handling and recording

1/ Ibid, p. 12.

of cash and related short term investments . . . , we express no opinion with respect to such items. 1/

It is significant that prior to the City's "fiscal ordeal" of 1975, there was little political support to alter the structure of the City's accounting system. The three audit reports released in the summer of 1974 documented a "deplorable" and "chaotic condition within the Comptroller's Office" with respect to internal accounting control, but there appeared to be little interest in remedying the situation. As Comptroller Goldin noted in May 1976:

"Although there was a public furor at the time over one reported discrepancy involving securities in a vault, I cannot say there was any broad support generated for the kind of expensive restructuring which is now underway. There was a short-lived move to provide funds to employ fifty additional accountants, but the movement quickly lost steam, and a bill to authorize new personnel died in the City Council. 2/

1/ Division's Exhibit "Harrison J. Goldin No. 9 for Identification," p. 1.

Note 5 to the financial statement in Peat Marwick's report stated that:

"Adequate internal control and security procedures to ensure the proper handling and recording of cash and related short term investments have not been formalized and practiced by the Comptroller's Office for some years. Examples of deficiencies are: (1) failure to reconcile bank accounts on a timely basis; (2) inadequate check signing procedures; (3) failure to provide proper security for unissued blank checks; (4) inadequate control over drawn but unissued checks; (5) absence of application of audit procedures to returned paid checks; and (6) failure to investigate and clear checks remaining outstanding for long periods of time."

2/ Office of the Comptroller, City of New York, Press Release, (4 May 1976): 3.

C. Audits by the Office of the
New York State Comptroller

The New York State Comptroller's Office by statutory mandate has made audits of certain of the books of the City since July 1971. Initially, it directed its inquiries to areas of high expenditure within the City for the purpose of reducing expenditures and increasing operational efficiency. The State Comptroller later broadened the areas of inquiry and undertook an analysis of the City's debt structure and of various aspects of the City's central budgetary and accounting practices. In an "interim report" published in July 1975 dealing with receivables for state and federal aid, ^{1/} the State Comptroller's Office stated that it was:

". . . examining into New York City's central budgetary and accounting practices in order to (1) identify shortcomings which have a bearing on the accuracy of the City's financial statements, . . ." ^{2/}

With respect to accounts receivable for state and federal aid on the City's books as of March 31, 1975 which were applicable to the years ended June 30, 1974 and June 30, 1973, the State Comptroller's report noted that the City's records indicated these receivables amounted to \$432.2 million, of which the State auditors examined \$373.3 million. The State auditors found that the \$373.3 million in receivables examined were overstated by \$324.6 million, or by over 85%. ^{3/}

^{1/} Office of the New York State Comptroller, Prior Year Accounts Receivable.

^{2/} Office of the New York State Comptroller, Prior Year Accounts Receivable, Managerial Summary, p. 1.

^{3/} Ibid, p. 2.

With regard to internal accounting control, the State auditors commented that "the City's procedures provided for only limited monitoring of these balances", and gave examples of such limited monitoring. 1/ They stated, for example, that:

"On or about October 31. . . , the Bureau of the Budget and City Comptroller jointly request City agencies for which receivable balances appear on the central books to reconcile the balances recorded centrally with the agency records, and to explain any differences. Out of 46 agencies for which receivable balances were recorded, only 30 were requested to reconcile their balances with the balances appearing on the City's central books. Furthermore, only 24 agencies responded to those requests." 2/

This and other problems led the State auditors to conclude that:

"The City's internal procedures for recording, maintaining and monitoring State and Federal accounts receivable are inadequate. Therefore, one cannot rely upon the central accounting records and related financial reports to present fairly the status of these receivables." 3/

1/ Ibid, p. 3.

2/ Office of the New York State Comptroller, Prior Year Accounts Receivable, p. 7. Until recently one agency "had not complied with State requirements for reconciling its claims to applicable revenue and appropriation accounts. Their representatives had contended that such a reconciliation was not possible." However, although the State auditors admitted that such a reconciliation is a complex task, they "demonstrated not only that it was possible (by successfully reconciling two test months), but that it was necessary on a continuous basis." Ibid.

3/ Office of the New York State Comptroller, Prior Year Accounts Receivable, Managerial Summary, p. 2.

During periods in which the City was selling RANs ostensibly backed by these receivables, no disclosure was ever made of the inherently unreliable nature of the City's records designed to account for the amounts allegedly anticipated.

The State Comptroller's Office published a second "interim report" on August 4, 1975, in which it concluded that over 80% of the \$502.3 million in real estate taxes listed by the City as receivable as of June 30, 1975 was either not collectible or not readily available. 1/ The report noted that:

"The City's budgetary and accounting practices result in an inflated estimate of real estate taxes to be collected to balance the annual expense budget, and do not make adequate provision for taxes that will not be collected. The result has been that budgeted real estate tax amounts have not been realized; for the most part, the revenue shortfall has been met by continued borrowing. 2/

As to the causes for the shortfall, the State Comptroller's report found:

"Two major causes for this shortfall are: (1) the City included properties in its tax rolls which were not subject to real estate taxes or for which taxes would not

1/ Office of the New York State Comptroller, Division of Audits and Accounts, Audit Report on Review of New York City's Central Budgetary and Accounting Practices; Interim Report No. 2- Uncollected Real Estate Taxes (Report No. NYC-26-76: 4 August 1975), p. 4. [Hereinafter referred to as "Office of the New York State Comptroller, Uncollected Real Estate Taxes"].

2/ Ibid. In the "Managerial Summary," this theme was stated as follows: "The City's Budgetary practices result in an inflated estimate of real estate taxes that it can reasonably expect to collect to balance the annual expense budget. Unless expenditures are reduced to make the shortfall, the City's budget is automatically out of balance; borrowings thus become necessary to meet the cash flow deficiency." Office of the New York State Comptroller, Uncollected Real Estate Taxes, Managerial Summary, pp. 1-2.

be collected, and (2) there has been insufficient provision for the increasing volume of defaulting taxpayers and tax cancellations and remissions." 1/

The amounts involved are substantial since real estate taxes receivable in the first category (property not taxable or from which taxes would not be collected) amount to \$282.6 million. 2/

The State Comptroller's audit report concluded:

"This report provides strong evidence that the City has not taken into account uncollectible real estate taxes in making its decisions. Practically all the information on these uncollectible receivables was readily available to City officials; however, the Finance Administration did not distribute it and neither the City Comptroller's Office nor the Budget Office requested it.

"It is vital that the City overhaul its real estate tax accounting, budgeting and reporting systems to preclude further distortion of the City's financial status and to make available accurate fiscal information on which to base future decisions." 3/

1/ Ibid, p. 4.

2/ Ibid, p. 4.

3/ Office of the New York State Comptroller, Uncollected Real Estate Taxes, p. 23.

D. Audit Commissioned By The Treasury Department

On December 12, 1975, another public accounting firm, Arthur Andersen & Co., was retained "to advise the Department of the Treasury on various financial and accounting matters related to Public Law 94-143, the 'New York City Seasonal Financing Act of 1975'." 1/

Arthur Andersen's report, dated December 29, 1975, was highly critical of internal control. In its transmittal letter to the Secretary of the Treasury, Arthur Andersen stated that they agreed with observations made by various City officials that "the City's financial systems and controls were and continue to be inadequate to provide complete and reliable financial data." 2/ Their report noted:

"In general, the lack of controls and inadequacies in the overall accounting systems and procedures raise questions about the City's ability to exercise control over the collection of revenues, the expenditures of money and the preparation of financial reports." 3/

1/ Arthur Andersen & Co., Report for the Secretary of the Treasury Regarding Information Relating to the Financing Requirements Under the New York City Seasonal Financing Act of 1975, 29 December 1975.

2/ Ibid, p. 3.

3/ Ibid, p. 20.

E. The Effects of Weak Internal Control

The City's lack of adequate internal control directly affected the City's fiscal plight and played a major role in the sale of revenue and tax anticipation notes based on information that was neither reliable nor accurate as to the true financial condition of the issuer.

Although it is difficult to completely separate the problems attributable to inadequate internal controls from those attributable to the City's accounting practices, it is apparent that the questionable veracity of underlying financial data served only to compound the incomplete and misleading picture which resulted from questionable accounting techniques.

The lack of adequate internal control provides no excuse for the inaccurate information which was published. Even accepting the City's unrealistic measurement premises, the overriding principles of reasonably adequate disclosure demanded that the lack of reliability inherent in reported information be fully revealed. Furthermore, the public duties of those responsible for the system mandated that an adequate system be maintained, not simply for financial reporting but also for the safeguarding of assets and other critical purposes of such a system. The ability of responsible officials to effectively administer the City's business could only be hampered by a state of affairs where both the records of the City and the assets subject to accountability were innately susceptible to errors, irregularities and manipulation.

III. FINANCIAL REPORTING BY NEW YORK CITY

A. Introduction

Although municipalities differ in many respects from commercial enterprises, the availability of reliable financial information is no less an important feature of the investing process with respect to their securities. In this regard it is evident that the City's various statutory reports, budgets and similar documents were defective in several material respects. None of these documents were drafted in a meaningful or understandable fashion or contained more than a modicum of disclosure of significant financial information. By focusing upon limited areas of expense and capital budget activity, certain reports successfully obscured the City's fiscal problems. In addition, many of these documents were prepared only annually and were quickly outdated.

The City also prepared "Statements of Essential Facts" in connection with its statutory "Notices of Sale" inviting bids on certain debt issues. These documents reflected many of the defects of other reports. Revenues were shown as equalling expenditures, implying a balanced budget condition. Textual disclosures were almost totally absent so that even the most sophisticated investor could not evaluate the degree of risk inherent in the obligations of the City.

The City also publicized information through various media on a piecemeal basis, including press releases, the City Record (an official daily publication) and speeches by representatives of the City government. While the total volume of information so disseminated was great, there was no real coherence and little effort was expended to make the disclosures comprehensible in the broader context of the City's financial affairs. Virtually every such discrete disclosure was characterized by the omission of material information necessary to make the communication comprehensible or meaningful.

B. Legal Considerations

It might be argued that the City's budgeting, bookkeeping and financing practices were in conformity with various relevant laws such as the City Charter, the General Municipal Law and the Local Finance Law, and that such laws evolved over a substantial period of years. Implicit in this assertion is an inference that the City could not comply both with the applicable local laws and with recognized accounting and disclosure standards.

These arguments are falacious. In discussing compliance with legal requirements, it is necessary to carefully distinguish the issue from various other aspects of the conduct of the City's affairs.

These include:

- 1) The budgetary process;
- 2) The basis of accounting;
- 3) Financing practices; and
- 4) Financial reporting and disclosure.

Both the budgetary process and the City's financing policies do appear to be closely related to legislative considerations. These in turn may impact on the basis of accounting chosen for a particular transaction. As the National Committee noted:

"It should be emphasized...that budgetary compliance is a paramount consideration in governmental accounting and must take precedence over the basis of accounting per se." 1/

In the chapter on financial reporting, they go on to point out however:

"...As applied to business entities generally, the principle of full disclosure means that the financial statements must reflect complete information on the financial position and operations of the entity to the extent that such statements will not be misleading to users... In this sense, the concept has equal applicability to the financial reports of governmental entities..." 2/

Even assuming that legal requirements permitted or mandated particular financing methods, budgeting techniques or even accounting bases, the City's fundamental obligations to make financial information comport with economic reality are not relieved.

In point of fact, however, nearly all the legislative considerations discussed herein had a direct effect only on the financing practices of the City, e.g. the issuance of debt instruments. In addition, many of the laws in question were

1/ National Committee, Governmental Accounting, p. 12.

2/ Ibid, p. 107.

permissive, not mandatory. We are aware of no New York State or City law which either required the City to use particular bases of accounting or mandated the sale of debt securities.

As Comptroller Goldin stated in the 1974-1975 Annual Report:

"The City's accounting and budgeting system, although lawful and uncritically accepted for many years, accomodated what in other accounting and budgeting systems would have been exposed as deficits." 1/

Mayor Beame, in his testimony, referring to the use of non-recurring revenues as a means of balancing the budget, remarked that this is "a common practice in use, not only in the City of New York, but in practically all cities throughout the country, in the State, and...in the Federal budget." 2/ He added:

"Now, of course, you might know and should know that all of these things in connection with the use of these one-shot items in most instances they were State permitted under legislation and sometimes state mandated." 3/

Distinctions must be drawn, however, between compliance with various provisions of local law and presentation of financial information for purposes of communicating to the public in a manner which is understandable and meaningful.

1/ City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1974-1975, p. xii.

2/ Testimony of Abraham D. Beame, p. 43.

3/ Ibid, pp. 46-47.

The National Committee stated that a governmental accounting system must satisfy the twin objectives of both compliance with various legal provisions and fair presentation of financial data:

"A governmental accounting system must make it possible: (a) to show that all applicable legal provisions have been complied with; and (b) to determine fairly and with full disclosure the financial position and results of financial operations of the constituent funds and self-balancing account groups of the governmental unit." 1/

Certainly, legal considerations cannot be construed to mandate or permit incomplete or misleading disclosure to the public. Compliance with legal requirements is an important consideration in the presentation of financial data, but it is not, in and of itself, dispositive. Consideration must also be given to the needs and rights of public managers, legislative and governing bodies, individual citizens, taxpayers, political groups, other governmental entities, investors, investment bankers, bond rating services and other persons whose professional or personal activities require them to acquire and analyze financial data. Where compliance with statutory conditions results in financial information which does not reflect financial reality, the need for full and complete disclosure becomes particularly acute.

C. Notices of Sale and Statements of Essential Facts

A document referred to as a "Notice of Sale" and "Statement of Essential Facts" was prepared by the City in connection with the sale of securities. The Notices of Sale announced the sale of securities and invited bids to be made.

1/ National Committee, Governmental Accounting, pp. 3-4.

The Statements of Essential Facts contained information, as of dates recent to the sales, concerning funded and temporary debt, a determination of the City's debt-incurring power (including assessed and full valuations of real estate), a schedule of bond maturity by years, schedules of debt issued within debt limits, summary figures indicating a balanced budget, schedules of general fund revenues, debt limitation exclusions, and a schedule of the tax levy and amounts still uncollected at various dates. There were no financial statements.

Partially as a result of the City's methods of balancing its budget and its overstatement of real estate taxes, certain of the financial data was incorrect. For example, the Statements of Essential Facts present a "balanced" budget, but the data was derived using the City's factitious accounting practices. As a further example, the computation of the debt incurring power was misstated because it was based upon valuations of real estate which included non-taxable properties. Most of the information contained in these documents was numerical in nature, without textual clarification. Conclusions which might be drawn from the numerical data on its face would almost surely be erroneous.

D. The Budget

During the budget preparation process, the Mayor's budgetary representatives gather data regarding expected revenues and expenditures for the forthcoming year, which is then compiled into

a proposed budgetary program. Ultimately, after much review, a proposed program, or Executive Budget, is submitted by the Mayor to the City Council and Board of Estimate for approval. ^{1/}

Subsequently, the City Council and Board of Estimate amend the Executive Budget as deemed appropriate, and submit a budget, balanced according to the City's methods, to the State Legislature for ratification.

Although the Executive and Adopted budgets contain a substantial volume of detailed information, these documents fall considerably short of meeting the test of full and fair disclosure.

In the Mayor's Message of May 15, 1974, the Mayor indicated the following actions, among others, to reduce the budget gap:

"Utilize surplus earnings of pension funds, for approximately \$125 million.

^{1/} The Executive Budget is comprised of budget analyses of various agencies of City government, as well as a "Mayor's Message" outlining areas considered important. The Mayor's Message dated May 15, 1974, for example, submitted in connection with the fiscal 1974-1975 budget, emphasized the "austere" nature of the budget, and discussed such matters as federal aid, budget priorities, and the problem of reducing and closing the "budget gap."

"Transfer sewer rent surpluses to the General Fund, for \$28 million."

Without further elaboration by the Mayor, it would seem difficult for an investor to assess the nature of these items. For example, the proposal to transfer pension fund "surplus" earnings fails to mention the outdated actuarial assumptions or the enormous unfunded liability of the pension systems. Similarly, with regard to the use of sewer rent "surpluses," no mention is made that these are caused by budgeting eighteen months' rents in the twelve month 1974-1975 fiscal year.

Other problems were evident with regard to the City's adopted budgets. Budget modifications throughout the year gave the budget a constantly changing nature, so that the adopted budget became quickly outdated. Changes were published in the City Record but interim updated versions of the budget were not generally available. Expenditures were summarized by department, but there was no indication, absent detailed analysis, of how they were to be financed. For example, the 1974-1975 budget (as adopted) had a summary schedule of revenues which set forth revenues in amounts as low as \$16,000, but failed to detail revenues totaling \$1,177,763,984. Instead, this massive figure was described as:

"Capital Budget and Special Funds including surplus interest earned on investments, services rendered to independent agencies such as Housing Authority, Transit Authority, etc." 1/

1/ City of New York, Expense Budget, 1974-1975, p. vi.

Extensive analysis is required to ascertain that included within this large revenue figure were amounts financing the expense budget from the transfer of capital funds (\$723,824,370), "special" funds (\$2,900,000), and "surplus" pension interest (\$261,424,983). A similar situation existed in the prior year (1973-1974), where the adopted budget obscured transfers of \$563 million from capital funds and \$48.1 million from special funds to support the budget for that year.

E. Annual Reports of the Comptroller

The City Comptroller, an elected official, is required by the City Charter annually to publish a report summarizing the financial activity of the City for the year. Usually running in excess of five hundred pages and weighing several pounds, it purports to present certain information regarding the City's expense budget, various tax and other revenues, uncollected real estate taxes, the City's reserve funds, borrowing limits, short and long term debt and other matters. About 550 copies were printed annually and distributed to banks, libraries and others. 1/

This report fails to reveal accurately the financial condition of the City in a manner understandable to a reasonably informed reader. This failure was confirmed by the testimony of bankers, brokers, bond counsel, rating agency personnel and

1/ Testimony of Sol Lewis, pp. 318-319.

representatives of the City who were unable to answer with certainty questions concerning the financial status of the City based upon information contained in the Comptroller's Annual Report. Steven Clifford, when he was associated with the New York State Charter Revision Commission for New York City described the 1972 Annual Report:

"This document . . . rivals Paradise Lost and the line budget in indigestibility. Running 542 pages, it includes a 161 page itemization of capital budget expenditures, a 77 page statement of expenses by department, a 22 page itemization of sinking fund operations, a 30 page listing of debt statistics, etc." 1/

Each of the deficiencies discussed herein relating to accounting practices, disclosures and internal control weaknesses are reflected in some way in these Annual Reports.

1. Receivables and revenues

Information is set forth in the report to the effect that the achievement of a "balanced budget" is predicated upon the assumption that the City will collect all of its Federal and State aid and real estate taxes receivable. Appropriate accounting principles applied by the State Comptroller established that

1/ Report of The Office of Comptroller of the City of New York, Prepared by Steven Clifford for the New York State Charter Revision Commission for New York City, February 1973, at 15.

the City had cumulatively overstated its receivables for real estate taxes by approximately \$408 million and for federal and state aid by about \$325 million at June 30, 1975. The City reflected these receivables throughout the report as if they were 100% collectible but failed to reveal that many of these balances represented little more than an imaginative approach to revenue accrual.

Financial schedules in the Annual Reports for 1974 and 1975, for example, failed to disclose the City's unusual basis for recording water charge and sewer rent revenues. The 1973-1974 report fails to adequately highlight the eighteen months of water charge revenues included in that year's budget. The 1974-1975 report is similarly deficient with respect to the accrual of sewer rent revenues made during that fiscal year.

Another itemized "receivable" concerned the New York Stabilization Reserve Corporation. This entity was organized to finance the City's expense budget through the issuance of debt securities. These securities were never issued, and the Stabilization Reserve Corporation was unable to provide the funds. The City nevertheless recorded the \$150 million as an "actual receipt" of the General Fund in 1974, classifying the item as a receivable from another fund, the "Miscellaneous Revenue Accounts Fund." Notwithstanding the problems concerning the issuance of debt by the Stabilization Reserve Corporation to support the 1973-1974 budget, the City budgeted an additional \$370 million as indirectly receivable from SRC for fiscal 1974-1975.

2. Liabilities and expenses

The 1973-1974 Annual Report also failed to reflect liabilities for such items as payroll and pensions. Payroll costs are reflected on a 364 day year basis with no disclosure of the annual escalation in unrecorded liabilities. In addition, the financial presentations in this Annual Report do not appear to reflect any liability for unpaid payroll and fringe benefit-related costs, such as vacation pay. The City's huge obligations for unfunded pension costs are reflected nowhere in the 1973-1974 Annual Report, and the unique treatment of so-called "excess" interest on pension fund assets was obscured in various financial presentations, which tracked the budgetary techniques contrived by the City to "balance" its revenues and expenditures.

3. Disclosures

The usefulness of any financial presentation is significantly dependent upon the understanding of the accounting policies followed in its preparation. Although the City did not purport to prepare its reports in accordance with GAAP, there was no meaningful disclosure, prior to 1975, of the basis on which they were in fact prepared.

While hardly a model for accounting policy disclosure, the City's methods of recognizing revenues and expenditures were described in the Comptroller's Annual Report issued on October 31, 1975:

"The Report which follows has been compiled on the basis of accounting principles and procedures in effect for New York City accounts during 1974-1975 and prior years. In general, this system employed a cash basis for recognizing expenses and an accrual basis for recognizing revenues, including end-of-year accruals in the case of local taxes other than real estate taxes and accruals crossing fiscal years in the case of non-reimbursable Federal and State aid. In the case of real estate taxes, the entire tax levy has been accrued as revenue. Tax Anticipation Notes were issued against the unpaid balance at the end of each year, which Notes were not fully redeemed until the end of the fifth year. In the case of reimbursable Federal and State aid, budgetary revenue estimates have been recognized as receivables." 1/

This explanatory note is conspicuously absent from earlier Annual Reports in which the Forewords imply that revenues were accrued, but which do not make apparent the City's treatment of recording expenditures:

"The operations of the Expense Budget for the Fiscal Year 1972-1973 are shown in detail in Part 2-A of this report, and are summarized in Statement 1. The receipts and receivables amounted to \$9,325,587,540 and the expenditures including contracts registered, totalled \$9,139,165,053." 2/

Other comments in the Annual Reports for fiscal years 1973 and 1974 alluded to the City's method of recognizing revenues and expenditures, but failed to explicitly set forth that the City recognized revenues on an accrual basis and expenditures on a cash basis.

1/ Annual Report of the Comptroller 1974-1975, at xiii.

2/ Annual Report of the Comptroller 1972-1973, at v.

In reviewing the Comptroller's 1974 Annual Report at the request of Comptroller Goldin, representatives of the Municipal Finance Officers Association informed the Comptroller that among the areas which required "comments or explanation" was the City's method of revenue and expense recognition because "[t]he basis of accounting is neither explained nor apparent from the report." 1/

The inherent unreliability of data reflecting cash, securities balances, receivables and similar items which were products of the City's "Rube Goldberg" system of internal control was disclosed nowhere. Instead, the Comptroller outlined in the foreword to the 1973-1974 Annual Report steps that had been undertaken to improve systems, procedures, and internal controls.

The deficiencies of the Annual Report as a vehicle for meaningful disclosure seem beyond dispute. In addressing the Municipal Finance Officers Association in May 1976, Comptroller Goldin said:

"To describe as 'some difficulties' what must have been the sheer futility of trying to understand the City's Annual Report under the old system is to demonstrate a diplomacy worthy of high office in the State Department.

"It is like saying that I, Harrison J. Goldin, might expect some difficulties should I climb into the ring with Muhammed Ali." 2/ [Emphasis in Original]

1/ Letter from Donald W. Beatty, Executive Director, Municipal Finance Officers Association, Chicago, to Harrison J. Goldin, Comptroller, City of New York, dated 27 March 1975.

2/ Office of the Comptroller, City of New York, Press Release, (4 May 1976), p 2.

APPENDIX A

Historical Overview of Municipal Accounting

A. History

1. Prior to 1930

Although it has been acknowledged that "the history of authoritative accounting pronouncements dates only from the 1930's," 1/ prior to this time there existed an extensive pool of accounting thought, knowledge, literature, and practice.

In this country the genesis of governmental accounting - federal, state, and municipal taken together - can be traced to the early years of the United States. In fact, certain procedures introduced into the federal fiscal system by Alexander Hamilton were still being utilized in 1948. 2/ However, governmental accounting practices prior to the twentieth century bear only slight resemblance to governmental accounting as it exists today. Current concepts of governmental accounting had their origin at the beginning of the twentieth century, as part of the municipal reform movement which sought to eliminate the scandalous and inadequate practices which had existed in the fiscal administrations of many American

1/ James M. Williams, Paper entitled "Generally Accepted Accounting Principles Applicable to State and Local Government," (Chicago: Municipal Finance Officers Association, 1976), p. 3.

2/ Lloyd Morey, "Trends in Governmental Accounting," Accounting Review (23 July 1948): 227.

cities. 1/ Among the reformers were the National Municipal League 2/ and the U.S. Census Bureau which began to seek uniformity in municipal accounting and reporting. 3/ As part of the thirteenth census of the United States, the Census Bureau issued a publication entitled "Statistics of Cities" which was based upon a uniform system of data classification intended as a standard for all cities in the United States.

During the first decade of this century, the growth of municipal government led to increasing interest in governmental accounting. In 1901 and 1902, the cities of Newton, Massachusetts, and Baltimore, Maryland published annual reports "along lines recommended by the National Municipal League. 4/ In the next two years, Chicago, several cities in Massachusetts and seventy cities in Ohio also adopted recommendations of the National

1/ Edward S. Lynn and Robert J. Freeman, Fund Accounting Theory and Practice (Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1947), p. 25.

2/ The National Municipal League was formed in 1894 to establish a forum for good City government. See Frank Mann Stewart, A Half Century of Municipal Reform (Los Angeles: University of California Press, 1950), p. 21, as quoted in 1976 by James H. Potts in a dissertation written for the University of Alabama entitled, "An Analysis of the Evolution of Municipal Accounting to 1935 with Primary Emphasis on Developments in the United States."

3/ Lynn and Freeman, Fund Accounting Theory and Practice, p. 25.

4/ Ibid, pp. 23-27.

Municipal League. In 1904 New York State enacted legislation to place cities within the State on a uniform basis, and in 1906 Massachusetts passed a similar law. 1/

Indeed, at this time, New York City was in the forefront of municipal reform. In 1905, Herman A. Metz was elected Comptroller of the City of New York, having campaigned on a platform which portrayed him as a ". . .business man for the head of the city's business office." By the time Metz became Comptroller, an estimated one-fourth of the City's eighty-million dollar personal services budget had been lost due to collusion, idleness, or inefficiency; and City departments were issuing bonds to finance their current operating expenditures. 2/ After spending a year "employed in getting in touch with the problem," 3/ Metz, in his remaining three years, established procedures to guide the City's fiscal operations with the active assistance of the Bureau of Municipal research. 4/

1/ DeWitt Carl Eggleston, Municipal Accounting (New York: The Ronald Press Company, 1914), pp. 23-24.

2/ Lynn and Freeman, p. 26.

3/ Bureau of Municipal Research, Handbook of Municipal Accounting (New York: D. Appleton and Company, 1913), p.v.

4/ The Bureau of Municipal Research had among its goals, "... to promote the adoption of scientific methods of accounting and of reporting the details of municipal business. . ." See DeWitt Carl Eggleston, Municipal Accounting (New York: Ronald Press Company, 1914), p. 24.

Metz, as Comptroller, prepared a "Manual of Accounting and Business Procedure for the City of New York," and had it promulgated by executive order. This manual set forth its purposes as:

- "1. To describe definitely the forms of documents to be used and the procedure to be followed by employees of the city, to the end that responsibility may be located for each step taken in each transaction resulting in the receipt and payment of money, the acquisition and sale of property, and the incurring and liquidating of liabilities
- "2. To establish and place in the hands of employees a manual containing definite rules, departures from which, in the administration of the city's affairs, may be treated as breaches of duty
- "3. To require those making any change in corporate practice to state such change in writing, and to assume official responsibility therefor
- "4. To make available to each one who has business dealings with the city the means of knowing the technical requirements and of understanding his rights
- "5. To establish a procedure which will make available to the public a definite test of economy, efficiency and fidelity of service." 1/

After Metz retired from office in 1909, having served only one term, he established a fund within the City's Bureau of Municipal Research. The purpose of this fund was to assist the Bureau in making available to other cities the experience of the City of New York in revising its accounting methods. 2/

1/ Bureau of Municipal Research, Handbook of Municipal Accounting, pp. v-vi.

2/ Ibid, p. vi.

With the aid of Metz's gift, in 1913 the Bureau of Municipal Research consolidated its literature into a single text entitled Handbook of Municipal Accounting. Commonly referred to as the Metz Fund Handbook, this text was distributed to approximately 325 American cities. The handbook brought together for the first time "many of the basic characteristics and requirements of municipal accounting, and outlined methods of appropriate treatment." This handbook has been identified as "the most significant contribution of the 1910 decade." 1/

One of the concepts in the Metz Fund Handbook still bears validity today. The handbook in its introduction, asserted that "the function of accounting is to produce complete, accurate, and prompt information about business transactions and results." 2/

In 1912 Congress passed the Federal Budget and Accounting Act which ". . . brought about a major change in the fiscal procedures of the government. In the budget area its provisions proved to be generally sound and productive of good results. In

1/ Morey, "Trends in Governmental Accounting," p. 227.

2/ Bureau of Municipal Research, Handbook of Municipal Accounting, p. ix.

accounting and auditing less satisfactory results were secured" 1/ A year later, New York City reappeared at the forefront of reform when its Comptroller transmitted to the Board of Estimate and Apportionment a plan for organization of a central purchasing department modeled on similar departments in railroad organizations. 2/

Textbooks now began to appear and in 1914 DeWitt Eggleston, a member of the AIA and former employee of the Department of Finance of New York City, published Municipal Accounting, the first reference work by a private author, which has been applauded as "a rather complete program of accounting practice and procedure for a municipality." 3/ During the next ten years, interest in governmental accounting continued with the publication of articles, pamphlets, and textbooks. Municipal leagues were formed in various states as others became more interested in the subject. 4/

The 1920's saw significant work in municipal accounting by various distinguished authors, 5/ but general interest in governmental accounting waned until the early 1930's. 6/ By 1933, although some progress could be seen, at least one expert in the area

1/ Morey, "Trends in Governmental Accounting," pp. 227-228.

2/ Eggleston, Municipal Accounting, p. 26.

3/ Morey, "Trends in Governmental Accounting," p. 227.

4/ Lynn and Freeman, Fund Accounting Theory and Practice, p. 26.

5/ Morey, "Trends in Governmental Accounting," p. 227.

6/ Lynn and Freeman, Fund Accounting Theory and Practice, p. 26.

was lamenting that there was a marked absence of general improvement. 1/

Thus, a request to twenty-seven cities, in 1930, for information concerning municipally owned water plants revealed that only eleven cities had "accounting systems that would allow them to present complete information about a certain single activity of the city, unless a detailed analysis were made." 2/ A more comprehensive review conducted in 1931 revealed that few of the fifty-six cities studied either prepared budgets or complete - financial statements, and "none of these cities brought budget accounts into use so that they would be continuous with the other accounts." 3/

2. Subsequent to 1930

The advent of the Depression gave rise to renewed interest in municipal accounting practices. The Municipal Finance Officers Association sponsored the organization of the National Committee to address accounting and financial reporting problems in the public sector.

1/ R.P. Hackett, "Recent Developments in Governmental and Institutional Accounting," The Accounting Review (8 July 1933): 122.

2/ Ibid.

3/ Ibid.

The establishment of the National Committee came at a time when there was still virtually no authoritative private sector or public sector accounting standards literature. 1/ During the 1930's, however, the AIA established its Committee Accounting Procedure to "work toward resolution of accounting and reporting problems of private sector enterprises, particularly those within the purview of the newly established Securities and Exchange Commission." 2/

The Municipal Finance Officers Association supported the organization of the National Committee "in order to bring together representatives of various groups concerned with municipal accounting and to put into effect sound principles of accounting, budgeting, and reporting." 3/ It was believed that the National Committee would formulate these principles in response to the "deplorable situation" that existed in the 1920's. 4/ The National

1/ Maurice Moonitz, Obtaining Agreement on Standards in the Accounting Profession, Studies in Accounting Research, No. 8 (Sarasota, Florida: American Accounting Association, 1974), pp. 15-16, cited by A.M. Mandolini in "Comments by A.M. Mandolini, Member of the Executive Committee of the National Council on Governmental Accounting (NCGA) on the Financial Accounting Standards Board (FASB) Discussion Memorandum - 'An Analysis of Issues Related to Accounting and Reporting for Employee Benefit Plans'", Exhibit A, page 1, Emphasis added /Hereinafter referred to as "Comments by A.M. Mandolini"/.

2/ A.M. Mandolini, "Comments by A.M. Mandolini" Exhibit A, p. 1.

3/ Lynn and Freeman, Fund Accounting Theory and Practice, p. 27.

4/ Joseph M. Lowery, "Governmental Accounting, Auditing and Financial Reporting," Municipal Finance (February 1968): 111.

A9.

Committee was created in 1934 "to formulate principles of municipal accounting, to develop standard classifications of accounts, uniform terminology for financial reporting by governmental units, to consider principles which should be followed in making governmental audits and to promote the recognition and use of these standards." 1/

The National Committee has historically maintained a close association with the Municipal Finance Officers Association, its sponsoring organization. The National Committee, furthermore, is national and international in membership and upon organization included the chairman of the Municipal Accounting Committees of each of the following:

- "1) American Association of University Instructors in Accounting (Now the American Accounting Association);
- "2) American Institute of Accountants (Now American Institute of Certified Public Accountants);
- "3) American Municipal Association;
- "4) American Society of Certified Public Accountants (Now merged with the American Institute of Certified Public Accountants);
- "5) International City Managers' Association;
- "6) Municipal Finance Officers Association of the United States and Canada, the sponsor;
- "7) National Association of Cost Accountants (Now National Association of Accountants);

1/ Municipal Finance Officers Association, Exposure Draft - A Report of the MFOA Task Force on the Sponsorship of the National Committee on Governmental Accounting and Related Programs (Chicago: MFOA, 1973), p. i.

"8) National Association of State Auditors, Comptrollers and Treasurers;

"9) National Municipal League; and

"10) U.S. Federal Bureau of Census in a liaison capacity." 1/

The National Committee took immediate action and at its organizational meeting tentatively adopted certain principles and set out a fourteen point program of research into areas of municipal accounting. 2/ These initial steps were endorsed, in 1934 and again in 1935, by the Special Committee on Governmental Accounting of the AIA. 3/

The National Committee, however, was an impermanent entity whose staff and facilities were provided by the Municipal Finance Officers Association. The original National Committee was discharged in the mid-1930s, and new Committees were later established on an ad hoc basis to review and revise earlier National Committee publications. When their review was completed these later Committees were discharged.

1/ Lowery "Governmental Accounting, Auditing and Financial Reporting," pp. 111-12.

2/ Lynn and Freeman, Fund Accounting Theory and Practice, p. 27.

3/ Special Committee on Governmental Accounting, American Institute of Accountants, Audits of Governmental Bodies (New York: American Institute of Accountants, 1934); and Special Committee on Governmental Accounting, American Institute of Accountants, Accounts of Governmental Bodies (New York: American Institute of Accountants, 1935).

All.

a. National Committee on Governmental Accounting

In 1948 the President of the Municipal Finance Officers Association pressed for reactivation of the National Committee to review and modernize its previous work. The resulting entity was called the National Committee on Governmental Accounting ("National Committee") ostensibly to reflect that its recommendations were applicable to other governmental units as well as to municipalities.

Thus, a reactivated and renamed Committee began its review with input from recognized experts in the field of governmental accounting and finance. 1/ The National Committee's efforts culminated with the publication of two significant volumes, Municipal Accounting and Auditing, published in 1951, and A Standard Classification of Municipal Accounts, published in 1953. These volumes updated and consolidated many of the ideas in the Committee's earlier releases.

In the late 1960s the National Committee reconvened to again update the concepts contained in these 1951 and 1953 publications. In March 1968, the National Committee issued Governmental Accounting, Auditing, and Financial Reporting, its eighteenth and most comprehensive volume, in recognition of "some changed concepts, procedures, and requirements related to governmental accounting and financial reporting which have taken place since the publication [in 1951 and 1953] of those two books." 2/

1/ Lowery, "Governmental Accounting, Auditing, and Financial Reporting," p.114.

2/ National Committee, Governmental Accounting, p. iii.

Governmental Accounting sets forth in one comprehensive, 234 page volume the principles and procedures of accounting, auditing, and financial reporting for all governmental units except national governments and their agencies. The statements and tables:

". . . when used together, constitute a detailed annual financial report of the finance officer of a governmental unit. These statements can, however, also be used in an annual audit report, and some of them could be adapted for use in the financial section of a so-called popular report. Also included are illustrative statements for interim reports prepared for shorter periods during a fiscal year. 1/

The account classifications recommended are "adaptable to all types of state and local governmental units irrespective of their size, activities, structure, or system of accounting." 2/

The National Committee explained:

"The classifications have been made elastic so that they can be condensed or expanded to meet the needs of an individual governmental unit without destroying the basic uniformity underlying its structure. The classifications will enable governmental units to report on a comparable basis simply by listing the account titles on a reporting schedule. In states which require their local governmental units to report financially on a uniform basis, some predicate their requirements on the account classifications promulgated by NCGA /the National Committee/, modified to meet needs of the given state." 3/

1/ Ibid.

2/ Ibid.

3/ Ibid [Footnote omitted].

The comprehensive and elastic nature of Governmental Accounting illustrates the utility of this text to professionals concerned with the accounting, auditing, and financial reporting process of a governmental unit. As one authority has noted, by combining generally accepted standards and principles applicable to governmental accounting with recommended procedure and practice, Governmental Accounting is:

". . . essential to any individual involved in the accounting, auditing, or financial reporting aspects of state and local government. It is a synthesis of principles, budgetary and accounting techniques, explanatory discussions, sample journal entries, and illustrative financial statements and schedules." 1/

Since the Municipal Finance Officers Association has distributed at least 32,000 copies of Governmental Accounting since its publication in 1968, 2/ it is not surprising that the activity of the National Committee on Governmental Accounting over the years has gained wide acceptance. Indeed, by 1940, the National Committee had distributed more than 12,000 of its publications, and by that time, "its statements were recognized as the generally accepted standards for municipal accounting." 3/ Such widespread distribution lead one textbook author to note, in 1948, that:

1/ Williams, Paper entitled "Generally Accepted Accounting Principles Applicable to State and Local Government," p. 7.

2/ Ibid, p. 8.

3/ The National Council on Governmental Accounting, Rules of Procedure (Chicago: NCGA, 1975), p. 1.

"There is no longer any doubt as to what constitutes good accounting, reporting, and auditing for public bodies. The work of the National Committee on Municipal Accounting in particular, in establishing standards and models in these subjects, provides an authority to which officials, accountants, and [the] public may turn with confidence." 1/

b. AICPA involvement

In contrast to the Municipal Finance Officers Association and the National Committee, the role of the AICPA until recently has been relatively passive in nature. The AICPA's predecessor entity, the AIA, supported the activity of the National Committee in two separate endorsements. A Special Committee of the AIA published a bulletin in 1934 dealing with governmental audits which noted, "the form and contents of the audit report should conform as far as practicable to the recommendations of the National Committee on Municipal Accounting, with due allowance for local conditions and requirements." 2/ The following year, the Special Committee repeated its endorsement of the National Committee, recommending that governmental accounts "be kept in accordance with the principles and classifications recommended by the National Committee on Municipal Accounting." 3/

1/ Morey, "Trends in Governmental Accounting," p. 231.

2/ Special Committee on Governmental Accounting, American Institute of Accountants, Audits of Governmental Bodies (New York: AIA, 1934), pp. 3, 7.

3/ Special Committee on Governmental Accounting, American Institute of Accountants, Accounts of Governmental Bodies (New York: AIA, 1935), pp. 3, 7.

Again, in 1953, the AIA's Committee on Accounting Procedure 1/ issued a statement of objectives which gave tacit endorsement to the activity of the National Committee. 2/

Thus, in the 1930's the AIA expressly endorsed the activities of the National Committee, and over the years the AIA and the AICPA have focused their attentions to areas other than governmental accounting. Although the National Committee and its successor organizations have received input from various sources including the AICPA and individual certified public accountants, the National Committee and its successors appear to have been the primary bodies in establishing GAAP applicable to governmental units.

The AICPA, however, has recently taken an active role in developing principles of governmental accounting. In 1974, its Committee on Governmental Accounting and Auditing published the AICPA's Audit Guide which relied heavily on the principles set forth in Governmental Accounting. The Committee noted in the preface to the Audit Guide that:

1/ The Committee on Accounting Procedure was an ancestor of the Financial Accounting Standards Board.

2/ Committee on Accounting Procedure, Accounting Research Bulletin No. 43 - Restatement and Revision of Accounting Research Bulletin Introduction, para. 5 (New York: AICPA, 1953).

"Proper use of this guide requires thorough knowledge of Governmental Accounting, Auditing and Financial Reporting. . . . published in 1968 by the National Committee on Governmental Accounting. . . .

"The blue book [Governmental Accounting] and this audit guide represent significant steps in the evolution of governmental accounting and financial reporting. This evolutionary process is continuing even today." 1/

The Committee further elaborated as to its endorsement of Governmental Accounting:

"A body of accounting practices for governmental units, that has received the general endorsement of governmental officials, the general public, and other persons interested in the financial statements of such units, has evolved over the years. The National Committee on Governmental Accounting (NCGA) in its publication entitled Governmental Accounting, Auditing and Financial Reporting (GAAFR), which has been acknowledged as an authoritative publication in the area of accounting for governmental units, has set forth 13 'basic principles' to be applied in accounting for governmental operations.

* * * *

"GAAFR's principles do not represent a complete and separate body of accounting principles, but rather are a part of the whole body of generally accepted accounting principles which deal specifically with governmental units. Except as modified in this guide, they constitute generally accepted accounting principles." 2/

1/ AICPA, Committee on Governmental Accounting and Auditing, Audits of State and Local Governmental Units (New York: AICPA, 1974), p. xi. [Hereinafter referred to as "AICPA Audit Guide"].

2/ Ibid, pp. 8-9 [footnote omitted].

The Audit Guide was published for the guidance of AICPA members "in examining and reporting on financial statements of state and local governmental units." In publishing the Audit Guide, the Committee noted:

"It [the Audit Guide] represents the considered opinion of the Committee on Governmental Accounting and Auditing and as such contains the best thought of the profession as to the best practices in this area of financial reporting. Members should be aware that they may be called upon to justify departures from the Committee's recommendations." [emphasis added] 1/

c. National Council on Governmental Accounting

Although the performance of the National Committee has had a major impact upon the development of governmental accounting, its sponsor, the Municipal Finance Officers Association expressed concern in 1973 that the ad hoc nature of the National Committee was insufficient in meeting the needs of modern society. 2/

For example, in the late 1960s, the AICPA determined that an industry audit guide was needed, and that certain aspects of Governmental Accounting required clarification or modification. Since the most recent National Committee had been discharged in 1968, there was no active National Committee to address these issues. Additionally, since the AICPA's Audit Guide was required to be

1/ Ibid, Copyright page, Notice to Readers.

2/ Robert J. Freeman, "Governmental Accounting Research and Standards - Setting: The Role of the NCGA," Governmental Finance 5 (May 1976): 7.

cleared by the Accounting Principles Board prior to the expiration of that body on June 30, 1973, the AICPA's committee could not wait for a new National Committee to be formed. 1/

The leaders of the Municipal Finance Officers Association established a task force to assess the situation. In March 1973, this task force issued its report and "stressed the need for an ongoing authoritative body to research governmental accounting and related issues and to promulgate and interpret governmental accounting and reporting standards." 2/

As a result, the Municipal Finance Officers Association established the National Council on Governmental Accounting in June 1974 as a continuing, quasi-independent body in recognition of the need "for a body to survey constantly governmental accounting principles and standards and to promulgate changes as needed." The Council is mandated to:

1/ A.M. Mandolini, "Comments by A.M. Mandolini," Exhibit A, p. 2. The AICPA's need to issue an Audit Guide prior to June 1973 lead to collaboration between the AICPA's Committee on Governmental Accounting and Auditing and a Committee of the Municipal Finance Officers Association in writing the Audit Guide, and resulted in an informal agreement of future cooperation. See Ibid, pp. 2-3.

2/ Freeman, "Governmental Accounting Research and Standards - Setting: The Role of the NCGA," p. 7.

"...develop, promulgate and interpret principles of accounting, financial reporting, and related financial management activities for governments in the United States and Canada...[and to] develop and promulgate appropriate methods, practices, and procedures for the effective implementation of such principles." ^{1/}

Such activity in the area of governmental accounting has recently attained greater visibility. The financial crisis of the City of New York has helped to expose the "overwhelming inadequacy" of the City's accounting (and financial information) system. ^{2/} One consequence of this exposure has been the enactment of the 1975 MAC Law that requires the City to adopt accounting standards which more closely approximate those standards set forth over the years by the National Committee and the AICPA.

d. MAC legislation

In June 1975, the New York State Legislature mandated the implementation of new accounting standards upon the City. In order for the City to receive financial assistance from MAC, the legislature required that the City adopt the New York State comptroller's uniform system of accounts for cities as modified by the State Comptroller for application to the City. The State Comptroller issued such modifications in a series of Accounting

^{1/} National Council on Governmental Accounting, Rules of Procedure (Chicago: National Council on Governmental Accounting, 1975), pp. 1-2.

^{2/} Jan M. Lodal, "Improving Local Government Financial Information Systems," Duke Law Journal 1976 (January 1977): 1133.

Systems Directives ("MAC Directives") which set forth the accounting and reporting principles to be followed by the City. ^{1/}

These MAC Directives are based in large part upon accounting principles previously promulgated by various interested organizations and accounting bodies. Three of such organizations are the National Council on Governmental Accounting, the AICPA, and the Financial Accounting Standards Board.

As noted earlier herein, the AICPA's Audit Guide endorsed the earlier work of the National Council on Governmental Accounting. Thus, the MAC legislation in effect mandates that the City adopt accounting principles as set forth in large measure over the years by the National Council on Governmental Accounting and its predecessor organizations.

Although the emphasis in the development of accounting principles has largely been in the commercial sector, it is clear that governmental accounting principles have developed as a result of considerable effort, research, and thought.

^{1/} Office of the New York State Comptroller, Summary of Accounting Systems Directives for New York City (As of August 31, 1976) (Report No. NYC-44-77: 30 September 1976), Managerial Summary, p. 1. [Hereinafter referred to as "Office of the New York State Comptroller, Summary of Accounting Systems Directives"].

B. Municipal Accounting and Generally Accepted Accounting Principles

The unique nature of governmental operations requires that governmental units maintain accounting systems different in character from other types of accounting systems. The National Committee and the AICPA each recommend that governmental accounting systems be organized on the basis of eight types of "funds", (segregated for the purpose of carrying on specific activities or attaining certain objectives) and two account groups. Each fund and account group constitutes an independent, separate reporting entity with individual sets of financial statements. This system is referred to as a fund accounting system. This differs from accounting for commercial enterprises, where the financial activity of an enterprise is summarized and reported in one set of financial statements for the entire reporting entity.

The meaning of the term "fund" as utilized in governmental accounting is distinguished from the meaning of the term as it is sometimes employed in commercial accounting in that the latter term refers to a type of account - an earmarked sum of cash or other assets - and in governmental accounting the term refers to a separate, distinct entity with its own self-balancing group of accounts.

The National Committee on Governmental Accounting and the AICPA recognize eight types of funds, which fall into two general categories: "operating" funds and "project" funds. "Operating" funds are designed to account for continuous and recurring transactions, and include the General Fund, Special Revenue Funds, Debt Service Funds, Enterprise Funds, Trust and Agency Funds, and Intragovernmental Service Funds. "Project" funds are principally used to account for capital improvement and similar programs of long term benefit, and these include Capital Projects and Special Assessment Funds.

In addition to eight funds, two account groups are recognized - a General Fixed Asset Group of Accounts and a General Long-term Debt Group of Accounts. Fixed assets are usually recorded in the accounts of a fund only when the fund is of a nature where the costs of the assets are recoverable from the operations accounted for by the fund, e.g., the costs of automobiles would appropriately be recorded in an Intragovernmental Service Fund. Otherwise, fixed assets which are "employed in the rendition of general governmental services to the public at large from general revenues and without remuneration on a direct service charge basis" ^{1/} such as roads, bridges, and fire trucks are referred to as "general fixed assets" and are accounted for

^{1/} National Committee on Governmental Accounting, Governmental Accounting, Auditing, and Financial Reporting (Chicago: Municipal Finance Officers Association, 1968) p. 9, [Hereinafter referred to as "National Committee, Governmental Accounting"].

in the "General Fixed Asset Group of Accounts." Long term debt is generally recorded in a fund's accounts only when revenues which are accounted for within the fund are earmarked for repayment of the debt. Otherwise, only the proceeds from long-term debt are recorded in the accounts of a fund, and the debt itself is accounted for through the General Long-Term Debt Group of Accounts.

The use of separate funds provides a convenient method of accounting for governmental activity. Various functions of government can be separately financed and controlled by individual sets of legal provisions. The fund allows a project or function to be financed by specific revenues to be expended for specific purposes defined by specific laws and regulations. For example, water and sewer operations might appropriately be accounted for in an "Enterprise Fund", which is a fund to "finance and account for the acquisition, operation and maintenance of governmental facilities and services which are entirely or predominantly self-supporting by user charges." / A motor pool or garage which offers services exclusively to other municipal departments might

/ National Committee, Governmental Accounting, p. 159.

appropriately be accounted for in an "Intragovernmental Service Fund", which is a fund "established to finance and account for services and commodities furnished by a designated department or agency to other departments and agencies within a single governmental unit." ^{1/}

Municipal accounting differs from commercial accounting in other respects as well. Commercial entities generally follow the accrual basis of accounting, while in municipal accounting, the basis of accounting is determined on a fund by fund evaluation.

The term "basis of accounting" refers to the time when revenues and expenses are recorded in the accounting records. For example, under the cash basis of accounting revenues are not recorded in the books of account until they are actually received in hand, and expenses are not recorded until each payment is made. Generally under the accrual basis of accounting, revenues are recorded at the time they are earned and expenses are recorded when the liability for them is incurred.

The National Committee stated its preference for the accrual method as a basis of accounting because this method:

^{1/} Ibid, p. 163.

"...provides a superior method of accounting for the inflow and outgo of economic resources in any organization, because it relates costs and expenditures to the time period in which benefits of the outlays are received and because it provides a more accurate matching of these benefits with any associated revenues." 1/

In endorsing the accrual method, the National Committee was critical of the cash basis 2/ and recommended that governmental units make "...maximum use of the accrual basis except in those cases where the nature of governmental financial operations does not permit the full accrual basis. In the latter cases, the modified accrual basis should be used." 3/ The AICPA has largely adopted these recommendations. 4/

1. Funds of a General Nature

According to the AICPA and the National Committee, funds established primarily to account for the revenues and expenditures for governmental operations of a general nature should use a modified accrual basis of accounting. These funds are classified as budgetary funds, and include the general fund, special revenue funds and debt service funds. The National Committee

1/ National Committee, Governmental Accounting, p. 11.

2/ The National Committee stated:

"Under the cash basis, an accurate comparison of expenditures in relation to services rendered is not possible, because the services may be rendered in one fiscal period and the disbursements related to such services not be made until the following fiscal period." Ibid.

3/ Ibid, pp. 11-12.

4/ AICPA, Audit Guide, pp. 13-17.

noted that for these funds:

" . . . the use of the full accrual basis is not feasible or practicable because of the character of their financial operations and revenue sources. . . . the expenditures of the General, Special Revenue, and Debt Service Funds do not generate and are not directly associated with fund revenues raised by taxation and other revenue-producing powers unique to state sovereignty. It is illogical, therefore, to attempt to match revenues and expenditures for the purpose of determining net income in the generally accepted manner - applicable to profit-motive organizations. At the same time, however, the basis of accounting is important in arriving at the financial position of these governmental funds, and it is for this reason that the Committee carefully defines the modified accrual basis which it recommends for these particular funds." 1/

The particular modified accrual basis recommended for such funds is:

"...that method of accounting in which expenditures other than accrued interest on general long-term debt are recorded at the time liabilities are incurred and revenues are recorded when received in cash, except for material or available revenues which should be accrued to reflect properly the taxes levied and the revenues earned."2/

The National Committee gave examples and outlined treatment appropriate for certain revenues:

" . . . some general revenues are assessed and collected in such a manner that they can be appropriately accrued on the governmental unit's accounts, whereas others cannot. Among the latter are current income taxes, sales taxes, gross receipts taxes, and such miscellaneous sources as parking meter revenues, fines and forfeits. Revenue sources which can and should be recorded on the accrual basis

1/ National Committee, Governmental Accounting, p. 12.

2/ Ibid, p. 11.

include property taxes, charges for current services, grants from other governments, and sales and income taxes where taxpayer liability has been definitely established and is legally enforceable. In the case of the property tax, for example, the tax is levied pursuant to law as of a specific date, the amount of the tax is precisely determinable in advance, and an enforceable legal claim attaches to the properties and/or taxpayers subject to the tax. The amount of property tax due a government can therefore be billed to taxpayers and recorded on the accounts of the taxing jurisdiction at the time tax statements are rendered in precisely the same manner that accounts receivable are recorded on the books of a private business enterprise." ^{1/}

The AICPA Audit Guide defines the modified accrual basis of accounting as one in which revenues should be recorded as received in cash except for (a) revenues susceptible to accrual and (b) revenues of a material amount that have not been received within the normal time for receipt. The Audit Guide then defines susceptibility and materiality as follows:

"Revenues susceptible to accrual....Revenues considered susceptible to accrual are those revenues that are both measurable and available. In substance, 'available' means that the item is a resource that can be used to finance the governmental operations during the year.

^{1/} Ibid, p. 12.

"Few types of revenues in budgetary funds possess all of the characteristics essential to meet both criteria of being measurable and available, which are requisite to being considered susceptible to accrual.

"Revenue sources that generally are not considered susceptible to accrual include those generated on a self-assessed basis, such as income taxes, gross receipts taxes, and sales taxes. Normally, such taxes would be recorded as revenue when received.

* * * * *

"Revenues of a material amount. Some revenues, even though not susceptible to accrual, should be recorded prior to actual receipt. Generally, material revenues otherwise not recorded until received should be accrued if receipt is delayed beyond the normal time of receipt. . . .

"Material revenues received prior to normal time of receipt should be recorded as deferred revenue. For example, if sales tax revenue normally is received after the financial statement date, but for some reason is received before the financial statement date, the amount should be recorded as deferred revenue until time of normal receipt." 1/ [Emphasis Added]

1/ AICPA, Audit Guide, pp. 14-16.

Expenditures, on the other hand, should be recorded on the accrual basis, except for:

"(a) disbursements for inventory type items, which may be considered expenditures at the time of purchase or at the time the items are used; (b) prepaid expenses, which normally are not recorded; [and] (c) interest on long term debt, which should normally be an expenditure when due." 1/

2. Funds of a Specific Nature

Funds established primarily to account for the revenues and expenditures for governmental operations of a specific nature should generally utilize the accrual basis of recognizing revenues and expenses. The AICPA classifies these funds as (1) funds which are similar to commercial enterprises, classified as (i) enterprise and (ii) intragovernmental service funds, and (2) other governmental funds, such as (i) capital projects funds, (ii) trust and agency funds, and (iii) special assessment funds. 2/ As the National Committee noted:

1/ Ibid, pp. 16-17. In addition to these three exceptions, the accrual method: further altered in situations where municipalities use an encumbrance method of accounting, initially recording expenditures based on commitments such as purchase orders and contracts.

2/ Ibid, p. 13.

"In each of these funds, expenditures can be recorded as soon as liabilities are incurred, and the nature of each fund's revenues is such that all revenues and other resources can be recorded when earned or levied. Thus, in the case of a conventional enterprise fund operation, the enterprise spends and consumes its resources to provide a product or service, the product or service is sold, and costs are matched with associated revenues to determine net income or loss. A similar cycle of commercial-type operations takes place in an intra-governmental service fund which periodically bills using departments for services rendered by the fund to them." 1/

Within a given municipality, the basis of accounting is determined on a fund by fund evaluation. It is likely that some funds within a given municipality might utilize the accrual basis of accounting and others the modified accrual basis.

Except for minor differences, the views of the National Committee and the AICPA are in agreement concerning the basis of accounting to be used by the funds of a municipality.

These and other GAAP standards applicable to governmental units have evolved over the years and since at least 1968, have been codified by a recognized authoritative body. While GAAP standards are not perfect they ". . . have been developed as a result of considerable research and thought, and . . . represent the 'state-of-the-art' in municipal financial reporting." 2/

1/ National Committee, Governmental Accounting, p. 12.

2/ Price Waterhouse & Co., draft copy of a report entitled, "A Review of Certain New York City Financial Reports for the Fiscal Years 1974-75 and 1975-76," December 13, 1976, pp. 2-3.

The phrase "generally accepted accounting principles" is a term which "encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time....Those conventions, rules and procedures provide a standard by which to measure financial presentations." 1/

Generally accepted accounting principles for municipalities have existed authoritatively since at least 1934. 2/ Since that time, the National Committee on Municipal Accounting and its successor organizations under the sponsorship of the Municipal Finance Officers Association have periodically published guidelines for governmental accounting with the cooperation and support of the AIA.

The eighteenth such publication, Governmental Accounting, is the most comprehensive of these publications. Also referred

1/ AICPA, Professional Standards, Volume 1: Auditing, Management Advisory Services, Tax Practice (New York: AICPA, 1975): Section 411.02 [Hereinafter cited as "AICPA, Professional Standards, Volume 1"].

2/ The reader should be aware that accounting thought, knowledge, and literature as applicable to both municipal and commercial entities existed prior to the decade of the thirties, but it wasn't until the thirties, with its economic depression in the aftermath of the stock market crash, that professional accounting societies began issuing their "authoritative" pronouncements.

to as the "blue book", Governmental Accounting updates and combines many of the previously issued guidelines and has gained recognition as an authoritative publication by many professional organizations dealing with governmental accounting and finance. including the AICPA 1/ and the Office of the New York State Comptroller. 2/

The accounting concepts set forth by these organizations, clearly represent the "state of the art" in municipal financial reporting. City Comptroller Goldin recognized the importance of these concepts in observing, that by deviating from such standards, New York City during the last decade and longer had "developed an accounting and budgeting system which by neatly accomodating deficits, provided an invitation to profligacy." 3/

1/ AICPA, Audit Guide, p. 9.

2/ Office of the New York State Comptroller, Accounting Systems Directive No. 6 (13 April 1976): 1-2.

3/ Division's Exhibit "Harrison J. Goldin No. 99 for Identification," p. 3. Comptroller Goldin testified that this document was apparently prepared after the creation of MAC in June 1975.

APPENDIX B

The Nature and Importance of Internal Control

Although internal control procedures vary with each individual entity, in general:

"Internal control constitutes the methods followed by a company /or other fiscal entity, such as a City/ (1) to protect assets; (2) to protect against improper asset disbursement; (3) to protect against the incurrence of improper liabilities; (4) to assure the accuracy and dependability of all financial and operating information; (5) to judge operating efficiency; and (6) to measure adherence to company-established /or City-established/ policies." 1/
/Emphasis added/.

The Comptroller General of the United States has stated that "internal control comprises the plan of organization and all the coordinate methods and measures adopted to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. The term embraces the policies, procedures, and practices established or encouraged by management as well as the plan of organization and other measures intended to carry them out." 2/

1/ Arthur W. Holmes and Wayne S. Overmyer, Auditing Principles and Procedures (Homewood, Illinois: Richard D. Irwin, Inc., 1971), p. 86.

2/ Comptroller General of the United States, Standards for Audit of Governmental Organizations, Programs, Activities & Functions (Washington, D.C.: U.S. General Accounting Office, 1972), pp. 32-33.

The Comptroller General goes on to note that the characteristics of a satisfactory system would include:

- "1. A plan of organization that provides segregation of duties appropriate for proper safeguarding of the entity's resources.
- "2. A system of authorization and record procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenses.
- "3. An established system of practices to be followed in performance of duties and functions of each of the organizational departments.
- "4. Personnel of a quality commensurate with their responsibilities.
- "5. An effective system of internal review.

"These elements, as important as each is in its own right, are mutually reinforcing and all are so basic to adequate internal control that serious deficiencies in any one normally would preclude effective operation of the system." ^{1/}

The AICPA divides its discussion of internal control into administrative control and accounting control, and has focused principally on accounting control:

"Accounting control comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:

- a. Transactions are executed in accordance with management's general or specific authorization.
- b. Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets.

^{1/} Ibid, p. 33.

- c. Access to assets is permitted only in accordance with management's authorization.
- d. The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences." 1/

Of these, the AICPA considers that the overriding criterion for both administrative and accounting controls "is the bearing which particular controls have on the reliability of financial statements . . . " 2/ Any appropriate system of internal control should serve to provide reasonable assurance that financial information is reasonably accurate.

The AICPA has outlined certain concepts implicit in the definition of accounting control, some of which it applied to the definition generally, and some of which it applied to the "essential" character of accounting.

1/ AICPA, Professional Standards, Volume 1, Auditing, Management Advisory Services, Tax Practice (New York: AICPA, 1975), Section 320.28. Administrative controls are described as controls which "comprise the plan of organization and all methods and procedures that are concerned mainly with operational efficiency and adherence to managerial policies and usually relate only indirectly to the financial records. They generally include such controls as statistical analyses, time and motion studies, performance reports, employee training programs, and quality controls." Ibid, Section 320.27. See also Section 320.27. [Hereinafter referred to as "AICPA, Professional Standards, Volume 1"].

2/ AICPA, Professional Standards, Volume 1, Section 320.12. On January 19, 1977 in Securities Exchange Act Release No. 13185, the Commission issued rulemaking proposals concerning internal control for registrants falling under its jurisdiction. These proposals are "designed to . . . promote the reliability and completeness of . . . financial information," and substantively adopt the objectives articulated by the AICPA as set forth above.

A. General Concepts

It is management's responsibility to establish and maintain the system of accounting control, and the cost of accounting control should not exceed the benefits to be derived. The concepts of accounting control are independent of the method of data processing used and apply equally to manual, mechanical, and electronic data processing systems. There are inherent limitations in any system, such as the possibility of errors arising from misunderstanding of instructions, mistakes of judgment, employee carelessness through distraction or fatigue, and intentional circumvention through collusion. 1/

b "Essential" Concepts

The AICPA also has outlined concepts, distinct from its "general" concepts. These are applicable to the essential characteristics of internal accounting control: 2/

Personnel. Personnel should be competent, honest, independent and should understand prescribed procedures.

Segregation of functions. Procedures designed to detect errors and irregularities should be performed by persons other than those who are in a position to perpetrate them.

1/ For a more complete discussion of these concepts see Professional Standards, Volume 1, Sections 320.31-320.34.

2/ For a more complete discussion of these characteristics see Professional Standards, Volume 1, Sections 320.35-320.48.

Execution of transactions. Independent evidence should be obtained to provide assurance that transactions are executed as authorized by persons acting within the scope of their authority and that transactions conform with the terms of the authorizations.

Recording of transactions. Transactions should be "recorded at the amounts and in the accounting periods in which they were executed and [should] be classified in appropriate accounts". This depends "largely on the availability of some independent source of information that will provide an indication that the transactions have been executed." In addition, transactions "should be recorded as promptly as practicable when the recording is necessary to maintain accountability for assets such as cash, securities, and others that are susceptible to loss from errors or irregularities."

Access to Assets. Access to assets should be limited to authorized personnel. "The number and caliber of personnel to whom access is authorized should be influenced by the nature of the assets and the related susceptibility to loss through errors and irregularities." ^{1/}

^{1/} Access to assets in this context includes both direct physical access and indirect access through the preparation or processing of documents that authorize the use or disposition of assets.

Comparison of recorded accountability with assets.

Records of assets should be compared with actual assets "to determine whether the actual assets agree with the recorded accountability. . . . Typical examples of this comparison include cash and securities counts, bank reconciliations, and physical inventories."

By its nature internal control is intrinsic to an effective accounting system and has a bearing upon the accuracy and reliability of an entity's financial data. While a poor system of internal control may not necessarily mean that financial data is unreliable, incomplete, or incorrect, it substantially increases that risk.

C. Applicability of Internal Control to Municipalities

Although the concept of internal control is often considered with reference to expression of an opinion by an independent auditor, the absence of independent audit does not affect the need for a properly functioning system of internal control. The system of internal control is one of checks and balances. The absence of an independent audit removes an important check and therefore increases the need for a strong system to compensate. This is no less true of a municipality than of any other entity. As early as 1956, one expert wrote that internal control is one of the most important considerations in any accounting system, including a governmental accounting system. "In governmental accounting, internal control is important because the essence

B7.

of representative government is the existence of a system of checks and balances to safeguard taxpayers and other citizens." ^{1/}

The National Committee noted in 1968 that although a detailed discussion of internal control was beyond the scope of Governmental Accounting, they mentioned that such discussion is readily available in numerous standard texts on accounting systems and auditing.

^{1/} R.M. Mikesell, Governmental Accounting (Homewood, Illinois: Richard D. Irwin, Inc., 1956), p. 15. The author was a CPA and professor of accounting at Indiana University. He noted on page 16 of his book that the three most important factors in the effectiveness of an internal control system are:

"1. An organizational structure with sufficient diffusion of responsibilities to permit apportionment of steps in a transaction, or in recording it, among two or more persons.

"2. A personnel staff large enough to permit distribution of duties and operations among a number of employees, that is, to provide for what is commonly called 'cross-checking'.

"3. Competent and thorough administration of the system. No system of internal control is self-enforcing, and a poorly administered system may be worse than none at all."

APPENDIX C

Application of Generally Accepted Accounting Principles
to the Unrecorded Pension Cost Liability of New York City

In the normal course of business, all pension plan sponsors regularly make adjustments, usually minor, in actuarial assumptions. Such changes are based on changes in circumstances (higher employee turnover for instance) which necessitate changes in assumptions. Generally accepted accounting principles require that these estimates be adjusted on a regular and timely basis.

The AICPA Industry Audit Guide for state and local governments 1/ states that the provisions of APB Opinion No. 8 are applicable to governmental units and the MAC Directive No. 8 2/ effectively prescribes the treatment set forth in Opinion No. 8. While some portion of the liability (that arising prior to the effective date of APB Opinion No. 8 - December 31, 1966) might be applied prospectively in connection with any retroactive adoption by the City of the Principles set forth in that Opinion, 3/ at least that portion of the additional liability resulting from the use of outdated actuarial assumptions during the period subsequent to the City's fiscal year ended June 30, 1968 (the year which the opinion was first applicable to the City) should be treated as an adjustment to the cumulative deficit.

-
- 1/ AICPA Industry Audit Guide "Audits of State and Local Governmental Units" (1974), pages 152-153.
- 2/ Office of the New York State Comptroller, "Accounting Systems Directive No. 8" (July 7, 1976).
- 3/ Accounting Principles Board Opinion No. 8 "Accounting for the Cost of Pension Plans" (AICPA, November 1966), paragraphs 48-49.

C2.

Under APB Opinion No. 20 1/ an error must be distinguished from a change in estimate. Errors result from mathematical mistakes, mistakes in application of accounting principles, or "oversight or misuse of facts that existed at the time the financial statements were prepared". 2/ A change in estimate results from new information or subsequent developments and accordingly better insight or improved judgment. APB Opinion No. 20 requires prospective treatment of changes in estimates but retroactive treatment for correction of errors. 3/ The provisions of Opinion No. 20 are applicable to governmental units. 4/

1/ Accounting Principles Board Opinion No. 20 "Accounting Changes" (AICPA, 1974), paragraph 13. APB Opinion No. 8 did not address the question of error corrections.

2/ Ibid, paragraph 13 (Emphasis added).

3/ Ibid, paragraphs 31 and 36.

4/ AICPA Industry Audit Guide "Audits of State and Local Governmental Units" (1974), pages 145-147.

Chapter Three



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**THE ROLE OF
THE CITY AND ITS OFFICIALS**

August 26, 1977

S E C U R I T I E S A N D E X C H A N G E C O M M I S S I O N

S T A F F R E P O R T

O N

T R A N S A C T I O N S I N S E C U R I T I E S
O F T H E C I T Y O F N E W Y O R K

Introduction and Summary

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Report on Accounting Practices and Financial Reporting	Chapter Two
Report on the Role of the City and Its Officials	Chapter Three
Report on the Role of the Underwriters	Chapter Four
Report on the Role of the Rating Agencies	Chapter Five
Report on the Role of Bond Counsel	Chapter Six
Analysis of Questionnaires Sent to Individual Investors, Syndicate Members and Managing Underwriters	Chapter Seven

Chapter Three

REPORT ON

THE ROLE OF THE CITY AND ITS OFFICIALS

August 26, 1977

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I. INTRODUCTION

The principle of full disclosure which applies to corporations applies equally to government officials. If they are not open and candid, if they manipulate important fiscal information, the result can only be a credibility gap of even greater proportions than the budget gap. ^{1/}

Securities issued by the several states and their political subdivisions (including the City of New York) are offered and sold extensively through the use of the mails and other facilities of interstate commerce. Indeed, large offerings of such securities, such as those made by the City of New York, could not be sold otherwise. Moreover, such securities are offered, sold and traded nationally and internationally — not simply within the borders of the issuing state or political subdivision.

By virtue of the large dollar amount of municipal securities issued and outstanding each year, such securities are a major factor in the Nation's economy and the national securities markets. In light of the national scope of the municipal securities markets, there is an overriding federal interest in assuring that there is adequate disclosure of all material information by issuers of municipal securities.

^{1/} Remarks by New York City Comptroller Harrison J. Goldin, Luncheon Meeting of New York Financial Writers' Association, March 4, 1975, printed in full in a press release of the Comptroller of that date.

Although municipalities have certain unique attributes by virtue of their political nature, insofar as they are issuers of securities, they are subject to the proscription against false and misleading disclosures.

From the perspective of investors, information concerning the fiscal health of any issuer of municipal securities, including the City of New York — which was the largest issuer of municipal securities in this country at the time under investigation — is obtained through the issuer's public statements concerning its finances and related affairs. The nature of these statements and the assumptions upon which they are based must be carefully and accurately communicated to the public, so that potential investors may be fully informed of all material facts relevant to their investment decision.

II. THE ORGANIZATION OF THE CITY OF NEW YORK:
CITY OFFICIALS AND THE BUDGETARY PROCESS

A. Governmental Organization ^{1/}

The financial management of the City of New York is largely the responsibility of the Mayor and the Comptroller.

1. The Office of Mayor

The powers of the Office of the Mayor of the City of New York are not exclusively executive. The Mayor, who is an elected official, serves as the

^{1/} This discussion is based upon the structure and organization of the City of New York as it existed during fiscal 1974 and fiscal 1975, and is intended to provide only an overview of these matters in the context of the budget process. On August 5, 1975, the State Charter Revision Commission for New York City published proposed amendments to the Charter of the City of New York, some of which would modify the duties and responsibilities of the major City officials as they existed during the period covered by this Report.

City's "chief executive officer," and he is vested with the broad, discretionary powers that generally are attributable to a mayor of a large municipality, such as the authority to appoint and remove numerous city officials. 1/

The Mayor exercises control over the budgetary process. He is required, by April 15 of each year, to "submit to the board of estimate and the [City] council (1) a proposed [Expense] budget for the ensuing fiscal year, and (2) a budget message, both of which shall be public records" 2/ The Mayor's budget message is required to include, among other things: "Estimates of all revenue receipts and recommendations for any changes in the revenue and fiscal sources and operations 3/

After the City Council and the Board of Estimate have had an opportunity to review and approve or modify the Mayor's budget, the Mayor has the authority to "disapprove any such increase, decrease, omission, addition or change and return such budget to the board of estimate and to the [City] council, setting

1/ See New York City Charter ("Charter") Chapter I § 3 and Chapter I generally. The Mayor, for example, may "create or abolish bureaus, divisions or positions within his executive office as he may deem necessary to fulfill his duties," Charter §3. In addition, the Mayor "... shall appoint the heads of administrations, departments, all commissioners and all other officers not elected by the people..." Charter §6.

2/ Charter §116. The Board of Estimate is composed of the Mayor, the Comptroller, the President of the City Council and the presidents of the boroughs, and is responsible, in essence, for the management of the City's real property and related activities. Charter, §§61-68.

3/ Charter §117 b. 3.

forth his objections thereto in writing." 1/ The Board of Estimate and the City Council, acting separately, may override the Mayor's modifications by a two-thirds vote. 2/ The Mayor "... shall keep informed during the course of each fiscal year, of the progress of expenditures and the receipt of revenues...." 3/

In addition to an Expense Budget, the City of New York also maintains a "Capital Budget" for capital projects of the City. This budget cannot exceed the maximum amount of debt which the Mayor certifies that the "city may soundly incur for capital projects during the ensuing fiscal year...." 4/ After the Mayor receives a proposed Capital Budget from the City Planning Commission, 5/ he submits an Executive Capital Budget to the Board of Estimate and the City Council. 6/ Thereafter, the budget review process is essentially the same as that for the Mayor's Expense Budget. 7/

The Mayor also has the "powers of a finance board under the local finance law." 8/

1/ Charter §121b.

2/ Charter § 121c.

3/ Charter § 123b.

4/ Charter § 215.

5/ Charter § 217.

6/ Charter § 219.

7/ Charter §§ 222, 223.

8/ Charter § 8c; Local Finance Law, § 2(4) (McKinney Ed. 1968).

Accordingly,

...whenever the mayor determines that obligations [of the City] should be issued and the amount thereof, he shall certify such determination to the comptroller who shall thereupon determine the nature of the term of such obligations and shall arrange for the issuance thereof. 1/

Abraham D. Beame was the Mayor of New York during most of the period covered by this Report.

2. The Office of Comptroller

The Comptroller, who is also an elected official, serves as the City's chief financial officer. In summary, he serves as advisor to

... the Mayor, the board of estimate and the [City] council on the financial condition of the city . . . and make[s] such recommendations, comments and criticisms in regard to the operations, fiscal policies and financial transactions of the city as he may deem advisable in the public interest." 2/

In connection with the annual preparation of the City's budgets, the Comptroller is required to submit to the Mayor, the City Council and the Board of Estimate certain detailed information with respect to, among other things, the status of various budgeting accounts and the "maximum amount and nature of debt which in his opinion the city may soundly incur for capital projects during each of the six succeeding fiscal years" 3/

Within four months after the close of the fiscal year, the Comptroller is required to "...publish a statement for such year, including a full and

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- 1/ Charter § 8c.
2/ Charter § 93.
3/ Charter § 212.

detailed statement of the receipts and expenditures of the city and the cash balance or surplus at the end of the fiscal year, an itemized statement of all taxes due and uncollected at the close of the fiscal year..." and numerous other categories of specific information. 1/

The Comptroller is also required to make certain types of periodic reports to the Mayor, such as a monthly report and estimate of the operations of the sinking funds and an annual report on those funds. 2/

Harrison J. Goldin was City Comptroller during most of the period covered by this Report, and Abraham D. Beame was his immediate predecessor in office.

3. Other City Officials

The Mayor and Comptroller were assisted in the performance of their duties by a number of high-level City officials:

James A. Cavanagh, Paul Gibson, Jr., and Judah Gribetz were Deputy Mayors, who, among other things, "act as the representative of the mayor on boards and committees, exercise jurisdiction over all legislative and ceremonial functions, . . . [and] supervise the executive office...." 3/ They were appointed by the Mayor.

Melvin N. Lechner was Director of the Budget, and was charged with the responsibility of preparing an executive budget for the ensuing fiscal year. He was appointed by the Mayor. 4/

1/ Charter § 93g.

2/ Id.

3/ Charter § 7.

4/ Charter § 111.

Seymour Scher, Florence Dreizen and William T. Scott were Deputy Comptrollers, who "...advise and assist the comptroller in all matters relating to borrowings and the investment of funds." 1/ They were appointed by the Comptroller. 2/

Ivan E. Irizarry, Finance Administrator, was in charge of the Finance Administration, which, among other things, was responsible for publishing once a month "...a full and detailed statement of the receipts and expenditures of the City during the preceeding month and the cash balance or surplus on the last day of such month." 3/ In addition to these duties, "...immediately after the closing of public inspection and examination of the books of annual record of the assessed valuation of real estate the administrator shall cause to be prepared from such books assessment-rolls for each borough in such manner as shall be provided by law." 4/ He was appointed by the Mayor. 5/

Sol Lewis, Chief Accountant, supervised the Bureau of Accountancy. Among other things, Lewis kept the City's official books and records, prepared the Comptroller's various statutory reports, including the annual report, was involved in the estimation of the City's cash requirements and how they were to be met, and

1/ Charter § 94.

2/ Id.

3/ Charter § 1521.

4/ Charter § 1513-1.

5/ Charter § 6.

prepared some of the documents necessary for the sale of securities. 1/ W. Bernard Richland, the City's Corporation Counsel, was responsible for the ". . . conduct of all the law business of the city . . ." and for ". . . the preparation of all . . . bonds and other legal papers of the city. . . ." 2/ He was appointed by the Mayor. 3/

B. The Budget

New York City's budget was the fundamental tool for managing its fiscal affairs. The City Charter required the preparation of two distinct budgets - the Expense Budget and the Capital Budget. The City Charter also established certain dates by which various events in the budgeting process must occur. 4/ The fiscal year of the City is July 1 - June 30.

1. The Expense Budget

The Expense Budget is an estimate for the upcoming fiscal year of the City's operating expenditures for municipal services of an ongoing nature, including police, fire, sanitation, education and debt service for the City's debt. It also includes estimates of funding sources necessary to support these expenditures, derived from real estate and other taxes, Federal and State aid, debt proceeds and other sources. 5/

1/ The staff has been unable to locate any authority within the Charter for New York City for the appointment of the Chief Accountant; we assume that he is appointed by the Comptroller pursuant to implied authority.

2/ Charter § 394.

3/ Charter § 6.

4/ See Charter, Chapter 6, as to the Expense Budget, and Chapter 9 as to the Capital Budget.

5/ See Charter, Chapter 6.

There is no statutory requirement that the Expense Budget be balanced when initially submitted by the Mayor, but the City Charter requires the City Council to establish the real estate tax rate so as to accomplish this purpose. 1/ Local law requires the City to balance its budget. 2/

Both the Board of Estimate and the City Council have the power to alter the budget as submitted by the Mayor, but the Mayor may veto any such action. Such a veto can be overridden only by a two thirds vote of both bodies. 3/ At the completion of this process, the budget is deemed finally adopted. 4/

After its adoption, various items in the Expense Budget may be modified by the Mayor, 5/ although some modifications require approval of the City Council and Board of Estimate. 6/ The City Council is empowered to modify only its own budget appropriation. 7/ All budget modifications are published in the City Record. 8/

2. The Capital Budget

The Capital Budget reflects appropriations for "capital projects" as defined in the City Charter. These include schools, hospitals, streets,

- 1/ Charter § 1515.
- 2/ Id.
- 3/ Charter §§ 120, 121.
- 4/ Charter § 121.
- 5/ Charter § 124b, c and f.
- 6/ Charter § 124c.
- 7/ Charter § 124f.
- 8/ Charter § 124.

sewage treatment plants, and other projects. 1/ Capital Budget expenditures are supported by long term borrowing ("funded indebtedness"), short term debt issued in anticipation thereof, and Federal and State aid. 2/ The Capital Budget is submitted, altered and adopted in the same way as the Expense Budget. 3/

C. The New York State Local Finance Law

1. Background

The Local Finance Law is a compilation of the New York State law relating

1/ Charter § 211:

The term "capital project" shall mean:

- (a) Any physical public betterment or improvement or any preliminary studies and surveys relative thereto.
- (b) The acquisition of property of a permanent nature including wharf property.
- (c) The acquisition of any furnishings, machinery, apparatus or equipment for any public betterment or improvement when such betterment or improvement is first constructed or acquired.
- (d) Any public betterment involving either a physical improvement or the acquisition of real property for a physical improvement consisting in, including or affecting:
 - (1) Streets and parks;
 - (2) Bridges and tunnels other than those crossing navigable waters.
 - (3) Receiving basins, inlets and sewers, including intercepting sewers, plants or structures for the treatment, disposal or filtration of sewerage, including grit chambers, sewer tunnels and all necessary accessories thereof;
 - (4) The fencing of vacant lots and filling of sunken lots.
- (e) Any combination of the above.

2/ See Charter, § 225 and 250.

3/ See Charter, Chapter 9.

to municipal finance and the management of municipal corporations. 1/
According to the former counsel to the Temporary State Commission for the
Study, Revision and Codification of the Laws Relating to Municipal Finance,
the purpose of the Law is to

[L]et a unit of government find in some other law
the power to spend, . . . [and] armed with such
authority, . . . turn to the Local Finance Law
for the power to borrow and for guidance in all
the processes involved. 2/

The concept that municipalities in New York State should be restricted
in the amount of debt which may be incurred was a result of the economic
crisis of 1873-1874, wherein

excess optimism and demand for local improvement,
hastened by waste, extravagance and corruption . . .

led to the conclusion that the

. . . mischief to be prevented was the creation of an
excessive debt, the carrying charges of which would
fall upon current revenues and the principal upon
posterity. 3/

2. Debt Limit

The above conclusion as to municipal debt resulted in an amendment to the
State Constitution limiting the long-term debt the City may issue for any
purpose to a maximum of 10 percent of the latest five year average of the

1/ The Local Finance Law is a highly technical, complex series of statutes,
and for purposes of this Report a detailed analysis of the Law is not
necessary. Accordingly, we have summarized only the salient features
of this Law.

2/ Lounsberry, The Scope and Basis of the Local Finance Law, published as
an introduction to the Local Finance Law (McKinney Ed. 1968).

3/ McCabe v. Gross, 274 N.Y. 39, 46, 8 N.E. 2d 269, 276 (1973).

full valuation of taxable property in the City. 1/ This 10 percent debt limit is commonly referred to as the "general debt limit." Certain types of debt are not subject to this limitation, including Tax Anticipation Notes ("TANs"), Revenue Anticipation Notes ("RANs") and certain Bond Anticipation Notes ("BANs"), obligations of Public Benefit Corporations ("PBCs") 2/ and indebtedness contracted to provide water, sewage, rail transportation, and certain other services and which was issued during certain time periods or met other specific tests. 3/ Although PBC obligations are excluded from the debt ceiling, the City is "liable" for loans made to PBCs by the State, in a manner similar to that of a guarantor. 4/

The State Constitution also provides that the City may contract additional indebtedness for low rent housing, nursing homes for low income patients and urban renewal purposes in an amount not to exceed two percent of an amount generally calculated in the same manner as the general debt limit. 5/ Certain types of indebtedness are not subject to the two percent limit, including the City's liability for repayment of State loans to PBCs (absent default by the PBC). This two percent Constitutional debt limitation is separate from, and in addition to, the general 10 percent debt limit. 6/

1/ New York State Constitution, Article 8, Section 4.

2/ Id., Article 8, Section 5. PBCs are corporate governmental agencies created by State Legislation to finance and operate projects or to perform services which may more effectively be provided than by the government itself.

3/ Id., Article 8.

4/ Id., Article 18, Section 5.

5/ The 2% limit, however, is calculated using assessed rather than full valuation. Id., Article 18, Section 4.

6/ Id., Article 18.

Under the New York State Constitution, the City is authorized to raise the full amount necessary to service its long-term debt by means of the real estate tax levy. In addition, the City is authorized to use the real estate tax levy to meet its expenses in an amount not exceeding 2-1/2% of the latest five-year average of the full valuation of taxable real estate within the City, less the amount of real estate taxes to be used to service short-term debt. 1/

Long-term debt may generally be issued only for periods not in excess of ". . . the period of probable usefulness of the object or purpose for which such indebtedness is to be contracted. . . ." 2/

D. Balancing the Budget

The City is required by law to balance its budget. 3/ As section III of this Report will show, New York had incurred chronic budget deficits for several years prior to fiscal 1975. The borrowings necessary to support the City's budget deficits were made possible by various techniques, which, among other things, allowed the City to accelerate accrued revenues and taxes while deferring recognition of expenditures. The following is a summary of certain of these techniques. 4/

1. "Capitalization" of Expenses

Although the City's two-part budget ostensibly distinguished between "operating" and "capital" expenditures, the distinction in practice was

1/ New York State Constitution, Article 8, Section 10.

2/ New York State Constitution, Article 8, Section 2.

3/ See page 9, n. 2, *supra*.

4/ A fuller treatment of these techniques, insofar as they impacted on the City's accounting practices, may be found in Chapter Two herein, Accounting Practices and Financial Reporting ("Accounting Report").

increasingly eroded. Items of a type historically financed by the Expense Budget were shifted to the Capital Budget in increasing proportions. The financing of expense items through the Capital Budget grew from \$195 million in 1971 to \$722 million in 1975. In the eleven year period through 1975, these amounts totalled over \$2 billion. ^{1/} The principal source of these current operating funds was long-term "funded" debt.

2. Improper Revenue Accruals

The City employed numerous techniques to justify accelerating the accrual of additional revenue. It accrued in June of each fiscal year estimated revenues to be received subsequent to fiscal year end and changed billing dates on water charges and sewer rents to recognize 18 months of revenue in a 12 month period.

3. Overstatement of Receivables

The City significantly overstated its federal and state aid and real estate tax receivables.

4. Pension Plan Practices

The City has five pension funds. By law, the Mayor has a fiduciary relationship, as trustee, to four of the funds and the Comptroller has a fiduciary relationship, as trustee, to all five of the funds. The City's pension funds have all been seriously underfunded. Moreover, at the direction of the Mayor and the Comptroller (who has been delegated sole investment authority) the funds made major purchases of City securities at the height of the City's fiscal crisis. ^{2/}

^{1/} Unpublished document titled "A Presentation to Mayor Beame's Council of Economic and Business Advisors by the Citizens Budget Commission," November 8, 1974 (Division's Exhibit "Abraham D. Beame No. 24 for identification").

^{2/} See Section IV. G, "Pension Fund Transactions," below. The "two year lag" was also applied to the fifth fund in 1971, during Mr. Beame's second term as Comptroller. Id.

In all but one pension fund, required contributions were made a full two years after they became due. This two year delay in making required contributions combined with outmoded actuarial assumptions have served to postpone billions of dollars of contributions by the City to the Pension Funds. "Excess" interest earned by the Pension Funds inured to the benefit of the Expense Budget, by reducing the City's already inadequate contributions by the amount of purported "excess" interest earned by the funds. It is likely that the City had an unfunded accrued liability to the pension funds, as of June 30, 1975, in excess of \$8 billion.

5. Payroll Costs

The City used a 364 day year in computing payroll liability. This postponed recognition of one additional day of payroll (or two in leap years) each year. As a consequence of several years of such practices, the Municipal Assistance Corporation ("MAC") ^{1/} indicated the City had to recognize \$130 million in accrued liability as of June 30, 1975.

E. Avoiding Debt Limitations on Issuing Long Term Debt

While not technically a budget balancing technique, certain tactics used by the City to circumvent its long term debt limits are relevant, insofar as they contributed to the City's massive debt. The City used public benefit corporations ("PBCs") to issue debt securities which otherwise would be charged to the City's applicable debt limits. The City wrote off \$520 million, as of June 30, 1975, which had been previously booked as "actual receipts" from proposed borrowings by the Stabilization Reserve Corporation ("SRC"), a PBC, when no receipts had actually been received by the City, then or ever. In addition,

^{1/} MAC was a state instrumentality created to aid New York City after the City was foreclosed from the debt markets in March, 1975.

the City freely switched certain debt from the 2% to the 10% limit, and back again, to suit its own purpose. This practice was first revealed by then Comptroller Beame in October, 1973. 1/

These practices continued through 1975. 2/ The facility with which this switching was accomplished is exemplified by testimony given to the SEC's staff by Steven Clifford, Special Deputy Comptroller.

Q: What types of housing debt are discharged against the two percent limitation?

A: I don't know. They used to transfer things back and forth between the ten and the two. I never understood it.

Q: Who was responsible for the transfers?

A: It was a combination of Budget and Comptroller. 3/

Finally, the overvaluation by the City of its real property 4/, in addition to its effect on the City's ability to issue short-term TANS, impacted on the City's ability to incur long term debt as well. Including city-owned and other non-taxable property in the City's real estate tax base increased the long term debt limits, which limits are based on an average of the assessed and full valuation of taxable real estate. 5/

1/ Report pursuant to Section 212 of the Charter with respect to the 1974-1975 Capital Budget and the Capital Program for Five Succeeding Fiscal Years (Oct. 15, 1973) at pp. 2-3, Division Ex. (Cavanagh) 3.

2/ See, e.g., Division Ex. (Lewis) 7.

3/ Testimony of Steven Clifford at pp. 159-160.

4/ See Accounting Report at p. 27 et seq.

5/ See Office of State Comptroller, Audit Report NYC-26-76 (Interim Report No. 2), at p. 9.

III. THE SECURITIES OFFERED AND SOLD BY THE CITY OF NEW YORK AND THE EFFECT OF THE MORATORIUM

On March 31, 1975, the City of New York had over \$14 billion of total debt outstanding, or about \$1,850 for each of the City's 7.5 million residents. Over \$2.4 billion of this debt was due to mature before June 30, 1975.

The City has traditionally relied upon the offer and sale of its debt securities to generate funds for municipal purposes. ^{1/} Both recent and long-term fiscal history of the City indicate that this reliance has been growing continually.

The growth in the City's long-term ("funded") debt is illustrated in the following table:

<u>Fiscal Year</u>	<u>Net Funded Debt **</u>	<u>Percent Increase Over 1915</u>
1915	\$ 973,734,136	
1925	1,291,524,543	32.6
1935	1,864,243,094	91.4
1944-45	2,285,233,052	134.6
1954-55	2,645,570,120	171.7
1964-65	3,919,838,874	302.6
1974-75	6,798,025,969	598.1

* Source: Annual Report of the Comptroller of the City of New York for Fiscal Year 1975-1976.

** Net funded debt is the difference between the gross funded debt and sinking fund holdings.

^{1/} For a discussion of the history of debt financing in the State of New York and New York City generally, see Lounsberry, The Scope and Basics of the Local Finance Law published as an introductory comment to the Local Finance Law (McKinney Ed. 1968).

In the two year period ending June 30, 1969, the City managed to reduce its net funded debt by about \$24 million, but in fiscal 1970 increased it by more than \$131 million. This marked the beginning of a series of continuous debt increases.

During the six-year period from fiscal 1970 through fiscal 1975, the City's net funded debt (excluding short-term debt) increased by about \$2.5 billion, an amount greater than the increase in net funded debt of the City for the prior 30 years.

As shown by Table II, the City offered and sold massive amounts of short-term debt securities and nearly doubled its total debt outstanding during this period.

TABLE II*

Summary of Total New York City Debt Outstanding, 1970-1975

(\$ thousands)

As of June 30	Short-Term Debt	Long-Term Debt	Total Debt
1970	1,288,175	5,235,830	6,524,005
1971	2,319,355	5,635,306	7,954,661
1972	2,650,205	6,379,963	9,030,168
1973	2,517,510	6,916,792	9,434,302
1974	3,415,875	7,651,952	11,067,827
1975	4,540,175	7,766,578	12,306,753

*Source: Annual Report of the Comptroller, Parts 6-A and 6-C for the respective years.

As a consequence of this increased reliance upon short-term debt, debt service costs (amounts needed to pay principal and interest on outstanding debt) became a recurring, significant segment of the City's expenses, as shown by Table III.

Table III
Debt - Service Expenses

(\$ thousands)

<u>Fiscal Year</u> <u>ended June 30</u>	<u>Debt</u> <u>Service*</u>	<u>Expense</u> <u>Budget*</u>	<u>Budget Devoted to</u> <u>Debt Service</u>
1970	705,753	6,722,824	10.5
1971	781,819	7,744,761	10.1
1972	847,433	8,659,194	9.8
1973	1,099,101	9,560,928	11.5
1974	1,175,973	10,287,546	11.4
1975	1,826,965	11,895,019	14.0

* Extracted from Annual Report of the Comptroller for the appropriate year.

This rapid increase in debt service costs, coupled with the City's increased reliance upon short-term debt to fill the gap between projected expenses and revenues, compelled the City to compete on a regular, recurring and ever-increasing basis for the funds of investors. Table IV lists the offerings and redemptions made by the City during the period October 1974 through June 1975.

TABLE IV
NEW YORK CITY DEBT
NINE MONTHS ENDING JUNE 30, 1975

DATE	INDIVIDUAL ISSUES	AGGREGATE DAILY ISSUES	INDIVIDUAL ISSUES REDEEMED	AGGREGATE DAILY REDEMPTIONS	TOTAL DEBT OUTSTANDING	MONTHLY CHANGE IN DEBT OUTSTANDING	TYPE OF LIABILITY
9/30/74					12,971,721,730		
10/01/74			61,890,000	61,890,000	12,909,831,730		Funded Debt
10/11/74			300,000,000	300,000,000	12,609,831,730		RANS
10/15/74			5,000,000				URNS
			18,032,000	23,032,000			Funded Debt
10/16/74	475,580,000	475,580,000	138,400,000	138,400,000	13,062,379,730		Funded Debt
10/18/74			68,345,000		12,923,979,730		RANS
	97,355,000						URNS
	420,405,000	517,760,000	370,405,000	438,750,000	13,002,989,730		RANS
10/31/74			5,100,000	5,100,000	12,997,889,730	26,168,000	Funded Debt
11/01/74			81,100,000	81,100,000	12,916,789,730		Funded Debt
11/12/74			130,000,000				TANS
	115,000,000		500,000,000				RANS
	500,000,000	615,000,000		630,000,000	12,901,789,730		RANS
11/15/74			5,159,100	5,159,100	12,896,630,630	(101,259,100)	Funded Debt
12/01/74			2,076,800	2,076,800	12,894,553,830		Funded Debt
12/13/74	200,000,000						TANS
	400,000,000	600,000,000			13,494,553,830		RANS
12/15/74			4,842,000	4,842,000	13,489,711,830		Funded Debt
12/18/74			200,000,000	200,000,000	13,289,711,830	393,081,200	TANS
1/01/75			66,297,000	66,297,000	13,223,414,830		Funded Debt
1/13/75	620,000,000		650,000,000				RANS
					13,393,414,830		RANS
1/15/75	200,000,000	820,000,000		650,000,000	13,393,414,830		RANS
2/01/75			52,534,000	52,534,000	13,340,880,830	51,169,000	Funded Debt
2/14/75			64,827,640	64,827,640	13,276,053,190		Funded Debt
2/15/75	290,000,000	290,000,000			13,566,053,190		RANS
			4,476,020	4,476,020			Funded Debt
2/24/75	161,440,000	161,440,000	300,000,000	300,000,000	13,703,017,170		RANS
2/25/75	170,000,000	170,000,000	170,000,000		13,573,017,170		RANS
	248,980,000	248,980,000		170,000,000	13,651,997,170	311,116,340	BANS
3/01/75			16,425,000	16,425,000	13,635,572,170		Funded Debt
3/05/75	140,000,000	140,000,000			13,775,572,170		RANS
3/14/75			200,000,000				RANS
	537,270,000				13,885,572,170		RANS
3/15/75		537,270,000	227,270,000	427,270,000	13,885,572,170		Funded Debt
3/20/75	375,000,000		70,574,000	70,574,000	13,814,998,170		RANS
		375,000,000	140,000,000	140,000,000	14,049,998,170	398,001,000	RANS
3/31/75					14,049,998,170		RANS
4/01/75			6,091,000	6,091,000	14,043,907,170		Funded Debt
4/14/75			600,000,000	600,000,000	13,443,907,170		TANS
4/15/75			44,473,000	44,473,000	13,399,434,170		Funded Debt
4/18/75	30,000,000						URNS
		30,000,000	107,610,000	107,610,000	13,321,824,170	(728,174,000)	URNS
5/01/75			67,827,000	67,827,000	13,253,997,170		Funded Debt
5/15/75			1,694,000	1,694,000	13,252,303,170		Funded Debt
5/30/75			220,000,000	220,000,000	13,032,303,170	(289,521,000)	BANS
6/01/75			348,000	348,000	13,031,955,170		Funded Debt
6/11/75	380,000,000		502,000,000				TANS
			250,000,000				RANS
	52,500,000	431,500,000		752,000,000	12,711,455,170		RANS
6/15/75			722,000	722,000	12,710,733,170		Funded Debt
6/25/75	248,980,000	248,980,000					BANS
			248,980,000	248,980,000	12,710,733,170		BANS
6/30/75			375,000,000				BANS
			248,980,000				BANS
	<u>220,000,000</u>	220,000,000		623,980,000	<u>12,306,753,170</u>	(725,550,000)	BANS
	5,861,510,000		6,526,478,560		12,306,753,170		

An examination of the City's debt transactions during the period October 1, 1974 to June 30, 1975 indicates a pattern of interlocking redemptions and sales of City debt securities which suggests that the City relied on the contemporaneous sale of additional short-term debt to meet its continuing debt-service obligations. 1/ Indeed, the City's ability to meet its general cash flow needs during this period was almost wholly dependent upon its ability to obtain purchases for its short term debt. As the City's Chief Accountant is claimed to have said in March, 1975, absent the ability to borrow, the City could go bankrupt. 2/

1/ See e.g., 1974-1975 Annual Report of the Comptroller, part 6-C.

2/ Margolies Ex. 4.

IV. KNOWLEDGE OF THE CITY AND ITS OFFICIALS DURING THE PERIOD OCTOBER, 1974 TO MARCH 1975, OF FACTS MATERIAL TO THE ISSUANCE OF CITY DEBT SECURITIES IN THAT PERIOD

A. INTRODUCTION

The purpose of this Section of the Report is to analyze the extent to which the City and its officials knew material facts which should have been disclosed in statements made by City officials in connection with the offer and sale of City debt securities. Part V of the Report will examine whether City officials disclosed these material facts.

B. KNOWLEDGE OF CITY OFFICIALS CONCERNING OVERSTATEMENT
OF FEDERAL AND STATE AID AND REAL ESTATE TAX RECEIVABLES

On August 29, 1975, the Municipal Assistance Corporation ("MAC") attributed \$778 million of the City's cumulative deficit as of June 30, 1975 to uncollected Federal and State aid and other receivables for the fiscal years 1971-1975. 1/ In October 1976, in refining the MAC figures, the Office of the City Comptroller attributed \$963 million of the revised \$5.078 billion deficit as of June 30, 1975 to a re-evaluation of aid receivables (\$678 million) and to the establishment of a reserve for Federal and State aid disallowances (\$285 million). 2/

In the summer of 1975, the State Comptroller estimated that \$408 million or 80% of the \$502 million of the City's real estate taxes receivable as of June 30, 1975 had been overstated. 3/ On August 29, 1975, MAC wrote off the entire \$502 million of real estate tax receivables. 4/

1. Federal and State Aid Receivables

Federal and State assistance is an integral component of the City's Expense Budget, amounting to 44.46% of the City's Expense Budget revenues for the fiscal year ending June 30, 1974. 5/

1/ Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1975-1976, p. 25, note M.

2/ Id.

3/ Office of the New York State Comptroller, Audit Report NYC-26-76, (Interim Report No. 2 - Uncollected Real Estate Taxes), at 4.

4/ Municipal Assistance Corp. Press Release dated August 29, 1975.

5/ Annual Report of the Comptroller of the City of New York for the fiscal year 1973-74, at viii (Oct. 31, 1974).

The City's internal control procedures for recording, maintaining and monitoring State and Federal accounts receivables were inadequate, and as a result, the amounts of State and Federal aid receivables shown on the City's books were necessarily unreliable. 1/

Melvin N. Lechner, Director of the Bureau of the Budget, who was responsible with the Mayor for the aid estimates, testified:

I think there was [sic] serious problems in the accounting information, the recordkeeping, the bookkeeping, the tracking, the monitoring, the following up on the receivables State and Federal aid, and that a number of practices were wrong and had to be changed. 2/

In the six years prior to and including fiscal 1975, the City consistently overstated these receivables. 3/ The City borrowed in anticipation of these overstated receivables by selling RANs. 4/

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- 1/ Office of the New York State Comptroller, Audit Report No. NYC-3-76 (Interim Report No. 1 - Prior Years Accounts Receivable) at 2.
- 2/ Testimony of Melvin N. Lechner taken June 4, 1976 at 358-9.
- 3/ Accounting Report, at 18, et. seq.
- 4/ Office of the New York State Comptroller, Audit Report No. NYC-3-76 (Interim Report No. 1 - Prior Years Accounts Receivable), p. 1-2 of Managerial Summary.

The City continued to carry on its books Federal and State aid as receivables without making an independent audit or verification of them. 1/ The City's borrowings were based upon the Mayor's estimates of receivables. 2/ Indeed, the City apparently defined an aid "receivable" to be the amount of its budget "estimate," and assumed (despite massive evidence to the contrary) that all estimated receivables would be collected.

A significant amount of the City's claimed receivables were challenged by Federal or State authorities. 3/ The City, however, did not remove such disputed receivables from its books. 4/ Deputy Mayor Cavanagh was shown

1/ This fact was confirmed in a memorandum from Sol Lewis to Comptroller Goldin dated May 29, 1975, wherein Mr. Lewis suggested additions to the forthcoming MAC prospectus. He stated the following:

"The portion of the Expense Budget funded with State and Federal aid is based on estimates by the Bureau of the Budget. Once the budget is adopted these are reflected on the books of the Comptroller's Office as receivables. It should be noted that these receivables have never been independently audited."

See Office of the Comptroller, City of New York, Annual Report of the Comptroller of the City of New York for the Fiscal Year 1973-1974, at viii.

- 2/ Section 25.00(c)(2) of the N.Y. Local Finance Law provides that the mayor must estimate the receivables available to support the issuance by the City of Revenue Anticipation Notes. N.Y. Local Fin. [McKinney §25.00(c)(2) n. 19].
- 3/ Office of the New York State Comptroller, Audit Report No. NYC 3-76 (Interim Report No. 1 - Prior Years Accounts Receivable) at 3 of Managerial Summary.
- 4/ Memorandum from Steven Clifford to Harrison J. Goldin, dated Oct. 1, 1974 (Goldin Div. Ex. 36).

a paragraph from the State Comptroller's Interim Report 1/ which indicated that the City carried Federal and State receivables on its books even when these receivables were attacked by Federal and State officials as being improper. Mr. Cavanagh rationalized the procedure by stating that by removing the receivable in question from the City's books, the possibility of collection of that claim would be destroyed. 2/ Therefore, the City kept all claims alive as long as possible whenever there was the remotest possibility of collection. 3/ There was no disclosure of the fact that the City carried disputed receivables on its books, did not reserve against the possibility of non-collection, and borrowed against these receivables by issuing RANs.

2. Real Estate

As discussed previously in the Accounting Report, the entire \$502 million of uncollected real estate taxes as of June 30, 1975 were written off. 4/ Examples of the various real estate receivables which the City carried on its rolls as of June 30, 1975 were the following: publicly-owned property totalling \$126.6 million; diplomatic property totalling \$4.7 million; and \$43.9 million for Penn-Central, a bankrupt corporation. 5/ Inclusion of these inflated tax levies on the City's rolls had the effect of increasing the City's overall debt limit, and permitted borrowings against inflated

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- 1/ Cavanagh Testimony at p. 322. The reference is to the Audit Report of the New York State Comptroller No. NYC-3-76 (Interim Report No. 1 - Prior Years Accounts Receivable) at 3.
- 2/ Cavanagh Testimony at at 322.
- 3/ Id. at 323-24.
- 4/ Municipal Assistance Corp. Press Release dated August 29, 1975.
- 5/ Office of the State Comptroller, Division of Audits and Accounts Report NYC-26-76. Report on New York City's Central Budgetary and Accounting System (Interim Report No. 2 -- Uncollected Real Estate Taxes), at 2

receivables. 1/ There was no disclosure of the fact that a significant portion of the City's real estate tax receivables were uncollectible, that the City did not reserve against the possibility of non-collection, and that the City was issuing TANs against uncollectible tax receivables.

3. Knowledge of Officials in the Comptroller's Office Concerning Over-estimation of Federal and State Aid and Real Estate Tax Receivables

It appears that senior officials in the Comptroller's office, including Comptroller Goldin, knew prior to and during the City's fiscal crisis that the City overstated its aid and tax receivables.

In a May 4, 1976 speech, 2/ Comptroller Harrison J. Goldin described some of the conditions which existed "at the start of the City's fiscal crisis" with respect to the accounting and budgeting aspects of Federal and State aid receivables and real estate taxes. He stated, in part, that:

The City could not be sure of the amount of valid State and Federal receivables because agencies conducted their own negotiations on Federal and State grants, provided their own budgetary input on the amounts expected, spent the money long before the grants were received (if, indeed, they were ever received) and clung to a touching faith in the validity of receivables long after they had proved as unreliable as a politician's promise.

* * *

The City could never count on receiving the full amount of real estate taxes budgeted in any particular year, because it insisted on budgeting 100 percent of the tax levy though it was the invariable experience in New York - even in better times - that collections run less than 95 percent of the tax levy. The difference in the case of tax levy of over three billion would obviously be somewhere around \$200 million.

* * *

1/ Id. at 3.

2/ Address of New York City Comptroller Harrison J. Goldin, at the Annual Conference of Municipal Finance Officers Association of the United States and Canada, San Francisco, California - May 4, 1976.

There was a broad feeling, I believe, that even though the City's accounting and budgeting had been revealed as a kind of Rube Goldberg conception - a system which defied understanding or control - it was better to leave it alone as long as it churned out enough money to meet the bills and pay the debts. 1/

During the relevant period, numerous memoranda were prepared by officials in the Comptroller's Office evidencing significant knowledge and concern with various types of budget gimmickry, including the overstatement of receivables.

Steven Clifford, a consultant to the Comptroller and the Charter Revision Commission, expressed extreme concern with the City's treatment of Federal and State aid receivables and real estate taxes. He expressed this concern repeatedly in written memoranda to and discussions with the Comptroller and other officials in the Office. 2/

Clifford, in an attachment to a memorandum dated May 15, 1974 and directed to the Charter Revision Commission, discussed several Charter solutions to the budget problem. A copy of this memorandum was also given to Goldin. 3/ One of the areas addressed was overestimation of federal assistance. Clifford stated as follows:

To avoid the embarrassment of having to report a deficit, more refined techniques of overestimation are used, for example, medicaid. When medicaid claims are submitted to the Federal Government, they become receivables against which the City can borrow. When the Federal Government questions and disallows some claims, they still remain receivables. After all maybe the feds will change their minds after the next presidential election. No need to be hasty. Knowledgeable sources in the Budget Bureau estimate that the City is carrying over \$200 million in questionable medicaid receivables on its books. 4/

1/ Id.

2/ Clifford Testimony at 341 and 194.

3/ Clifford Testimony at 76.

4/ Clifford Memorandum to the Commissioners of the Charter Revision Commission dated May 15, 1974, Appendix Heading Off Reality at the Budget Gap, at 2 (Clifford Div. Ex. 4)

Finally the ultimate in phony revenues - self taxation. This year the City will levy real estate taxes of about \$40 million on property owned by the City itself and borrow against these receivables. These taxes will then be cancelled four years from now. 1/

In yet another memorandum to Comptroller Goldin, dated October 1, 1974,

Clifford stated, in part:

To balance the expense budget, the City employs a series of unsound budgeting and accounting practices including carrying forward bogus receivables, levying taxes on City-owned property...[and] overestimation of revenues.... 2/

He urged the Comptroller to take a number of actions to examine these "unsound budgeting and accounting practices." 3/ Among the actions Clifford recommended were audits by October 15, 1974 of "two of the most egregious accounting practices of [the City]: (1) the carrying forward of receivables; and (2) the levying of taxes on City owned property." 4/ It was Clifford's suggestion that Comptroller Goldin expose these two accounting practices because "postponing the day of reckoning through unsound accounting and budgeting will only aggravate the problem." 5/ The recommended audits were never undertaken. 6/ Goldin testified that his First Deputy Comptroller

1/ Id. at 3.

2/ Memorandum from Steven Clifford to Harrison J. Goldin dated October 1, 1974 at 1, (Clifford Div. Ex. 5).

3/ Id. at 2-3.

4/ Id. at 3.

5/ Id. at 2.

6/ See Clifford Testimony at 104; Goldin Testimony at 176.

reported that the audits were not feasible because, among other things, they would have involved "... after the fact disallowances [of receivables] ... [and] post-hoc changes in the law." 1/

In Mr. Clifford's appendix to the October 1, 1974 memorandum, he listed the unsound practices to which he was making reference. These included, among others:

1. Carrying forward of receivables - In New York City, we create a receivable not when we bill for services, not when we deliver reimburseable services, but when we estimate revenues.... In this method overestimations of state and federal aid need never be recognized, they can simply be rolled over.
2. Self taxation - The City continues to levy taxes on property after the city takes title to the property. This gives the City a real estate tax receivable against which it can borrow even though no taxes will ever be paid.... 2/

This memorandum further stated that "The total amount of bad receivables which may have been rolled forward may exceed \$500 million." 3/

On October 8, 1974, Steven Clifford and Jonathan Weiner wrote a memorandum to Seymour Scher, First Deputy Comptroller, regarding the amount of short-term debt that was being issued in anticipation of Federal and State aid receivables. This memorandum once again raised the issue of the validity of these receivables. 4/ The authors stated:

1/ See Goldin Testimony at 178.

2/ Id. at 4.

3/ Id. at 4.

4/ Internal Memorandum from Steven Clifford and Jonathan Weiner to Seymour Scher dated October 8, 1974 (Div. Ex. 6, Clifford).

The much more difficult and probably more important issue to be resolved is the validity of the State and Federal receivables as of 6/30/74. This is by no means an easy task.... 1/

On December 19, 1974, Clifford forwarded a memorandum to Comptroller Goldin and other officials 2/ of the Comptroller's office proposing that the City recognize reductions in real estate taxes due to delinquencies and remove City owned property from the tax rolls in order to eliminate unsound accounting and budgeting practices. This memorandum actually suggested writing off certain receivables -- \$500 million of Federal and State Assistance and \$510 million in real estate taxes, specifically allocating \$80 million to City owned property presently on the tax rolls and \$430 million to recognition of real estate tax reductions. 3/

On January 21, 1975, Clifford prepared a memorandum to Comptroller Goldin regarding "Presentation on Financial Crisis to 'Influentials'". In this memorandum, Clifford reiterated a number of points which he had already made to Comptroller Goldin and other key officials of the City. He indicated that increases in the amount of short-term debt could not be explained by delays in receipt of Federal and State aid. Furthermore, he pointed out that these receivables have never been audited and might be seriously overstated. 4/

1/ Id. at 2.

2/ Memorandum from Steven Clifford to Comptroller Goldin and others dated December 19, 1974 (Clifford Div. Ex. 9).

3/ Id. at 4.

4/ Memorandum from Clifford to Goldin dated January 21, 1975 (Clifford Div. Ex. 15, at 1).

Thus, between October 1974 and January 1975, Comptroller Goldin was repeatedly advised that the Federal and State aid receivables which the City used to support its RAN offerings were significantly overstated. In addition, Comptroller Goldin had been advised by this date that the real estate tax receivables which the City used to support its offerings of TANs were also significantly overstated. As the fiscal crisis intensified, the invalidity of the City's real estate tax receivables became increasingly clear to the Comptroller's Office.

On March 18, 1975, for example, Irwin Shapiro of the Comptroller's Office prepared a memorandum for Jerome Turk of that office regarding "Validity of Real Estate Tax Receivables as Basis for Outstanding Tax Anticipation Notes." It stated that:

It is apparent that payment of the above outstanding Tax Anticipation Notes payable during the 1974-1975 year will have to be met from current revenues and not from the collection of Real Estate Taxes Receivable as of 6/30/74. 1/

This memorandum reflects that over 50% of these receivables were rolled forward from the years 1969 to 1973 and that approximately \$40 million of these receivables originated prior to 1969. It further reflects a very low rate of collection for taxes overdue in prior years. 2/

In mid or late March 1975, Herman Charbonneau, a Vice President of Chemical Bank, and another Chemical Bank official, had a lunch meeting

1/ Memorandum from Irwin Shapiro to Jerome Turk, dated March 18, 1975, at 1 (Clifford Div. Ex. 20).

2/ Id.

with Robert Wilson of the Comptroller's staff during which the City's fiscal problems were discussed at length. Charbonneau testified that Wilson told him a substantial amount of aid receivables being carried on the City's books were "fabricated." 1/

1/ Charbonneau at 351-54.

4. Knowledge of Officials of the Mayor's Office Concerning Over Estimation of Federal and State Aid and Real Estate Tax Receivables

Abraham D. Beame, prior to becoming Mayor of New York City on January 1, 1974, had served two non-consecutive terms as Comptroller of the City of New York - from 1962 through 1965 and subsequently from January 1970 to December 31, 1973. 1/ From 1952 to 1962, he served as New York City's Director of the Budget. 2/ In these capacities he was intimately involved in the City's budgetary and accounting practices. This involvement continued while he was Mayor of New York City. 3/

The Mayor, pursuant to statute, has the responsibility for certifying to the City Council an estimate of Federal and State aid applicable to the current year's budget. 4/ Because the internal accounting controls maintained by the City both during the period of the City's fiscal crisis, and for a number of years prior thereto, were grossly inadequate, 5/ the estimates of receivables were necessarily inaccurate. In fact, these receivables were substantially overstated both during Mr. Beame's tenure as Comptroller and as Mayor. 6/

1/ Beame Ex. 2.

2/ Id.

3/ Beame testimony 9-12, 32-34, 55-56; Clifford testimony 116-117.

4/ N.Y. Local Fin. L. [McKinney §25.00(c)(2)].

5/ Accounting Report; Melvin Lechner testimony, at 358-359.

6/ Accounting Report.

During Mr. Beame's second term as Comptroller and first term as Mayor, the amounts of uncollected real estate taxes increased consistently and significantly each year, from \$187.5 million as of June 30, 1969, to \$502.2 million as of June 30, 1975. 1/ The real estate assessment roles are kept by the City Finance Administrator, who is appointed by and reports to the Mayor. 2/

Indeed, increases in real estate tax delinquencies prompted Steven Clifford, when he was with the City's Finance Administration in 1969, to have a computer run made on the 200 highest tax delinquencies in the City at that time. As a result, he determined that a large portion of these delinquencies were receivables on City owned property. 3/ Clifford brought this to the attention of the City's Finance Administration and the Bureau of the Budget. A Budget Bureau official advised Clifford that he was reluctant to remove these properties from the tax rolls, because doing so would reduce the City's debt limit. It was later reported to Clifford that the Budget Director determined not to remove the properties. 4/

In fact, a portion of both the Federal and State aid receivables and the real estate receivables which were ultimately written off by MAC as of June 30, 1975 were created and carried forward during Mayor Beame's tenure as Comptroller, as well as having been carried forward from prior periods. A report by the New York State Comptroller indicates that for the fiscal years ending June 30, 1973, and June 30, 1974, Federal and State aid

1/ Accounting Report, at 29.

2/ See Section II of this Report, supra.

3/ Clifford Testimony, at 81-89.

4/ Id.

receivables had been overstated by \$324 million. 1/ The cumulative uncollected balance of real estate taxes increased from fiscal 1969 to fiscal 1975 by over \$314 million.

During Mayor Beame's tenure as Comptroller, the City's Finance Administration prepared analyses of real estate tax receivables as of June 30, 1972 and later as of June 30, 1974 (by which time Mr. Beame was Mayor). Each of these studies showed a large increase, not only in uncollected real estate taxes, but also in the amounts of real estate taxes due from publicly owned properties - primarily the City itself (\$59 million out of \$283 million as of June 30, 1972 and \$150 million out of \$409 million as of June 30, 1974). 2/ Therefore, uncollected tax receivables from publicly owned property were carried and increased on the City's books during the tenure of Mayor Beame as Comptroller.

Thus, the practice of overestimating Federal and State aid receivables and real estate tax receivables was engaged in during at least part of the time Mr. Beame was Comptroller and continued during his tenure as Mayor.

The 1974-75 budgets were the first Mr. Beame was responsible for as Mayor. In commenting during May, 1974, on the soundness of the Mayor's expense budget,

1/ Resulting in a deficit of \$291.7 million. Office of the State Comptroller, Audit Report NYC-3-76, (Interim Report No. 1), p. 4 of managerial summary.

2/ Office of the State Comptroller, Audit Report NYC-26-76 (Interim Report No. 2), p. 2 of managerial summary.

John Weiner, then a consultant to the Comptroller's office, noted that he was surprised to see "some rather outrageous gimmickry (of the genre usually reserved for 'last minute skulduggery . . .')", some "phony savings in revenues" and "unsound practices." 1/ He stated that "thus far, \$530 million (at least) in budget balancing items for 1974-75 is gimmickry, a total of which I believe surpasses most previous excesses." He further stated that "Beame is storing up a lot of trouble for himself. What in fact will be done next year? Borrow again?" He concluded with a recommendation to Goldin that ". . . you must responsibly disassociate yourself from some of these practices. . . ." 2/

First Deputy Director of the Budget, John Lanigan, who assists the Mayor in estimating Federal and State aid receivables, suggested in a meeting on March 3, 1975 with members of the Comptroller's office that one method to meet a portion of the needed increase in the City's debt limit would be for Lanigan to increase the amount of the City's Federal and State aid receivables. 3/

In October, 1974, Deputy Mayor Cavanagh, in a memo to Mayor Beame, indicated concern with overstated "revenues", albeit no specific mention was made of receivables. 4/ He specifically pointed out that one cause of the "1974-1975 budget problem" was "gimmicks - overstatements of

1/ Memorandum from John Weiner to Harrison J. Goldin, May 6, 1974.

2/ Id.

3/ Clifford Ex. 22, memo from Lewis to Scher and Goldin, March, 1975.

4/ Memo from Deputy Mayor Cavanagh to Mayor Beame, October 26, 1974, at 1.

revenues, understatements of expenses." 1/

Deputy Mayor Cavanagh testified in response to staff inquiries that it was the City's policy to continue to carry State and Federal aid receivables on its books even when these receivables were attacked by federal and state officials as being improper. He indicated that the City kept its claims alive as long as possible whenever there was the remotest possibility of collection. The City did not remove the receivables on the City's books, according to Cavanagh, so as not to destroy the possibility of collection of the claim. 2/ Mayor Beame also testified before the staff that he was aware that certain receivables carried on the books during fiscal 1975, and which were ultimately written off, were receivables from the federal government, the validity of which the federal government disputed. 3/

Many persons directly involved in the City's financial crisis, with whom the Mayor dealt regularly on issues concerning the City's finances and debt structure, including persons in the Comptroller's office, the Mayor's office, officials of the major New York City underwriters, the Comptroller's Technical Debt Management Committee ("CTDM"), the Financial Community Liasion Group ("FCLG"), the Finance Administration, the Budget Bureau and others were aware of or concerned with the possibility that the City's Federal and State aid receivables and the real estate receivables were overstated.

During essentially the same period, the Mayor had a number of meetings with certain of the aforementioned persons, as well as others, in which the

1/ Id.

2/ Cavanagh testimony at 322.

3/ Beame testimony at 63-64.

City's fiscal problems was the general topic. In at least three such meetings, the reliability of the City's receivables was discussed either by the Mayor or officials of New York's major underwriters.

On December 17, 1974 the CTDM met at Gracie Mansion. In attendance were banking and City officials including Frank P. Smeal of Morgan Guaranty Trust Co., Comptroller Goldin and Mayor Beame. At one point Smeal indicated that there were doubts as to whether or not City debt had a first lien on revenues. Later on, following Smeal's comment "that you cannot run the City on borrowed money," Mayor Beame is reported to have stated that "we are borrowing against firm receivables." Mayor Beame also indicated that the City borrowed against expected revenues, as it has always done. 1/

On March 11, 1975 at a FCLG meeting attended by City officials and leading underwriters, Mayor Beame stated that all short-term borrowing was against anticipated revenue due to New York City. 2/

On March 17, 1975 at a meeting with the Mayor attended by various bank officials, including Ellmore Patterson of Morgan, David Rockefeller of the Chase Manhattan Bank and William Spencer of Citibank, the financial community's growing concerns with the City's fiscal future were discussed. 3/ At this meeting the general subjects contained in a memorandum prepared by

1/ Minutes of CTDM Committee Meeting, December 17, 1974 (Goldin Div. Ex. 28). Attached hereto as Appendix A.

2/ Rousseau Div. Ex. 15, Chronology at March 11, 1975.

3/ Patterson testimony at 78.

a bank officer for the meeting were discussed. Among the subjects listed in the memorandum were various "gimmicks" used to balance the budget, including the overestimation of Federal and State aid receivables. 1/

In addition to the previously mentioned expressions of concern with the overstatement of Federal and State aid receivables, there were a number of public announcements concerning these and related issues during this same period of time, such as the following:

On January 10, 1975 David Breen, formerly a municipal bond analyst of Weeden & Co., stated in a speech delivered before the City Club of New York that delinquent real estate taxes had increased from \$80.4 million in fiscal year 1969-70 to \$148.6 million in fiscal year 1973-74. This represented a delinquency rate increase of 85%. If the delinquency rate of the first quarter of fiscal 1975 continued for the entire year, it appeared that \$190 million of such taxes would not be collected in the next fiscal year. 2/ The next day, the Mayor and Comptroller issued a joint press release attacking Breen's speech, indicating among other things that Breen was "irresponsible." The release did not respond substantively to Breen's allegations concerning receivables. 3/

In an address before the New York Municipal Analyst Group on January 24, 1975, John Fava, Deputy Finance Administrator, outlined four options for

1/ Proposed Statement to Mayor Beame by Patterson, Rockefeller, and Spencer, on March 17, 1975. (Patterson Div. Ex. 7)

2/ Chronology at January 10, 1975.

3/ Chronology at January 11, 1975.

New York City that could be put into effect should the City's receivables prove to be overestimated. 1/

In a press release dated February 18, 1975 Ivan E. Irizzary, New York City Finance Administrator, responded to newspaper reports appearing the previous weekend claiming the City's real estate tax arrearages amounted to \$460 million. Mr. Irizzary stated:

of the reported \$460 million of City real estate tax arrearages, \$356 million is chargeable to years prior to the beginning of the current fiscal year, with some of it dating back more than 10 years. Another \$45 million erroneously attributed to "tax arrearages" is not collectible by the City because of adjustments in the 1974-75 tax levy for cancellations, abatements and discounts allowed by law or required by court action. 2/

For eight of the 12 years prior to becoming Mayor, Mr. Beame had been the City Comptroller. During all of this time the City's internal accounting controls had been inadequate. The unsound practices described above existed both during his tenure as Mayor and as Comptroller. A large portion of the Federal and State aid and tax receivables carried on the City's books during his tenure as Comptroller were ultimately written off as uncollectible. Deputy Mayor Cavanagh and Mayor Beame both testified that the City continued to carry Federal aid receivables on its books even after their validity was disputed by the Federal government. 3/

1/ Chronology at January 24, 1975.

2/ Testimony of Ivan Irizzary at 94; Press release, February 18, 1975.

3/ On April 13, 1977; Hale Champion, Undersecretary of the Department of Health, Education and Welfare ("HEW"), wrote to Mayor Beame concerning certain New York State and City Federal aid receivables which have

(footnote continued)

Based upon all of the above, Mayor Beame knew the City's Federal and State aid and real estate tax receivables were overestimated and overstated. The Mayor denied any knowledge of these practices in his testimony before the staff:

- Q. Mr. Mayor, in addition to the one-shot revenues, it has been stated that the City would from time to time overestimate its revenues at the commencement of a fiscal year for purposes of producing a balanced budget.
- A. Not in my time. I certainly wouldn't permit it. I know of no such instance where anything like that occurred....

* * *

- Q. Mr. Mayor, it has been stated that the City would, in the preparation of its budget, overestimate the receivables due it from the State and Federal government.

Do you agree or disagree with that statement?

- A. Based on the information given to me by my staffs, I disagree with the statement. * * * 1/

(footnote continued)

been in dispute "for nearly three years." The letter indicates that HEW intends to propose a settlement "with respect to all valid claims submitted to date." (emphasis added) The letter does not quantify the proposed settlement, or further describe the "valid" claims referred to, and indicates that "agreed on disbursement" would be "[s]ubject to concurrence by the President and the Congress. . . ." So far as the staff is aware, negotiations as to the disputed receivables are still in progress.

1/ Beame testimony at 48, 56.

C. KNOWLEDGE OF THE CITY AND ITS OFFICIALS CONCERNING THE RISK OF NON-MARKETABILITY OF CITY SECURITIES

1. Introduction

The purpose of this part is to examine the knowledge of the City and its officials, during the period October, 1974 through March, 1975, regarding the increasing risk that the City would be foreclosed from the public markets. The City was, in fact, foreclosed from the market after March 20, 1975.

During the period October 1, 1974 through March 13, 1975, the City of New York issued about \$4 billion in short-term debt securities to the public. 1/ There was a progressively mounting concern in this period as to the City's ability to meet its debt obligations as they came due. In addition, it was becoming increasingly clear that the City's borrowing needs in the current and forthcoming fiscal years would be immense, even in relation to the City's then current record levels of short and long term borrowings. 2/ These future borrowings would be needed to retire debt obligations issued by the City as they matured or to meet other pressing cash needs of the City. 3/

Information as to the City's future ability to use the public debt markets as a source of revenue was highly material during this time period. Given the City's chronic and ever increasing expense budget deficit, the inability to obtain such borrowings in the market would impact severely on the City's ability to meet its current debt obligations as they matured.

1/ 1974-75 Annual Report of the Comptroller, parts 6-A and 6-C.

2/ See Section III of this Report, supra.

3/ Id.

2. Knowledge of the City and Its Officials

From the very beginning of the period, senior City officials knew of the escalating threat to the marketability of City debt securities. Thus, on October 7, 1974, a meeting of the CTDM was held. 1/ In attendance on behalf of the City were Comptroller Goldin, First Deputy Comptroller Seymour Scher, Third Deputy Comptroller William T. Scott, Chief Accountant Sol Lewis, and several other members of the Comptroller's staff. These City officials were advised by the City's lead underwriters that some committee members were concerned about the City's potential saturation of the market; that the City's securities might not be saleable at any yields; and that there might be a "negative reaction" from the rating agencies (such as Moody's and Standard and Poor's) to the volume of City securities being offered. Comptroller Goldin indicated that he was extremely concerned with these matters and asked the committee if it would wish another meeting with the Mayor. 2/

On the next day, October 8, 1974, Melvin N. Lechner, Budget Director, prepared a memorandum for Mayor Beame. In this memorandum, Lechner discussed the forthcoming 1976 Capital Budget. In commenting on an anticipated budget gap of \$648 million, Lechner warned that the marketability of

1/ Chronology at October 7, 1974.

2/ Minutes of the CTDM Committee, October 7, 1974.

the City's bonds "will continue to be increasingly difficult" because of (1) the size and frequency of the offerings; (2) the fact that Citibank might drop out of the bidding for City debt leaving only one bidder; (3) a change in the City's bond rating; and (4) the thin market for City obligations. 1/

Thus, Comptroller Goldin, Budget Director Lechner and Mayor Beame had actual knowledge, from the outset of this period, that the City's ability to publicly sell debt securities was in doubt. As the period progressed, the information available to the Mayor, the Comptroller and their respective subordinates only served to increase such doubts.

For example, Jonathan Weiner, Special Adviser to the Comptroller, sent a memorandum to Goldin, Scher and Scott on October 11, 1974 concerning the market for the City's short-term debt. The memorandum discussed market absorbability of City issues, using a table from the Daily Bond Buyer, SIA Supplement, October 2, 1974, as a reference. This table pointed out, among other things, that New York City issued 43.73 percent of all short-term debt securities issued by all municipalities in the first half of 1974. Moreover, Weiner stated that City short-term notes represented 27.57% of all such issues outstanding in the first half of 1974, 2/ and that this percentage would soon increase substantially. 3/

1/ Memorandum from Melvin N. Lechner to Abraham D. Beame, October 8, 1974.

2/ Memorandum from Jonathan Weiner to Harrison J. Goldin, Seymour Scher, William T. Scott, October 11, 1974.

3/ Id.

As the New York Times reported on December 16, 1974:

the Comptroller . . . thinks the city's poor performance in the debt markets reflects primarily the "tremendous glut" of city bonds and notes. "I've been saying for a considerable period of time that the City's quantum borrowing is going to lead us into a serious supply-demand problem — and it has," said Mr. Goldin in an interview last week. 1/

The gravity of the threat to the marketability of City securities was a subject of an extended meeting of the CIDM held on December 16 and 17, 1974. At the December 16 meeting, Comptroller Goldin presented a four-part program designed to (1) reduce the "glut of City paper overhanging the market," and (2) produce a "stabilizing impact on the market." 2/ In the ensuing discussion, Richard B. Nye ("Nye") of First Security Co. declared that "the Mayor must be told unequivocally of the severe market conditions which 'this gimmick [the four-part program] merely relieves temporarily.'" 3/

The CIDM meeting reconvened at Gracie Mansion at 8:00 a.m. on December 17. Mayor Beame, Comptroller Goldin, Deputy Mayor Cavanagh and Budget Director Lechner all were present. 4/ The discussion began with Wallace O. Sellers of Merrill Lynch, Pierce, Fenner & Smith making the following observations:

- (1) In recent weeks the capital markets had been a total disaster;

1/ New York Times, December 16, 1974.

2/ Goldin 27, Minutes of the CIDM Committee, December 16, 1974

3/ Minutes of CIDM Meeting, December 16, 1974.

4/ Memorandum from F.P. Smeal to file, December 17, 1974.

- (2) Some of the City's bonds had been selling at as much as 11 percent yield;
- (3) The difficulties encountered in selling the City's obligations made it "likely that there would be no bid at all" on January [1975] bond sale;
- (4) The Goldin plan presented the previous evening changed the current situation but the problem would reappear; and
- (5) Although the City's ability to pay its debt was not in question, the issue was the ability of the market to absorb issuances of the magnitude contemplated by the City. 1/

Frank P. Smeal ("Smeal") of Morgan Guaranty Trust Company concurred in Merrill Lynch's assessment that the basic problem was merely being postponed, not solved. According to Mr. Smeal, the City differed from the Federal government in that the latter prints money.

The Comptroller summarized the bank's concern that "in their present weakened condition the sheer magnitude of [City] borrowing makes it impossible for the capital markets to absorb the quantity of debt we are issuing."

In response to a statement made by Mayor Beame that the financial community and the capital markets had not carried out their responsibility to promote and purchase City obligations, Smeal retorted that "the market has just suffered the greatest losses in history in its support of the

1/ Minutes of Special CTDM Meeting, December 17, 1974, attached hereto as Appendix A.

City's debt." Nye also stressed the grave nature of the situation, emphasizing that "the whole system could come tumbling down." The Mayor responded that he was fully aware of the gravity of the situation.

The Mayor's perception of the situation appears to have been correct. At the time of the December CTDM meeting, Comptroller Goldin and other City officials were being advised by Clifford that the City had to raise "\$7.3 billion in short and long-term debt over the next ten months, but markets are already saturated." 1/ This projected need for \$730 million per month was substantially more than the City had historically borrowed in such a short period of time. 2/ Yet, despite the information conveyed at the December 17 CTDM meeting, Comptroller Goldin issued a press release immediately after the meeting which failed to disclose the material facts which had been openly discussed, and which attempted to reassure the public that the situation was well in hand. The full text of the minutes of the December 17 CTDM meeting is set out as Appendix A hereto; the Comptroller's Release is annexed as Appendix B.

On January 9, 1975, concern for the market's ability to absorb further offerings of City securities was again expressed to the Mayor and the Comptroller by the City's lead underwriters. In a meeting at Gracie Mansion called by the Mayor, the underwriters stated that the clearinghouse banks did not have the capacity to take on all of the proposed City financing by themselves. 3/ The banks pointed out, in support of their concern, that

1/ Memorandum from Steven Clifford to J. Goldin, et al., December 19, 1974 entitled Restructuring City Finances.

2/ See Section III, supra.

3/ Chronology at January 9, 1975.

the underwriters of the City's October 1974 bond issue had incurred large losses.^{1/}

As the City's financial situation deteriorated, the information flowing to the Mayor and the Comptroller increasingly questioned the City's ability to sell future debt securities.

On January 21, 1975, Clifford sent a memorandum to Comptroller Goldin regarding the City's fiscal crisis. ^{2/} The memorandum reported that, among other things: (1) interest rates were at an all-time high, and if City debt could not sell at these rates, it could not sell at all; and (2) the market could collapse, forcing a bankers' agreement or a moratorium on redemption of debt. ^{3/}

In a February 6, 1975 letter from Mayor Beame to Ellmore C. Patterson, chairman of Morgan Guaranty Trust Co., the Mayor recognized that "there have been disturbing reports of brokers advising clients not to invest in New York City bonds and notes because of the 'risk' involved." ^{4/}

Thus, by the beginning of February, 1975, both Mayor Beame and Comptroller Goldin had been apprised of the mounting concern regarding the marketability of City securities by City officials and by officials of the major New York banks, and the Mayor and Comptroller possessed or had access to information which confirmed the factual basis for this concern.

^{1/} Id.

^{2/} Memorandum, Steven Clifford to Harrison J. Goldin, "Presentation on Fiscal Crisis to 'Influentials,'" January 21, 1975.

^{3/} Id. at 2-3.

^{4/} Letter, Abraham D. Beame to Ellmore C. Patterson, February 6, 1975.

During February, the crisis intensified. At a February 20, 1975 meeting between the Mayor and the Financial Community Liaison Group, the Mayor was reportedly told that "today was the day that the money ran out." 1/ As things turned out, this statement was premature, but by only three weeks.

By early March 1975, two additional factors had further exacerbated the situation. First, the Urban Development Corporation became insolvent, thereby depressing the municipal credit market, 2/ and the City was reported to be some \$903 million short of the then-existing borrowing authority it needed to satisfy cash needs for the remainder of the fiscal year ending June 30, 1975. This projected shortfall was reported to Comptroller Goldin by Sol Lewis, Chief Accountant, on March 3, 1975. 3/ The same information had been previously communicated by Mr. Lewis to John Lanigan of the Bureau of the Budget earlier on the same date. 4/ Lewis also advised Lanigan that:

— the willingness of the financial community to absorb bond sales was so questionable that the Comptroller committed himself last December to sell no more than a total of \$640,000,000 of bonds during the first six-month period of this calendar year. 5/

The City had scheduled two BAN offerings for early March. A \$537 million sale was to take place on Thursday, March 6. While a merged syndicate eventually made a bid on the BANs which the City accepted, the

1/ Friedgut Ex. 1; Friedgut at 42.

2/ See, e.g., Annual Report of Comptroller, 1974-1975, at v.

3/ Chronology at March 4, 1975.

4/ Id.

5/ Memorandum, Sol Lewis to Harris Goldin and Seymour Scher, March 3, 1975.

conditions placed on the sale were severe. One of the conditions was that a disclosure statement, drafted by counsel for the underwriters, be issued as a press release by Comptroller Goldin at the time the announcement of the award of the notes was made. 1/ This statement, as drafted, read as follows:

Economic conditions and cash needs of the City have necessitated an extraordinary amount of borrowings by the City in the municipal credit markets in recent years and the need for such borrowings will remain large in the near future. Past and prospective borrowings are causing the City to approach its constitutional debt limit. These conditions adversely affect the City's access to the municipal credit markets, to which the City must look for the financing it deems necessary to meet expenses and maturing obligations. Thus, the interest on the Notes awarded today reflect the risk inherent in the City's present financial condition. While solving the City's fiscal problems is not an easy matter, we shall nevertheless make every effort to sell bonds to fund these notes when the time comes, and I am confident it can be done. 2/ (Emphasis added)

The underscored sentence of the draft release did, at least to some degree, touch upon the information which the Mayor and the Comptroller had been privy to in the preceding months. However, as released by the Comptroller, the statement read as follows, in pertinent part:

Other factors contributing to this high rate of interest are the recent negative occurrences in the municipal credit markets, adverse economic conditions and the City's ever increasing cash needs which had necessitated extraordinary borrowings by the City and every expectancy of a continuing need for high borrowings. While solution of the City's fiscal problems is not an easy matter,

1/ Chronology at March 6, 1975.

2/ Chronology at March 7, 1975.

Comptroller Goldin expressed his confidence that the City would, when the time comes, be in satisfactory legal and fiscal position to sell Bonds to fund these Notes. 1/

On March 13, 1975, one week following the \$537 million BAN sale, a \$375 million RAN sale was scheduled. In preparation for this offering, the Mayor, the Comptroller, Deputy Mayor Cavanagh and other City officers met with the merged syndicate on March 11, 1975. 2/ In a preparatory meeting on March 10, 1975, Ellmore Patterson, chairman of the FCLG, had told that group that the parties present must be prepared to discuss with the Mayor the issue of marketability. 3/

At the meeting with the Mayor, marketability was discussed at length. The Mayor was told that the sheer volume of short-term borrowing was a problem and that the size of the permanent rolled-over short-term debt was becoming, at best, impossible to handle. 4/ The mere assertion of the Constitutional priority of the City's debt would no longer suffice to persuade the public to buy the City's securities. 5/

Moreover, the Mayor and other officials present were told by Patterson that it was absolutely vital that the public market be kept open to the City, because the banks represented at the meeting held \$1.2 billion of City

1/ Id.

2/ Chronology at March 11, 1975.

3/ Chronology at March 10, 1975

4/ Chronology at March 11, 1975

5/ Id.

securities in their own portfolios. 1/ This sum represented 20% of the banks' aggregate net capital. 2/ Thus, the banks could not take on the contemplated offering unless they could sell it publicly. 3/

Gedale Horowitz of Salomon Bros., near the end of the meeting, stated that despite the institution of a regular borrowing schedule by the City, the number of purchasers of City securities was dwindling and the April bond issue was in jeopardy. 4/ As matters turned out, the City was unsuccessful in marketing any public offering of City debt securities between the March 13 RAN sale and the moratorium. 5/

It appears from the foregoing that both the Mayor and the Comptroller were aware of the rapidly closing debt market at a time when the City was offering and selling securities to the public without adequate disclosure of this fact and its ramifications.

1/ Id.

2/ Id.

3/ Id.

4/ Id.

5/ Id. at March 26, 1975.

D. CITY OFFICIALS' AWARENESS OF PROBLEMS WITH
THE DEBT LIMIT AND UNENCUMBERED DEBT MARGIN

The "unencumbered debt margin" is the limit on the debt the City may incur, less the total of outstanding borrowings and amounts authorized for approved capital expenditures for which bonds have not yet been sold. 1/ The size of the unencumbered debt margin was of concern to Comptroller Goldin from his first days in office. In discussing the unencumbered debt margin in February 1974, he noted that:

The extent of the unencumbered margin is considered an important factor in the investment community for purposes of assessing the attractiveness of City bonds, an assessment which translates directly into interest costs to our taxpayers and the City's ability to provide critical services. 2/ (Emphasis added)

* * * * *

. . . . diminution and certainly elimination of the City's reserve borrowing capacity is a negative factor among those who rate and among those who buy City obligations. 3/ (Emphasis Added)

In an earlier report, dated October 15, 1973, then Comptroller Beame projected an unencumbered debt margin of \$238.9 million as of June 30, 1974. 4/ However, in a memorandum dated February 1, 1974, Chief Accountant Sol Lewis advised Comptroller Goldin that as of January 31, 1974, the City

1/ February 10, 1974 Report of the Comptroller Pursuant to Section 220 of the Charter, at 6.

2/ Id. at 7.

3/ Id. at 15.

4/ October 15, 1973 Report of the Comptroller Pursuant to Section 212 of the Charter, at 11.

actually had a negative unencumbered debt margin of \$31.2 million. 1/

Comptroller Goldin, in his report of February 10, 1974, discussed the erosion of the unencumbered debt margin. He expressed concern that:

. . . the real possibility exists that absent the pursuit of these critical remedies the City may not only for the first time in modern history, at least, have no unencumbered margin whatever, but indeed, be operating with a negative margin*" (*footnote: "To be sure, at no point will the City have exceeded its legal ability to borrow.") 2/

In view of the situation, Comptroller Goldin proposed several alternative means to restore the unencumbered debt margin, including an expansion of the City's debt incurring capacity by reducing the equalization rate, the transfer from the Capital Budget to the Expense Budget of certain expenditures which historically belonged in Expense Budget, delaying the issuance of certain expenditure authorizations until the actual expenditures were imminent, the assumption by the Housing Development Corporation of additional Mitchell-Lama projects then being charged against the City's debt limit, the increased use of quasi-independent agencies to fund capital projects, or rescindments of authorizations for capital expenditures.

However, the Comptroller opined:

The above alternatives represent a wide range in terms of acceptability: all the way from prudence to mere gimmickry or worse. In my opinion, the condition calls for massive rescindments. . . . 3/
(Emphasis in original)

1/ Lewis Ex. 5.

2/ February 10, 1974, Report of the Comptroller Pursuant to Section 220 of the Charter, at 12.

3/ Id. at 14-16.

On February 10, 1974, the same date as the Comptroller's report referred to above, Melvin N. Lechner, the Director of the Budget, issued a press release which stated, in part:

Our examination of the elements which enter into the computation of the unencumbered margin indicates that the following actions can result in an unencumbered margin of approximately \$100 million on June 30, 1974:

- The anticipated approval of exclusions from the debt limit by the State Comptroller.
- The transfer of certain charges from within the debt limit to outside the debt limit.
- The rescindments included by the Mayor in his Executive Capital Budget.

We are confident that the Mayor and the Comptroller, as responsible fiscal officers, will insure that at no time will our commitments exceed the availability of funds within the debt limit. 1/

William Sharkey of the Bureau of the Budget acknowledged the negative unencumbered debt margin in a memorandum dated February 21, 1974, to Budget Director Lechner. Sharkey observed:

Although the statement is negative as of today, a number of actions now in process could make it positive as of February 28. The 58 million exclusion for housing could be approved by the State Comptroller. The 20 million exclusion for the passenger terminal could also be approved. The rescinding of the CBX for water supply would give us 11 million. With all these actions imminent it would appear premature to take drastic corrective action. . . .

1/ Press Release of the Office of the Mayor, 72-74, February 10, 1974.

The preparation of the February 28 statement will not take place until early in March. Sol is going on vacation until March 4. On his return he will inform me as to the actual condition of the statement. If needed I could then produce the amended CBX, dated prior to February 28, and thus insure that the statement is positive.

Although he [Lewis] agreed to the above, he is very nervous. I asked him to treat our conversation in confidence since I was acting on my own. I will keep you posted on the latest details as they occur. 1/

An internal memo by Jim Carney of the Comptroller's Office, dated May 30, 1974, reviewed ". . . several disturbing patterns which must be modified if this City is to remain, over the long term, fiscally and operationally viable." 2/ Identified among those areas was the problem that ". . . the unencumbered debt margin at July 1, 1974 will be exceeded by \$30 million if all planned expenditures are undertaken." 3/ Contributing to the problem was the fact that the expense budget for 1974-1975 incorporated ". . . a dramatic 25 percent increase in the use of long-term debt (capital funds) in many instances financing operating expenses that surely cannot be construed as capital improvements. . . ." 4/ The inclusion of \$715 million in capital funds in the proposed expense budget could ". . . only increase further the amount by which the debt margin may be exceeded." 5/

1/ Lechner, Ex. 8.

2/ Memo of Jim Carney, May 30, 1974, at 1.

3/ Id.

4/ Id.

5/ Id.

On June 21, 1974, Sol Lewis, Chief Accountant, reported to Comptroller Goldin concerning the continuing trend toward exceeding the City's debt limit. He stated:

This memorandum is to advise you of what has occurred to the borrowing margin since we "blew the whistle" in the February 15th Report.

The Bureau of the Budget appointed a task force, with Bill Sharkey at its head, to keep a continuing watch on the status of the unencumbered margin.

* * * *

As best as we can project now, if all the anticipated charges to the margin were to materialize on July 1, our unencumbered margin would then be between \$30 million and \$50 million negative.

But that will not happen. Budget intends to schedule authorizations for the capitalization of expense budget items (the OC items in the Capital Budget plus additions) on a quarterly basis. So it is unlikely that we will reach a negative position before the end of this calendar year.

At that time, a decision will have to be made as to whether we wish to continue to publish our present format of Debt Statement, showing a negative balance, or change it to cut off at the legal limit.

But before that, some time in September, when work begins on the Comptroller's statutory October 15 report, we will have to confront the question of the unencumbered margin.

In the preparation of that report, schedules are prepared showing all the pending charges to the margin, the estimated margin as of June 30, 1975, the estimated expansion of borrowing power to occur in fiscal 1975-1976, and the consequent availability of funds in that year. Then, the Comptroller must make a judgment as to the wisest split of the available funds as between a reserve and what should be made available for the next capital budget. The latter figure is then discussed with the Director of the

Budget with a view toward agreement between what the Comptroller says in his October 15 Report and what the Mayor certifies two weeks thereafter.

I will keep you informed of any further major developments affecting the margin. 1/

On July 15, 1974 Budget Director Lechner, in a memorandum to Mayor Beame, regarding the debt limit, stated:

Our projection of the unencumbered margin in the 10% debt limit at the close of fiscal 1975 and fiscal 1976 leads to the following conclusions:

(1) After taking into account the capital budget and expense budget claims on the debt limit during fiscal 1975, together with rather conservative estimates of budget amendments, 225 actions, additional judgments and claims, housing needs and other charges, there will be a "deficit" in the unencumbered margin of \$120 million on June 30, 1975. This figure is consistent with our discussion of these matters last January.

(2) Using our best current information about expansion of the margin for fiscal 1976 and deducting the "deficit" of \$120 million for fiscal 1975, we estimate the margin on July 1, 1976 will be approximately \$1.12 billion.

(3) Claims against the margin in fiscal 1976 for judgments and claims, continuation of expense budget funding, housing actions, "bread and butter" capital budget lines and discretionary capital projects which will be ready for funding total approximately \$1.83 billion or \$710 million more than the available unencumbered margin.

(4) Of the claims against the unencumbered margin for fiscal 1976, discretionary items, that is, new capital projects, account for \$600 million. The \$710 million short fall in debt limit room indicates an inability to fund any new capital projects in fiscal 1976 and a need to reduce current reliance on capital funds for such items as expense budget support or "bread and butter" projects by \$110 million.

(5) While we have spoken of these projections as of June 30th in each year, the actual charges may be recognized by the Comptroller much earlier in the year. Thus, for example,

1/ Lewis, Ex. 6.

the Comptroller may indicate in his October 15th statement that the margin will be exhausted and in deficit by the end of the fiscal year.

Logically there are three means of dealing with this serious and continuing problem: (i) reducing the use of borrowed funds; (ii) expanding the margin, perhaps by a further reduction in equalization rates; and (iii) new or expanded exclusions of debt currently contracted or proposed to be contracted.

Concerning a reduced rate of capital spending, it is difficult to reduce substantially the amount of debt limit charges for the current fiscal year. Some rescindment of capital budget authorizations is technically possible though perhaps politically difficult, and new charges by way of amendment or 225 action can be strenuously resisted. Nonetheless, this year's commitment seems reasonably firm. Next year, of course, we have more options, though it is difficult to foresee substantial reductions in the use of borrowed funds for the expense budget in light of the significant budget gap we can already predict.

The second possibility, expansion of the margin, seems equally unlikely. While our estimate of debt reduction and full value increase for fiscal 1976 is admittedly crude at this point, it is unrealistic to anticipate substantially higher figures. Moreover, our recent discussion of the equalization rate in Albany makes it unlikely that we will see a further, favorable change in equalization. Indeed, there is some possibility that the State Board's analysis of the equalization rates for prior years will cause it to revise the rate upward, producing even less full value than we estimate.

Finally, we are considering possible new exclusions from the debt limit. A description of these possibilities is attached. They range from reasonably straightforward shifts of debt between the 10% and 2% debt limits, through a series of legal theories for excluding present charges, to the increased use of public benefit corporations. Many of these proposals represent a change from past legal and accounting practice. All of them will require extensive discussion with the City and State Comptrollers and probably with Bond Counsel and representatives of the financial community as well.

I suggest that we meet to discuss these figures and the possible ways of dealing with them. 1/

1/ Memorandum from Melvin N. Lechner to Mayor Abraham D. Beane, July 15, 1974, 3 pages.

E. MATERIAL UNCERTAINTIES AS TO EXISTENCE OF A FIRST LIEN FOR PRINCIPAL OF SHORT-TERM NOTES

Debt service is the payment of principal and interest on all bonds and notes issued by the City of New York. Bondholders and noteholders have first claim under the State Constitution to all revenues which come into the City. 1/

Payment of debt service shall be the first lien on all of the City's revenues. 2/

1. Introduction

A source of great comfort and assurance to thousands of investors who held New York City securities was the representation that, irrespective of the City's misfortunes, their investments were totally secure. This notion stemmed from a widely-held misconception. Investors were told by City officials and others that the repayment of principal and interest on City securities constituted a "first lien" on the City's revenues.

The first lien, so-called, did not apply to payment, on the maturity date, of the principal of the various anticipation notes — TANS, BANS and RANS — issued by the City. This fact was not adequately disclosed to the public at any time during fiscal 1975 or before, although numerous City officials and their advisers were aware of this critically important information at a time when anticipation notes were being sold to the public.

In recent years, the public sale of anticipation notes was a major source of City funds and many public investors relied on the existence of a first lien in making their investments. 3/

1/ Comptroller Goldin's Press Release No. 74-4, dated January 11, 1974.

2/ News Release, Office of the Comptroller of New York City, No. 75-31, March 7, 1975. (Emphasis added)

3/ Over 81% of the respondents to one of the staff's investor questionnaires were advised or understood that debt service on notes was a first lien on all the City's revenues both as to principal and interest. See Analysis of Questionnaires Sent to Individual Investors, p. 2.

Inasmuch as the City's anticipation note offerings had short maturity dates, accurate information as to a noteholder's right of prompt repayment of principal was especially critical.

2. Anticipation Note Representations

For years, debt service on all notes and bonds of the City were represented to the investing public as having a first lien upon all revenues coming into the City. In nearly all instances, the Notices of Sale for the securities offered by the City contained the following representation:

Payment of debt service shall be the first lien on all of the City's revenues. 1/

The Notices of Sale on all notes sold to the public in fiscal 1975 contained this language. The representation, however, was highly misleading. The New York State Constitution expressly excludes noteholders of anticipatory obligations from a constitutional right to have "first revenue" of the City set aside to pay the principal of their notes on maturity 2/ and at least one court has so

1/ See, e.g., News Release, Comptroller's Office, 75-31, with attachment, "Notice of Sale."

2/ The New York State Constitution, Article 8, Section 2, paragraph 4, provides that:

Provision shall be made annually by appropriation by every county, city, town, village and school district for the payment of interest on all indebtedness and for the amounts required for (a) the amortization and redemption of term bonds, sinking fund bonds and serial bonds, (b) the redemption of certificates or other evidence of indebtedness (except those issued in anticipation of the collection of taxes or other revenues, or renewals thereof, and which are described in paragraph A of Section five of this article and those issued in anticipation of the receipt of the proceeds of the sale

(footnote continued)

held. 1/ The noteholders appear to have a constitutional right with respect to "first revenue" at maturity only as to the interest accruing on such notes.

With respect to TANs and RANs, five years must elapse from the date of issuance before an investor holding a TAN or RAN has a constitutional right to have the "first revenue thereafter received" set aside to redeem the principal amount of the notes. 2/ With respect to BANs, the State Constitution does not appear to specify a right to "first revenue" for redemption of principal even after five years. 3/ Nor has there been found any state or city law which creates or purports to create a "first lien" other than the Constitution.

(footnote continued)

of bonds theretofore authorized) contracted to be paid in such year out of the tax levy or other revenues applicable to a reduction thereof, and (c) the redemption of certificates or other evidence of indebtedness issued in anticipation of the collection of taxes or other revenues, or renewals thereof, which are not retired within five years after their date of original issue. If at any time the respective appropriating authorities shall fail to make such appropriations, a sufficient sum shall be set apart from the first revenue thereafter received and shall be applied to such purposes. The fiscal officer of any county, city, town, village or school district may be required to set apart and apply such revenues as aforesaid at the suit of any holder of obligations issued for any such indebtedness. (Emphasis added)

1/ Washburn v. Goldin (unreported), N.Y. Law Journal, Jan. 6, 1977, p. 10.

2/ Article VIII, §2

3/ Id.

3. Serious Concerns of Various City Officials

Preceding and throughout the City's fiscal crisis, Mayor Beame and Comptroller Goldin engaged in a major public relations program aimed at assuring the public of the safety of their investments in City debt securities. ^{1/} The Mayor and the Comptroller stressed the purported Constitutional protection afforded City securities by means of a first lien on all City revenues.

^{1/} October 22, 1974 Mayor Beame Release; October 1974 "Fiscal Newsletter" issued by Ivan E. Irizarry; November 7, 1974 letter from Mayor Beame and Comptroller Goldin to The New York Times; November 15, 1974 joint statement of Mayor Beame and Comptroller Goldin; November 20, 1974 the Daily Bond Buyer; December 20, 1974 public address by Comptroller Goldin to City Club of New York; January 9, 1975 Gracie Mansion meeting between Mayor Beame, Comptroller Goldin and Deputy Mayor Cavanagh and the City financial community; February 6, 1975 letter from Mayor Beame to Ellmore Patterson, Chairman, Morgan Guaranty Trust Co.

The existence of a first lien as to anticipation notes was considered by City officials and various lawyers in connection with proposed debt security offerings during the City's fiscal crisis, and there was general agreement that there was none. Yet, so far as it can be determined, the non-existence of a first lien as to principal of anticipation notes was never publicly disclosed to investors.

On January 17, 1975, after a conversation with Comptroller Goldin, William T. Scott, Third Deputy Comptroller, sent a memorandum to Sol Lewis, Chief Accountant, regarding proposed research to be done on BANs. In this memorandum, Scott asked "are these BANs a first lien on all City revenues?" 1/

During the Commission's investigation, Steven Clifford testified that in March 1975, he had discussions with Eugene Keilin, General Counsel to the Bureau of the Budget, regarding the applicability of the first lien to the City's notes. These discussions took place during the drafting sessions for the proposed Report of Essential Facts issued in connection with the March RAN sale. During these discussions, Clifford testified that Keilin advised him that there existed a serious question as to the applicability of the first lien to the City's anticipation notes:

1/ See Memorandum dated January 17, 1975 from William T. Scott to Sol Lewis.

What I remember clearly was Gene telling me that it wasn't - that it wasn't all that clear under the law that the notes were a first lien. 1/

At approximately the same time, Keilin also informed Under Secretary of the Treasury John Bennett that he believed, in the event of a bankruptcy of the City, that a court would not enforce the first lien on City revenues in favor of bond or noteholders. 2/

During late 1974 and early 1975, there were also discussions among City officials and lawyers from the Wood, Dawson firm, the City's bond counsel for over 40 years, 3/ regarding the applicability of the first lien. A

1/ See Clifford Testimony at 438.

2/ See Chronology, at March 20, 1975. It is unclear whether Keilin's belief at this point rested on the foregoing legal analysis, or on the theory that those in "essential services," such as police and firemen, would be given a priority regardless of the status of a noteholder's lien. During December, 1974, officials of major New York banks had questioned

whether, in a case of extreme hardship, the Court would require the payment of bondholders in full before any payment of municipal employees salaries has never been decided.

(Internal First National City Bank memorandum by Paul S. Tracy, Vice President, dated December 10, 1974.)

In addition, at the CTDM meeting on December 17, 1974, Frank P. Smeal, of Morgan Guaranty Trust Company, questioned whether, with the ever-growing militancy of the unions with which the City must deal, debt service was really a first lien on revenue. See Minutes of CTDM Meeting, Appendix A.

3/ In July 1971, Wood, Dawson, Love & Sabatine firm advised Merrill Lynch that:

The Constitution does not require annual appropriations to be made for redemption of the principal of tax anticipation notes [TANs] or Revenue Anticipation Notes [RANs] until such notes or renewals thereof have been

(footnote continued)

concern was raised in these discussions that the first lien did not apply to all of the City's outstanding obligations. The question was raised whether clarification of the representation which traditionally appeared in the Notice of Sale for notes as well as bonds should be made, in that a consensus had been reached to the effect that a first lien did not apply to anticipation notes. Rather than changing the historical language which appeared in the Notices of Sale, however, it was decided that additional language, referencing the Constitutional provisions, should be added to the Notices of Sale for bonds only; no change at all was made with respect to anticipation notes. 1/

With respect to these matters, Alexandra Altman, Assistant General Counsel to the Office of Management and Budget, gave the following testimony to the staff:

- Q. Was the concept of a first lien discussed in this drafting session? [In early 1975]
- A. It may have been I don't remember.
- Q. At that point in time did you feel that there was a first lien that attached to these revenue anticipation notes?

(footnote continued)

outstanding five years after the date of original issuance, whereupon annual appropriations are required to be made in the case of bonds.

There is no mandatory constitutional requirement for annual appropriations to be made for redemption of the principal of Bond Anticipation Notes [BANs] or Urban Renewal Notes.

(Letter dated July 23, 1971 from the law firm of Wood Dawson, Love & Sabatine to Jules L. Merron, Corporate Department of Merrill Lynch.)

1/ See generally, Altman Testimony, at 116, et seq.

A. No.

Q. Why was that?

A. Well I had read the Constitution and I didn't think that article, Article 8, Section 2 of the Constitution gave those notes what you would call a first lien. I didn't know of anything else that would.

Q. All right. When, in point of time, did you review the Constitution and come to that conclusion?

A. Its tough to remember. It was sometime during the period you're interested in, December or January. . .

Q. Did you communicate that to anyone, either orally or in a memorandum?

A. Well I believe I discussed it with General Counsel, [of the Budget Bureau] Eugene Keilin and with Ken Hartman [then an attorney in the Corporation Counsel's office] . . . I also think I discussed it with Leo Sabatine [of Wood, Dawson]. I'm trying to remember now. That's probably it.

Q. Did any of these people disagree with your analysis?

A. No.

* * *

Q. Did you know whether or not the City of New York advertised that the holders of revenue anticipation notes had a first lien on City revenues?

A. I think that the Notices of Sale generally said that they did.

Q. Did you have any discussion with any of these people about that language as it appeared in the Notice of Sale?

A. Yes.

Q. And when did these discussions take place?

A. Sometime around that period of time.

* * *

- Q. Could you indicate, Miss Altman, the parties that you recall having discussions with respect to your understanding of the Constitutional provisions [regarding the first lien]?
- A. I think I said that it would be Ken Hartman, Gene Keilin, and Leo Sabatine.
- Q. Is Mr. Hartman an attorney?
- A. Yes. He was with the law firm of the City at that time.
- Q. Okay. . . What is your recollection in point of time of your discussion with Mr. Sabatine?
- A. Well, I asked Mr. Sabatine why he had permitted the language to stay in the Notice of Sale for bonds.
- Q. Bonds or notes?
- A. For bonds and I believe the same language was in for notes. I asked him why he let it stay in at all. He said that -- he sort of agreed with me that if you looked at the Constitution, the Constitution didn't specifically provide for a first lien. So he had been confronted when he took over the New York City business [in the firm of Wood, Dawson, Love & Sabatine] upon the death of the partner who had handled it for thirty years, up until the late 60's, with what to do about this language. He said that the City was reluctant to take it out because it was sort of historically considered to be true and characteristic of City obligations and so he had simply insisted on inserting the paragraph immediately before or after this language paraphrasing what the Constitution did provide. (emphasis added) 1/

On March 7, 1975, the City made a \$537,270,000 BAN offering. 2/ On March 13, 1975, the City commenced a \$375,000,000 RAN offering. 3/ On the

1/ Id.

2/ News Release, 75-30.

3/ News Release, 75-33. This issue actually closed on March 20, 1975.

Notices of Sale for both issues the following representation is made:

Payment of all debt service shall be the First Lien on all of the City's revenues.

There is no statement in either of these Notices of Sale indicating that there is the slightest doubt regarding the existence of a first lien on the principal of anticipation notes, nor was the Constitutional language of Article VIII, § 2 even paraphrased.

Subsequent to the above offerings, a White & Case lawyer wrote the following in an undated memorandum to the files:

I called Sandy [Alexandra] Altman to discuss the "first lien" language in Article 8, Section 2, of the New York State Constitution. I told her that it appeared BANs were not covered in that Section and yet the Notice of Sale for the March issue contained the first lien language. Sandy was aware of the problem and stated that the Notice of Sale and advertisements contained "a lot of loose language." She said that the gap in Article 8, Section 2 may have been filled by the fact that the underlying bonds have a first lien. She also stated that the first lien language had been dropped from the Notices of Sale for RANs and TANs at the request of either Hawkins, Delafield or Wood, Dawson. ^{1/} She stated that she was not the proper person in the City to get this information from and told me to call Ken Hartman.

I called Ken Hartman today and he was also aware of the problem. He agreed that it appeared the BANs were excluded from the first lien language. He stated that there were a lot of problems in Notices of Sale and with the use of the first lien language generally. He further stated that if the City continued to use first lien language it could "get blown out of the water." He said he would do some further research in the area and get in touch with us (he said his research would concentrate on the Vanderzee case). ^{2/}

^{1/} In fact, these Notices of Sale did not drop the first lien language.

^{2/} See White & Case Memorandum to the files: "Clearing House Banks re NYC Financing Plan." White & Case has advised the staff that the memorandum was prepared in Mid-April 1975.

In light of the above, the unqualified assurances as to the existence of a first lien, made in official documents, Notices of Sale, and in the statements of Mayor Beame 1/ and Comptroller Goldin 2/, were unwarranted.

1/ See, e.g. letter of Mayor Beame and Comptroller Goldin to the Editor, New York Times, November 7, 1974, quoted in Section V, below.

2/ Id.

F. THE ABORTED FEBRUARY 1975 TAN OFFERING

1. Background

On February 13, 1975, the City announced the proposed sale of \$260 million in TANS dated February 28, 1975. 1/ The TAN offering was aborted, however, when the City could not satisfy bond counsel that the City's anticipated tax revenues as of the date of issue were adequate to support the offering.

Because of the escalating threat to the City's continued access to the public debt market, disclosure of this negative information would have been material to the investing public. However, there was no disclosure. Indeed, Mayor Beame and Comptroller Goldin publicly and emphatically asserted that the TAN was cancelled because of the unprecedented request for updated information regarding tax receivables, thereby deflecting attention from the City's deteriorating financial condition, the rapidly closing debt market and the fact that the City did not have sufficient tax receivables to support the TAN. This part will explore the knowledge of City officials as to the insufficiency of the tax receivables and the reasons the TAN was cancelled.

2. The Cancelled TAN

The City cannot legally issue TANS unless it has, at the time of issuance, sufficient uncommitted real estate tax receivables to support the TANS. 2/ With regard to the scheduled \$260 million TAN offering, the City certified that as of January 30, 1975, its uncollected real estate

1/ Notice of Sale, dated February 13, 1975.

2/ New York Local Finance Law, §24.00 a.4 (McKinney 1968).

tax receivables were \$1,405,800,000. 1/ White & Case, as bond counsel to Bankers Trust Company, interpreted the New York Local Finance Law to require that ". . . the amount of uncollected taxes be stated as of the issue date of the note . . ." and determined to require an appropriate updated statement from the Comptroller. 2/ Hence, White & Case wanted data as to the amount of uncollected real estate taxes as of February 28, 1975 -- the issue date -- rather than January 30, 1975.

Real estate taxes were payable to the City on December 31 of each year. 3/ New York State's Real Property Tax Law provides a grace period of 31 days, which allows real estate taxpayers to submit their taxes up to January 31 without penalty. 4/ White & Case was concerned that the certification as of January 30 did not take into account payments of real estate taxes to the City on January 31 and thereafter, which payments would necessarily reduce the amount of still outstanding taxes against which tax anticipation notes could be issued.

In fact, because of tax payments made between January 30 and February 28, the City did not have the amount of real estate tax receivables against which it could issue the TANs. White & Case was provided figures on February 25 by an "accountant for NYC" which indicated that the City "had exceeded its debt limit for the TANs by \$112 [million]." 5/

1/ Certificate No. 30-75, dated February 13, 1975.

2/ Position paper of White & Case, dated July 6, 1977, page 10.

3/ New York Real Property Tax Law §900(1) (McKinney 1972).

4/ Id.

5/ Id. Ex. 3; Memorandum of Richard Peters dated March 27, 1975, at 8. These figures may have been provided by Sol Lewis. Altman testimony at 87.

As one City official stated, "there didn't appear to be margin for the TANS sale, if you counted in the February receipts of real estate taxes -- as reported by the tax collectors offices but not recorded on the books of the Comptroller." 1/

Officials of the Comptroller's Office maintained that actual figures of real estate tax receivables beyond January 30 were unavailable, since the Comptroller only compiled such figures on a monthly basis. They informed White & Case that raw data as to the receivables was available from the tax collectors of the counties in the City. Comptroller Goldin and his subordinates were unwilling to certify, or even supply an estimate of such information. 2/ Comptroller Goldin stated in a meeting with syndicate members and bond counsel that "the [post-January 30] numbers that Mr. Lewis had provided were not reliable and were not supportable. 3/

On February 27, White & Case advised the Comptroller's Office that in place of a formal certificate, White & Case was willing to accept a letter stating that the Comptroller's Office believed that real estate tax receipts between January 30 and February 28 would not leave an encumbered uncollected balance less than the principal amount of the tax anticipation notes being offered. 4/

1/ Testimony of Alexandra Altman, May 11, 1976, at 59 and 89; testimony of Sol Lewis, June 11, 1976, at 146.

2/ Memorandum of Richard Peters, dated March 27, 1975, at 3, 5-7.

3/ Testimony of Marion J. Epley, at 130.

4/ Memorandum of J. Epley, dated February 2, 1975, at 2.

A proposed letter to White & Case, to be signed by the Comptroller, was drafted by White & Case on the morning of February 27. William Wood of the Comptroller's Office agreed, with certain modifications, to the request by White & Case that such a letter be provided. Thirty minutes later, however, Sol Lewis and William Wood telephoned White & Case to say that the Comptroller's Office would not supply either a certification or a letter.^{1/}

On February 27 and 28, a series of meetings were held among representatives of the syndicate banks, their attorneys and City officials to consider the concerns of White & Case. A White & Case memo to the files dated February 28, 1975, recounts an exchange which occurred during one of these meetings, held at the Comptroller's Office at 9:30 p.m., on February 27 and attended by Mr. Goldin:

The meeting commenced by Mr. Goldin stating that the City was 'ready, willing and able' to issue and deliver \$260 million of notes on the following morning and he requested a statement of the position of the two syndicates. At Mr. Sanford's request, [Epley] outlined the 'situation' for Mr. Goldin, arising from our reading of the statute, the furnishing of estimates to us by Mr. Lewis, and our advice to our client that, in order to render a clean legal opinion, it would be necessary to obtain reasonable satisfaction as to the amount of tax collections subsequent to January 30. ^{2/}

* * *

The gentleman identified as Mr. Goldin's personal lawyer then suggested to me that White & Case state in our opinion that figures subsequent to January 30 with respect to tax collections had been unavailable. I then asked the bankers present whether they would be willing to accept an opinion saying that the Notes were valid and binding obligations, provided they complied with the maximum limit set by the statute as to which we were unable to obtain any information. The reaction was as expected -- such an opinion would be totally unacceptable to their purchasers. ^{3/}

^{1/} Id.

^{2/} Id. at 6.

^{3/} Id. at 8.

In the morning of February 28, Leo Sabatine of the Wood Dawson firm discussed:

a possible earlier cutoff date than February 28, suggesting February 6. He said he knew that the figures would show that the City had sufficient outstanding tax receivables on the 6th of February and probably did not by the 13th. [Sabatine] and Ken Hartman [of the Corporation Counsel's Office] both expressed the feeling that this is what the figures would show. 1/

During another meeting on February 28, 1975, Comptroller Goldin offered to produce figures on real estate tax revenues up to February 6, 1975, but refused to certify any information beyond that date. As a result, Bankers Trust refused delivery of the notes and the issue was cancelled. 2/

A telephone conversation between White & Case and William Scott, Third Deputy Comptroller of the City, on March 3, 1975 was memorialized by White & Case in a memorandum of that date:

During our conversation Mr. Scott observed 'very honestly' the City estimated that by March 20 there would only be about \$80 million in uncollected tax revenues available for the issuance or renewal of TANs at that time. He also observed that on Friday [February 28] 'everybody' recognized that the City was just 'going through the motions' in view of the obvious inadequacy of the uncollected taxes to cover the \$260 million note offering. He assured us, however, that the City's mistake had been an honest one. 3/ (Emphasis added)

3. Representations by City Officials Regarding the Reasons for Cancelling the TAN

Despite the facts that high City officials had been intensively involved on a daily basis with every aspect of this critical offering and that serious questions had been raised, and remained unresolved, as to the sufficiency of real estate tax receivables to support the

1/ Memorandum of Richard Peters, dated March 27, 1975, at 11-12.

2/ Chronology at February 28, 1975.

3/ White & Case memo to the files, dated March 3, 1975.

issue, Comptroller Goldin and Mayor Beame made public statements at or about the time of the cancellation of the offering, which did not adequately disclose the material facts relating to the cancellation.

During the deliberations between the representatives of syndicate banks and the City on February 28, a spokesman for Comptroller Goldin issued the following press release:

The full status of the City's February 19th sale of Tax Anticipation Notes is still being resolved this afternoon and further comment will follow.

Contrary to inaccurate reports which have been circulated, there is no question concerning the sufficiency of City tax revenues to meet all obligations including the February 19th offering. The certainty of repayment is in no way an issue in the deliberations now taking place. All obligations offered by the City carry an absolute Constitutional guarantee to investors and it is irresponsible to suggest otherwise. The City has never in its history failed to meet an obligation when due, nor will it ever fail to do so. 1/

The New York Times reported that a second release from Goldin's office on February 28 stated:

It is completely inaccurate to report or imply that there's any question concerning the sufficiency of tax revenues to meet all obligations, including the notes which are the subject of today's report. 2/

In a luncheon address before the New York Financial Writers' Association on March 4, 1975, Comptroller Goldin gave a further explanation of the events which transpired leading up to the cancellation of the TAN sale on February 28. Goldin stated, in part:

1/ Press Release from the Office of the Comptroller, dated February 28, 1975, No. 75-23.

2/ New York Times article dated March 1, 1975, at 29, entitled "Banks Cancel City's Sale of \$260 - Million in Notes."

There was no objection or question, I might add, over the amount which I was prepared to certify as of January 31, since it was very much in excess of the figure necessary to justify the borrowing.

* * *

I found it hard to believe that the purchasers who had given no signal at the bid-opening on February 19th of any new or different demand for information, would fail to consummate the sale on February 28th on the basis of an unprecedented and impossible demand made on February 26th.

Not only did this happen, but inaccurate reports were circulated, attributed to sources within the purchaser's organization, which appear to cast damaging aspersions on the City's very solvency - which was, of course, never at question in the entire issue.

* * *

The sale which was cancelled would not have exceeded the schedule of debt issuance which was published last December and greeted with approval in the financial community. And, needless to day, [sic] the Notes were full faith and credit obligations, secured by a first lien not only on real estate revenues but on all City revenues of which real estate is only about 26 per cent. 1/

In a public letter to Ellmore C. Patterson, Chairman of Morgan Guaranty Trust Co., Mayor Beame castigated the financial community for high rates charged the City on its borrowings and stated further that:

The recent to-do about the mid-February note sale, with unreasonably timed requests by bankers for hitherto unneeded information causing the cancellation of the note sale, is another indication that the financial community is going out of its way to make things difficult for the City of New York. 2/

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- 1/ Press Release of the Office of the Comptroller, dated March 4, 1975, No. 75-26.
- 2/ Letter to Ellmore C. Patterson from Mayor Beame, dated March 5, 1975.

G. PENSION FUND TRANSACTIONS

"... [D]espite the false rumors you may have heard, all five City pension systems are actuarially sound. The formulae governing the funding of the five pension systems are established, implemented and regulated in your interest.

This is implicit in the law. Your pensions are protected. They are safe.

As you know, I, as City Comptroller, am a member of the Board of Trustees, of each pension system. Each system (and the law) has delegated to me the responsibility of investing the funds in that system.

... I want to leave you again with the flat statement that all five City pension systems are safe and sound." 1/

1. Background

New York City maintains a number of pension systems for its employees and employees of various independent agencies. The main systems are the following: 2/

- a. The New York City's Employees' Retirement System;
- b. The Teachers' Retirement System;
- c. The Board of Education Retirement System;
- d. The Police Pension Funds;
- c. The New York Fire Department Pension Fund.

The City's annual expenditures for pensions are substantial. The temporary Commission on City Finances has estimated that the City will expend \$1 billion

1/ Address by Comptroller Abraham D. Beame to Annual Meeting of N.Y.C. Civil Service Retired Employee Association, Tuesday, April 3, 1973 (delivered by a representative of the Comptroller).

2/ Report of Permanent Commission on Public Employee Pension and Retirement Systems ("Permanent Commission"), State of New York Executive Department, March, 1975.

for retirement benefits during the 1977 fiscal year. Aside from debt service, contributions for retirement benefits represent the largest City expenditure that is not directly related to the performance of public services. 1/

The responsibility for investment of pension funds is not specifically delineated in the City Charter. Rather, each of the five pension systems has a Board of Trustees which is responsible for the management of the fund. However, the respective boards have delegated the investment function to the City Comptroller. 2/ Thus, the City Comptroller is the central figure in pension fund management. The Mayor serves as a trustee of all of the pension funds except the Teacher's Retirement System. The retirement benefits provided under the City systems are protected by the New York State Constitution and such benefits may never be "diminished or impaired." 3/

2. Re-Focus of Investment Strategy in 1962

Historically, City pension funds maintained a large concentration of its own municipal bonds in their portfolios. For example, in 1961, the year before Mr. Beame's first term as City Comptroller, nearly \$2 billion, or two-thirds of the funds' total assets, were invested in City bonds. Upon assuming office as Comptroller in 1962, Mr. Beame instituted a policy of switching pension fund investments in low-yielding City bonds to higher-yielding corporate bonds, mortgages and common stock. 4/

1/ May 20, 1977 Official Statement.

2/ Report of Office of Comptroller, November 9, 1973.

3/ See New York State Constitution, Article 5, Section 7.

4/ See News Release, December 4, 1973, 73-297.

In 1973, during his second term as Comptroller, Mr. Beame termed this change "a considerable benefit both to the pension funds and to the City." 1/ At the same time, Mr. Beame indicated that since 1962, no City bonds or any other municipal bonds were sold to the City's pension funds. By December, 1973, only approximately \$341 million of New York City bonds were held in the pension fund portfolios. 2/

This investment strategy was analyzed in a report on the Office of the Comptroller of the City of New York prepared by the State Charter Revision Commission Staff in November, 1973. This report indicated:

Except for the past few years, Comptrollers and their appointees have proved to be inferior investment managers. Investing in City bonds until 1961 was a highly questionable practice. Since the pension funds are tax exempt, the earnings foregone by investing in low yielding municipal bonds vastly exceeded savings accruing to the City through lower interest charges on its debt. The emphasis on corporate bonds from 1963 to 1970 unfortunately coincided with the most prolonged bond bear market in history. Throughout the 1950's and 1960's, Comptrollers consistently neglected significant equity investment.

However, because Comptrollers used archaic measurement techniques, this poor investment performance was hidden from almost everyone, even the Comptrollers themselves. Only once was the Comptroller's performance independently measured on a basis that revealed unrealized gains and losses--in the study of the Fire Pension Fund. It revealed that the fund had a negative rate of return in the period studied (1963-67). If Comptrollers had simply invested the legal limit in high grade common stock, the funds would have earned another \$1 billion over the last two decades.

1/ Id.

2/ Id.

The most obvious causes of poor performance were faulty control systems and inadequate personnel (both managerial concerns). 1/

Beginning in late December, 1974, the City again began selling City securities directly to its pension funds. 2/

The pension funds also were used in an attempt to narrow the increasing budgetary gaps experienced by the City by the use of various accounting practices. Senior City officials, including the Mayor and the Comptroller, were aware of these practices.

The views of Mayor Beame regarding the aggressive use of pension fund assets to compete with the underwriters are aptly summed up in the following excerpt from the minutes of a Special Meeting of the Comptroller's Advisory Technical Debt Management Committee on December 17, 1974:

The Mayor pointed out that at one time the pension systems were almost the sole buyers of City's securities. Today's rates make it possible for the systems to resume buying City securities. He did not view this as a 'one-shot' deal, but as a procedure that can continue to be followed as long as rates remain high. He was outraged at the rate the City was forced to pay at the last [securities] sale and, consequently, views purchases by the pension systems as a form of competition with the banks. 3/ (emphasis added.)

The Mayor and the Comptroller and other City officials were able to effect questionable transactions in pension fund assets because they were in positions of control with virtually no accountability for their

1/ See Report on Office of the Comptroller of the City of New York, prepared by State Charter Revision Commission staff under the direction of Steven Clifford, November, 1973.

2/ See letter from Mr. Beame to Mr. Goldin dated December 12, 1974.

3/ See Minutes, Appendix A.

management of the pension fund assets. Throughout the discussion below, the persistent conflicts of interest in the management of the pension funds is evident. 1/

3. Underfunding of Pension Funds

As indicated in the Accounting Report, there were numerous deficiencies in the City's manner of reporting and in its use of accounting principles regarding accrued pension liabilities. In its study of the City's pension systems, the Permanent Commission noted that the progressive deterioration in the financial adequacy of the City's retirement systems is "in large part because the City has chosen to use pension underfunding as one method of balancing its operating budget." 2/

The Permanent Commission report indicated that "starting in 1967, at about the time that pension benefits were being substantially increased, the City initiated the first of its attempts to reduce 'artificially' its required contributions to its pension systems." 3/

1/ It should be noted that the staff's investigation did not examine a number of conflict of interest problems related to the management of the City's pension fund assets. Examples of these potential conflicts are the means by which investment advisers, banks and brokers are selected to act as such for the pension funds and the extent to which they participate in the investment management of the City's pension funds. No analysis was made of the initial selection of, or trading patterns related to, the securities in the pension fund portfolios, other than securities of New York City. The channeling of brokerage commissions was not explored, nor was the degree to which cash on hand was managed so as to obtain maximum interest return investigated.

2/ Permanent Commission at 30.

3/ See generally, the Permanent Commission Report at 32.

In large measure the underfunding was attributable to the fact that the cost estimates for the City's pension plans were based on unrealistic assumptions. The City did not accurately determine the costs of promised benefits primarily because it utilized outmoded actuarial assumptions. The result has been an insufficient appropriation of City funds and a material underfunding of City pension fund liabilities. 1/

The Permanent Commission report, in March, 1975, harshly criticized the unchanged assumptions upon which the City's actuarial tables are based and indicated that the "continued use of unchanged assumptions leads to the understatement of the true costs of retirement benefits and to underfunding of the retirement systems." 2/ The Permanent Commission indicated that "amazingly, the assumptions used for the New York City Employees Retirement System were prepared for a 1914-18 Commission on Pensions from the City's records of experience from 1908-14 -- more than a half-century ago." 3/ The report specified six highly inaccurate actuarial assumptions. These matters are set forth in detail in the Accounting Report.

Moreover, the Permanent Commission reached the following conclusions concerning the use of pension underfunding as a method of balancing the City's operating budget:

1. The City's refusal to adopt realistic actuarial assumptions has resulted in a systematic failure to pay current pension costs, thereby increasing future liabilities and, hence, the retirement contributions in future years.

1/ See generally, the Permanent Commission Report at 6-8.

2/ Permanent Commission Report at 13.

3/ Permanent Commission Report at 12.

2. The City's refusal to adopt realistic actuarial assumptions has led to the approval of benefit increases without full realization of the additional costs involved, resulting in a further increase in the annual contribution rate.
3. Despite the fact that the estimates of current costs are unrealistically low, the City has failed to pay even those official costs -- thereby leading to a further spiraling in the annual contribution rate. 1/

The unrealistic use of actuarial assumptions was well-known to City officials for years. These recurring problems were pointed out in periodic examinations of the City systems conducted by the State Department of Insurance. 2/ In virtually every recent annual report made by the City Actuary to the City's retirement systems, warnings similar to the following have been given:

The experience since the last actuarial investigation indicates the need for changes in the active service tables, salary scales and the pensioners' mortality tables and studies leading to the preparation of new tables will be made. When new tables reflecting current experience have been determined, a report will be presented to the Board for appropriate action. 3/

Indeed, Steven Clifford advised Comptroller Goldin in October, 1974 about "serious underfunding of City pension fund liabilities." 4/ Clifford stated to the Comptroller that the "City is taking \$125 million out of the pension funds to use for 74-75 expenses when it really should be increasing its contribution." 5/

1/ Permanent Commission at 30-32.

2/ Permanent Commission Report at 12.

3/ City Actuary's Report, cited in Permanent Commission Report at 12.

4/ See Clifford memo dated October 1, 1974 to Harrison J. Goldin.

5/ Id.

The seriousness of the conscious effort to underfund the City's pension plans has grave consequences for the future viability of the entire retirement system. As Arthur Anderson & Co. indicated in its December, 1975 Report on the Financial Requirements of New York City, "it has been concluded by certain civic groups and official State commissions that the costs are significantly understated and that the past service liability of \$6.1 billion could be significantly higher." 1/ (emphasis added)

4. Funding Lags

Historically, all City pension funds, except the New York City Teachers' Retirement System, received their contributions a full two years after pension costs were incurred. This phenomenon has been termed the "two-year lag." It was two years from the time the City incurred pension costs to the time contributions were made. The rationale advanced for this policy was administrative efficiency. 2/

In 1971, when Mr. Beame was City Comptroller, funding for the City Teachers' Retirement System was placed on the same two-year lag basis as the other retirement systems. The Permanent Commission report, in referring to this change, indicated that, "although there were rather

1/ Report for the Secretary of the Treasury Regarding Information Relating to the Financing Requirements under the New York City Seasonal Financing Act of 1975, prepared by Arthur Anderson, December 27, 1975 at p. 5. Indeed, this liability may exceed \$8 billion. May 20, 1977 Official Statement of City of New York, p. 52.

2/ Permanent Commission at 33.

insignificant administrative reasons advanced for the change, the real reasons were the resulting reductions in required City contributions of approximately \$85 million in 1971-72 and \$140 million in 1972-73." 1/ In referring to a \$17 million budget cut in 1973-74, realized by postponing pension fund payments, Steven Clifford stated, "the obverse of bogus revenue is phony budget cuts, for example, underestimation." 2/

On December 10, 1974, a mid-year budget review was undertaken by the Comptroller's Office to identify and document unsound financial practices and to calculate the current debt and debt service costs resulting from these practices. One practice to be reviewed was the shifting of expenses from a current fiscal period to a future period. Two examples involving postponements of pension fund payments cited were:

"(1) postponing a \$70 (?) million payment to the Teachers' retirement system in 1972-73; and

(2) postponing payment of the \$17 million due to the Teachers' retirement system in 1973-74." 3/

Deferring required contributions resulted in an enormous liability for the City. As set forth in the Annual Report of the Comptroller of the City of New York for the Fiscal Year 1975-1976, \$2.167 billion was allocated to the cumulative deficit of the City, all of which reflected only the impact of funding lags, including the so-called "two-year lag." 4/

1/ Permanent Commission report at 34.

2/ Memo from Steven Clifford to the Comptroller, May 15, 1974, at 3 of Appendix.

3/ See memo dated December 10, 1974 from Steve Clifford to Seymour Scher.

4/ See The Annual Report of the Comptroller 1975-1976.

5. Excess Pension Interest

Another questionable technique utilized by the City to balance its budget was the use of "excess pension interest" to reduce current pension fund contributions required to be made by the City. In recent years, in excess of \$100 million per year of such "earnings" have been included in the City's budget as reductions of annual pension costs. The Permanent Commission outlined the City's use of "excess" pension interest as a means to reduce recorded pension costs:

In the past, the City had always made an additional contribution to the Systems when the interest earnings for the year fell below the statutory 3% assumption (now 4%). In the 1960's, interest earnings began to exceed the statutory assumption, and the excess interest earned during the year for which contributions were being made was used to reduce the current contribution. Thus, in fiscal year 1970-71, for example, the City would be making the contribution for the pension costs attributable to the 1968-69 fiscal year. If the Retirement System had earned interest in excess of the 4% statutory rate during 1968-69, the excess interest would be used to reduce the contribution in 1970-71. This 'excess interest deduction' is improper from an actuarial viewpoint, since sound actuarial practice requires that any such excess (or, indeed, any loss, together with any other actuarial gains or losses) be spread over a realistic period. An even more serious objection to such 'interest deductions' is the fact that the City failed to consider unrealized appreciation or loss in determining whether there were any excess earnings. In short, the City would declare an interest 'excess' in a particular year even though the losses in value in its stock and other holdings far exceeded the entire interest earnings for the year. 1/

An example:

During this approximate period, the City Employees' Retirement System and the Police Pension Fund lost

1/ See Permanent Commission Report at 34-35.

approximately \$334 million in the value of their stock portfolio. This loss alone would have completely eliminated the alleged "excess interest," and would have actually produced an interest deficit of approximately \$75 million. 1/

In a letter dated May 15, 1974 to Governor Malcom Wilson, Mayor Beame referred to a pending bill before the Governor "for Executive action" concerning "the use of income from investments of retirement systems and pension funds maintained by such city to pay public employer obligations in relation to such systems and funds." 2/ Mayor Beame related that the bill "would clarify existing budgetary and fiscal procedure by allowing New York City to use, for a period of one year, pension interest surpluses which are credited by earnings in excess of four per cent." 3/ Mayor Beame further assured Governor Wilson that "This would have no adverse effect on the City's five actuarily funded retirement systems" (emphasis added). 4/ Mayor Beame indicated that this bill was one of several discussed by the Governor, the Mayor of New York City, and legislative leaders as a means of resolving New York City's fiscal gap for the fiscal year commencing July 1, 1974.

In contrast to the Mayor's assurances, a memorandum analyzing possible objections to the bill stated the following:

- a. The bill represents the purest fiscal gimmickry. . . .

* * *

1/ Id., at 35.

2/ See Beame letter to Wilson, May 15, 1974.

3/ Id.

4/ Id.

- b. In a very real sense, there is no "excess income" in the City's retirement systems. The City's Fire Department Pension Fund has a \$200 million deficit at present. 1/

By utilizing the "excess interest" device, the City was able to reduce pension fund contributions in the following amounts:

1972	-	\$ 17.5 million
1973	-	\$ 41.9 million
1974	-	\$ 50.7 million
1975	-	\$261.4 million <u>2/</u>

The reduction of City contributions helped it to balance the expense budget during these years, but at the cost of a materially adverse impact upon the viability of the City's pension plans.

As the Permanent Commission said in 1974:

The results of such gimmickry are almost tragic. They deceive the public employee and the taxpayer into believing that pension costs (and costs of government in general) have been met. In fact, such costs have not been met--they simply have not been paid. Therefore, next year's taxpayer not only must shoulder his proper share of government costs, but also the costs which have not been paid in prior years and which unfairly have been shifted to him. 3/

Moreover, there was no disclosure of this practice to the investing public.

6. Use of Pension Fund Assets to Purchase City Securities

In a speech in May of 1976, Comptroller Goldin stated:

1/ See Memorandum prepared by Richard Hegner concerning Assembly Bill No. 12393.

2/ See May 20, 1977 City of New York Official Statement, p. 32 note 8.

3/ Permanent Commission at 36.

With a commitment to invest \$2.53 billion of pension fund assets in City obligations, the five retirement systems are now well on the way to becoming the City's major creditors. The survival and soundness of the City therefore become matters of profound concern to both the active and retired members of the systems and to the union officials who represent such members as trustees of the funds. 1/

At the December 17, 1974 CTDM meeting, Mayor Beame and Comptroller Goldin met with various representatives of several securities dealers. At the conclusion of this meeting, the City announced that it intended to curtail its public borrowing for the first six months of 1975. At that time Mr. Goldin conceded that

the large supply of city bonds and notes overhanging the market was depressing prices and discouraging potential purchasers. While the City's obligations continue to offer absolute security to investors, that large supply of such securities requires steps to curtail further borrowing to the maximum possible extent. 2/

It was further indicated by City officials that part of the curtailed borrowing plan was to be accomplished by limited investments by City pension funds in City securities. 3/

In a letter to Comptroller Goldin, dated December 12, 1974, Mayor Beame asked that the the trustees of the City's pension plans adopt a policy of acquiring obligations of the City for their portfolios. In this letter, Mayor Beame indicated the following:

-
- 1/ Address of New York City Comptroller Harrison J. Goldin at Annual Conference of Municipal Finance Officers, Tuesday May 4, 1976.
 - 2/ Wall Street Journal, December 18, 1974 "New York City Slashes Public Debt Plans for First Half 'After Issues' Poor Showing."
 - 3/ Id. It is instructive to compare the minutes of the CTDM meeting, attached as Appendix A, with Comptroller Goldin's Press Release of the same date, attached as Appendix B.

I would, therefore, urge that the Investment Advisors to the Pension Funds be requested to develop a program to include the purchases of City obligations with the normal cash flow in the Pension Systems and from switches of securities now in the fixed income portfolios, using the proceeds for the purchase of City of New York obligations.

This temporary measure, during this unusual period, would also serve as a significant expression of confidence in the City of New York by its own employees. 1/

Thus, the policy of avoiding pension fund investments in City securities was abandoned. Increasingly, as the fiscal crisis intensified, and access by the City to the securities markets was restricted, the City sold its securities to its own pension funds. These purchases were made in extremely large amounts.

At the time of these purchases of City securities, the City's underwriters were balking at taking any further securities for their own account. As the debt markets progressively closed to the City, Pension Funds increased their investments in City Securities despite the risks increasingly evident in such investments. In 1973, the pension funds had only nominal holdings in City securities. By the end of fiscal 1977, it is estimated that 35% of all pension fund assets was invested in City obligations.

The rationale advanced to justify the sale of City securities to pension funds is that such sales ease the large borrowing costs that would otherwise be incurred by the City, and do "not deprive people of money that

1/ Letter from Mayor Beame to Comptroller Goldin, December 12, 1974.

could be utilized for essential services." ^{1/} This justification, however, ignores the interests of the pension funds' beneficiaries whom the Mayor, the Comptroller and the Board of Trustees of each fund are pledged to protect. This is even more critical because the non-taxable pension funds' yields from City tax-exempt securities, in general, are significantly less than that obtainable from "taxable" corporate issues of similar quality. Moreover, the increased use of pension fund assets to support the City's securities helped mask the City's deep-seated financing problems.

The extent to which the sound investment objectives of the pension plans were neglected in favor of the expedient interests of the City is demonstrated by a memorandum dated June 30, 1975 from Steven Clifford to Harrison J. Goldin. In discussing a proposed financial plan for the City, the memorandum specifies two possible uses of pension fund assets:

Pension Fund - New Purchase

Liquidating a portion of their current portfolios, the pension funds can obtain up to \$630 million in cash. This should be invested in City notes rather than M.A.C. bonds, since the limited debt authority of the latter should be reserved for public issues.

Pension Fund - Reverse Repos

The Cash needs of the pension funds and the adverse budgetary impact of further portfolio liquidation will prevent additional long-term commitments to [the] City, secured by June revenues. In this manner, the City can shift cash inflows from June, when it expects a surplus, to September and January, when it expects deficits. The pension funds can raise the

^{1/} Statement of Comptroller Harrison J. Goldin to the City Council, State Legislative Committee, City Hall, City of New York, February 21, 1975.

cash without selling securities, through a bank loan secured by pension fund securities. ^{1/}

7. Conflicts of Interest Concerning the City's Pension Funds

Individuals who manage and control pension funds are fiduciaries of the highest degree. The enormous size and scope of the City pension plans make it absolutely essential that these funds be soundly administered. They must be operated with unquestioned prudence and integrity. It is of utmost importance that the pension plans be managed for the exclusive benefit of the plan's beneficiaries.

Throughout the City's fiscal crisis, fiduciaries, such as the Mayor and the Comptroller, found themselves in untenable positions of conflict. There was a tension between keeping the City afloat and prudent administration of the City's pension funds. Although the Comptroller exercised control

^{1/} In addition to direct purchases of City securities by pension funds, assets of the funds were invested in New York City "Mortgage Loans In-Rem." In 1974, Peat Marwick & Mitchell estimated that the City's Pension Plan held:

Approximately 800 to 900 mortgages owned by various retirement systems which have been given by the City following a public auction sale on previously fore-closed properties.

In addition, Peat, Marwick & Mitchell indicated that:

There are significant principal and interest arrearages dating back three years on many of these loans, with the arrearages on at least two loans dating back to the late 1960's. Actions to foreclose and/or sell these mortgages back to New York City should be taken so that the monies can be obtained and reinvested at higher current rates."

See, Examination of Certain Assets of Various Retirement and Pension Systems Held By or Under the Custody of the Comptroller of the City of New York, March 31, 1974.

over the pension fund assets, he acted with the knowledge and approval of the Mayor. The Mayor knew of the uses being made of the pension fund assets and encouraged the pension funds to accelerate their purchases of City obligations. As the Mayor or his representative acts as a Trustee for four of the five pension funds of the City, he must share responsibility with the Comptroller for the use of their assets.

In a very real sense, the City's pension plans became the last repository of any sizeable amount of funds for the City to draw upon during its fiscal crisis. The City's continued access to public markets was in jeopardy, the large financial institutions were threatening to withdraw further support of the City, and the City's cash needs were escalating. Faced with these crises, the City turned to its last source of funds, the pension funds, which were freely utilized in an attempt to shore up the City's finances. At the time, the Mayor and the Comptroller were aware of the risks entailed in an investment in City securities, 1/ and of the weakened state of the pension funds themselves. 2/

The ability of the Mayor and the Comptroller to exercise investment control over pension fund assets is a fundamental problem in the structure of the City's pension funds. Indeed, the impossibility of managing the pension plans solely in the interests of the pension fund beneficiaries was recognized before the crisis began. For example, in a November, 1973 Report on the Office of the Comptroller of the City of New York, prepared

1/ See Section IV. C., supra.

2/ Supra, at 12.

by the State Charter Revision Commission Staff, there is a discussion of the "Role Conflict" of the Comptroller. Enumerated among the "numerous conflicts inherent between the Comptroller's various powers and responsibilities" is:

Debt management conflicts with investment management; he invests in his own bonds. 1/

The report later states:

Other roles of the Comptroller conflict with his duties. For example, as debt manager, he is unable to make an independent evaluation of New York securities. 2/

Such organizational problems may be at the root of the questionable decisions which were made in the investing of very large sums of the City's pension fund assets in the City's securities. The techniques used to defer required City contributions directly affected the pension plans and encouraged liberalization of benefits without an adequate understanding by the public of the real costs of such increases.

1/ State Charter Revision Commission, Report on the Office of the Comptroller of the City of New York, November, 1973, p. 29.

2/ Id., at 47.

H. THE USE OF ASSETS OF THE TRANSIT
UNIFICATION SINKING FUND

1. Introduction

This section will examine the City's use of certain sinking fund assets to purchase City securities during February, 1975, and the knowledge of City officials of a serious problem as to the propriety of the transaction.

There are four Sinking Funds for the amortization and redemption of obligations of the City of New York: the Sinking Fund of the City of New York ("City Sinking Fund"), the Water Sinking Fund of the City of New York ("Water Sinking Fund"), the Rapid Transit Sinking Fund of the City of New York ("Rapid Transit Sinking Fund") and the Transit Unification Sinking Fund of the City of New York ("TUSF"). 1/

In February 1975, during the City's financial crisis, the City's Pension Funds sold \$200 million face amount City obligations (Bond Anticipation Notes due January 13, 1976) to the City's Sinking Funds. 2/ The Sinking Funds' purchases were executed on the Comptroller's authority, 3/ and \$35,684,389.49 of the purchase price came from the funds of TUSF. 4/

1/ Report of the Operations and Condition of the Several Sinking Funds of the City of New York for the Redemption of Debt For Fiscal Year July 1, 1974 to June 30, 1975, dated August 30, 1975 ("Comptroller's Annual Report on the Sinking Funds").

2/ Comptroller's Annual Report on the Sinking Fund; New York Daily News, February 21, 1975, p. 21; The New York Times, February 21, 1975.

3/ Memoranda from William T. Scott, Third Deputy Comptroller, to John A. Reilly, Principal Investment Officer (Bonds), dated February 11 and 25, 1975.

4/ Comptroller's Annual Report on the Sinking Funds.

With the cash realized from the sale to the sinking funds on February 25, 1975, the City's Pension Funds then purchased a new issue of approximately \$249 million of City Bond Anticipation Notes from the City maturing on June 25, 1975. 1/ The apparent purpose for this "three way" transaction was to provide the City with cash needed to meet an upcoming payroll. 2/

There appears to have been, at the very least, a material uncertainty at the time of this transaction as to its consistency with a contractual agreement between the City and holders of bonds redeemable from TUSF.

2. The Plan to Sell City Securities to the Sinking Funds

On Tuesday, December 17, 1974, Mayor Beame and Comptroller Goldin met with representatives of several securities dealers. Following the meeting, the City announced that it intended to curtail its public borrowing for the first six calendar months of 1975. 3/ At that time, Goldin admitted that "the large supply of City bonds and notes overhanging the market was depressing prices and discouraging potential purchasers." 4/ He further stated that "while the City's obligations continue to offer absolute

1/ Comptroller's Workpaper; Memorandum from William T. Scott, Third Deputy Comptroller, to John A. Reilly, Principal Investment Officer (Bonds), dated February 25, 1975.

2/ On January 26, 1977, Counsel to the City orally indicated to the staff that the transaction was done in this manner because the Sinking Funds had only \$200 million in available cash, whereas, the City needed more than \$248 million. The Pension Funds had sufficient additional cash so that upon completion of the transaction, the City's cash flow requirements could be met. See also New York Daily News, February 21, 1975, p. 21 and The New York Times, February 21, 1975.

3/ Wall Street Journal, December 18, 1974 "New York City Slashes Public Debt Plans for 1st Half After Issues' Poor Showing," p. 29.

4/ Id.

security to investors, that large supply of such securities requires steps to curtail further borrowings to the maximum possible extent." 1/ It was further indicated by City officials that part of the curtailed borrowing plan was to be accomplished by investments of City Pension and Sinking Fund monies in the City's obligations. 2/

3. Repeal of Section 275(b) of the City Charter

At the time the City announced its plan to invest Sinking Fund assets in City securities, Section 275(b) of the City Charter required, among other things, that the Comptroller, who was responsible for administration of the Sinking Funds, invest Sinking Fund assets as follows:

When it is possible to purchase for any sinking fund other than the transit unification sinking fund any obligations of the city at less than par, other than obligations issued for the purpose of transit unification, the comptroller shall invest such moneys only in such obligations; provided, however, that when it is possible to purchase any obligations, issued for the purpose of transit unification sinking fund, at less than par out of moneys of the transit unification sinking fund, and redeemable from the transit unification sinking fund, at less than par out of moneys of the transit unification sinking fund, the Comptroller shall invest such moneys only in such obligations;. . .

Since Section 275 of the Charter mandated investments of sinking funds assets in City obligations selling below par, and there were such City obligations in the secondary market selling below par, in December 1974 the Sinking Funds were unable to invest in issues of City obligations at par or above. To remove this impediment, the Comptroller "urge[d] the

1/ Id.

2/ Id.

enactment" of a bill in the State Legislature amending the City Charter to delete Section 275(b). 1/

On February 21, 1975, in connection with the proposed legislation to repeal Section 275(b), Comptroller Goldin testified before the City Council State Legislation Committee. 2/ He testified that the repeal of Section 275(b) would permit the Sinking Funds to purchase City securities at par, thereby implementing the plan announced by the City in December 1974 to invest assets of the City's Sinking Funds and Pension Funds in City securities and reducing the pressure on the capital markets for the City's newly issued securities. 3/

Goldin further testified that the legislation was part of a program of alternatives necessitated by the cancellation, due to a lawsuit, 4/ of a \$260 million sale of BANs by the Stabilization Reserve Corporation. 5/ He indicated that the passage of the legislation was being accelerated so that the purchase of City securities by the Sinking Funds could be effected the following week to enable the City to meet its obligations in the least expensive way possible. Goldin justified the proposed

1/ Memorandum in Support of An Act to Amend the New York City Charter submitted by Harrison J. Goldin, Comptroller.

2/ Statement of Comptroller Harrison J. Goldin to the City Council, State Legislation Committee held at City Hall, City of New York, February 21, 1975 ("Statement of Comptroller Goldin to Legislation Committee").

3/ Id., at 2-4, 24.

4/ The Wein suit, discussed in Chronology at Feb. 10, 1975.

5/ Id., at Feb. 10, 1975.

repeal of Section 275(b) by stating that "[t]he savings that we would effect, if we were to go into the secondary market and purchase municipal obligations would not be nearly so beneficial to the hard-pressed taxpayer" as the savings which would inure to the City's benefit if the Sinking Funds' available cash were used to purchase the new City securities.

The Comptroller also told the Legislation Committee that he and the Mayor had conferred on the matter of using Sinking Fund and Pension Fund assets to purchase new offerings of City securities and that the Mayor had originally proposed the repeal of Section 275(b) when he (the Mayor) was the City Comptroller.

The Comptroller was successful, and Section 275(b) was repealed on February 24, 1975. 1/

Although the Comptroller testified on February 21, that Sinking Fund assets were to be used to purchase the upcoming February 25, 1975 Bond Anticipation Note offering, that offering was actually purchased by the City's Pension Funds 2/, and ten days before the Comptroller's testimony, on February 11, 1975, William T. Scott, Third Deputy Comptroller, directed John A. Reilly, Principal Investment Officer (Bonds), to sell to the Sinking Funds, which includes TUSF, Bond Anticipation Notes (maturing January 13, 1976)

1/ Opinion No. 108,221 of W. Bernard Richland, Corporation Counsel, to Harrison J. Goldin, Comptroller, dated September 19, 1975 ("Richland Opinion No. 108,221").

2/ Comptroller's Workpaper.

from the City Pension Funds. 1/ The Pension Funds in turn used the cash from the Sinking Funds to purchase the Bond Anticipation Note offering on February 25, 1975. 2/

Of the \$203,910,797 used by the Sinking Funds to purchase the Bond Anticipation Notes from the Pension Funds, \$35,684,389.49 came from TUSF (\$35,000,000 face amount of notes plus \$684,389.49 premium). 3/

4. The Contractual Agreement with TUSF Bondholders

Although the repeal of Section 275(b) removed the statutory bar to investing moneys of the Sinking Funds, including TUSF, in new City obligations, it appears that the purchase of City obligations by TUSF from the Pension Funds may have been improper under a contractual agreement between the City and holders of bonds redeemable from TUSF.

On January 1, 1939, Article VIII of the New York State Constitution became effective. This Article provided for (1) incurring debt by the City for transit unification purposes, and (2) paying off such debt serially or amortization thereof from a sinking fund to be created. 4/ In August, 1939, the Board of Estimate approved the purchase by the City of the facilities, properties, rights and securities of several privately-owned

1/ Memorandum from William T. Scott, Third Deputy Comptroller, to John A. Reilly, Principal Investment Officer (Bonds), dated February 11, 1975.

2/ Comptroller's Workpaper; Comptroller's Annual Report on the Sinking Funds; Oral Statement to the staff by Counsel to the City on January 26, 1977.

3/ Comptroller's Annual Report on the Sinking Funds.

4/ Memorandum of Wood, Dawson, Love & Sabatine dated February 21, 1975.

bankrupt railroad companies, which then comprised the City's mass transit system. 1/

The agreement of sale between the City and the committees representing the bondholders of the transit corporations provided for payment for the facilities by the City through the issuance of Corporate Stock bearing a 3% yearly interest rate. 2/ The 3% Corporate Stock ("TUSF Bonds") was to be amortized through a sinking fund established for such purpose. 3/ The TUSF Bonds were issued on June 1, 1940 with a maturity date of June 1, 1980. 4/ The agreement of sale further provided that:

When it is possible to purchase any of such Corporate Stock at less than par, cash in such sinking fund shall be invested only in such Corporate Stock, but the City shall not be required to invest cash held in other sinking funds now or hereafter existing in said Corporate Stock, except as may be required by law in effect at the time of any such investments. (Emphasis supplied). 5/

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- 1/ Board of Estimate, Journal of Proceedings, May 23, 1940, p. 3331.
- 2/ Opinion No. 108174 of W. Bernard Richland, Corporation Counsel, to Harrison J. Goldin, Comptroller, dated June 25, 1975 ("Richland Opinion No. 108174").
- 3/ Richland Opinion No. 108174. TUSF was established in 1939 through the enactment of Section 273(a) of the City Charter, which states that the purpose of TUSF is the "amortization and redemption of all corporate stock of the city of New York issued on and after . . . [January 1, 1939], for transit unification purposes."
- 4/ Specimen Interim Certificate of Corporate Stock for Transit Unification.
- 5/ Richland Opinion No. 108174.

This clause appears to constitute an agreement between the City and the holders of the TUSF Bonds, the essence of which is that when TUSF Bonds are selling below par, cash in TUSF must be invested only in TUSF Bonds.

In the Comptroller's testimony before the Legislation Committee, there was no discussion of TUSF separate and apart from the other Sinking Funds. There was no discussion of the contractual agreement for redemption of TUSF Bonds. However, there was discussion of the City's role in providing stability in the secondary market for City securities. The Comptroller took the position that it was desirable for the City to have the choice of whether or not to support the secondary market. He stated that:

. . .it is not the holders of the New York City obligations that have a right to expect that the City . . . is going to . . . support the secondary market. I refuse to accept on the city's behalf any such obligations from time to time; [sic] if we choose to support the secondary market we do so. . . 1/

During the Comptroller's testimony, the Sinking Funds were not discussed as separate entities and no recognition was given to the fact that the use of TUSF cash was restricted, not only by Section 275(b), but by the contractual agreement giving priority to the redemption of TUSF Bonds when such bonds were selling below par. At the time of TUSF's purchase of City obligations from the Pension Funds, TUSF Bonds were selling below par. 2/

1/ Statement of Comptroller Goldin to Legislation Committee, p. 72.

2/ Comptroller's Annual Report on the Sinking Funds; Letter from William T. Scott, Third Deputy Comptroller, to W. Bernard Richland, Corporation Counsel, dated April 17, 1975; Memorandum from John A. Reilly, Principal Investment Officer (Bonds), to William T. Scott, Third Deputy Comptroller, dated April 15, 1975.

5. Bond Counsel's Advice to the City on Use of TUSF Monies

When he testified on February 21, 1975, the Comptroller told the Legislation Committee that the City had discussed the plan to use Sinking Fund assets to purchase City securities with legal counsel to the City and had encountered no objection. 1/ However, in a memorandum dated February 21, 1975, prepared by Wood, Dawson, Love & Sabatine ("Wood Dawson firm"), bond counsel to the City for over 40 years, the Wood Dawson firm recited advice it had previously given the City. Wood, Dawson advised that (1) the requirement that TUSF Bonds be purchased when selling below par was probably part of the contract with holders of TUSF Bonds, (2) if Section 275(b) were amended, that portion of it which was merely a codification of this contractual agreement should be left in, and (3) if said proviso were repealed but the City followed the requirements thereof as if it had not been repealed, there would be no impairment of contract. 2/ By negative implication, if the City did not follow the requirements of "said proviso" as if "it had not been repealed," there may well have been an "impairment of contract."

The Wood, Dawson memorandum of February 21, 1975 also stated:

John Thompson of City's Corporation Counsel's office apparently advised the City Council that: plans for unification of transit system required that transit unification sinking fund [assets] be used to purchase corporate stock issued for such purpose when selling below par. Therefore, City had to follow such requirement even if it was not in the charter. Therefore it was O.K. to repeal the proviso referred to

1/ Statement of Comptroller Goldin to Legislation Committee, p. 27.

2/ Memorandum prepared by Wood, Dawson, Love & Sabatine, dated February 21, 1975 ("Wood, Dawson Memorandum").

above, but City would have to comply with substantially identical provisions in the plans of unification.
(Emphasis supplied). 1/

There is every indication the contractual agreement with TUSF Bondholders remained in force after the repeal of Section 275(b). The City's Corporation Counsel, W. Bernard Richland, on two occasions advised Comptroller Goldin of the requirement of the contractual agreement to use TUSF monies to acquire TUSF Bonds. On June 25, 1975, in response to a request to review a proposed tender offer for TUSF Bonds, Corporation Counsel Richland unequivocally advised Comptroller Goldin:

[t]hough subdivision b of 275 of the Charter was repealed by Chapter 6 of the laws of 1975, under the agreements of unification and re-adjustment . . . the City is still obligated to purchase . . . [TUSF Bonds] at less than par whenever possible. 2/

On September 18, 1975, William T. Scott, Third Deputy Comptroller, wrote to Corporation Counsel Richland, this time to "urgently" request an opinion as to whether TUSF cash could be used to purchase obligations of the City's Municipal Assistance Corporation ("MAC"). On September 19, 1975, Richland replied in Opinion Number 108221, in which he reiterated the advice he gave in the previous Opinion issued on June 25, 1975. Richland concluded that:

In these circumstances I am obliged to advise you that if it is possible to purchase at less than par . . . [TUSF Bonds], you may not use moneys of . . . [TUSF] for the purchase of securities

1/ Wood, Dawson Memorandum, p. 3.

2/ Richland Opinion No. 108174.

of . . . [MAC], but may use such moneys only
for the purchase-at-less-than par of . . .
[TUSF Bonds]. 1/

TUSF purchased \$6,000,000 MAC Bonds in September, 1975. 2/

6. The Comptroller's Fiduciary Duties to the TUSF Bondholders

Section 93 of the City Charter provides that the Comptroller, in administering and managing the Sinking Funds, shall be deemed to be acting in a fiduciary capacity.

Throughout his testimony before the Legislation Committee, Goldin balanced his duty to act in the City's best interests and his fiduciary duty to the Sinking Funds. He recognized that as a fiduciary to the Sinking Funds it was his obligation and full commitment to get the best deal possible for the Sinking Funds 3/ and stated that "there will be no disadvantage to the sinking fund[s] or holders of sinking fund obligations" 4/ Goldin further testified that the Sinking Funds would get a "competitive yield . . . and at the same time the city would save money." 5/ Several questions were asked about possible conflicts of interest and Goldin responded to one such question as follows:

1/ Richland Opinion No. 108221.

2/ Comptroller's Statement of Operations of the Several Sinking Funds of the City of New York for the Redemption of Debt for the Period September 1, 1975 to September 30, 1975.

3/ Statement of Comptroller Goldin to Legislation Committee, p. 34.

4/ Id., p. 4.

5/ Id., pp. 35-36.

That conflict is not being exacerbated by this law. It is being diminished because, for this reason, if this Council or any legislature wants to tell me that my fiduciary responsibility is better served if I caused the taxpayers of our city to pay a higher interest rate in the general public auction market, rather than the lower interest rate that we can obtain and still meet our fiduciary responsibilities to sinking fund holders, that is a judgment that I would not make but others can make. 1/

Goldin thus took the position that the repeal of Section 275(b) and the consequent purchase of City securities presented no conflict of interest and did not harm the Sinking Funds.

However, the use of TUSF assets in a manner apparently inconsistent with the contractual agreement with the TUSF bondholders contrasts sharply with Comptroller Goldin's assertion that his action in purchasing City securities met his "fiduciary responsibilities to [the TUSF Bondholders]." As Comptroller, Goldin was privy to the City's grave financial condition and its need for money. As a fiduciary, he owed a duty to the TUSF Bondholders to make relatively risk-free investments.

7. Monthly and Annual Reports of the Operations and Condition of the Sinking Funds

The staff has been unable to discover any evidence that existing TUSF Bondholders were advised, in connection with TUSF's purchase of City securities, that TUSF's contractual obligations regarding the retirement of its own securities were unimpaired by the repeal of 275(b), and that, at the very least, there was a material uncertainty as to the propriety of the Comptroller's purchase of City securities for TUSF's account.

1/ Id., p. 34.

Sections 277 and 278 of the City Charter require the Comptroller to prepare and submit to the Board of Estimate monthly and annual certified Reports of the operations and condition of the Sinking Funds. The staff has examined the Comptroller's monthly certified report for the month of February 1975 ("Monthly Report") and the annual certified report for the fiscal year ended June 30, 1975 ("Annual Report"). Both Reports reflect the Sinking Funds' purchase of the City obligations from the Pension Funds; however, neither Report fully, fairly and adequately discloses the facts and circumstances surrounding the transaction, i.e., the repeal of Section 275(b), the impact of the subsequent purchases on the agreement for redemption of TUSF Bonds, the potential impropriety of the Comptroller's actions as a fiduciary of TUSF and counsel's advice as to these matters.

8. Possible Consequences of the Use of TUSF Assets

Any default on the City obligations purchased by TUSF would have material consequences for the protection TUSF offers to its bondholders. As of June 30, 1975, TUSF had assets of approximately \$256,000,000 and liabilities of approximately \$250,000,000, leaving only a surplus of approximately \$6,000,000. Included in the \$256,000,000 of assets is the \$35,000,000 of City obligations purchased in February 1975 by TUSF from the Pension Funds. 1/ If these City obligations fell in face value 17% or more, there would have been a deficit in the fund. At the time the purchases were made, there was a substantial risk that such a drop in value would in fact occur.

1/ Comptroller's Annual Report on the Sinking Funds.

V. FULL AND FAIR DISCLOSURE - THE CITY VERSION

A. Introduction

Although the federal securities laws specifically exempt securities of certain classes of issuers, including municipalities, from their registration and reporting provisions, ^{1/} these laws prohibit misleading statements by all persons selling securities concerning the financial condition of and other material facts relating to an issuer. Accordingly, statements and representations made to the public by a municipal issuer in connection with the offer, sale and trading of its securities must be fair and accurate in material respects and not misleading.

The Staff has examined the public disclosure made by the City and its officials in connection with the offer and sale of City securities between October 1974 and March 1975, a period in which the City sold approximately \$4 billion in notes alone to the public. The staff has found that a consistent theme in the City's public statements during this period was the safety of an investment in City securities. The City and its officials attempted to

^{1/} Section 3(a)(2), Securities Act of 1933; Sections 3(a)12 and 12(a), Securities Exchange Act of 1934.

minimize investor concerns regarding the City's financial prospects by distinguishing between budgetary problems on the one hand and the safety of an investment in City securities on the other. These constant reassurances were made in the face of the knowledge of City officials of material adverse information regarding such investments. This Section of the Report will examine the City's disclosures during its fiscal crisis in light of the knowledge possessed by City officials regarding the City's financial condition and the safety of its securities.

In testing the disclosure, it must be borne in mind that the City's bonds and notes were not marketed exclusively to the major City banks which formed the underwriting syndicates. Ultimately, a large part of these offerings were purchased and held by small or less sophisticated investors throughout the United States and other countries. Until November, 1974 the smallest denomination in which a City security was available for purchase was \$25,000. At that time, with the City's fiscal crisis worsening, the City lowered the minimum denomination to \$10,000 in an active effort to

reach smaller investors. 1/ The campaign for the small investor was successful, and the staff's report on individual investors details the experience of many individuals who invested in City securities with little understanding of the material risks involved. 2/

B. Press Releases and Public Statements Disseminated by the Mayor and the Comptroller

Press releases and other public statements disseminated by the Mayor and the Comptroller were a major source of official information about the City's financial condition and the safety of its securities. Taken as a whole, these statements and releases had dominant promotional overtones. They did not provide investors with accurate and balanced information as to the City's finances and its securities. While such releases and statements may have been aimed at various constituencies, the Mayor and Comptroller had a duty not to mislead public investors as to the City's financial health and the safety of an investment in City securities.

During and prior to the City's fiscal crisis, information about the City was available from many sources. Newspaper articles frequently questioned the City's fiscal health, and reported on many occasions adverse information regarding the City's budgetary problems. However, such articles, and similar statements made by persons in the private sector, were no substitute for authoritative, official disclosures. The information in the market place was

1/ News Release, Office of the Comptroller, November 22, 1974 (74-134). At about this same time, the City attempted to set up a voluntary payroll deduction plan to encourage City workers to buy these securities. This plan ultimately was not put into effect. See News Release, Office of the Comptroller, January 30, 1975 (75-9).

2/ See Analysis of Questionnaires Sent to Individual Investors.

confusing, contradictory, and fragmented. In addition, City officials regularly responded to the most negative disclosures with strong denials, thereby aiding in the obfuscation of the facts about the City's financial condition and the safety of its securities.

Insofar as City officials themselves voluntarily disseminated adverse information, these disclosures were almost always fragmentary and isolated, and generally managed to blunt any negative effect by ending on an overall positive tone unwarranted by the facts. In addition, financial disclosures made in press releases and other public statements were not presented in a context which provided the ordinary investor with a full grasp of the City's financial plight.

City officials were invited to expand on their disclosures at various times during fiscal 1975. On one occasion Comptroller Goldin was advised by a representative of one of the City's underwriters that an official bond disclosure statement would improve communication with the investment community in view of the "misleading" information generated in the news media about the City. Attached to the letter was an outline for such a statement. 1/ By letter of August 21, 1974, the Comptroller acknowledged the worth of the suggestion and thanked the writer for taking the time to write. 2/ No statement of the type suggested was used by the City for the public distribution of its securities during fiscal 1975. 3/

1/ Solari at 12 and Letter from William J. Solari to Harrison J. Goldin, August 8, 1974.

2/ Letter from Harrison J. Goldin to William J. Solari, August 21, 1974.

3/ In a sale by the City of its securities to New York City Pension Funds commencing in July 1976, the City provided a detailed official statement.

Both Mayor Beame and Comptroller Goldin repeatedly assured investors that the City's budget problems, no matter how serious, had nothing to do with the City's ability to pay its debts. Unwarranted reassurances as to the safety of City securities are the outstanding characteristics of their releases during the City's fiscal crisis.

As shown below and in other parts of this Report, these public statements were misleading in regard to a number of serious aspects of the City's finances — for example, the overstatement of receivables and the underfunding of City pension funds. The Mayor and Comptroller failed to apprise investors that the City was rapidly reaching a time when it could no longer sell vitally needed new issues in the market. Note investors were promised an unqualified "first lien" on all city revenues, despite the material uncertainties as to the existence and extent of such protection. Underlying all the City's statements during the fiscal crisis was the unwarranted note of optimism struck by both the Mayor and the Comptroller in their appeals to prospective investors in City securities.

The public statements issued by Mayor Beame and Comptroller Goldin, most of which were broadly reported by the news media, were the most important official vehicles for disclosure during the City's fiscal crisis. A representative sampling of the significant statements and releases will now be analyzed in some detail.

1. Unwarranted Reassurances

Between October 1974 and March 1975, a period during which the City was selling securities and contemplating further sales to the public, the City was in the throes of an acute fiscal crisis. Throughout this period, Mayor Beame and Comptroller Goldin issued statements which constantly reassured the

public that investments in City securities were both sound and attractive. Indeed, on numerous occasions, the Mayor and the Comptroller actively promoted investments in City securities. They transformed essentially negative news into overly optimistic statements and continuously reasserted that the securities offered by the City had a sound fiscal backing. They deflected attention from the City's financial condition by blaming outside forces such as national inflation and recession. They also blamed the major New York banks, primarily for "outrageously" high interest rates imposed on City securities and for their supposed failure to "sell" the City to prospective investors.

The Mayor and Comptroller repeatedly denied that there was any relationship between those fiscal problems which they acknowledged and the City's ability to repay its obligations. However, the relationship between the City's ability to repay and its budget and similar fiscal problems could hardly have been more direct. The City's unsound budgetary and accounting practices were entwined with the escalating borrowings which had glutted the market with the City's securities. Repayment was necessarily dependent on continued borrowings since the City's other anticipated sources of funds were wholly insufficient to both ensure continuation of vital governmental services and support its constantly maturing and ever-increasing short-term debt.

The City used its releases not only as a means for supplying its existing security holders with a steady stream of reassurances concerning the safety of their investments, but also as a means of actively seeking to attract new investors.

In November 1974, when the City lowered the minimum denomination for its notes from \$25,000 to \$10,000, the Comptroller's Office issued the following invitation to new investors:

The change to smaller denominations will permit additional private investors to obtain the good yields which are currently being offered on the City's short-term obligations. If demand can be increased among this category of investors, it should be reflected in the competitive bidding by the investment syndicates to whom the City sells its paper. At the same time, we are moving with caution in order not to cause greater problems for thrift institutions which are already experiencing an outflow of deposits. We will monitor the results and determine future policy accordingly. 1/

The Mayor was reported to have emphasized his own investment in City securities as late as March 23, 1975. 2/ This allowed the public to draw the inference that if the Mayor, with his knowledge, experience and position had invested his own money in the City, then such investments must be safe.

The following excerpts are typical of the unwarranted positive reassurances which pervaded the public statements of both City officials during this period.

News Release, Office of the Mayor, October 22, 1974:

The Mayor emphasized that the City's credit position was "solid and strong," even though the national economy is under the stresses of both inflation and recession, and even though these inflationary-recessionary trends are "creating some budget balancing problems for the City."

The Mayor said, "There is absolutely no question about the City's ability to repay all of its debts on time,

1/ News Release, Office of the Comptroller, November 22, 1974 (74-134).

2/ New York Times, March 24, 1975 articles entitled "Beame Outlines Plan to Reduce City Borrowing" and "Beame Purchase Backs His Confidence in City."

and that this ability has improved over the last fifteen years." 1/

Letter of Mayor and Comptroller, Published in The New York Times

November 11, 1974:

Bankruptcy means that liabilities exceed assets or that credit obligations cannot be met — a situation in which the City of New York, even in the darkest days of the Great Depression, never has found itself, nor will it

It should be clear, in connection with our municipal budget, that the Constitution of the State of New York makes our New York City bonds and notes a first lien on all revenues which include the real estate tax, all other City taxes, fees and permits, all state aid and all Federal aid.

Over and above the constitutional, legal and moral guarantees afforded to investors in New York City notes and bonds is the fact that they are investing in the world's wealthiest and soundest city as far as these obligations are concerned

This picture should be very reassuring to all city investors.

A recitation of these facts should by no means be construed as complacency in the face of the city's budget difficulties. While we have not always agreed on ways and means to place the budget in balance, we do agree that tough fiscal decisions and reforms, including substantial capital budget reductions, will have to be made in order to cope with runaway inflation, unemployment, business recession and the carryover effects of past fiscal practices

We will do what needs to be done in the general interest of taxpayers, for the preservation and strengthening of the city's economy and to insure the continuing soundness of the city's obligations as an investment medium. 2/

1/ News Release, Office of the Mayor, October 22, 1974 (529-74).

2/ Letter, Abraham D. Beame and Harrison J. Goldin to the Editor, The New York Times, dated November 7, 1974, published in The New York Times, November 11, 1974.

News Release, Office of the Comptroller, December 1, 1974:

. . . the budget deficit "should not impair confidence in the essential soundness and safety of the City's obligations." 1/

Speech by the Comptroller, December 20, 1974:

New York's budget problems should be of only marginal interest to investors, who are protected by the State Constitutional guarantee making New York City bonds and notes a first lien on all revenues. 2/

Joint Statement of Mayor and Comptroller, January 11, 1975:

This City is not bankrupt, near bankrupt nor will it ever be bankrupt. This City has always repaid all of its obligations on time and it always will. 3/

News Release, Office of Comptroller, March 4, 1975:

For the truth is that from the time of the Revolutionary War, through the dark days of the Great Depression, and in every era of national economic uncertainty - New York City has compiled an unblemished record of full payment of bond principal and interest without a single default.

Investors in New York City securities are, therefore, absolutely protected. 4/

News Release, Office of the Comptroller, March 13, 1975:

We have experienced an insistent drumbeat of publicity on our budget problems, and this publicity has sometimes unfortunately failed to distinguish between balancing a budget, which is a problem; and meeting obligations to our creditors, which

1/ News Release, Office of the Comptroller, December 1, 1974 (74-138).

2/ Remarks by Harrison J. Goldin at the City Club of New York, December 20, 1974.

3/ News Release, Office of the Mayor, January 11, 1975 (20-75).

4/ News Release, Office of the Comptroller, March 4, 1975 (75-26).

the City has never failed to do and which, it is my conviction, it never will fail to do, barring a complete collapse of our economic system and capital markets

So the impact on New York of national and international inflation and recession which has affected all cities, is a separate issue, which should be of only marginal interest to investors. 1/

2. Examples of Misleading Statements and Omissions 2/

Information disseminated by City officials was incomplete. The actual financial condition of the City during and prior to the City's fiscal crisis was not disclosed. Nor were risks involved in an investment in City securities adequately explained.

a. First Lien

Both Mayor Beame and Comptroller Goldin made unqualified statements that bond and note investors had State Constitutional and legal guarantees of a

1/ News Release, Office of the Comptroller, March 13, 1975 (75-35).

Mayor Beame and Comptroller Goldin continued to make statements of this nature after this date. For example, in a March 23, 1975 Press Release, the Mayor said:

"We will pay all interest and redemption costs on time."

"We will meet our payrolls."

"We will not lose our basic fiscal strengths."

News Release, Office of the Mayor, March 23, 1975 (111-75). See also, News Release, Office of the Mayor April 9, 1975 (132-75); Remarks by Harrison J. Goldin at Union League Club, April 15, 1975.

2/ One significant series of public statements will not be discussed herein. It relates to the cancellation, on February 28, 1975, of a \$260 million TAN issuance. Two press releases of the Office of the Comptroller and a speech by the Comptroller concerning this matter are discussed in Section IV.F. of this Report, supra.

first lien on all City revenues, including all City taxes and all Federal and State aid. There has been no public statement which might be said to indicate, even obliquely, that the first lien guarantee might not exist or was qualified. This was a misrepresentation with respect to the holders of anticipation notes which comprised the major part of the City's offerings during this period. 1/ Yet, throughout the final months of 1974 and the beginning months of 1975, both the Mayor and Comptroller repeatedly stressed the first lien protection afforded investors in City bonds and notes. 2/

I acknowledge that City obligations like all obligations - even U.S. Government obligations - can sometimes be a market risk because markets will rise and markets will fall and investor interest will likewise rise and fall.

But I maintain that our securities are not in any sense a credit or security risk. Investors in New York City securities are protected, as you know, by State Constitutional and legal guarantees of a first lien on all City revenues, including all City taxes and fees and all Federal and State aid. 3/

At the time these unequivocal statements were released, representatives of the Bureau of the Budget, Corporation Counsel's Office and the Office of the Comptroller knew or had been advised that serious questions existed as

1/ - See Section IV.E. of this Report regarding the uncertain existence of such a first lien. New York City's total debt outstanding as of June 30, 1975 was \$12,306,753,170. (Statement of the Bonded Indebtedness as of July 1, 1974 and June 30, 1975, The City Record, Wednesday, September 3, 1975, p. 3431.) These figures represents \$7,766,578,170 in bonds (Comptrollers' Report 1974-75, p. 461). It also includes \$380,000,000 in TANs, \$2,560,000,000 in RANs, \$30,000,000 in URNs and \$1,570,175,000 in BANs (Comptroller's Report 1974-5, p. 506).

2/ See, e.g., News Releases, Office of the Comptroller, January 29, 1975 (75-8); February 27, 1975 (75-22); March 4, 1975 (75-26); Office of the Mayor, October 22, 1974 (529-74); April 9, 1975 (132-75).

3/ News Release, Office of the Comptroller, March 13, 1975 (75-35).

to whether the principal amounts of City anticipation notes were protected by a first lien on City revenues. 1/

b. Internal Controls

Shortly after assuming office, Comptroller Goldin commissioned a series of three audits of the securities, mortgages and bank accounts of the City employee retirement and trust funds of which the Comptroller was custodian, and of the general City Treasury. Each of the audits made adverse findings concerning the state of the City's internal controls relative to the matters examined. 2/ Although City press releases discussed the audits and their negative findings, during the summer of 1974, this potentially significant disclosure was overshadowed by a highly publicized dispute which developed between Mayor Beame (the City's former Comptroller) and Comptroller Goldin over who was to blame for the deplorable state of affairs documented in the audits. 3/ In addition, a series of releases neutralized this potentially negative information relating to internal controls by discussing proposed legislation for required outside annual inventories and audits, 4/ commencement of an accounting reconciliation of certain discrepancies disclosed by the report on the City's pension funds, 5/ and a program to fill vacancies in

1/ See Section IV.E., supra.

2/ See Accounting Report.

3/ News Releases, Office of the Mayor, July 22, 1974 (383-74); July 28, 1974 (392-94); Office of the Comptroller, July 28, 1974 (74-94); August 5, 1974 (74-100).

4/ News Release, Office of the Mayor, July 25, 1974 (386-74); Office of the Comptroller, July 25, 1974 (74-93).

5/ News Release, Office of the Comptroller, July 29, 1974 (74-95A).

the Comptroller's Office. 1/ Despite the aura of reform emanating from these releases, during the 1974-75 period, internal controls were not significantly improved and investors were not informed of the continuing inadequate City financial records.

C. Positive Disclosures Concerning City's Financial Condition

Both the Mayor and the Comptroller also issued statements which emphasized certain purported positive aspects of the City's financial condition. When viewed in a larger context, many of these so-called positive factors were misleading.

Thus, the two officials often asserted that City revenues were several times in excess of the required debt service. 2/ This statement was misleading because, among other things, these revenues were routinely overstated and expenses were routinely understated.

In discussing the City's fiscal strength and unquestioned ability to meet its debt service, Mayor Beame and Comptroller Goldin highlighted the City's ownership of \$14 billion of real estate. 3/ This statement was incomplete in light of the impracticability of converting the City's illiquid and "essential services" assets into cash with which to pay off its obligations.

1/ News Release, Office of the Mayor July 29, 1974 (391-74).

2/ See, e.g., News Release, Office of the Mayor, October 22, 1974 (529-74); Letter, Abraham D. Beame and Harrison J. Goldin to the Editor, The New York Times, November 7, 1974, published in The New York Times, November 11, 1974; News Release, Office of the Mayor, March 23, 1975 (111-75); News Release, Office of the Mayor, April 9, 1975 (132-75).

3/ Letter, Abraham D. Beame and Harrison J. Goldin, to the Editor, The New York Times, dated November 7, 1974, published in The New York Times, November 11, 1974.

The disputes over the size of the City's budget gap was another source of fragmentary disclosure. Although the Mayor and Comptroller issued several releases concerning the size of the gap and proposed means to close it, these releases never effectively revealed its true dimension. Instead, the information given to the public centered on a dispute in late 1974 between the Mayor and Comptroller over whether or not the budget gap for the 1974-75 fiscal year was \$330 million, \$650 million or some intermediate figure. ^{1/} In fact, these estimates were totally unreliable. ^{2/} Furthermore, the full extent of the much larger cumulative budget gap went undisclosed. ^{3/}

On at least two occasions Mayor Beame publicly noted that, "[t]here are very few cities in America which repay outstanding debt as quickly as New York City does." "Almost half of our current outstanding debt will be repaid by 1980, which is only five years away; and more than 70 percent of our current outstanding debt will be repaid by 1985, which is only ten years away." ^{4/} Repayment of such large percentages of debt in such a short period would be a positive factor only if the City could reasonably anticipate having the resources to redeem the debt upon maturity. However, the City was dependent on continued access to the capital markets to supply its ever-increasing need for revenue to retire matured obligations.

^{1/} News Releases, Office of the Comptroller, December 1, 1974 (74-138); December 2, 1974 (74-139A); Office of the Mayor, November 22, 1974 (579-74); December 11, 1974 (603-74).

^{2/} See Accounting Report.

^{3/} In the Comptroller's Annual Report, 1975-1976, the cumulative budget deficit was pegged at \$5.1 billion as of June 30, 1975.

^{4/} News Release, Office of the Mayor, January 11, 1975 (20-75); see also, News Release, Office of the Mayor, October 22, 1974 (529-74).

d. Risk of Non-Marketability

During fiscal 1975, the Mayor and the Comptroller were advised by their staffs and members of the financial community that the City was in grave danger of being foreclosed from selling further debt instruments on the open market. Disclosure of this fact would have been of great importance to investors, but there was none. In the spring of 1975, the City was in fact foreclosed from the capital markets, but in the six months preceding foreclosure, it sold to the public about \$4 billion in notes alone.

In December 1974, as a result of the large amount of City debt overhanging the market, and in order to improve the supply-demand balance, Comptroller Goldin publicly announced a reduced and regularized borrowing schedule for the first six months of 1975. 1/ In January 1975, City officials met with several leading bankers. At this meeting the bankers stated that there were serious doubts as to the market's capacity to absorb more City securities and that the clearinghouse banks did not have the capacity to take on all of the proposed City financing by themselves. 2/ The Mayor and Comptroller issued a joint statement following this meeting. The statement, which ended on a note of optimism, omitted any mention of the information communicated to them concerning this critical problem. 3/

In the early months of 1975 the Comptroller generally referred to the "whole overburdening of the tax-exempt market," as a condition likely to

1/ News Release, Office of the Comptroller, December 17, 1974 (74-141).

2/ Patterson at 25-29, and Sanford at 22, 25.

3/ Joint Statement from the Offices of the Mayor and the Comptroller, January 9, 1975.

worsen rather than improve. 1/ The Comptroller failed to disclose, however, that the market for the City's debt securities in particular was rapidly closing. 2/

On March 7, 1975, the City announced the sale of \$537,270,000 of BANs. The underwriters had insisted that a disclosure statement prepared by counsel to the underwriters be issued as a press release by the City at the time of this announcement. 3/ This was a condition of submitting the bid. The Comptroller's release stated:

Comptroller Harrison J. Goldin announced today the award of \$537,270,000 principal amount of Bond Anticipation Notes at an approximate rate of 8.69% per annum. Comptroller Goldin stated that this relatively high rate of interest is due to several factors, among which is a pending law suit filed on February 5, 1975 by a Mr. Wein, against the City, its Mayor and its Comptroller. . . .

Other factors contributing to this high rate of interest are the recent negative occurrences in the municipal credit markets, adverse economic conditions and the City's ever-increasing cash needs which have necessitated extraordinary borrowings by the City and every expectancy of a continuing need for high borrowings. While solution of the City's fiscal problems is not an easy matter, Comptroller Goldin expressed his confidence that the City would, when the time comes, be in a satisfactory legal and fiscal position to sell Bonds to fund these Notes. 4/

A sentence in the draft press release prepared by bond counsel which was deleted from the above-quoted final release read as follows: "These

1/ News Release, Office of the Comptroller, March 13, 1975 (75-35).

2/ See Section IV. C., supra.

3/ Charbonneau Ex. 11.

4/ News Release, Office of the Comptroller, March 7, 1975 (75-31).

conditions adversely affect the City's access to the municipal credit markets, to which the City must look for the financing it deems necessary to meet expenses and maturing obligations."

A March 12, 1975 article in The New York Post regarding the sale of these BANs reported that the Comptroller had said that the banks were distributing his press release of March 7, 1975 to dealers as "disclosure," a term with which he did not disagree. 1/

The March 7 press release does not adequately disclose the City's problems. Outside factors are pointed to such as the "recent negative occurrences in the municipal credit markets" and "adverse economic conditions." When some problems are discussed, such as the City's cash needs, it is in the most general terms. This release did not in any meaningful way apprise investors of the magnitude and seriousness of the City's fiscal situation. More importantly, it did not explain how the City's difficulties resulted in a risk to investors in City securities. Indeed, the release ends on a somewhat positive note that was unwarranted by the existing facts. The City's response to a perceived need and a demand for disclosure was insufficient.

e. Summary

In summary, the public statements of City's highest officials failed to disclose adequately, effectively and meaningfully the disastrous financial condition in which the City found itself during this period. Moreover, the statements defused the potential impact of negative information with constant and overridingly optimistic reassurances.

1/ New York Post, March 12, 1975.

In lieu of providing hard data relevant to investors' needs and concerns, the City instead assuaged the fears of prospective and current investors with unwarranted claims of legal protection, inflated and inaccurate assertions of financial strength, and with unexplained statements that the City's financial problems had no bearing on the City's ability to honor its obligations upon maturity.

A particularly stark example of the contrast between the public disclosures made by the Mayor and Comptroller and the material information to which they were privy can be seen in the Release by Comptroller Goldin on December 17, 1974, attached hereto as Appendix B, describing the CTDM meeting held that morning. A comparison of the full text of the minutes of the CTDM meeting, attached hereto as Appendix A, with the above Release, highlights both the inadequacies of the disclosure and the awareness of the City's top officials regarding such inadequacies.

The public statements of the Mayor and Comptroller did not provide either new or current investors with the information necessary for informed investment decisions. Instead of disclosing the situation as it existed - the disclosure to which investors were entitled - City officials made misleading statements to the investing public as to material facts critical to investment decisions.

C. Disclosure Through the City's Financial Reports

Few aspects of the City's financial records were subject to meaningful review and verification prior to the summer of 1975, by which time the City had been precluded from the capital money markets. At that time, the State Comptroller issued reports relating to his review of the City's financial records. He found a number of the major discrepancies discussed in this Report, including the first reliable finding that the City's cumulative deficit was more than \$5 billion.

The City issued reports relating to its financial condition. 1/ These reports were not intended to be nor did they serve as disclosure documents. They were prepared to meet local law requirements. These reports were not prepared using uniform accounting practices; thus, they could not be compared with one another. Further, the accounting practices upon which each was based were left unstated. Reports concerning related financial matters were issued at different times during the fiscal year. The data and self-defined categories of financial information in various City reports differed from each other to such an extent that experts on City finance considered the reports to be virtually useless in analyzing the City's financial condition. 2/

In addition, the questionable accounting and financial reporting practices of the City, coupled with the City's lack of adequate internal accounting controls, rendered it impossible to generate reliable financial information, and left no opportunity for any true assessment of the City's financial condition.

The City made disclosures through the issuance of various reports mandated by law and in materials prepared in connection with the offer and sale of securities.

1. Annual Report of the Comptroller

The Annual Report of the Comptroller was required by the Charter to be issued on October 31 of each year and covered the fiscal year ended the

1/ These reports were not made widely available to the public. For example, the City published 550 copies of its "Annual Report for 1973-1974."

2/ See, e.g. letter from Donald W. Beatty, Executive Director, Municipal Finance Officers Association, to Harrison J. Goldin, March 7, 1975; News Release, Office of the Comptroller, May 4, 1976 (76-30)

previous June 30. By the time this document was printed in October, the information it contained was already stale and outdated. 1/

The 1973-1974 Annual Report of the Comptroller, issued October 31, 1974, ran 542 pages, including a 161-page itemization of capital budget expenditures, a 77-page statement of the expenses by department, a 22-page itemization of sinking fund options, and a 30-page list of debt statistics. 2/

The Annual Report, with its complex, highly specialized, unrelated categories of information, was not intended to be and did not serve as a meaningful disclosure document. Both within and without the City Administration, the Annual Report was viewed as an incomprehensible document.

2. Other Statutory Reports

Another category of reports mandated by law involve the Executive Expense and Capital Budgets and their preparation. It was never possible to "freeze" either Budget at any given time for purposes of analysis because they were "modified" on an ongoing basis throughout the fiscal year. 3/

The Comptroller is obligated by Section 220 of the City Charter to report annually on the Mayor's proposed capital budget, and to include in this report an estimate of the unencumbered margin. Section 212 of the City Charter requires that the Comptroller annually prepare and

1/ Cf. Comptroller Goldin's Press Release 77-50.

2/ Report of the Office of the Comptroller of the City of New York, prepared by Steven Clifford for the New York State Charter Revision Committee for New York City, February 1973, at p. 15. Dissemination of the Annual Report was very limited. For the fiscal year 1973-74, only 550 copies of the report were printed.

3/ Each "modification" was supposedly published in the City Record as a discrete daily item. Even if one were to accumulate all prior items at any given time, their integration into one meaningful "financial statement" would have been incapable of accomplishment.

report his recommendations on the maximum amount and nature of debt the City may incur for capital expenditures. 1/ The Comptroller is also obligated by Section 113 of the City Charter to report annually on the status of the Tax Deficiency Account, Tax Appropriation and General Fund Stabilization Reserve Fund (the "Rainy day fund") and the following fiscal year's appropriations for debt service and the sinking funds. 2/

The statutory reports pursuant to Sections 113, 212 and 220 were not disseminated to any significant extent. Indeed, there have been members of the syndicates bidding on City securities who were unaware of their existence. 3/

These statutory reports were inherently misleading and inadequate, because of the unreliability of the financial data they contained. In addition, these reports failed to disclose the unsound budgetary and accounting practices described in the Accounting Report. Furthermore, they were issued as separate and discrete reports which could not reasonably be matched or compared so as to glean comprehensive information from them in the aggregate.

1/ City Charter, Sections 212 and 220.

2/ Id., Section 113.

3/ In a survey of syndicate members, the Commission asked whether members had received, utilized or relied upon any of a number of documents issued by the City, including among other things, the Comptroller's Monthly Statements, the Annual Report, the Fiscal Newsletter, the Capital Budget, the Fiscal Budget and the Comptroller's Reports issued pursuant to Sections 113, 212 and 220 of the City Charter. Most of the firms responding indicated that they had not received, utilized or relied upon such information. See, Analysis of Questionnaires Sent to Syndicate Members.

Other purported disclosures by the City included the issuance of the City's Fiscal Newsletter and a monthly statement of the Comptroller regarding cash receipts and disbursements. These were also inadequate disclosure documents in that they received limited distribution, and contained only fragments of relevant information. Any financial data presented therein was unreliable as well, because of the City's lack of internal accounting controls.

3. Notices of Sale and Statements of Essential Facts

Prior to March 13, 1975, in connection with each offering of City securities, the Comptroller issued a Notice of Sale. When bonds were issued, a Supplemental Report of Essential Facts was included in such Notice of Sale. With respect to notes, the Notices of Sale indicated that a report of essential facts would be available on request, but none were ever prepared. 1/

All of these documents were deficient in terms of disclosure. The Notices of Sale for Notes did little more than announce the offering of debt. The Supplemental Reports of Essential Facts provided a bit more information, but such information was not timely, complete or reliable. 2/

4. The Report of Essential Facts

a. Background

As a result of "increasingly serious questions as to the credit and the fiscal condition of the City," 3/ White & Case, bond counsel to the

1/ See Report on The Role of Bond Counsel, at 71.

2/ See, e.g. Notice of Sale of \$475,580,000 of Serial Bonds of the City of New York Dated October 15, 1974, and Supplemental Report of Essential Facts attached thereto.

3/ Chronology at March 8, 1975.

underwriters, drafted a "Report of Essential Facts" ("Report") for use in the \$375 million RAN offering scheduled for March 13, 1975. 1/ This was the first time any purported disclosure document other than the Notice of Sale itself had been prepared for use in an anticipation note offering. 2/

The information contained in the draft had been provided by the Comptroller's Office. 3/ The draft report was reviewed by underwriters and City officials, changes made, and put in final form as of March 13, 1975. 4/

While the Report contained more extensive financial data concerning the City than had ever before been disseminated in connection with the offer and sale of City securities, it was nevertheless inadequate as a disclosure document. The data contained therein was misleading, incomplete, and lacking in sufficient textual explanation to be of significant use even if accurate.

Over and above the numerous specific misstatements and omissions in the Report, certain basic problems with its structure and content rendered it misleading.

First, it was based on data generated in large part by the City's system of internal accounting controls. These controls were inadequate in several respects, as the Accounting Report explains in detail. Hence, the data generated therefrom was inherently unreliable.

Second, no financial statements are contained in the Report. The fragmentary information concerning specific assets, liabilities, revenues and

1/ Chronology at March 12, 1975.

2/ See p. 131, n. 1, supra.

3/ Chronology at March 12, 1975.

4/ Chronology at March 12, and 13, 1975.

expenditures which are presented are either meaningless or affirmatively misleading outside the context of the City's overall financial position and results of operations. The most glaring omission, in this regard, is the lack of any disclosure regarding the City's massive cumulative deficit.

Third, significant elements of the data presented are based on the City's unique basis of accounting. The City's accounting "principles" were virtually incomprehensible. In any event, there was no explanation of the accounting principles on which the information in the Report was based.

These and other fundamental errors, as well as the specific omissions and misstatements described in Appendix C, hereto, are reflected on virtually every one of the 12 pages of the document.

b. The Report of Essential Facts - Inadequacies as a Disclosure Document

Even if the selective information contained in the Report had been completely accurate, the Report would have been inadequate as a disclosure document. The clearest deficiency was its almost total failure to inform a prospective investor of the risks inherent in an investment in City securities as of March 13, 1975. There is no disclosure that the City's access to the capital markets was in imminent peril. There were no disclosures regarding, among other things: (1) the City's need to borrow in order to meet its near, immediate and long-term debt obligations; (2) the high degree of likelihood that a note purchaser would be unable to resell the note into the public markets at par; (3) the material uncertainties regarding collectibility of the federal and state aid and real estate tax receivables related to the issuance of the City's RANs and TANs; (4) the

liquidity of an investment in City securities; (5) the massive unfunded accrued liability to the City's pension funds; (6) the City's assumptions as to revenues and receivables might well prove to be unfounded; (7) the material uncertainty whether note purchasers had a "first lien" on all City revenues; and, (8) the City's ability in the future to service its debt obligations. A detailed analysis of the Report of Essential Facts is contained in Appendix C hereto.

In sum, the City's reports and other public documents did not adequately disclose highly material facts regarding the City's financial condition and its securities.

VI. CONCLUSION

This Report has described the knowledge of the City and its officials, particularly the Mayor and the Comptroller, as to the events surrounding the City's fiscal crisis. The following conclusions appear to be warranted, based on the evidence gathered by the staff: (1) the City consistently spent more than it received in revenues; (2) City officials were aware that there was an ever-growing disparity between revenues and expenses; (3) City officials employed certain unsound budgetary, accounting and financial reporting practices which created the appearance that revenues and expenses were in balance; (4) City officials prepared and published various reports which did not, individually or in the aggregate, clearly, fully and accurately describe such practices or reveal the the City's true financial condition; and (5) the Mayor and the Comptroller made numerous reassuring public statements concerning the City's financial condition and the safety of investments in the City's debt securities, which statements facilitated the sale of the City's securities, and which did not provide adequate disclosure of the facts. In sum, the Mayor and the Comptroller misled public investors in the offer, sale and distribution of billions of dollars of the City's municipal securities from October 1974 through at least March 1975.

The Mayor and the Comptroller had knowledge of the facts. The Mayor controlled the budgetary process, and was fully aware of the gamut of unsound budgetary, accounting and financial reporting practices utilized by the City. Prior to assuming office as Mayor, Mr. Beame had spent 15 years in the City's Office of Management and Budget and eight years as Comptroller. After assuming office in January, 1974, Comptroller Goldin quickly became

aware of the facts. Comptroller Goldin's consultants and assistants, particularly Steven Clifford, provided him with detailed memoranda as to these unsound practices and their effectiveness, often in terms of actual dollar amounts, in masking the City's true and disastrous financial condition.

To the extent that the City's budget overestimated revenues and understated expenses, borrowing was needed to cover the resulting "budget gap." To the extent that the budget employed other practices to mask the further disparities between anticipated receipts and expenditures, even greater borrowing "authority" was needed from the State. The City's true financial needs were overwhelming, and for this reason the need for fair disclosure was compelling.

Furthermore, the City's inadequate internal accounting controls resulted in unreliable and inaccurate financial information. The Mayor and Comptroller knew this. The inaccurate information was utilized in the City's fragmented official reports issued throughout the fiscal year. More importantly, this data was selectively reproduced in parts of the City's Notices of Sale and Reports of Essential Facts in connection with the offering of the City's debt securities.

Investors were injured by these practices, particularly when the New York State Legislature imposed a moratorium on the payment of principal and interest on the City's short-term debt maturing subsequent to November 15, 1975. After March, 1975 and prior to and during the moratorium, certain investors sustained large losses by selling into

the declining and severely restricted secondary markets for the City's debt securities. For example, by December 31, 1975 certain RANs had declined 45% in principal amount in actual trading.

The political, economic and social pressures which assailed the City did not erupt overnight, but were burgeoning for many years. The City was only partially successful in obtaining increased federal and state aid; on the state level, additional City borrowing "authority" in lieu of an equivalent amount of state aid was provided in many instances. In addition, the City's ability to raise revenue through taxation had apparently been extended to the point where further increases might have adversely impacted the City's economy. The City's officials were apparently unwilling or unable to reduce expenses to reflect the lack of needed revenues.

Even if one could assert that the City was motivated in good faith by these factors to seek out new investors to keep itself "afloat," that would constitute no excuse for misleading them in connection with the offer and sale of City securities. The City faced hard choices. But it was not appropriate to shift a large part of the risk inherent in the City's predicament to public investors without adequate disclosure of what that risk entailed.

Such deceptive practices proved counter-productive, insofar as they postponed the hard choices which had to be made and exacerbated the City's pyramiding deficits. Once revealed, such practices could not have aided the City's credibility as an issuer in a market where investor confidence plays a key role.

Insofar as the socio-economic conditions of the City impact its finances, they become items of importance to be disclosed to investors. After the crisis, the City itself recognized this obligation. A major part of its June 16, 1977 Official Statement, a disclosure document prepared in connection with the offering of certain bonds, was thus devoted to "Economic and Social Factors." The introduction to that part states:

This section presents information on what the City considers to be its major economic and social indicators. The economic and social factors described here influence, directly and indirectly, both City revenues and City expenditures. They affect the ability of the City to impose and collect, and the ability of City residents to pay taxes, and they determine in part the level of demand for services which the City must provide. Also described in this section are factors which may have a significant, though indirect, impact on the City's tax base and economic structure. (p. 97)

The federal securities laws administered by the Securities and Exchange Commission have as their principal purpose the protection of public investors. Accordingly, our inquiry has been to determine whether, under the circumstances, the measure of disclosure mandated under the federal securities laws was provided in connection with the offer, sale and distribution of the City's debt securities. We conclude that it was not.

APPENDIX A

There follows in full text the minutes of the December 17, 1974 meeting of the Comptroller's Technical Debt Management Committee, held at Gracie Mansion. Present at the meeting on behalf of the City were Mayor Beame, Deputy Mayors Cavanagh and Lechner, and other officials of the Mayor's Office; Comptroller Goldin, Chief Accountant Sol Lewis, the Deputy Comptroller, Steven Clifford, and other members of the Comptroller's Office. Among those representing the City's major underwriters were Wallace Sellers of Merrill Lynch, Thomas LaBrequé and John Devine of Chase Manhattan Bank, Richard Kezer of Citibank, and Frank Smeal of Morgan Guaranty Trust Co. Other representatives of the financial community included Gedale Horowitz of Salomon Brothers, and Richard Nye of First Security Co. The meeting commenced at 8:00 a.m.

Minutes of Special Meeting of the Comptroller's Advisory
Technical Debt Management Committee

December 17, 1974 8:00 a.m. Gracie Mansion

The Comptroller noted that he had arranged with the Mayor to set up this meeting at the request of the Committee for the purpose of enabling the Committee to discuss with the Mayor the City's debt and proposed borrowing as it impacts the capital markets. He further stated that the new borrowing schedule he presented to the Committee at a meeting the previous evening had been shown to the Mayor.

Mr. Sellers began the discussion by pointing out that in recent weeks the capital markets had been a total disaster, that some of the City's bonds had been selling at as much as an 11% yield, that the difficulties encountered in selling the City's obligations had made it likely that there would be no bid at all on a January bond sale. Although the revised schedule submitted the previous evening changed that situation for the present, the

problem will reappear. No one questions the City's ability to pay its debt; it is merely a question of the ability of the market to absorb issuances of such magnitude.

Mr. Smeal stated that although the new schedule will temporarily reduce the demands on the market, the pension systems' absorption of a portion of the debt is also temporary. Consequently, we are merely postponing, not solving, the problem. Any resulting relaxation would be a mistake. The basic problem is the size and frequency of the City's borrowings. What is now required is a strong and joint effort to indicate the City's plan to bridge the gap.

Mr. Horowitz stressed that people who invest these days are essentially "buying" management. Consequently, it is absolutely essential to show a united face with joint statements on the City's problems and proposed solutions.

Mr. Kezer pointed out that since early October, while other money rates were going down, the City's rates were consistently going up. Only a concerted effort by the Mayor and Comptroller can reverse this trend.

Mr. Labrecque stated that although we all wish to solve current problems and seek short-run relief for the market, we must also develop long-range solutions and firmly establish the City's credibility.

Mr. Sellers stated that borrowing to finance deficits is no longer a viable procedure.

The Mayor pointed out that at one time the pension systems were almost the sole buyers of City's securities. Today's rates make it possible for the systems to resume buying City securities. He did not view this as a "one-shot" deal, but as a procedure that can continue to be followed as long as rates remain high. He was outraged at the rate the City was forced to pay at the last sale and, consequently, views purchases by the pension systems as a form of competition with the banks.

The Mayor stated further that in the real world all governmental budgets must go up annually and, as a consequence, borrowing will also go up. The question is the frequency of such borrowing, the increase of which is a puzzle to him.

Mr. Sellers responded that the size of the issues is the cause of the frequency.

The Mayor stated that we want to work with the financial community, that the banks can and should help "sell" the City, and should not just sit by and tell the City to reform.

Mr. Smeal responded that the position of the City is different from that of the Federal Government in that the latter prints the money. The City needs the institutional market. With the ever-growing militancy of the unions with which the City must deal, a question arises as to whether debt is really a first lien on revenue.

Mr. Sellers stated that on the last City bond sale the banks "lost" \$50 million. It is important for the City that the banks survive.

The Mayor mentioned that the only really new borrowing the City will engage in is the \$520 million to be borrowed by the Stabilization Reserve Corporation. Although Albany had wanted us to borrow \$800 million, we limited it to \$520 million. No new taxes were imposed. All other City borrowing is against expected revenue, as it has always been.

The Comptroller then stated that what the banks are saying is that in their present weakened condition the sheer magnitude of our borrowing makes it impossible for the capital markets to absorb the quantity of debt we are issuing.

The Mayor pointed out that the reaction of the layman is that the City's debt is weak, not that the banking system is capital-short. He asked how the current proportion of City debt in the market compared to prior years.

Mr. Labrecque responded that it is now double.

Mr. Smeal said that if there were no more deficit financing there would be no problem.

The Mayor responded that he cannot commit himself to that. All he can say at this point is that he is taking some very tough steps to economize and that he will seek aid in Albany and Washington.

Mr. Horowitz pointed out that the City has lost its institutional market. Although the City's banks will continue their support, the out-of-City banks have stopped buying the City's obligations. It is that market that we must recapture.

The Mayor responded that the banks are the City's best buttress for supporting municipal debt and that they must, therefore, "sell" the City to the rest of the country.

The Comptroller pointed out that the problem is one of supply and demand.

Mr. Smeal interposed that you cannot run the City on borrowed money.

The Mayor responded that we are borrowing against firm receivables. It is the financial community and the capital markets that have not carried out their responsibility.

Mr. Smeal stated that the market has just suffered the greatest losses in history in its support of the City's debt.

Mr. Nye stressed the extreme gravity of the situation, emphasizing that the whole system could come tumbling down.

Mr. Beame responded that he was fully aware of the gravity. The question is will the banking community "sell" the City.

Mr. Nye pointed out that the City must publicly recognize its socio-economic problems and that the unions must be made aware of them, too.

The Mayor responded that we will do everything we can to restore confidence.

Mr. Horowitz stated that the City needs a better press. The newspapers keep talking of deficit financing.

Mr. Nye inquired whether the City's leaders can persuade the financial writers and the financial community that the budget problems are not so bleak.

The response of the Mayor was that we have tried to do this repeatedly.

Mr. Smeal suggested that the Mayor and Comptroller seek jointly to reassure the financial community.

The Mayor responded that this had been done.

Mr. Nye replied that it was unconvincing.

Mr. Sellers suggested the holding of a municipal financial forum.

The Mayor agreed. He asked for the Committee's support in getting Albany to give us their promised aid more promptly.

Mr. Sellers responded that they would be more than willing to accompany the Mayor to Albany and Washington.

The Comptroller thanked the Mayor for giving his time and attention to the problems raised by the Committee.

APPENDIX B

FOR RELEASE: IMMEDIATELY
DECEMBER 17, 1974

74-141

Comptroller Harrison J. Goldin announced today a sharply curtailed public borrowing schedule for the first six months of 1975, intended to reduce the supply of City obligations on the market and reassure investors that restraint in public borrowing will accompany austerity in spending.

Mr. Goldin made the announcement following a meeting this morning at Gracie Mansion with Mayor Beame and the members of the Comptroller's Technical Debt Management Committee.

In place of a previous tentative plan to issue both bonds and notes in January, the City will issue only notes in the sum of \$620 million, Mr. Goldin stated. Beyond January, the Comptroller revealed a revised tentative schedule to issue \$140 million in bonds in February and \$500 million in bonds in April. Notes will be issued from February through June, according to the tentative schedule, at the rate of \$550 million per month.

The amounts on the tentative six-months schedule include the borrowing which is contemplated during the period by the Stabilization Reserve Corporation, the Comptroller stated.

The curtailment in public debt offerings will be chiefly accomplished by short-term limited investments of city pension fund and sinking fund money in City obligations, Mr. Goldin explained. Use of the pension funds, as suggested by Mayor Beame last week, is

contingent on approval by the fund trustees, he added.

The early morning meeting at Gracie Mansion was held to permit a general discussion among the Mayor, the Comptroller, and the members of the Technical Debt Management Committee on market conditions for municipals, and on the revised tentative borrowing schedule which had been developed by the Comptroller during the preceding night.

In a statement issued following the meeting, the Comptroller said it was the consensus of his Advisory Committee that while the City's obligations continue to offer absolute security to investors, the large supply of such securities on the market and the further amounts overhanging the market have been depressing prices and discouraging potential purchasers.

"We believe that by improving the supply-demand balance through cutting back our public borrowing we can help the market to absorb future offerings and thus have a favorable effect on interest rates from the City's standpoint," Mr. Goldin explained.

* * *

The sale scheduled for Tuesday, January 7, will consist of \$620 million in Revenue Anticipation Notes, to be dated January 13, 1975 and to mature January 12, 1976. Bids will be received up until 11 A.M. on January 7 in the Comptroller's Conference Room in the Municipal Building.

APPENDIX C

The Report of Essential Facts - Structure and Content

The analysis that follows is not intended to be comprehensive. Rather, it is meant only to be illustrative of the basic flaws in the City's financial disclosures chronicled in greater detail in the Accounting Report.

The Report of Essential Facts ("Report"), itself was a twelve page document, the face page and an index page. It contained numerous "schedules" and tables, and one textual "Statement with respect to Cash Flow Projections."

The face page consisted of eight lines, reading as follows:

March 13, 1975

REPORT OF ESSENTIAL FACTS

Attached is the report of essential facts referred to in the Notice of Sale by the City of New York with respect to Revenue Anticipation Notes of the City offered for sale on March 13, 1975.

Harrison J. Goldin
Comptroller, City of New York

The second page was merely an index.

a. The first schedule (page 3) was entitled "Schedule of Anticipated Short-term Borrowings." This Schedule contained a list of anticipated public short-term borrowings through June 30, 1975. The Schedules contained three columns, entitled "Approximate Settlement Date," "Amount (in Millions)," and "Nature of Borrowing." This schedule contained at least the following misleading information:

(i) The \$375 million RAN issue, listed for March 20, 1975, was reflected as being based on "State Revenue Sharing." There was no disclosure of the material risk that the City would not have sufficient collectible

state revenue-sharing receivables to support such notes and others previously issued.

(ii) A \$270 million BAN issue was listed for May 15, 1975, without any mention of the material risk that the City would shortly be foreclosed from the debt market, and thus unable either to sell the bonds "anticipated" to fund the notes or otherwise obtain revenues to repay these and other notes.

(iii) Two BAN issues, totalling \$520 million, were listed as anticipated offerings by the Stabilization Reserve Corporation. While a footnote conditioned these sales on "[t]he successful final disposition of [the Wein] suit," there was no disclosure of the fact that the City had "balanced" its fiscal 1975 budget by including these funds in revenues.

b. On page 4 of this Report was a "Statement with respect to Cash Flow Projections." This statement briefly mentioned that the City has a "computerized cash flow" forecasting system, and asserted that:

[P] rojections produced by this system indicate that the future borrowings listed [in the Schedule of Anticipated Short-term Borrowings], together with projected City revenues, will be both necessary and sufficient to meet the City's cash needs through June 30, 1975, including the redemption of maturing debt.

The Statement concluded that:

The City requires continuing access to the capital markets in the approximate amounts listed [in the Schedule of Anticipated Short-term Borrowings] in order to meet its cash needs through June 30, 1975.

The foregoing Statement omitted to state at least the following material information:

(i) That the "cash flow" of the City and projections related thereto were irrelevant to the "revenue" data presented elsewhere

in the Report, because such "revenues" were not recorded on a cash basis, but rather on an unusual accrual basis.

(ii) That "continuing access to the capital markets" would be necessary, not only until June 30, 1975, but well beyond that date, both to "meet [the City's] cash needs" and to avoid default on existing and acutely necessary future debt issuances.

c. On page 5 of the Report, there were two Schedules listing the maturity dates of the City's short and long-term debt which was to mature on or before June 30, 1975. The Schedule of short-term debt, by listing only debt outstanding as of March 6, 1975, avoided having to list the \$375 million RAN offering to which the Report itself was directed. By ignoring this offering, it is unclear if the \$375 million in revenue needed to redeem this issue, which matured on June 30, 1975, was accounted for in the Statement of Cash Flow Projections described above.

d. On page 6 of the Report, there was a Schedule of "Revenue Anticipation Notes ["RANS"] Outstanding as of March 11, 1975." The RANS listed were broken down by category of receivable against which they were issued. This Schedule was materially deficient in at least the following respects:

- (i) The amounts of uncollectible and/or unearned revenues included in the various receivable categories are not disclosed.
- (ii) Receivable balances are given as of two different dates (January 31 and February 28, 1975), neither of which conforms to the dates of the related note issuances.

e. There was a schedule of "Debt Outstanding -- February 28, 1975" on page 7 of the Report. This schedule reflected both short and long term debt, and reflected a total debt figure of \$12.5 billion. This schedule omitted at least the following material facts:

(i) As of March 13, 1975, the date of the Notice of Sale for the \$375 million RAN offering, the City's total debt was \$1 billion greater than that indicated. Following the RAN offering (i.e., as of March 20), the City's total debt was in excess of \$14 billion.

(ii) Much of the City's "temporary" debt was, and had to be regularly refinanced, making it essentially "permanent" in nature despite the ostensible short-term maturity date of each issue.

f. A schedule on page 8 of the Report was entitled "Determination of Debt-Incurring Power as of February 28, 1975". In computing the general debt limits, this schedule listed the assessed and full valuations of "taxable" real estate. It omitted to list, however, the material amounts of non-taxable property which the City carried on its tax rolls as taxable.

g. On pages 9 and 10 of the Report, there was a miscellaneous table entitled "Supplemental Essential Facts." This Table was materially deficient in at least the following respects:

(i) The calculation of debt limits on page 9 omitted to disclose the non-taxable properties on which the calculations were partially based.

(ii) The calculations of "operating expenses" on page 9 omitted to disclose that the City recorded costs, not as they were incurred, but on a delayed cash basis.

(iii) The itemization of "Gross Expenses" on page 10 also failed to disclose the City's method of accounting for expenses. In addition, the nine month figures were noted as being "as per Budget as Adopted", without any explanation of the material differences between the "adopted budget" under the City's unique system and actual expenditures.

(iv) The itemization of various sources of "revenues" on page 10 omitted to disclose both the unusual "accrual" basis used by the City to recognize revenues without regard for the period in which they were earned, and the material uncertainty as to the existence and collectibility of material portions of these revenues.

h. On page 11 of the Report, there was an itemization of "local property taxes." This schedule was deficient in that it did not explain the City's tax revenue recognition practices. Moreover, fiscal 1974-75 data was noted as being "per Tax Resolution as Adopted," without an explanation of how the "tax resolution" under the City's unique system differs from actual tax collections.

i. On page 12 of the Report, there was a schedule of "Funds Applicable to the Reduction of Debt." This schedule was deficient in at least the following respects:

(i) It listed "Costs and Investments" of the City's sinking funds without disclosing:

(1) The valuation basis (e.g., cost, market value, etc.) for the investments;

- (2) It did not disclose that substantial portions of sinking fund investments were in the City's own securities;
 - (3) It did not disclose that the Transit Unification Sinking Fund invested in City securities in apparent contravention of the Fund's initial contractual covenants.
- (ii) Under the caption "Cash Balances," there was a subheading entitled "Balance of 1974-1975 Expense Budget Appropriations. . . . This "balance" was unrelated to "cash". It merely reflected the remaining budget allocation. This subheading, in addition, did not reflect:
- (1) The City's lack of internal control over assets of the sinking funds and the related unreliability of the data resulting therefrom; or
 - (2) The City's "per books" overdraft of \$262 million as shown by its February 28, 1975 cash receipts and disbursement statement (which statement was not included in the Report).
- j. A "Statement of Real Estate Taxes" also on page 12, listed uncollected taxes from the 1970 through 1975 levies but omitted to state that significant portions of these taxes were also uncollectible.



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**THE ROLE OF
THE UNDERWRITERS**

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

Introduction and Summary

Chronology of Events October 1, 1974 - April 8, 1975	Chapter One
Report on Accounting Practices and Financial Reporting	Chapter Two
Report on the Role of the City and Its Officials	Chapter Three
Report on the Role of the Underwriters	Chapter Four
Report on the Role of the Rating Agencies	Chapter Five
Report on the Role of Bond Counsel	Chapter Six
Analysis of Questionnaires Sent to Individual Investors, Syndicate Members and Managing Underwriters:	Chapter Seven

Chapter Four

REPORT ON THE ROLE OF THE UNDERWRITERS

August 26, 1977

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I. INTRODUCTION AND OVERVIEW

This Chapter of the Report describes the role of a number of financial institutions that acted as underwriters in the distributions of the securities of the City of New York ("City") during its fiscal crisis -- particularly during the period from February through April 1975. Their knowledge of the crisis and the City's related problems, the inadequacies of their disclosures of materially adverse information regarding the budgetary and financial problems of the City, and their failure to fulfill their responsibilities to the investing public are detailed. The financial institutions principally involved include Chase Manhattan Bank ("Chase"), First National City Bank ("Citibank"), Morgan Guaranty Trust Company of New York ("Morgan"), Manufacturers Hanover Trust Company ("Manufacturers"), Bankers Trust Company ("Bankers"), Merrill Lynch Pierce Fenner & Smith, Inc. ("Merrill Lynch") and the Chemical Bank ("Chemical"), sometimes hereinafter referred to collectively as the "underwriters". ^{1/}

From October 1974 to April 1975, the City offered and sold through the underwriters about \$4 billion of short-term debt securities. In connection with the sale of these securities to the public, representations were made ^{2/} emphasizing the capacity and financial strength of the City to meet both its principal and interest obligations on a timely basis. Throughout this period, however, the underwriters had detailed knowledge of the City's financial crisis and its related problems: the growing gap between the City's revenues and expenditures; the use of short-term borrowings which had to be rolled over continuously to cover the gap; the widening of the gap during the 1974-1975 fiscal year;

^{1/} These institutions were among the City's principal underwriters of City's securities during September 30, 1974-April 30, 1975 period. See Appendix A, infra.

^{2/} Id.

and the rapid growth of the City's short-term debt. Notwithstanding the representations that were being made to public investors, the underwriters became increasingly aware during this period that the City would soon be unable to continue to finance its ever-increasing deficit.

The underwriters realized that because of these conditions and the fact that the market had become saturated with billions of dollars of City securities, their capacity to distribute successfully substantial additional quantities of City debt had been significantly impaired. The underwriters were also aware that the basic underpinnings of the Bond Anticipation Notes ("BANS"), Revenue Anticipation Notes ("RANS") and Tax Anticipation Notes ("TANS") -- the availability of revenues to cover the RANS and TANS and the marketability of bonds or the availability of revenues to redeem the BANS -- were in serious question. Despite this knowledge on the part of the underwriters, they continued to make representations concerning the safety of the investment and failed to disclose material facts concerning the City's securities.

As the fiscal crisis became particularly severe in early 1975, the underwriters continued to offer and sell City notes to the public as safe and secure investments without disclosure of significant risks. At the same time, certain of the underwriters were in the process of reducing or eliminating their holdings of the notes. Moreover, certain underwriters determined not to purchase additional City notes for their own accounts and for their fiduciary accounts. As the crisis worsened, the principal officers of the underwriters became actively involved in discussions concerning the City's fiscal crisis, the continued marketability of City securities, and the inadequacy of the disclosures being made to the investing public. Nonetheless, in early

1975, they proceeded without adequate disclosure with offerings of over \$1.5 billion of City notes.

The underwriters were subject to intense pressure by City officials to underwrite and market City securities. They recognized the immediate and catastrophic consequences of the failure to continue to market City securities to the public, and the fact that full disclosure would have eliminated this market. In March of 1975, the underwriters had large investments in City bonds and notes exceeding \$1 billion, or 20% of their combined equity. 1/ Thus, impairment of the market for the City's securities would have seriously affected the banks. As Deputy Mayor Cavanagh stated: "[T]he banks and us are in a community of interests. If we go down, they go down." 2/ Whatever reasons led the underwriters to market the City's securities without adequate disclosure, their conduct cannot be justified under the federal securities laws.

The conduct and role of the underwriters raise the question of whether changes should be made in the process of conducting municipal securities offerings in the future, to assure that the underwriters are sufficiently independent and that their paramount concern will be their responsibilities to the investing public. The underwriting process should be carefully examined to consider the question of whether this process can be structured so as to better protect public investors and to prevent the recurrence of the events described in this Report.

1/ Testimony of Ellmore Patterson at 57-58.

2/ The New York Times, March 20, 1975, at 43.

II. THE MARKETING OF THE CITY'S SECURITIES

Over the past several decades, the City has relied upon the underwriting process to market billions of dollars of its securities. An underwriting syndicate comprised generally of large banks and brokerage institutions purchased bonds or notes from the City with a view to distributing the securities to the public market, including other banks, brokers and other public investors. The underwriting process prevalent in New York during the period covered in this Report has typically followed an established pattern.

Certain prospective bidders, particularly financial institutions which had previously participated in an underwriting, received from the City a "Notice of Sale", a document prepared by the City, setting forth the type of security, the amount, a maturity schedule, and information concerning the bidding procedure. 1/

Subsequent to the publication of the City's intention to proceed with an offering, members of the investment community typically contacted one another to form a group which, in turn, would bid on the prospective issue. Often the formation of the selling syndicate was based upon prior associations among the same financial institutions in previous underwritings of the same type of securities as those subject to the prospective offer. 2/ The syndicate, as it is commonly called, typically had one or more syndicate managers. During the period of this Report,

1/ Testimony of Rousseau (March 26, 1976) (Rousseau I) at 37, 40; See generally Securities Industry Association, Fundamentals of Municipal Bonds, (76-77) (9th Ed. 1973) (hereinafter cited as Fundamentals).

2/ Testimony of Rousseau I at 37-8.

the management function was held by several major New York City banks. 1/

By the time the syndicate was formed, each of its members typically had received documents concerning the proposed offering, including the Notice of Sale from the City and the Daily Bond Buyer "Worksheet" from the Daily Bond Buyer, the latter containing, among other things, information concerning the bidding procedures. 2/ In addition, the syndicate members, which usually subscribed to the services of one of the three large rating agencies, obtained from these agencies a rating and back-up analysis concerning the particular offering. 3/ The members of the group reviewed this and other information in their possession prior to discussing the "bid" to be submitted to the City. 4/ Moreover, to assist themselves in determining an appropriate bid, syndicate members often made preliminary inquiry of customers to determine the interest of the public in the forthcoming issue. 5/

Within a week or so before their bid was submitted, the underwriting syndicate gathered at the offices of the syndicate manager. At the meeting, they discussed offering prices, profit margins, bid prices and participation shares. A bid was then communicated to the City and the sale was awarded by the City to the lowest bidder. 6/

1/ See Appendix A.

2/ Testimony of Rousseau I at 41, Fundamentals, at 80.

3/ Testimony of Rousseau I at 41.

4/ Testimony of Rousseau I at 44-45.

5/ Testimony of Rousseau I at 84.

6/ Fundamentals at 80-81; see generally Testimony of Rousseau I at 44, 45-85.

City notes were typically sold to underwriters on an undivided account basis—members of the syndicate were responsible for their pro rata share of the offering based on their original participation, regardless of the number of securities which each member may have sold. 1/ Any unsold allotment of any one underwriter was therefore spread among all underwriters on a pro rata basis. 2/

Underwriters then distributed their "take-down" to the public, at times maintaining a position for their own account in the securities involved. No commissions or fees, as such, were received by the underwriters for marketing the City issues. Instead, the underwriters sought to and ultimately did realize a profit by reselling the securities to investors at a price higher than the price paid to the City. This mark-up is known as the "spread". 3/

In connection with the sale of such securities, the underwriters typically did not furnish any offering documents to the investors. However, on March 13, 1975, the underwriters commenced to disseminate for the first time a purported "disclosure" document entitled "Report of Essential Facts", which had been prepared by the City and the underwriters which was inadequate.

1/ Testimony of Rousseau I at 27; Fundamentals at 79.

2/ Fundamentals at 29; but see Testimony of Rousseau I at 28.

3/ Fundamentals at 75.

III. BACKGROUND

Long before October 1974, the financial community realized that the City's fundamental problem was the insufficiency of revenues to meet expenses, resulting in a chronic and ever-increasing budget gap. The financial community had also come to understand the consequences of using short-term debt issues to close its budget gap and questionable budgetary practices to conceal the gap. ^{1/}

^{1/} Citibank internal memorandum, Jac Friedgut to Walter I Spencer, President (March 14, 1975) ("Communicating Acute Fiscal Concern to the Mayor"—reflects on past warnings) (Div. Ex. Friedgut 1); See Morgan internal memorandum, Research Group to Municipal Bond Dep't (September 6, 1974); Letter, William J. Solari (Donaldson, Lufkin & Jenrette) to Harrison J. Goldin (August 8, 1974); Citibank internal memorandum, Paul S. Tracy, Jr., to Salesmen and Traders (July 29, 1974); Morgan handwritten documents and internal credit report of New York City (July 9, 1974); Letter and attachments, Sol Lewis to John L. Larkin (Citibank Senior Vice President) (July 10, 1974); Citibank internal memorandum John Berenyi to Richard F. Kezer (June 5, 1974); Minutes, Comptroller's Technical Debt Management Committee (May 21, 1974) (attended by, among others, Goldin, Scher and Lewis for the City, and representatives of Chase, Morgan and Citibank); Chase internal memorandum, New York City's Expense Budget (Karen Gerard, Economics Group, May 17, 1974) (This memorandum was preceded by a two page unsigned outline setting forth "An Acoroach to New York City's Fiscal Problem" dated "approx. March 10, 1974"); Minutes, Comptroller's Technical Debt Management Committee (April 9, 1974); Citibank internal memorandum John Berenyi to Salesmen and Traders (April 5, 1974); Letter and attachments, Karen Gerard (Chase) to Walter Cadette (Morgan) (January 14, 1974); Chase internal report, Karen Gerard, Long-Range Scenario Study: Looking Ahead for the New York Metropolitan Area—Alternatives for 1985 (January 1974) (22 page report); Morgan internal memorandum, William J. Solari to Frank P. Smeal (Executive Vice President) (July 3, 1973); Citizens Budget Commission, Inc., New York City's Debt Problem (July 1973); Temp. State Comm'n to Make a Study of the Operation of the City of New York, New York City: Economic Base and Fiscal Capacity (April 1973); Chemical internal memorandum, D.D. Miner to D.C. Platten (1st Vice President) (June 19, 1972); Citibank, Economics Dept., Profile of a City (1972) (249 page hardcover book); Int'l Inst. of Pub. Finance, David Grossman, Issues in Urban Public

Footnote continued on next page.

As early as March 7, 1966, Herman Charbonneau, Vice President, Municipal Department of Chemical, who was later to play a significant role on behalf of the bank during the City's crisis period, wrote an internal memorandum decrying the City's practice of making up the gap between current expenditures and revenues by selling RANs and other short-term debt instruments. 1/ In the memorandum, Charbonneau concluded that the use of such

deficit funding is an inherently unsound operation, and one which can lead to disaster. New York City's resort to this practice was the fundamental reason for the recent downgrading of its credit rating. Any improvement in that rating, and in the City's general financial position, must begin with elimination of borrowing to meet current expenses. 2/

In 1971, a summary of prior studies of City finances going back to 1952, entitled A Study of Studies, was prepared by the City of New York Commission on State-City Relations. 3/ The Study concluded in part that "without question,

Footnote continued from preceding page.

Finance, Some Innovations In the Budgetary Process In New York City (1972); Morgan internal Municipal Bond Report regarding City General Obligation Bonds (December 1, 1971); City of New York Comm'n on State-City Relations, Study of Studies: An Analysis of the Work and Recommendations of a Generation of Task Forces on New York City's Fiscal Crisis (December 1971); Chase internal report, Karen Gerard, Financing the City of New York--Recent Trends and Their Future Implications (October 14, 1971); Morgan internal credit report regarding New York City (July 7, 1971); The Urban Inst., Creative Budgeting in New York City--An Interview with Former Budget Director Frederick O.R. Hayes (June 1971); Chase internal report, New York City's Credit (July 10, 1970); Citizens Budget Commission, Inc., On the Mayor's Executive Expense Budget for 1967-68 (May 9, 1967); Graduate School of Pub. Adm., New York U., Financing Government in New York City (June 1966); Chemical internal report, Analysis of New York City's Fiscal Problems (Herman R. Charbonneau, March 7, 1966).

- 1/ Chemical internal memorandum, Analysis of New York City's Fiscal Problems, passim (Herman R. Charbonneau, March 7, 1966).
- 2/ Id. at 2.
- 3/ City of New York Comm'n on State-City Relations, Study of Studies: An Analysis of the Work and Recommendations of a Generation of Task Forces on New York City's Fiscal Crisis (December 1971).

the expenditure-revenue gap of New York City, identified in 1952, further confirmed in 1966, remains the fundamental dilemma of the City fiscal crisis." 1/

A July 1973 report, entitled New York City's Debt Problem, issued by the Citizens Budget Commission Inc. ("CBC"), 2/ a blue-ribbon private research organization, explored the size and cost of the City debt, the use of debt for current expenses, the improper inclusion in the Capital Budget of operating expenses, and the dangerous cycle thereby created. 3/ This report also analyzed the City's borrowing capacities and powers, the misuse of those powers, and the City's circumvention of the State constitutional limitations on the amount of permissible City debentures. 4/

On March 14, 1975, Jac Friedgut, a Citibank Vice President, in an internal memorandum, described the earlier warnings of the CBC. 5/ Friedgut cited warnings about ever-increasing expenditures, artificially balanced budgets, rising debt service expenses and misuse of long-term debt for financing expenses. 6/ These warnings, according to the memorandum, were issued as early as June 1973, and continued through the end of 1974. 7/ In addition, Friedgut noted that there had been eight

1/ Id. at 7.

2/ Citizens Budget Commission, Inc., New York City's Debt Problem (July 1973). The Chairman of the Board of the CBC was William S. Renchard, Chairman of the Executive Committee of Chemical and among its trustees were Norborne Berkeley, Jr., President of Chemical, William R. Cross, Jr., Senior Vice President of Morgan, John J. Larkin, Senior Vice President of Citibank, Raymond T. O'Keefe, Executive Vice President at Chase, William R. Salomon, Managing Partner of Salomon Bros. and Robert G. Wilmers, a Morgan Vice President. Id. unpaginated cover sheet.

3/ Id. at 1-4.

4/ Id. at 6-18.

5/ Citibank internal memorandum, William I. Spencer, President, from Jac Friedgut, Communicating Acute Fiscal Concern to The Mayor 1-2 (March 14, 1975) (Div. Ex. Friedgut 1).

6/ Id. at 1-4.

7/ Id.

meetings in 1974 of the Mayor's Council of Economic and Business Advisors (made up of members of the financial and business community). 1/ At one of these meetings, according to Friedgut, the Mayor was told that the City's fiscal situation must improve sharply. 2/

On July 24, 1974, Fitch Investor's Services ("Fitch") issued an analysis of the City's finances and securities. 3/ The Fitch analysis also focused on increasing reliance by the City upon short-term financing, loss of jobs in the City, the growing burden imposed by the City pension funds on the City budget, and the use of debt to finance recurring expense items. 4/

On October 10, 1974, Fitch issued an up-date of its July 24th report further amplifying on these and other aspects of the City's financial crisis. 5/ In its October report, Fitch downgraded the rating of the bonds and, after discussing the dimensions of the City's fiscal crisis it concluded: "[f]ailure of the City to take serious steps to [resolve its worsening fiscal problems] would suggest, at this time, that it may have difficulty in meeting all its financial obligations, debt service as well as operating expenses." 6/

1/ Id. at 2-4.

2/ Id. at 2.

3/ Fitch Investors Service, Fitch Municipal Bond Dep't, New York City--Its Debt, Financial Structure (Financial Future?)--An Analysis (David M. Breen, Vice President, July 24, 1974).

4/ Id. at 1.

5/ Fitch Investors Service, Fitch Municipal Bond Div, New York City--Its Debt, Financial Structure (Financial Future?)--An Analysis: An Update of July 24, 1974 Report (October 10, 1974).

6/ Id. at 3.

By the Fall of 1974, the dangers inherent in the revenue-expenditure imbalance and the use of debt for current expenses were appreciated by the underwriters. Several internal reports and memoranda of the underwriters indicate their concern with the revenue-expenditure gap and the extensive use of short-term notes to bridge the gap. 1/ One of the consequences of the increasing reliance on short-term financing to cover the gap was the glutting of the public market for these securities. Many of the underwriters, in late 1974 and thereafter, expressed great concern that the market for such securities might become saturated, foreclosing the public markets as a source of future financing for the City. 2/ Their concern grew with the budget deficit and the City's dependence on short-term debt. Thus, the components of the financial crisis, including questionable budget practices, the rapid escalation in the City deficit and the mushrooming use of short-term financing, were major danger signals, and those conditions, and their consequences and risks, should have been disclosed to investors.

IV. UNDERWRITERS' KNOWLEDGE

As the City's financial condition worsened during the 1974-1975 period, the underwriters, from their contacts with City officials, meetings with other members of the financial community, their own internal research and analysis, and public comments and statements, developed a more thorough understanding of the dimensions

1/ See, e.g., Bankers internal report, New York City's Credit (October 15, 1974); Chemical internal memorandum, R.V. Adams to W.S. Renchard (October 16, 1974); Bankers Trust internal draft memorandum to Alfred Brittain III (November 8, 1974); Bankers handwritten notes (November 8, 1974).

2/ See, Chemical internal memorandum R.V. Adams to W.S. Renchard (October 16, 1974); Chemical internal memorandum R.V. Adams to D.C. Platten (October 25, 1974); Bankers internal draft memorandum to Alfred Brittain III (November 8, 1974); Bankers internal memorandum, Truxton B. Pratt to William D. Moore (December 11, 1974); Morgan internal memorandum, Amos T. Beason to Frank Smeal (December 13, 1974); Minutes, Comptroller's Technical Debt Management Committee (October 7, 1974).

and significance of the City's financial crisis. This information demonstrated the seriousness and immediacy of the City's financial crisis, the necessity of the City's rolling-over and increasing its short-term debt, and the deterioration of the market for the City notes. The information also indicated that the public statements and information being provided by City officials and others to the investing public were misleading.

A. Statements by City Officials

During the October 1974 - March 1975 period, City officials made many conflicting and confusing statements concerning the City's financial condition and prospects. The City's two top officials, the Mayor and the Comptroller, engaged in an extensive public dispute over the magnitude and severity of the City's fiscal crisis. 1/ One key issue concerned the size of the budget deficit for Fiscal Year 1974-1975. 2/ The differences between their public estimates amounted to hundreds of millions of dollars. Moreover, throughout this period, there were other conflicting statements on the size of past, present and future budget deficits and other matters. There were also significant conflicts concerning the steps being taken to remedy the situation. 3/

In addition to the confusing debate between the City's two highest officials, the public was otherwise presented a generally confusing picture. Juxtaposed against a series of newspaper articles and public speeches setting forth the City's problems 4/ were a number of overly optimistic statements by City

1/ See Chronology at November 29, 30, 1974; February 25, 1975; March 24, 1975.

2/ See Chronology at November 29, 30, 1974; December 1, 4, 1974; March 2, 24, 1975.

3/ See Chronology at November 29, 1974; January 20, 1975; February 15, 16, 1975.

4/ See Chronology at October 15, 19, 27, 1974; November 4, 25, 26, 30, 1974; December 1, 10, 1974; January 10, 13, 20, 24, 1975; February 2, 18, 20, 21, 25, 26, 1975; March 1, 2, 3, 18, 20, 21, 22, 23, 31, 1975.

officials about the safety of City securities. 1/ These articles and speeches should have alerted the underwriters to the need for further inquiry and appropriate public disclosure.

B. Underwriter's Internal Information

Discussed below is an analysis of the underwriters' awareness of specific categories of information pointing to the seriousness of the problems facing the City and the potential risks to investors.

1. Budget Practices and the Widening Budget Gap

During the winter of 1974, the underwriters developed an increased awareness of the significance of the acceleration in the City's deficit and the use of the questionable budget practices and unsound accounting conventions to disguise the extent of the gap between expenditures and revenues.

For example, on October 16, 1974, Richard V. Adams, a Senior Vice President of Chemical, met with members of the CBC to discuss New York City's fiscal problems. The topics discussed included the budget deficits of the City for several years, the use of illusory budget balancing and the growth of short-term obligations. 2/ In the October 16 memorandum, copies of which were sent to Norborne Berkley, Jr., Chemical's President, William Renchard, Chairman of its Executive Committee and Donald Platten, another high bank official, Adams characterized as a budget "gimmick" the City's use of Capital Budget funds to pay for expense items. 3/

In an internal Morgan memorandum, dated December 13, 1974, Amos T. Beason, Vice President, reported on the City's situation to Frank Smeal, Executive Vice

1/ See Chronology at October 25, 1974; November 9, 11, 14, 15, 20, 26, 1974; December 1, 23, 30, 1974; January 11, 28, 1975; March 1, 4, 5, 12, 23, 1975.

2/ See Chemical internal memorandum, R.V. Adams to W.S. Renchard (October 16, 1974).

3/ Id.

President. 1/ Beason wrote that the City's problems, while serious, were solvable if City officials perceived and understood them, but City officials did not appear to comprehend the gravity of the situation. 2/ His memorandum stated that the City's past fiscal problems had been dealt with by increased borrowing, budget gimmicks and larger amounts of state and federal aid. 3/ Beason said that dealers and investors felt that the City's financial institutions and the State and Federal governments would not permit the City's collapse, but investors needed concrete signs that the City's problems were being addressed. 4/ Beason also stated that the City's banks might be forced to purchase for their own accounts large amounts of City debt if the market for that paper collapsed. 5/ However, before they took on large amounts of City paper, Beason suggested that the City's banks require the City to take a number of steps to cut expenses, build revenues, and most importantly, come forward with "honest" budget figures and plans. 6/

Karen Gerard, a Chase economic researcher, wrote an internal report entitled The City's Fiscal Situation--The Budget Gap is Real. 7/ This Report, dated December 16, 1974, noted that the City had previously experienced annual budget

1/ Morgan internal memorandum, Amos T. Beason to Frank Smeal (December 13, 1974).

2/ Id. at 1.

3/ Id.

4/ Id.

5/ Id. at 2.

6/ Id. at 2-3.

7/ Chase internal report, The City's Fiscal Condition--The Budget Gap is Real (Karen Gerard, Economics Group, December 16, 1974).

crises, but unlike those of previous years, the current crisis was real. 1/
The Report concluded that the City's spending had grown faster than its receipts
during a time that the City's economic base was weakening. 2/

In a December 26, 1974 memorandum to Amos T. Beason, Eric Altman, a Morgan
researcher, observed:

- The City used short-term borrowing as an ordinary source of income;
- The City violated accredited accounting standards and used gimmicks
in order to appear to have a balanced budget; and
- The City used an accrual basis in accounting for receivables and a
cash basis for payables. 3/

In a memorandum of January 8, 1975, Adams of Chemical noted continued doubt
about the City's fiscal practices and the size of the City's deficit for fiscal
1975, and concluded that "we just don't know the facts." 4/ He also discussed a
possible budget deficit for fiscal 1975-76 of \$1 to \$2 billion. 5/

As the City's financial crisis intensified, the underwriters, including their
most senior officers, who were informal advisers to City officials, were summoned
to provide financial guidance and consultation. On January 9, 1975, the Financial

1/ Id. at 1.

2/ Id. at 13.

3/ Morgan internal memorandum, Eric Altman to Amos T. Beason 1-4 (December 26,
1974).

4/ Chemical internal memorandum, R.V. Adams to D.C. Platten 1 (January 8,
1975) (Div. Ex. Adams 9).

5/ Id.

Community Liaison Group ("FCLG") was formed. 1/ The underwriters and the City were brought together in a series of meetings at which the fundamental concerns about the clash between the City's budget gap and its constant need for new debt were aired in great detail. Among the principal problems discussed were the inability of the City to continue on the path of ever-increasing budget gaps and short-term note issuances, the use of budget gimmicks to disguise the true state of the City's deficit, and the need for immediate City action to remedy the situation. A recurrent theme during these meetings was a recognition of the scope of the problems, the need for immediate action, the consequence of the failure to take such action, and the difficulty, given political realities, of taking effective action. 2/

The investing public was not apprised of these facts and the potential consequences to them.

1/ The FCLG was composed of the principal officers of the City's major financial institutions, and was chaired by Ellmore Patterson, Chairman of Morgan. The members of the FCLG included: William I. Spencer, Citibank President; Alfred Brittain III, Chairman of the Board of Bankers; David Rockefeller, Chairman of the Board of Chase; Donald C. Platten, Chairman of the Board, Chemical; John F. McGillicuddy, President, Manufacturers; Donald T. Regan, Chairman of the Board, Merrill Lynch and William R. Salomon, Managing Partner, Salomon Bros. The Staff Committee of the FCLG was composed of senior management level officers of these institutions. The Chairman of the Committee was David A. Grossman, Senior Vice President of the Chase, and a former high-level City Budget Bureau official. Other members included: Roy Anderes, Bankers Vice President (Portfolio Management); Karen Gerard, Chase Urban Affairs Consultant (Economics Group); Herman Charbonneau, Chemical Vice President (Municipal Department); Jac Friedgut, Citibank Vice President (Corporate Planning); Jean Rousseau, Merrill Lynch Vice President & Manager (Municipal Bond Department); and Amos T. Beason, Morgan Vice President (Municipal Credit & Finance).

2/ A description of FCLG (and FCLG staff committee) meetings is found at Chronology, January 9, 13, 24, February 11, 25, March 7, 8, 10, 11, 12, 17, 26-27, 28, 29, 31, 1975.

2. Questionable Revenue and Tax Receivables

Billions of dollars of City debt notes were issued on the basis of estimated receipts of taxes and other revenues. Receipt of a substantial amount of these revenues was highly questionable. The inadequacy of the receivables related to the issuance of the TANS and RANS was suggested by the fact that the City constantly had to rely on new debt issues in order to redeem the old notes as they became due. Furthermore, the deficit, instead of being reduced, was growing ever larger, and could be financed only by issuance of further short-term instruments. At the end of February 1975, in connection with a \$260 million TAN offering, the City had to cancel the offering when it was unable to certify current information concerning its tax receivables. 1/

The continuing and rapidly accelerating growth in the City's use of short-term debt, which was characterized by some of the underwriters as the "floating temporary debt" 2/ or as the "permanent floating debt," 3/ the ever-mounting revenue-expenditure gap, and other factors raised in the minds of many of the underwriters serious questions about the validity of the tax and revenue receivables supporting the City short term debt issues.

In a December 26, 1974 memorandum, Eric Altman of Morgan raised a question about the City's assumption, despite contrary experience, of collection of

1/ Chronology at February 28, 1975.

2/ Citibank Internal report, Jac Friedgut to William I. Spencer, The City Budget Mess 2 (March 3, 1975) (Div. Ex. Friedgut 6).

3/ Merrill Lynch internal memorandum Jean J. Rousseau to Donald T. Regan, "Mayor's Advisory Committee Meeting--March 11, 1975" (March 13, 1975) (Div. Ex. Rousseau 15).

its receivables. 1/ "By some estimates", he wrote, "restating the City's financial position in realistic terms according to accepted accounting principles will involve a write-off of \$2.7 billion at June 30, 1975." 2/ Altman contended that this write-off was too large for the banking community to finance, and that the State, with its own fiscal difficulties, would be of limited assistance. 3/

On January 15, 1975, Karen Gerard, a Chase economist, wrote a report to David Grossman, a Chase Senior Vice President, entitled A Note On the Relationship Between New York City's Immediate Debt Problems and the Longer Range Budget Situation. 4/ She noted at the outset that "it is generally claimed" that the City's "mushrooming of short-term debt" had expanded proportionately with the growth of Federal and State aid, but, that in fact, the growth in debt had increased much faster than had such aid. 5/ She noted that one of the several possible explanations would indicate grave consequences for the market for the City's securities, in the following words:

The large volume of new issues could conceal a more serious problem of whether there is in fact anticipated aid behind the debt. If [this] were true, the consequences would be grave for both the short-term and the long-term municipal market. 6/

She concluded that:

1/ Note 3, p. 15, supra at 2.

2/ Id. at 3.

3/ Id. at 3-4.

4/ Chase internal report, A Note on the Relationship between New York City's Immediate Debt Problems and the Longer Range Budget Situation (Karen Gerard, January 15, 1975).

5/ Id. at 1.

6/ Id. at 2.

Because the impact is far different depending upon which factor is behind the rise [in short-term debt] it is extremely important to have this question answered candidly . . . [It] is essential to find out what the real situation is. 1/

A number of public speeches including a January 10, 1975 speech to the City Club by David M. Breen, a securities analyst, raised the very same questions concerning the legitimacy of the tax receivables and receivables in general. 2/

John Fava, Deputy Finance Administrator of New York City, in an address given on January 24, 1975 to the New York Municipal Analysts Group, raised the problems that might arise if past anticipation notes had been issued against receivables which had proven to be overestimated and uncollectible. 3/

As discussed below, the law firm of White & Case had received one set of figures from the City which indicated that the City would exceed its debt limit for TANs by approximately \$112 million with this offering. 4/ The underwriters were informed of this development, and the TAN offering collapsed because of the inability of the City to certify or make available current information concerning the City's receivables. 5/

1/ Id.

2/ Remarks by David M. Breen, Municipal Bond Analyst, Weeden & Co., before the City Club of New York (January 10, 1975).

3/ Remarks by John L. Fava, Deputy Finance Administrator, City of New York, before the New York Municipal Analysts Group (January 24, 1975).

4/ See pp. 43-44, infra.

5/ Id.

A Wood Dawson Love and Sabatine ("Wood Dawson") memorandum dated March 11, 1975, concerning a long-range solution to the financial difficulties of the City, copies of which were sent to various members of the FCLG, including Chase, Morgan, Chemical, Citibank, Merrill Lynch, Salomon and Bankers, cited a number of questionable accounting practices, including anticipating the receipt of questionable receivables. 1/

On March 25, 1975, Herman Charbonneau of Chemical had lunch with a City employee who advised him that a substantial amount of the receivables on the City's books, upon which the City's RANs were dependent, were fictitious. 2/

3. The First Lien

One of the significant selling inducements for investors in City notes was that the payment of debt service on these notes had a "first lien" on all City revenues. 3/ Rumors of distress with the City's financial condition were allayed by promotional claims by City officials and the underwriters that the notes would have a "first lien" on all City revenues. 4/ As indicated in another Chapter of the Report, there were material uncertainties as to the existence of a "first lien" for the principal of the City's short-term notes. 5/

Apart from the question whether a "first lien" existed, it was questionable as a practical matter, whether it could ever be exercised, given the need for

1/ Memorandum, Wood Dawson to Ellmore C. Patterson, FCLG Chairman, "A proposal for providing one of the essential elements in finding a long range solution for the current financial difficulties of New York City" (3-4) (March 11, 1975).

2/ Testimony of Charbonneau, at 351-354.

3/ See generally, the Chapter of this Report entitled Role of the City and its Officials. See also, the Chapter of this Report entitled Analysis of Questionnaires Sent To Individual Investors.

4/ See generally, the Chapter of this Report entitled Role of the City and its Officials.

5/ Id.

the City to provide essential services such as police and fire protection. 1/ The doubts concerning the "first lien" were reflected in the Fitch Report of October 10, 1974 cited above. 2/ In addition, Frank Smeal of Morgan, at a special CTDM meeting with the Mayor on December 17, 1974, raised questions as to the validity of the City's claim that its debt really had a first claim on revenues. 3/

An internal Citibank memorandum, dated December 10, 1974, addressed to the bank's salesmen, discussed, among other things, the "first lien" issue. 4/ The memorandum distinguished between the constitutional protection afforded the City's bondholders and the less stringent protection afforded its noteholders. 5/ It also raised the possibility that, in a time of distress, the City might successfully avoid preferences of payments to security holders over employees' salaries. 6/

4. Difficulty in Marketing City Securities

As the gap between the City's revenues and expenditures increased, the City was forced to resort to greater and more frequent issuances of short-term paper. With the sale of \$500 million in RANs and \$115 million in TANs on November 12, 1974, the City had placed \$2,500,000,000 of its notes into the market within a two

1/ See generally, the Chapter of this Report entitled Role of the City and its Officials.

2/ Note 5, p. 10 supra, at 2.

3/ Minutes, Comptroller's Technical Debt Management Committee at 2 (December 17, 1974).

4/ Citibank internal memorandum, Paul S. Tracy, Jr., to Salesman and Traders (December 10, 1974).

5/ Id.

6/ Id.

month period. 1/ Between November 12, 1974 and February 20, 1975, the City offered over \$2,300,000,000 in City debt obligations. 2/

During the October 1974 to February 1975 period, the underwriters' concern over the saturation of the marketplace increased significantly. This concern was based on the rapid escalation in the amount of City note issuances, combined with the narrowing of the market for City securities, resulting, in part, from the inability or unwillingness of financial institutions, including the underwriters, to absorb additional City paper. 3/

The decline of investor confidence in the City's paper further narrowed the market. 4/ This is graphically indicated in a December 13, 1974 Chemical memorandum, which noted:

1/ The Wall Street Journal, October 29, 1974 at 35; See also Appendix A.

2/ See Appendix A.

3/ See, e.g., Chemical internal memorandum, R.V. Adams to D.C. Platten (October 25, 1974); Letter, Richard L. Tauber to Corey R. Smith (December 3, 1974); Bankers internal memorandum, Truxton B. Pratt to William H. Moore (December 11, 1974); Morgan internal memorandum, Amos T. Beason to Frank P. Smeal (December 13, 1974); Chase internal report, The City's Fiscal Situation—The Budget Gap is Real, note 7, p. 14, supra, at 5; Minutes, Comptrollers Technical Debt Committee passim (December 17, 1974); Chemical internal memorandum, R.V. Adams to D.C. Platten (January 8, 1975); Testimony of E. Patterson at 25; Testimony of Sanford at 22, 25; Chase internal memorandum, David Grossman to Willard C. Butcher (January 22, 1975); Chemical internal memorandum, R.V. Adams to D.C. Platten (January 30, 1975); Chronology at February 25, 1975 (FCLG meeting).

4/ The declining investor confidence in City securities is reflected in many of the citations in Note 3, p. 22, supra. See also City of New York, Office of the Mayor, "Joint Statement by Mayor Abraham D. Beame and Comptroller Harrison J. Goldin," (November 15, 1974); Daily Bond Buyer, "New York City Prices Plummet 100 Basis Points in Free Market" (November 27, 1974); Morgan internal memorandum, Amos T. Beason to Frank P. Smeal (December 13, 1974); Barron's (January 13, 1975) at 7-8; Merrill Lynch internal memorandum, Jean J. Rousseau to Donald P. Regan (February 27, 1975); Citibank internal report, Jac Friedgut to William I. Spencer, Note 2, p. 17, supra.

The market for New York City obligations is no longer viable. Concern about the City's affairs has paralyzed the market, and dealers have heavy inventories of N.Y.C. securities which cannot be sold except at severe losses. These heavy positions reduce dealers' ability to underwrite other municipals, adversely affecting the entire tax-exempt bond market. . . . All of this is occurring in a generally strong bond market. . . . 1/

The combination of erosion of investor confidence and the placement of such huge quantities of City notes not only pushed interest rates up, but also created a marketing problem for the City and its underwriters. The special marketing problems and the determined efforts of the underwriters to overcome them are reflected in the letter of Jean J. Rousseau, Vice President in charge of Merrill Lynch Municipal Bond Department, to The New York Times on January 23, 1975 (printed February 6, 1975), in which he said:

In simple fact, thousands of public investors, large and small, purchased the notes through the underwriting group, which included municipal bond dealers as well as the banks (which were acting principally as distributors rather than as investors for their own portfolios).

Public investors had become alarmed about the city's finances and its heavy issuance of short term debt. Consequently, they had to be persuaded of the city's merits by the investment community and induced to purchase its notes by a very attractive interest rate. . . .

The New York investment community rose to a difficult challenge in promoting and distributing the city's note issue despite doomsday pronouncements concerning the city and its debt. The success of the sale and subsequent price increase on all New York City issues reflect a restoration of public confidence at least in New York City's ability to float and repay its debt. The constructive steps taken before the sale by Mayor Beame and Controller Goldin [sic] had much to do with that restoration of confidence, but so did the active sponsorship and promotion of the city by the New York banks and dealers. 2/

1/ Chemical internal memorandum, R.V. Adams to D.C. Platten 1 (December 13, 1974).

2/ Letter to the Editor from Jean J. Rousseau, The New York Times (February 6, 1974).

One result of this situation was the resort to the use of smaller denominations in the issues after November 1974. On November 22nd, the Comptroller announced a new City offering for December 2nd amounting to \$600 million in various types of short-term notes. 1/ Beginning with that issue, investors could purchase notes in denominations of \$10,000. 2/ In explanation of the lower denomination notes, the Comptroller stated that the change was designed to broaden the market for the City's securities, and thus improve bids for these securities. 3/

The Comptroller had first raised the idea at a November 12th meeting of the Comptroller's Technical Debt Management Committee ("CTDM Committee") attended by Merrill Lynch, Chase, Salomon Bros., Citibank and others. 4/ The decision to lower the denominations was reached on November 19th. 5/ Citibank urged that ten percent of the December 2 offering be in \$10,000 notes; Chase argued for forty percent. 6/ The Comptroller's Office compromised with a final figure of approximately 15%. 7/ The small denominations, the underwriters had previously argued, were undesirable

1/ News Release, Office of the Comptroller, City of New York (November 22, 1974); The New York Times, November 25, 1975, at 1.

2/ See Note 1, p. 24 supra. (For forty years prior to this discussion City notes had been sold in denominations of \$25,000 or greater.)

3/ Id.

4/ Minutes, Comptroller's Technical Debt Management Committee 1 (November 12, 1974)

5/ Citibank internal memorandum, Paul S. Tracy, Jr., to Richard F. Kezer (November 19, 1974).

6/ Id.

7/ Id.

because they required increased recordkeeping and a greater solicitation effort, thus reducing their profit. 1/

Shortly after the decision to issue \$10,000 notes, a memorandum was sent to Merrill Lynch account executives by its bond division. 2/ The memorandum stressed the fact that, with the December 2nd \$600 million issue, there would be available for the first time notes in denominations of \$10,000. 3/ The memorandum stated:

With \$10,000 multiples available buyers may purchase \$10,000, \$20,000 and any multiple of \$5,000 above \$20,000. This should open up a whole new market of potential tax-exempt note buyers. This should afford a great opportunity to open up new accounts and to bring in new funds. 4/

In the December \$600 million offering of various short term notes, at least \$90,000,000 (22.5%) of the \$400 million of RANS sold were in relatively small \$10,000 denominations. 5/ In succeeding issues of City securities, the \$10,000 denomination notes played a significant role. For example, in the February 4, 1975 offering of \$290,000,000 in RANS, 24.1% (\$70,000,000) were in \$10,000 notes. 5/

Notwithstanding the resort to the \$10,000 notes, the underwriters' concern over the saturation of the marketplace was not allayed. On December 17, 1974, the Comptroller's TDM Committee met with Mayor Beame. 7/ A Merrill Lynch representative

1/ Testimony of Charbonneau, at 116-117.

2/ Merrill Lynch internal memorandum, John S. de Graffenried (Vice President & Manager, Municipal & Corporate Bond Sales Development Dept) to Account Executives (November 20, 1974) ("NOT TO BE SENT OUT").

3/ Id. at 1.

4/ Id.

5/ The Wall Street Journal; December 2, 1974, at 25.

6/ Harrison J. Goldin, Comptroller, Signature and Non-Litigation Certificate 1 (February 14, 1975).

7/ Minutes, Comptroller's Technical Debt Management Committee (December 17, 1974).

told the Mayor that the capital market had been a "total disaster" in recent weeks, that some of the City's bonds were selling at as much as an 11% yield, and that there were difficulties in selling City securities. 1/ Therefore, he stated, it was likely that there would be no bid on the January bonds. 2/ A member of the Committee indicated that there was no question of the City's ability to pay, but said that the market could not absorb offerings of the magnitude contemplated. 3/ Smeal of Morgan said that the basic problem was said to be the size and frequency of the borrowings. 4/ He also said that purchases by the pension systems could afford only temporary relief. 5/ The Merrill Lynch representative said that borrowing to finance deficits was no longer a viable practice. 6/

On January 8, 1975, Labrecque of Chase prepared a briefing for David Rockefeller in connection with a meeting to be held at the Mayor's request the next day between representatives of six banks and Mayor Beame and Comptroller Goldin. 7/ The briefing memorandum at the outset stated:

BASIC PROBLEM: New York City has approximately \$7 Billion in Bonds and Notes to issue or refinance in calendar 1975, during a period when their budget deficit is getting worse. Many institutional investors have sold their bonds and the Chicago Banks have withdrawn from the Underwriting Syndicates. There are only 16 members left in the combined Note Syndicate. 8/

1/ Id.

2/ Id.

3/ Id.

4/ Id.

5/ Id.

6/ Id.

7/ Chase internal memorandum, "Briefing Memorandum for David Rockefeller-- Meeting with Mayor Beame and Comptroller Goldin on Thursday, January 9, 1975" from Thomas G. Labrecque (January 8, 1975).

8/ Id. at 1.

Labrecque summed up his briefing memorandum with the conclusion that "real solutions are going to be hard for the City and require a continuing aggressive sales effort on the part of the Investment Community. Most of the obvious budget moves and financing options have been exhausted." 1/

The January 8, 1975 Chemical memorandum noted above, concerning the \$620 million RAN sales states that, while the market for City securities had shown some improvement, the record high interest rates were a product of, among other things:

- (1) An oversupply of City securities in the market;
- (2) Much negative publicity about the City;
- (3) A continuing narrowing of the market with several institutions withdrawing. 2/

On January 9, 1975, stressing the dire state of the market for City securities, representatives of six major banks (Chase, Citibank, Chemical, Morgan, Bankers and Manufacturers) met at Gracie Mansion with Mayor Beame and Comptroller Goldin. 3/ The Mayor stated that the banks were not selling the City and its securities. 4/ The bank representatives responded that they had serious doubts as to the market's capacity to absorb more City securities and that the clearing house banks did not have the capacity to take on all of the anticipated offerings by themselves. 5/ The bankers indicated that the City's investment community was willing to cooperate with the City to re-open the marketplace for City securities. 6/

1/ Id. at 3.

2/ Note 4, p. 15 supra at 1-2.

3/ Testimony of Sanford at 20; Testimony of E. Patterson at 22-23.

4/ Testimony of Sanford at 24-25, See also, note 7, p. 26, supra.

5/ Testimony of E. Patterson at 25; Testimony of Sanford at 21-22.

6/ Testimony of E. Patterson at 28-30; Testimony of Sanford at 22, 25.

During the period of February through March 1975, the underwriters continued to express to City officials their serious concern about the deterioration of the market for City securities. 1/ It was apparent to the underwriters that unless the City took drastic action—highly unlikely—to eliminate its deficit, the ability to market City securities would soon come to an end. 2/

The deteriorating condition of the markets for the City's securities was a material fact which should have been disclosed to investors.

5. Rating Agencies

The rating agencies played a significant role in the sale of City securities because of the importance investors gave to such ratings in making their investment decisions. 3/ Notwithstanding increasingly obvious signs of deterioration in the City's financial condition through 1974 and the first quarter of 1975, the rating agencies continued their high ratings of City securities. 4/

November 8, 1974 notes from the files of Bankers indicated that there was pressure on rating agencies to keep the ratings of City obligations above the point at which savings banks would be required to divest themselves of such obligations. 5/ A December 3, 1974 letter to a substantial client from a Morgan Vice-President indicated that while the City was experiencing severe financial

1/ See, e.g., Chronology at February 20, 25, March 6, 10, 11, 14, 17, 19, 24, 27, 1975.

2/ See, e.g., Chronology at February 20, March 11, 14, 17, 19, 24, 27, 1975.

3/ See, e.g., Testimony of Isolano at 13; Testimony of Lebenthal at 68.

4/ See The Rating Agencies Chapter of this Report.

5/ Bankers' handwritten notes, November 8, 1974.

problems, its ability to pay its obligations was unquestioned. The author stated that although the rating agencies would give the City the benefit of the doubt, a downgrading was very possible, which would result in the market for City securities being considerably narrowed. The recommendation: a reduction in City holdings by means of not renewing matured obligations and tax-loss trading. 1/

While both Standard & Poors and Moody's maintained their "A" ratings, beginning in December they accompanied the ratings with reports which indicated substantial questions about the safety of investments in the notes. This information included such things as a significant drop in the current assets-liability ratio. Standard & Poors further indicated that the City had substantially increased its short-term debt burden and that the ability of the City to successfully market future debt issues would be dependent upon its ability to retain investor confidence by maintaining a truly balanced budget. 2/

While the underwriters were stressing the ratings in their selling efforts they did not disclose their concern as to the reliability of the ratings, the qualifications which accompanied the ratings and the substantial risk that the favorable ratings would be changed.

6. The Underwriters' Trading for Their Own and Their Fiduciary Accounts

One of the most interesting aspects of the underwriters' conduct during this period is their trading in City notes for their own accounts and for their fiduciary accounts.

1/ Letter, Richard L. Tauber to a client, December 3, 1974.

2/ See the Rating Agencies Chapter of this Report.

(a) Trading for Own Accounts

The Commission staff has analyzed transactions in City notes during the period from December 1974 to April 1975 by Bankers, Chase, Chemical, Citibank, Manufacturers and Morgan.

(1) Pre-March 1975 Offerings

The analysis shows that from December 13, 1974 to March 14, 1975, 1/ the six banks participated in the underwriting of four public offerings of City notes (a total of approximately \$1.5 billion in notes). Each bank except Chemical sold its entire underwriting "take-down" position in the offerings to the public, other banks, brokers, or public investors. None of the banks except Chemical retained any portion of these offerings in their investment or trading accounts. Chemical, while marketing to the public a significant portion of its take-down of the offerings, did retain a portion of the offerings (ranging from 13% to 52% of its original take-down) in its investment account.

(2) March 1975 BAN and RAN Offerings

Issues of BANs totalling approximately \$537 million were closed on March 14, 1975. An analysis of the BANs issues reveals that as of April 30, 1975, the six banks retained no portion of their take-down of the \$46 million part (8.10% due September 11, 1975) of the BAN issues. With respect to the balance of the issues (approximately \$491 million) in 8.75% notes due March 12, 1976, although subsequent to March 14 it appears that generally the banks made a continued effort to distribute their holdings to the public and, for

1/ During this period the banks also purchased for their own accounts an offering of \$170 million of RANs on February 24, 1975 and a March 5, 1975 RAN offering of \$140 million. These offerings were for 1 and 15 day periods, respectively.

the most part, ultimately succeeded, as of April 30, they retained a substantial portion of the issues (ranging from 5% in the case of Bankers to 76% in the case of Morgan). The staff has further concluded that the fact that significant amounts of City securities were retained by the banks on April 30 largely reflects the banks' inability to sell such securities to the public. It appears the banks sought to avoid, as much as possible, taking a substantial investment position in City notes.

An issue of \$375 million of RANs closed on March 20, 1975. An analysis of that issue reveals the same general trading pattern as the 8.75% of the March BAN issue, although the percentages of these RANs held by the underwriters was higher than for the 8.75% BANs. 1/

Between mid-March and April 30, moreover, all the banks except Bankers and Morgan continued to reduce their position in the March BAN and RAN issue by at least 1/3 or more of their original take-downs through sales to the public.

(b) Changes in Overall Positions, September 1974 to April 1975

An analysis of changes in the banks' overall positions between September 30, 1974 and April 30, 1975, indicates that all except Chemical followed a policy of trying to reduce or eliminate their own holdings in City notes by sales and by not reinvesting in new issues the proceeds obtained by them from redemption of maturing issues. This policy was adversely affected by the March BAN and RAN offerings which the banks were unable to sell and which accordingly they were forced to retain.

1/ Bankers in the 2-3 week period subsequent to the offerings purchased an additional \$4 million of RANs.

On September 30, Bankers had a total initial position, excluding syndicate and manager accounts, of \$118,670,000 of notes and, as of April 30, 1975, its position amounted to approximately \$58 million. Of the latter amount, \$40 million represented a position in the March BAN and RAN offerings which apparently reflects an inability to dispose of the notes into the market place.

Of greater interest is an analysis of Bankers Trust's investment account. At September 30, Bankers Trust had in its investment account more than \$48,000,000 in City notes. All of these notes had maturity dates before April 30. In the interim period, Bankers purchased an additional \$68,000,000 in notes of which \$12,700,000 was the early March bridge loan for 15 days which matured on March 20 and was redeemed. More than \$43,000,000 represent the unmarketable March BANs and RANs. If it was not for the March BANs and RANs, Bankers' investment position would have been reduced simply through maturity from more than \$48,000,000 to approximately \$10,000,000.

Chase's total September 30 position in City notes was approximately \$165 million, and its position as of April 30, 1975 was approximately \$58 million. Of this latter amount, approximately \$43 million represents holdings in its trading account, apparently as a result of the inability to distribute the March BAN and RAN offerings. An analysis of Chase's investment account reflects the same pattern. As of September 30, its investment account held approximately \$74 million in City notes, and, as of April 30, its investment account held no City notes.

As of September 30, 1974, Citibank, according to figures furnished by it, held a total position in City notes of \$24 million, and at April 30,

approximately \$30 million in notes. The great bulk of the \$30 million represented the portion of the March BAN and RAN offerings which were held in Citibank's trading accounts, and which the bank was apparently unable to sell. It is important to note that all of the holdings described above were in Citibank's trading account and that Citibank throughout this period maintained a zero position in its investment account. 1/

Manufacturers had total holdings of approximately \$180 million in City notes as of September 30, 1974. By April 30, these holdings had been reduced to approximately \$163 million, \$64 million of which represented March BANs and RANs, which it apparently was unable to market. Most significantly Manufacturers had very limited purchases in activity from October to until March offerings. On October 9, which was very early during the period, Manufacturers purchased \$35,000,000 in BAN and RAN notes. Thereafter until March 1975 it made no purchases of notes. During this period, Manufacturers' position declined from \$179,000,000 to \$149,000,000 in notes apparently

1/ Citibank in a letter dated August 23, 1977 has indicated that there were no City notes held in their investment account after June, 1974 and only a small amount after March, 1974. It further states that no purchases were made of any short-term municipal securities and the over-all portfolio account was substantially reduced during this period because Citibank's consolidated tax position did not enable it to utilize as much tax-exempt income as previously.

primarily through redemption upon maturity. ^{1/} Thus, while Manufacturers reductions in positions were not as extreme as those of the other banks, it does apparently reflect a desire by the bank to reduce its holdings of New York City notes.

The information with respect to Morgan is, in large part, based on a document it submitted to the Commission entitled Chronological Narrative of the Participation of Morgan Guaranty. This information reflects a total position in the notes as of November 30, 1974 of \$51.1 million, which is represented by notes with very short maturity. Approximately \$1.1 million matured in January 1975 and the remaining \$50 million matured in April 1975. From the end of November 1974 and until March 1975, Morgan made no additional purchases of City notes for its investment account.

While Morgan was a member of the syndicates for a substantial number of the offerings during the November 1974 to March 1975 period, all of take-downs were promptly distributed. In March, Morgan took down and held

^{1/} On August 23, 1977, counsel for Manufacturers submitted a letter to the Commission in which it stated that "it would obviously be unfair and unwarranted to conclude that Manufacturers Hanover in any way 'bailed out' of its New York City holdings or to imply in any Report issued by the Commission that Manufacturers engaged in such conduct." It cites in support of its contention the fact that in the period from September 30 to April, Manufacturers' portfolio account invested \$124,800,000 in City notes. To put their figure into proper perspective it is necessary to note that of the \$124,000,000 in purchases, \$35,000,000 represented the very early purchases of October 9, \$19,000,000 consisted of the fifteen day bridge loan in early March which fits into a very special category, and the remainder of approximately \$70,000,000 represents purchases of the March BANs and RANs which as we indicated above appear to be unwanted merchandise which the banks feel compelled to take and by no means reflected any real desire to invest. On balance, the staff concludes that it was the desire of Manufacturers during this period to reduce its position in the City notes.

for investment for a substantial period of time, \$98 million in BANs and RANs. At the same time, it sold substantial additional amounts of these notes. ^{1/}

Morgan's reasons for taking such a large position in March are unclear. Morgan maintains that it was motivated in great part by its desire to assist the City, and also that, since it had concluded that the City could solve its problems, the City notes were sound investments. The reasons given by Morgan are questionable. Their trading activities follow the same pattern as that of the other banks. Morgan was unwilling, apparently, to take an investment position in the offering of City notes, at least from November 30 until the issuance of the March BANs and RANs. Also, Morgan internal memoranda and analyses cited elsewhere in this Report reflect deep concern about the City's financial position and the risks posed on investments in the notes. Thus, it appears to the Commission staff that Morgan's increasing position in March in City notes reflected the weakness of the market for the notes and not a desire to take an investment position in the City's notes.

Chemical appears to have been an exception to the general rule. Chemical's position in City notes on September 30, 1974 was approximately \$232 million, and its position on April 30, 1975 was \$227 million,

^{1/} Morgan resold more than \$16 million of BANs and more than \$11 million of RANs within a relatively short time after their acquisition by Morgan.

Morgan has represented to the staff that it did not solicit purchase orders with respect to either the March 7th BAN offering or the March 13th RAN offering; and that it had discouraged purchases by individuals of those notes. Morgan further stated that, because of legal advice, the Comptroller's March 7th release was read to prospective purchasers. Morgan further stated that all of its sales were made to sophisticated financial institutions primarily banks and insurance companies. Submission by Morgan Guaranty entitled "Chronological Narrative of the Participation of Morgan Guaranty", at 19-21, 29-30.

reflecting a reduction of approximately \$5 million. Chemical's investment account on September 30, 1974 amounted to approximately \$187 million in notes and by April 30, had increased to approximately \$224 million. However, approximately \$33 million of this amount represented the March BANS and RANs.

While Chemical thus appears not to have been following the policy of reducing or eliminating their holdings of the City notes, this appearance may simply be a function of the relatively late date at which Chemical determined to try to get out of the notes.

The policy decision is first reflected in a January 30, 1975 internal memorandum, in which a Chemical officer noted a decrease in holdings of City decrease in holdings of City securities in dealer and portfolio accounts. 1/ He also said that the bank did not expect to find it necessary to increase its holdings in City securities as a result of an inability to sell forthcoming issues. The memorandum stated:

The syndicate pricing will be aimed squarely at prompt sales to investors.

* * *

[W]e continue to believe that the City will meet its obligations. The real new money financing pressure for the City is likely to occur after August of this year. By this time we will be in a position to assist the City if necessary since by then \$185.5 million of our holdings will have run off.

* * *

Recommendation: [t]hat we do nothing precipitous with regard to reducing our holdings immediately, but let maturities do this for us. 2/

1/ Chemical internal memorandum, R.V. Adams to D.C. Platten 1 (January 30, 1975) (Div. Ex. Adams 10).

2/ Id. at 1-2.

(c) Trading for Fiduciary Accounts

During 1974 and early 1975, a number of the underwriters determined not to purchase City securities for their fiduciary accounts. Morgan made no purchases of City securities for its fiduciary accounts after July of 1974. 1/ In a March 14, 1975 letter, an official of Morgan pointed out to a client that previously "we were somewhat concerned about the city's ability to rollover its short term debt when it came due." The official indicated that the firm had not had any reason to change its prior opinion. The official stated that the firm felt that the client should sell her New York City holdings "even though it would probably be on an 8% basis which would mean a price of probably a little under 97". 2/

By January 1975, the investment management group of Citibank had adopted a policy of not purchasing New York City bonds or notes for any accounts for which it had fiduciary responsibility and the only exception permitted would be unsolicited orders followed-up by confirming written instructions. 3/

(d) Conclusion

The underwriters were apparently unwilling, if they could avoid it, to take down for their own investment any significant portion of new offerings of City notes, and, in fact, followed a policy of eliminating or reducing their positions. These practices reflect a significant limitation of the market for City notes. It also reflects, as does the policy adopted with respect to fiduciary accounts, the banks' own evaluation of an investment in City notes. For these, among

1/ Staff Schedule of Bank Trust Accounts Transactions in BANS, TANS, RANS, September 30, 1974 to April 30, 1975, prepared from information supplied by the underwriters.

2/ Letter from Walter B. Terry to a client (March 14, 1975).

3/ Citibank internal memorandum, G.C. McCarthy, Jr., to Paul J. Collins (January 22, 1975).

other reasons, the underwriting banks' marketing practices with respect to both their own purchases and purchases on behalf of their fiduciaries, were material, and should have been disclosed.

V. REPRESENTATIONS TO INVESTORS

No offering document was disseminated to investors in connection with the sale of City securities until March 13, 1975, when a document entitled "Report of Essential Facts" was employed in connection with a RANs offering. While no formal document had been previously distributed, the City and the underwriters had made numerous oral and written representations in connection with the various offerings. These representations were confusing, misleading and contradictory, and omitted to disclose to investors material information concerning the financial condition of the City, the risks involved in investing, the nature of the purported first lien, the nature of the City's receivables supporting the issuance of the securities, the facts concerning the severely restricted marketability of the securities, and the position taken by the underwriters for their investment and fiduciary accounts.

The newspaper "tombstone" advertisements announcing a public issue, placed by the underwriters, contained specific affirmative representations. They stated that the holders of the paper would be paid back the sum invested, with interest, at a date certain and also stated that the notes were general obligations of the City backed by the City's full faith and credit, without disclosure of the crucial facts concerning the matters discussed above which were known by the underwriters. ^{1/} Without qualification, investors were led to believe they would be fully repaid, upon maturity, of the full principal and interest.

^{1/} See, e.g., advertisements in The Wall Street Journal, March 10, 1975, and in The New York Times, September 24, 1974, October 3, 1974, December 4, 1974, January 7, 1975, February 26, 1975, and March 14, 1975.

Furthermore, investors were entitled to assume, in the absence of contrary disclosure, that the New York City notes were relatively safe and without substantial risk of default. 1/

It appears that a number of the City's underwriters distributed the City's "Ten Good Reasons for Investing in Tax Exempt Bonds of New York City," which, simply put, was a selling document, not a disclosure document, and which stressed the safety of the City's paper. 2/ Among the principal factors influencing investors' decisions to purchase City bonds and notes were favorable ratings by rating agencies and the purported first lien in City revenues. 3/ Further, many investors reported that their bank or broker had represented to them that the securities were highly rated, had a first lien, or were, in general, safe investments. 4/

As part of its selling efforts, on November 27, 1974, Merrill Lynch's management, in a memorandum to its salesmen entitled "Opportunity Knocks", described the December City note issue and urged the salesmen not to:

. . . overlook the opportunity afforded here to call accounts and prospects who are normally precluded from buying tax-exempt notes because of the \$25,000 requirement.

The memorandum concluded:

Do your customers and yourself a favor. Bring this new issue to their attention. These notes are double-barrelled obligations and will be at very attractive yields. 5/

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- 1/ See generally, James A. Lebenthal, Consequences of New York City Default on Individual Bond Owner (October 13, 1975).
- 2/ See Minutes, Comptroller's Technical Debt Management Committee 3 (April 9, 1974); Invoice, Scoop Printing Co., Inc., to Citibank, for 60,000 copies of "10 Good Reasons. . ." (September 12, 1974).
- 3/ See Chapter of this Report entitled Analysis of Questionnaires Sent to Individual Investors, Syndicate Members and Managing Underwriters, Appendices A and B, Question No. 9(c) and (d) and Question 7(a).
- 4/ Id. at Question 7(a).
- 5/ Merrill Lynch internal document addressed to Salesmen and Account Executives (November 27, 1974).

A similar Merrill Lynch circular dated December 3, 1974, entitled "Something to Talk About" noted that:

Yesterday's New York City tax-exempt notes offer an opportunity to call your customers and prospects with something interesting to talk about. All of the recent adverse publicity has hurt the market for New York City bonds and notes. In order to be able to market the \$600 million notes, the underwriting accounts were merged and the notes priced at extremely attractive levels. Remember these notes are payable from the pledged revenues in the first instance, but they are also general obligations of the City. Moody's rates both the RAN and TAN notes MIG-2. Moody's Investment Grade-2 are defined as "High quality, bearing little risk that all terms as to time and amount will be met."

We will give any office up to 250M notes firm overnight to work on a sales campaign. Why not make some calls this evening and discuss New York City notes with your customers or prospects. Remember 8 1/2% and 9% tax-exempts have to stand out when compared to savings account yields. The Sales Manager or Municipal Man should request notes for each office from the office's contact in Municipal Sales Liaison. 1/

In addition to the specific representations made by the underwriters in connection with the sale of the City's securities, City officials extensively commented on the City's finances and securities. These statements were often widely disseminated to the media. These public announcements were designed to promote the sale of the City's securities by reassuring investors of the essential safety of the investment, the ability of the City to meet its obligations, and the constitutional "first lien" backing of all City obligations. 2/ Denying that the City was close to bankruptcy, the Mayor and Comptroller admitted that the City had financial problems but blamed the problems on the fiscal practices of past administrations, inflation and recession. 3/ Even the negative statements were accompanied

1/ Merrill Lynch internal document (December 3, 1974).

2/ See, Chronology at October 22, November 11, 14, 15, 20, 26, December 20, 30 1974, January 11, February 11, March 2, 7, 12, 22, 23, 1975. To a large extent almost all of the Mayor's and Comptroller's statements were calculated to promote the sale of City securities.

3/ See, Chronology at October 22, 27, November 9, 11, 15, 20, 26, December 20, 1974, January 28, February 15, March 7, 20, 23, 1975.

by optimistic statements about the City's notes and bonds. 1/ These public announcements attempted to distinguish "between the problems of balancing the budget and the basic ability of the City to meet its credit obligations." 2/

The representations described above, in the various forms they took, had a single common thread: they were designed to facilitate the sale of City notes by emphasizing the safety and soundness of an investment in those notes. Under the circumstances known to the underwriters at this time, these representations were materially misleading, and the underwriters omitted to disclose material facts known to them.

VI. TIME OF CRISIS—THE FEBRUARY-MARCH OFFERINGS

A. Background

During the period from February 19 through the end of March 1975, the City attempted to market four note issues totalling over \$1.3 billion. One of these offerings, \$260 million in TANS, was cancelled because of the inability of the City to certify the sufficiency of tax receivables available to support the notes. 3/ Three remaining offerings were carried out through two public offerings (approximately \$537 million in BANS on March 7 and \$375 million in RANS on March 13) and a private placement (\$140 million in RANS on March 5). 4/

At this point, the underwriters were aware that the City's financial crisis had exacerbated to the point of near collapse of the City's fiscal structure. They were concerned with the adequacy of the receivables underlying the RANS,

1/ See Chronology at October 22, November 14, 26, 1974, January 20, March 2, 7, 22, 23, 26, 1975. Most of the statements mentioned in the footnotes immediately above and below were tinged in part with optimism.

2/ See Chronology at November 15, 26, December 23, 30, 1974, January 11, March 7, 23, 1975.

3/ Chemical internal memorandum, Alois S. Jureik to Herman Charbonneau 1-2 (March 3, 1975).

4/ See Appendix A.

and the high probability that the City would not be able to sell bonds or obtain other revenues to repay the BANs. The City and the underwriters had never utilized any disclosure document until the March 13 RAN offering. The underwriters discussed the issue of making full disclosure and determined to proceed with the scheduled March 13th RAN offering. At the same time they continued to sell their unsold allotments from prior issues with minimal disclosure, in part because of their fear that full disclosure would render City securities unmarketable. 1/

The City needed over a billion dollars in less than thirty days in order to meet its cash needs. Difficult decisions about the underwriters' continued participation with the City had to be made, necessitating the involvement of the underwriters' highest officials. At this point, the underwriters' ability to market the City notes was rapidly evaporating. The underwriters had accumulated City securities to the extent of over 20% of their combined equity, and would not, according to Walter Wriston, Chairman of Citibank, "stuff" any more City notes into their portfolios. 2/

On February 20, 1975, at a meeting with Mayor Beame and his Council of Business and Economic Advisers concerning the City's financial crisis, Walter Wriston of Citibank later reported, the Mayor was told "today was the day that the money ran out." 3/ On the same day, an internal analysis by Jac Friedgut, a Vice-President of Citibank, described the City's financial problems in somber terms. 4/ Friedgut pointed out that the City had obviously overstated budget revenues and

1/ See generally Chronology at March 5 and 6, 1975; Div. Ex. Epley 15; Div. Ex. Rousseau 3.

2/ Five pages of handwritten notes marked FNCB, dated 3/6.

3/ Div. Ex. Friedgut 1, note 1, p.7 supra, at 3; Testimony of Friedgut at 41-43.

4/ Citibank internal report, New York City's Financial Difficulties (February 20, 1975). (Div. Ex. Friedgut 2)

noted that some \$300 million in borrowed funds had been used to balance the 1973-74 budget in the face of revenue shortfalls. 1/ The analysis also pointed out that the City had exhausted a significant portion of its potential financial flexibility. 2/ Friedgut stated that the City had indirectly circumvented the State constitutional limits on the use of long-term borrowing to finance Expense Budget shortfalls by shifting \$700 million of current expenses to the capital accounts during fiscal 1975. 3/ Friedgut warned that such a shift would increase future debt service charges and reduce the City's ability to finance genuine capital projects. 4/

Over the next few days, a series of meetings were held among the Mayor, other City officials and various members of FCLG and the Mayor's Council of Business and Economic Advisors. 5/ A February 20 memorandum advised Walter B. Wriston, Citibank Chairman, to inform Mayor Beame at the upcoming meeting on February 24, 1975 of the Council of Business and Economic Advisors to take a number of steps, including cutting costs by, among other things, reducing the number of City workers; instituting substantial service cutbacks, increasing service charges (such as the subway fare) and making major reductions in capital expenditures. 6/ The memorandum also called for significant budget reforms. 7/

1/ Id. at 1.

2/ Id. at 2.

3/ Id.

4/ Id.

5/ See Chronology at February 20, 25, 1975.

6/ Citibank internal memorandum, William G. Herbster to Walter B. Wriston (February 20, 1975).

7/ Id. at 2.

In a February 25th memorandum prepared by Jac Friedgut for use by William I. Spencer, Citibank's President, at a luncheon meeting with the Mayor, Friedgut stated that

proposals [such as those discussed above] will, not surprisingly, be unpopular with the Mayor. He will complain that he has no authority over such leviathans as the municipal unions, the Board of Education, the hospitals corporation, and other quasi-independent agencies. Such a defense is both true and not true. If the situation is critical enough (which it is) and the Mayor is tough (which he might be) many things can be done even if they are technically not possible. The time is now." 1/

Friedgut ended another memorandum describing a meeting of the Committee staff of the FCLG by stating that the Committee and the CBC should "work in concert . . . to prepare a unified analysis which would clearly demonstrate the absolute inviability of the City if it continued on its present course." 2/

Comptroller Goldin was publicly stating at this time that the City could not rely on Federal or State funds to make up the \$900 million budget deficit and urging that the City must drastically limit expenditures. 3/

B. The Aborted TAN Offering

On February 19, the sale to two syndicates headed by Chase and Bankers of \$260 million in TANs was announced. 4/ On February 26, the Bankers representatives informed members of its syndicate that White & Case, its counsel, had informed it that based on the figures furnished by an accountant for the City, it appeared

1/ Citibank internal memorandum, Jac Friedgut to William I. Spencer (February 25, 1975).

2/ Citibank internal memorandum, Jac Friedgut to William I. Spencer (February 26, 1975) (Div. Ex. Friedgut 3).

3/ See The New York Daily News, February 26, 1975 at 41 (editorial entitled "Fiscal Folderol").

4/ News Release, Office of the Comptroller, No. 75-20, February 19, 1975.

that the City would exceed its debt limit by \$112,000,000 if the TANs offering were made. 1/ In light of this, White & Case was unwilling to give a "clean" legal opinion, without which the offering was virtually impossible. 2/

The next day, February 27, the Bankers' New York City note syndicate met with Marion J. Epley, Esq., of White & Case. 3/ Epley reported that the figures provided to him indicated that the City did not have receivables sufficient to cover the proposed TAN offering, and that such an offering would cause the City to exceed its debt limit. 4/ Later that day, the City furnished Epley with a second set of figures which showed no deficit. 5/ White & Case indicated that it would issue a legal opinion only if the City provided current financial information and certified that the information was accurate. 6/ That day, the Chase syndicate, which was supposed to take \$140 million of the proposed TAN offering, was advised of the problems encountered by White & Case. 7/

Thus, on February 27 and 28, a series of meetings ensued among the syndicate members, their counsel and City officials. These meetings were held in an effort to obtain assurances from the City that anticipated tax revenues were sufficient to cover the issuance of the TANs, as well as to discuss alternatives

1/ Handwritten document (Div. Ex. Eide 3).

2/ Chemical internal memorandum Alois S. Jureik to Herman Charbonneau (March 3, 1975) (regarding a February 27 meeting) (Div. Ex. Eide 2).

3/ Id.

4/ Id.

5/ Div. Ex. Eide 3, note 3, p. 43, supra.

6/ Div. Ex. Eide 2, note 2, p. 43, supra.

7/ Id.

which would allow the TAN offering to go forward. 1/ Epley stated that he would proceed on the basis of certified current estimates, but the Comptroller was unwilling to certify current estimates. 2/ On February 28, representatives of White & Case were advised by the Comptroller that the City was prepared to certify figures as of February 6. White & Case, however, decided that February 6th information was not sufficiently current, and refused to issue its opinion based on their inability to determine from City documents whether there were sufficient uncollected taxes to lawfully issue the TANs. 3/ Bankers and Chase then refused to accept delivery of the TANs to be purchased by their respective syndicates. 4/ The TAN offering was cancelled. 5/

The Comptroller's public explanation of the cancellation of the TAN offering never disclosed the real reasons for the cancellation of the offering. A February 28th press release by the Comptroller stated that, contrary to reports which had been circulated, there was no question concerning the sufficiency of City tax revenues to meet all obligations incurred by the February 19th offering. 6/ Indeed, a March 1st New York Times article quoted the Comptroller as saying the cancellation came about because of a "sudden demand by underwriters unprecedented in the history of the City for data that could not be physically compiled, checked and verified

1/ See Chronology at February 27 and 28, 1975.

2/ Marion J. Epley, Memorandum for the Files (February 28, 1975); Testimony of Goldin at 54, 61, 111-112; Div. Ex. Eide 2, note 2, p. 43, supra.

3/ Div. Ex. Eide 2, note 2, p. 43, supra.

4/ Id. at 2, 3.

5/ Dow Jones Broad Tape, February 28, 1975.

6/ The New York Times, March 1, 1975, at 29.

in the short time available." 1/ The New York Times article, however, also quoted representatives of Bankers and Chase as saying that the offering had been cancelled because the City was unable to establish that the offering was within the borrowing limit. 2/ On March 1, Mayor Beame and Comptroller Goldin were quoted in a New York Post article as saying that the City had no immediate cash problems, and that future borrowing would be more than sufficient to meet New York's obligations. 3/ In this exchange, however, the reasons for the cancellation and its implications for the City were not disclosed.

The implications of the cancellation of the February 1975 TAN offering were very disturbing. A major source of City financing had been closed off after the City's estimates of revenues had not been satisfactorily confirmed. In light of the collapse of the TAN offering and the increasing cash flow deficits which had to be made up by short-term financing in a market increasingly resistant to purchasing New York City securities, the aborted TAN offering raised serious questions about the ability of the City to meet its daily cash needs.

C. The First Week of March

The gravity of the City's fiscal situation was once again revealed when a March 2 New York Times article reported that Comptroller Goldin had, since December, twice revised his fiscal year 1974-75 estimates of the City deficit,

1/ Id.

2/ Id.

3/ The New York Post, March 1, 1975 at 3.

but was refusing to make his revisions public to avoid a confrontation with the Mayor. 1/

A March 3, 1975 memorandum entitled "The City Budget Mess" written by Jac Friedgut of Citibank to Spencer, its President, described the City's financial and accounting procedures and their implications for the future in stark terms. 2/ Friedgut stated that the City's basic problem was the rapid growth of expenditures as compared to income, coupled with the City's use of short and long-term borrowings to finance the deficit. 3/ Friedgut attributed the growth of short-term borrowing from \$1.3 billion to approximately \$5 billion to the City's need to meet the revenue-expenditure gap. 4/ Friedgut went on to point out that the long-term debt had increased from \$5 billion in 1970 to \$8 billion in 1975, and that an important element in this increase had been the City's use of such funds to finance current expenditures. 5/ Friedgut also described as "staggering" the increase in the City's debt service charges, which had grown to \$1.435 billion a year. 6/ Friedgut concluded that no time could be wasted in putting the City's fiscal house in order and that only a commitment to drastic action by the City should cause the financial community to give further credit. 7/ Such action, Friedgut stated, would include a reduction in the City

1/ The New York Times, March 2, 1975, at p. 46.

2/ Citibank internal memorandum, Jac Friedgut to Mr. William I. Spencer, President, The City Budget Mess (March 3, 1975) (Div. Ex. Friedgut 6).

3/ Id. at 1.

4/ Id. at 2.

5/ Id. at 2.

6/ Id. at 2.

7/ Id. at 3.

budget from \$13 billion to \$12.2 billion by means of a freeze in labor costs and a reduction in City services. 1/ Additionally, Friedgut recommended that the banks demand that the City cease its practice of using such procedures as overestimating revenue, underestimating expenditures, advancing collections of revenues and manipulating its accounting practices. 2/

A March 5, 1975 internal memorandum by Friedgut entitled "The Banks and New York City" made many of the points contained in the memorandum of March 3, and stated that unless the City budget deficit was reduced by \$884 million for fiscal year 1976, the City's fiscal situation would not be viable. 3/

D. The March 7 BAN Offering

A series of meetings which were held beginning March 4, among syndicate members, their counsel and City officials regarding the \$537 million BAN offering, led to a single bid by the merged syndicate and a negotiated interest rate of 8.69%. 4/ This was a departure from the usual past practice whereby competitive bids were submitted by rival syndicates. During the course of these meetings, the participants raised the question of whether the debt limit of the City would be exceeded and whether a disclosure statement should be issued in connection with the issuance of the BANs. 5/ Polls were taken of the underwriters as to

1/ Id. at 4-5.

2/ Id. at 4.

3/ Citibank internal memorandum "The Banks and New York City" (Jac Friedgut, March 5, 1975) (Div. Ex. Friedgut 7).

4/ See Chronology at March 5, 6, 7, 1975.

5/ Testimony of Charbonneau at 302-303; Testimony of Isolano at 63; Testimony of Brophy at 16-19; Handwritten notes "N.Y.C. Subcommittee, 3/7/75" (Div. Ex. Grossman 4); Handwritten notes "Meeting at Chemical 3/5/75, 4:30 p.m." (Div. Ex. Epley 15).

as to whether they would participate in the underwriting, and whether they favored disclosure in the course of the sale of the notes. 1/

Chase wanted to proceed with full disclosure. Manufacturers seemed to prefer full disclosure but suggested that the offering be conducted on a limited liability basis. Bankers wanted to participate but noted a marketability problem. Chemical expressed a desire to participate but was unsure about full disclosure, commenting that perhaps a brief and comprehensive statement would suffice. Citibank was unsure whether it wanted to participate but thought a disclosure statement would raise additional issues. 2/ It appears that the Morgan representative recommended that the offering be conducted on a private placement basis, but that there were strong feelings among the underwriters that they not buy this issue as an investment for their own accounts. They decided, however, to make a public offering "as an effort to keep markets going." 3/ It appears that Merrill Lynch favored not having a disclosure statement. 4/ It also appears that Merrill Lynch indicated that

1/ Div. Ex. Epley 15, note 5, supra at 47; Testimony of Brophy at 17-19.

2/ Div. Ex. Epley 15, note 5, supra at 47.

3/ Testimony of Smeal at 108-109.

4/ The notes of an employee of White & Case state the following under the heading of "Disclosure": "Merrill - would rather not have disclosure statement". In the left margin of the notes appears the following: "Merrill - marketing (yes - w/o disclosure)" (Div. Ex. Epley 15, note 5, supra at 47); Charbonneau Ex. 19.

Rousseau, a Vice President of Merrill Lynch's municipal bond department testified that the reason for Merrill Lynch's opposition to disclosure was that Merrill Lynch felt that disclosure was irrelevant and could be misleading. The reason Rousseau gave is that the sole basis on which the City notes were being offered was the commitment of the City's full faith and credit and the constitutional obligation to repay the notes. Rousseau further testified that the discussion of marketability in the context of disclosure related to the utility of a disclosure document in marketing City notes.

it would participate in the underwriting without disclosure. During the course of the discussions among the underwriters, remarks were made to the effect that full disclosure would limit the marketability of the notes. 1/

It was decided that the proposed BAN offering would be publicly marketed, and that disclosure, to the extent any would be made, would be accomplished by a news release from the Comptroller and a Report of Essential Facts. 2/ In fact, however, the Report was not utilized until after March 13. The City, after some hesitation, on March 7th, accepted the bid of the merged syndicate in the \$537 million in BANs at a negotiated rate of 8.69 percent. 3/ City officials were displeased by the rate, described it as very high, and attributed it to the UDC crisis; they said, however, that it was the best obtainable under the circumstances. 4/

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- 1/ Testimony of Rousseau (April 14, 1976) at 95; Charbonneau Ex. 19; Charbonneau at 237-238.
- 2/ "New York City \$537,200,000 Bond Anticipation Notes Conditions of the Bid" (undated, unsigned typed single page document) (Div. Ex. Charbonneau 11).
- 3/ Testimony of Charbonneau at 310; News Release, Office of Comptroller, No. 75-30 (March 7, 1975).
- 4/ News Release; Office of Comptroller, No. 75-30 (March 7, 1975).

On the same day, the Comptroller, in a press release explained that the relatively high rate on the BANS was in part caused by the Wein litigation as well as by recent negative occurrences in the municipal bond markets, adverse economic conditions and the City's ever-increasing cash needs. 1/ Stating that solution of the City's fiscal problems was not an easy matter, Comptroller Goldin expressed his confidence that the City would, when the time comes, be in a satisfactory legal and fiscal position to sell bonds to fund the BANS it was now issuing. 2/

Comptroller Goldin's statement glossed over the City's problems by attributing the City's financing problems, in great part, to extraneous factors. Certainly, the Comptroller's statement was no substitute for full disclosure by the underwriters considering the information then in their possession. Such a statement should have disclosed the serious risk that, in the future, long-term bonds could not be sold or other revenues sources used to repay the BANS. Given the serious questions concerning the ability to market City bonds, it is questionable whether it was proper to proceed with the BAN offering.

1/ News Release, Office of Comptroller, No. 75-31 (March 7, 1975).

2/ Id.; See also Chronology at March 7, 1975 for a discussion of the differences between the Comptroller's release and the release as originally drafted by counsel for the underwriters.

E. The March 13, 1975 RAN Offering

With the closing of the BAN offering on March 7, 1975, attention was directed to a proposed offering of \$375 million in RANs. At a meeting of the Grossman Committee on the afternoon of March 7th, attended by representatives of many of the members of the underwriting syndicates, many issues were raised in connection with the feasibility of proceeding with the offering including suggestions that the City would soon exceed its borrowing capabilities. 1/ Questions were also raised about the availability of revenues to support the proposed RAN issue and whether it was necessary to analyze the data underlying the City's figures. It was discussed that such an inquiry might raise disclosure problems if it were determined that revenue receivables would not support the issuance of the notes. There was also discussion of other problems that might result from full disclosure, 2/ and of the need for alternative ways for the City to meet its cash needs other than through the issuance of City debt. It was indicated that the budget gap for the 1975-1976 fiscal year would approximate \$2 billion. 3/

In the next several days, there were discussions with City officials concerning the proposed RAN offering and the problem of marketing City offerings in the light of the City's financial condition and the growing City deficit.

1/ Div. Ex. D. Grossman 4, note 5, p. 47, supra; Testimony of Charbonneau at 314-18; Typed outline bearing the handwritten notation, "David Grossman, Chase Bank presentation item #2" (March 8, 1975) (Div. Ex. Charbonneau 21); Seating Chart "Meeting of March 7, 1975" (Div. Ex. D. Grossman 7A).

2/ Div. Ex. Charbonneau 21, supra.

3/ Id.

The City officials took the position that there were sufficient receivables available to cover all outstanding RANs, including the proposed issue of \$375 million, and produced schedules purporting to support their contentions. 1/

At a March 10 meeting of the FCLG, Chairman Ellmore Patterson of Morgan asked all the underwriters present to quantify their City debt holdings to support their claim to the City that they could no longer take large amounts of City debt paper into their inventory. They calculated that they held over \$1.2 billion in City securities, or 20 percent of their combined equity. 2/

A meeting of the merged syndicate with respect to the RAN offering began on March 12, and reconvened the following day. 3/ The final consensus was that the disclosure obligations would be met through the publication of the Report of Essential Facts. 4/ It was stated that the underwriters' duty was not to "rummage around" as required by the Securities Act, but rather to provide buyers with copies of the Report of Essential Facts. 5/ At a FCLG meeting on March 7th, Wood Dawson had stated that the underwriters had no reason

1/ Handwritten notes labeled A1274 (Div. Ex. Goldin 76); Chase internal memorandum, David Grossman to Messrs. O'Sullivan, Chase et al., "Supporting Materials for New York City Note Issue" (March 11, 1975); Merrill Lynch internal memorandum, Jean J. Rousseau to Donald T. Regan, "Mayors Advisory Committee Meeting - March 11, 1975" (March 13, 1975) (Div. Ex. Rousseau 15).

2/ Note 1, p. 3, supra.

3/ See generally Chronology at March 12, 1975.

4/ Testimony of Smeal at 138-142, 186-187; Letter, White & Case to Prospective Members of the Bidding Syndicate for RANs to be offered on March 14, 1975 (March 12, 1975).

5/ Jean J. Rousseau, handwritten notes (March 12, 1975).

to look behind the City's statements unless there was some definite reason to suspect "hanky panky" and there was discussion as to whether revenues existed which could be used to retire the RANs at maturity. During the second day of the meeting, Jean Rousseau of Merrill Lynch made a cryptic notation in his notes of "possible criminal liability if we participate." 1/

The Report of Essential Facts ultimately issued on March 13 in connection with the RAN offering was materially inadequate. It contained a schedule of the City's proposed borrowings through June 30, 1975 and a schedule short-term and long-term debt maturing through June 30, 1975. It also stated:

New York maintains a computerized cash flow forecasting system to project cash receipts and disbursements. Projections produced by this system on March 9 indicate that the future borrowing listed on page 3, together with projected City revenues, will be both necessary and sufficient to meet the City's cash needs including through June 30, 1975, including the redemption of maturing debt. The City requires continuing access to the capital markets . . . in order to meet its cash needs through June 30, 1975, including the redemption of maturing debt. 2/

The Report of Essential Facts failed to contain, among other things, any significant disclosure of the City's continued and growing budget deficit and budget gimmickry and their likely effect on the City's ability to secure additional necessary financing. Nor did the Report of Essential Facts disclose the likelihood that a financial crisis was imminent, and that such a crisis

1/ Jean J. Rousseau, handwritten notes (March 13, 1975)(Div. Ex. Rousseau 4A). In his testimony before the staff, Rousseau explained this notation. He said that he recalled that, at the meeting, Epley of White & Case had stated that the syndicate members might be liable to holders of the outstanding RANs if they took action which was contrary to that taken in connection with prior RAN issuances. Testimony of Rousseau at 164-5 (May 13, 1976).

2/ Harrison J. Goldin, Comptroller, City of New York, "Report of Essential Facts" (March 13, 1975).

could only be averted by drastic City action or drastically increased State and Federal aid. In addition, there was not any disclosure of the likelihood that the City would be unable to raise additional funds through June 30 from the public market, despite its need for such additional financing to meet its debt service and operating needs. There were other serious disclosure deficiencies known to the underwriters and detailed in the "City and Its Officials" Chapter of this Report. The underwriters went forward with the RAN offering despite their serious questions about City receivables the City's ability to support the RANs it was about to issue.

F. Post March 15 Developments

The action and statements of representatives of the underwriters over the course of the six weeks after March 15, during which time the efforts to sell the March 7 BAN and March 13 RAN offerings were ongoing, clearly indicate inadequacies of the disclosures made during that time period. These actions and statements further indicate a recognition on the part of the underwriters of the adverse impact full disclosure would have had on their sales effort. Further questions were raised about the propriety of the underwriters proceeding with the offerings in view of the questionable nature of the receivables supporting the RANs and the improbability of redeeming the BANs with bonds or from revenue sources. The underwriters during this period were clearly aware that the City's financial structure was on the verge of collapse, yet proceeded with nearly a billion dollars of offerings during the first 15 days of March, and continued public sales of City securities after White & Case had specifically advised them of potential securities law liability should they continue without full disclosure.

On March 14, 1975 the Comptroller's TDM Committee met with Comptroller Goldin to discuss the City's financing schedule for the balance of the fiscal year ending June 30, 1975. 1/ The Committee members present, including top officials of Chase, Citibank and Salomon Brothers, discussed the fact that the possibility of obtaining the funds the City required through public offerings was not good. According to a memorandum written by Frank Smeal of Morgan, Comptroller Goldin was informed by Smeal that, in his view, the banks were at or close to saturation with respect to City securities. As of March 14, only about \$57 million (15 percent) of the \$375 million RAN offering and \$240 million of the \$537 million BAN offering had been sold. The Committee discussed the City's cash requirement of \$550 million by April 14, 1975, and alternative sources of funds. The Committee members told the Comptroller that they were "scared" about the City's finances. 2/

The underwriters apparently would no longer be comforted by the Mayor's assurances of a balanced budget. 3/ In addition to being foreclosed from the public market, the City could not expect, under prevailing economic conditions, to raise revenues or cut expenditures so as to produce an accurate and balanced budget. 4/

A memorandum written in preparation for a forthcoming meeting to be held between the Mayor and David Rockefeller of Chase, William Spencer of Citibank and Ellmore Patterson of Morgan on March 17, 1975, noted various foreboding signs. 5/

1/ Morgan internal memorandum, Frank Smeal to Ellmore Patterson (March 14, 1975).

2/ Id. at 1-2.

3/ A memorandum entitled "Proposed Statement to Mayor Beame by the Messrs. Patterson, Rockefeller, Spencer on March 17, 1975" (Div. Ex. E. Patterson 7) stated: "The Market will not be reassured by assertions of balanced budgets when balance is achieved by further borrowings or gimmicks or shifting accounts or a general overstatement of revenues and understatement of expenses." Id. at 3.

4/ Morgan internal memorandum, supra, note 1, at 3.

5/ Div. Ex. E. Patterson 7, supra, note 3.

The memorandum began with a statement that public knowledge of the meeting could trigger a panic in the market and that the group should publicly state that the meeting was related to the continuing effort of the group to help the City solve its problems. The memorandum incorporated into a proposed statement to the Mayor that the March 13 RANS were not selling well "in spite of the fact that we had a clean legal and a thoroughly acceptable 'record of essential facts' as a substitute for a very damaging disclosure statement." (Emphasis added) 1/ The memorandum stated that the City would require about \$1.7 billion in short-term and \$500 million in long-term money to make it through the end of the fiscal year. The memorandum further stated that the ability of the banks to supply money had been virtually exhausted and the market had been manifesting little interest in City issues - all at a time when the City's borrowing needs were greatest and budget problems most visible. Noting that the City's problems were rooted in its living beyond its means, the memorandum concluded that "[t]he magnitude of the needs are such that they can only be supplied by agencies of the Federal government." 2/

The proposed statement further discussed the City's borrowing requirements for the remainder of the fiscal year. 3/ The memorandum further indicated that the banks had invested between 1/5 and 1/4 of their equity in City obligations, thereby eviscerating their ability to raise revenues through the purchase of additional amounts. 4/ It further discussed the market's inability to

1/ Div. Ex. E. Patterson 7, note 3, p. 54, supra, See also Chronology at March 14, 1975.

2/ Div. Ex. E. Patterson 7, supra, at 2.

3/ Id. at 2.

4/ Id. at 2.

absorb even one-half of the previous week's note issue. 1/ It was apparent that the public market for City securities was closed and that the City, if possible, would have to seek to enlist the support of the State and Federal governments for aid. The proposed statement noted the various techniques the City had used to balance its budget. 2/

The use of these questionable budget practices was communicated to a Congressional delegation from New York by Citibank's Jac Friedgut, who noted that expectations of large increases in State and Federal aid was unrealistic. In his written remarks distributed at the meeting, he said that "[u]nless something gives [in the budget] the city fiscal situation might not be viable and New York City paper would then be suspect, regardless of interest rate." 3/

On March 18, it was reported in The New York Times that the New York State Pension Committee had issued a report which found the pension funds "dangerously depleted by a decade of budget 'gimmickry.'" The report stated the City had chosen to underfund its pension funds to balance its budget, and that from 1967 to 1975, total underfunding came to \$2 billion. 4/

A memorandum, also dated March 18, from Thomas Labrecque to Willard Butcher, described Chase's holdings in City securities and the City's projected borrowing needs for the fiscal year. He concluded that

1/ Id. at 2.

2/ Id. at 3-4. See also, note 1, p. 54, supra at 2.

3/ See Chronology at March 18, 1975; Presentation by Jac Friedgut, Vice President, Citibank, before the New York City Congressional Delegation 6, (March 18, 1975).

4/ The New York Times, March 18, 1975.

Given the sales performance of New York City obligations over the last two weeks, the City's ability to float this amount of debt [\$2.15 billion] is tenuous at best. While this picture could be helped by a significant budget cut on the Expense side, the probability of this happening over the short run is minimal if in fact, there is a chance at all. 1/

On March 19, Grossman of Chase prepared a memorandum to David Rockefeller concerning the "City Problem in April" [sic], wherein he stated that if the City could not to sell its scheduled debt for April, it would be in a cash deficit position of over \$400 million on April 14. 2/ He explained that although the City appeared to be able to meet its April 11 payroll, only \$68 million would then be available to redeem \$600 million in TANS maturing that week. 3/ He reached the obvious conclusion that there was little time available to develop viable alternatives. 4/

On the same date, the CBC released a statement concerning the City's fiscal situation. The Committee observed that the cost of the City's current operations could no longer be met out of current revenues or anticipatory borrowings. 5/

On March 20, 1975, Grossman of Chase and John Thompson of W.H. Norton & Co., a broker-dealer, met in Washington with Under Secretary of the Treasury John Bennett. During the meeting, Grossman outlined in general terms the City's financial problems. Bennett noted that by continuing to sell the City's securities in the public market without disclosure, the underwriters

1/ Chase internal memorandum, Thomas G. Labrecque to Willard C. Butcher, "New York City Financing Picture" 1 (March 18, 1975).

2/ Chase internal memorandum, David A. Grossman to David Rockefeller 1 (March 19, 1975).

3/ Id.

4/ Id. at 2.

5/ Citizens Budget Commission, Inc., Statement by the Citizens Budget Commission on New York City Fiscal Situation 2 (March 19, 1975).

had potential legal exposure under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. 1/ Immediately after the meeting, Grossman telephoned David Rockefeller, and reported on the meeting with Bennett. On his return, the same day, Grossman met with Chase's lawyer to discuss the meeting with Bennett. 2/

Having determined that the spread between prime paper and lesser credits was "historically wide", Bankers, on March 20th, decided to downgrade its rating of City notes and recommend that the bank liquidate its holdings in such notes. 3/ On March 23rd Mayor Beame gave a press conference and presented a multi-point plan to help alleviate the City's financial crisis. 4/ Despite the fact that other members of the investment community had concluded otherwise, 5/ Ellmore Patterson, Chairman of Morgan, issued a press release on March 24 acclaiming the program as a move in the right direction. 6/

On March 24th, representatives of the investment community, including Citibank, Chase, Morgan, Salomon Bros. and Chemical, met with Goldin and members of his office. Goldin stated that the City needed \$2.3 billion to get through June. Several representatives of the investment community projected that the maximum amount which could be raised in April was between \$100-200 million,

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- 1/ Testimony of D. Grossman at 190-191; Memorandum of interview with Undersecretary of the Treasury John Bennett 1 (April 19, 1976).
- 2/ Testimony of D. Grossman at 196-199.
- 3/ Bankers internal memorandum, Roy Anderes to Ed Sibert and Bill Lutz, "New York City [illegible] and Bonds" (March 20, 1975) (Div. Ex. Anderes 3).
- 4/ News Release, Office of the Mayor, No. 111-75, March 23, 1975.
- 5/ Bennett Interview, note 1, supra at 3. In this regard, on March 25 representatives of several New York banks told John Bennett that Beame's speech was a disaster inasmuch as it failed to deal with the realities of the situation. Id.
- 6/ News Release by Ellmore C. Patterson, Chairman of the Board, Morgan (March 24, 1975).

while others noted their belief that no market for City securities existed at all. Goldin alluded to the April 11th payroll and April 14th maturity date for certain notes and stated that several hundred million dollars was required to meet these obligations. He also reported that the City had been experiencing difficulties in seeking relief from the federal government. 1/

On March 25 representatives of Morgan, Citibank, Chase, Salomon Bros., as well as City representatives and other representatives of financial institutions, met with Treasury Department and Federal Reserve officials in Washington. 2/ Bennett, who had arranged the meeting to convince the City to be factual and objective in advising the public of the problems, felt the meeting was of no help. 3/

On March 26, the staff of the FCLG met. 4/ Grossman reported on various discussions with the Federal government, indicating that there was no present prospect that it would provide needed funds. Grossman also stated that if "one time shots," financing of current expenses in the capital budget, overestimating of revenues and other such practices were eliminated, the true budget gap would be "+ \$2 Billion", 5/ Jean J. Rousseau, head of Merrill Lynch's Municipal Bond Division, stated that he believed the market for City securities was "crippled,"

1/ One page document produced by Chemical.

2/ "Chronological Narrative of the Participation of Morgan Guaranty Trust Company of New York City in Matters Relating to New York City: December 1974 through March 1975" 36 (hereinafter cited as "Morgan Submission").

3/ Bennett Interview, note 1, p. 58, supra, at 2-3.

4/ "New York City - Staff Advisory Committee" (Jean J. Rousseau, March 26, 1975) (Div. Ex. Rousseau 21).

5/ Id. at 1.

and, absent some encouragement, very unlikely to be able to absorb another issue. 1/

On March 26, representatives of Morgan, Chase, Citibank, Manufacturers, Bankers and Chemical met. Among other things, they discussed the immediacy of the City's cash needs and the possibility of default by the City. In fact, at that time, counsel to certain of the banks were exploring the implications of a potential City default and bankruptcy. 2/

On the following day, Patterson of Morgan, Rockefeller of Chase and Spencer of Citibank met with Beame and Goldin and an official of the Federal Reserve Bank in New York City at Gracie Mansion, again to discuss the City's financial problems. The group discussed the lack of interest in City securities in the market place and the urgencies of the City's cash needs in light of the April 14 maturity date of substantial amounts of City notes. A Federal Reserve official indicated that a Federal Reserve loan was unlikely. The group decided to work toward developing a fiscal reform program to restore investor confidence. 3/

Discussions concerning the fiscal crisis, fiscal reform and the opening of a public market for City notes continued on March 28 at Chase's offices. Those present included City and Federal officials and representatives from Chase, Morgan, Manufacturers, Chemical, Merrill Lynch, Citibank, Bankers, and Salomon. The immediate objective of the discussions was to determine what steps were necessary and what time schedule was appropriate to bring about adequate financing by April 14. 4/

1/ Id.

2/ Morgan Submission, note 2, p. 59 supra at 36-37.

3/ Testimony of Rockefeller at 57-58; Testimony of E. Patterson at 89-90; Testimony of Beame at 189; Goldin Ex. 83; Labrecque Ex. 22.

4/ See Chronology at March 28, 1975.

The discussion continued on March 29. The agenda for the meeting reflects that it was decided, among other things, that the City should embark upon a program upgrading the quality of its financial reporting and accounting procedures and issuing a comprehensive prospectus for each future securities sale. 1/

On the afternoon of March 31, representatives of the Chase, Chemical, Morgan, Citibank, Manufacturers, Bankers, the New York Federal Reserve Bank, and White & Case met at the Chase's offices. 2/ The group discussed the possibility of anti-trust implications concerning their recent meeting and then turned to the possibility of underwriting the City notes to be sold on April 14. 3/ Marion J. Epley, Esq., of White & Case, advised the group that there would be very serious disclosure problems attendant to the resale of such notes to the public. He further advised that the required disclosure would probably create serious marketing problems. 4/ Epley stated that his firm had advised Bankers that in view of the developments since the issuance of the March notes, continued selling may give rise to possible liability under Rule 10b-5 to a selling underwriter and recommended that those present might consult with counsel. 5/ Sanford of Bankers later stated,

1/ FCLG Memorandum and accompanying handwritten notations, "Elements of A Fiscal Improvement Program For New York City" (Second draft, March 29, 1974) (Div. Ex. Flanigan [sic] 20); See also Chronology at March 29, 1975.

2/ Marion J. Epley Memorandum for Files (March 31, 1975).

3/ Id. at 1-2.

4/ Id. at 2.

5/ Id. at 2-3.

and Labrecque of Chase agreed, that their banks might continue to make sales of City notes with the understanding that if the City should default thereon, the bank would repurchase them at the original sales price. 1/

Labrecque stated that White & Case had been asked to examine the effect of a City default on April 14th, when \$600 million in TANs became due, and had been asked to study the possibility of a "secured" financing in April. 2/ The discussion turned to the City's willingness to recognize the priority of debt repayment "over payments to police, welfare recipients, etc." 3/ Sanford stated that the City still had not demonstrated the willingness to lay off employees if such were required to produce a balanced budget. 4/ There followed a brief discussion concerning the draft of a document entitled "Elements of a Fiscal Improvement Program for New York City", the City's fiscal problems and the fact that various Federal officials had stated that the City would not receive additional Federal aid. 5/ White & Case was instructed to proceed with revision and substantial expansion of the Report of Essential Facts employed in the earlier RAN offering. The possibility was discussed that adequate disclosure might be impossible under the circumstances and this was acknowledged by the bankers present. 6/

On March 31 John F. Thompson of W.H. Morton & Co., sent a memorandum to Frank P. Smeal and Amos T. Beason of Morgan with suggestions for solving

1/ Id. at 3.

2/ Id. at 3-4.

3/ Id. at 5.

4/ Id.

5/ Id. at 5-7.

6/ Id. at 9-10.

the City's fiscal crisis. 1/ The memorandum began with a statement that a solution to the City's fiscal crisis was impossible before April 14. 2/ Thompson mentioned the possibility of a City default ("would do more harm than good", he said), and stated that almost \$3 billion of RANs were outstanding due to the City's practice of retiring RANs from previous years with the proceeds of larger borrowings against current revenues. 3/ "Thus, the deficits resulting from revenue shortfalls in several succeeding years have in effect been folded into a cumulative balance of RANs outstanding." 4/

On April 1, 1975, Epley wrote a letter to Labrecque of Chase concerning disclosure questions involved in marketing New York City securities. 5/ In part, the letter stated:

While it may be possible for updating and supplementing [the Report of Essential Facts dated March 13, 1975] to satisfy the applicable legal requirements with respect to future underwritten offerings, we understand from our discussions with the Banks that the adverse information which would be required in such a Report would in all likelihood render the City securities unsaleable.

One of the suggestions which has evolved. . .has been the preparation by the City of a comprehensive prospectus to be updated and circulated in connection with each sale of bonds and notes by the City.

* * *

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- 1/ Memorandum, John F. Thompson to Amos T. Beason and Frank P. Smeal 1 (draft, March 31, 1975).
- 2/ Id. Thompson wrote: "The seriousness of the problem must be recognized by all concerned, although quietly. . ." Id.
- 3/ Id.
- 4/ Id.
- 5/ Letter, Marion J. Epley to Thomas Labrecque (April 1, 1975). Copies of the letter were sent to Citibank, Chemical, Manufacturers and Bankers. Id.

Regardless of the form which any ultimate disclosure document may take, we reemphasize our advice that public sales of New York City securities, in the absence of what may be agreed upon as full and meaningful written disclosure, would be contrary to the best interests of both the City and the Banks and could result in a substantial exposure to liability both to primary and secondary purchasers of the securities. 1/

On the following day, Epley wrote substantially the same letter to Ellmore Patterson of Morgan. 2/ The text of the two letters differed only in that the last sentence of the first paragraph of the April 1st letter, cited above, was omitted and replaced, on April 2nd, by:

It may be possible by updating and supplementing that Report to satisfy the applicable legal requirements with respect to future underwritten offerings. 3/

On April 2nd, Standard & Poor's suspended the City's "A" rating on general obligation bonds, attributing the suspension to the rapidly deteriorating ability of the City to raise money in the capital market, which had put unusual strains on the City's immediate cash position. 4/

On April 4th, it was announced that the State would give the City \$400 million as an advance payment of aid. 5/ With the suspension of the City's "A" rating by Standard & Poor's and the City's resort to an advance of State aid

1/ Letter, Marion J. Epley to Thomas Labrecque, (April 1, 1975) note 5, p. 63, supra.

2/ Letter on the letterhead of White & Case, White & Case to Ellmore C. Patterson (April 2, 1975).

3/ Id.

4/ Dow Jones Wire Service Release, April 2, 1975.

5/ The New York Times, April 4, 1975, at 1, 30.

to avoid a default, the underwriters' traditional role of marketing the City securities to the public had come to an end. The events of the last weeks of the period covered by this Report represented merely the foreseeable and inevitable culmination of the basic underlying problems created by the City's revenue-expenditure gap. Thus, Epley's and Bennett's warnings about the dangers of selling the City notes without substantial additional disclosures were equally applicable throughout the October through March period.

VII. PRICE EFFECTS OF CITY FISCAL CRISIS

After April 20, 1975, the City's fiscal crisis had an unsettling effect on the prices at which City notes were traded. ^{1/} Because of uncertainties created by the crisis, there were significant fluctuations in these prices during this period. Price and volume information for trading in City notes is not available on bases comparable to that available for industrial bonds or stock. The Commission staff found it necessary to obtain price data from specific trades directly from various municipal bond dealers.

The analysis shows that, starting during July 1975, the price of City notes dropped markedly. Thus, while prices had ranged to a low of \$96 (on a par value of 100) during May and June, a substantial decline is discernible beginning about July 21, 1975. The data analyzed by the Commission staff relates to issues of varying coupon rates and maturity dates. One can discern the decline in prices by following the patterns of specific issues.

For example, based on the data analyzed, a 9.40% City RAN (with a maturity date of January 12, 1976) traded on July 17 at a price of \$96.80, a discount

^{1/} A chart showing prices for periodic trades analyzed by the Commission staff is annexed as Appendix B.

of only 3.2% off par value. Five days later, however, notes from the same issue traded at \$86, a 14% discount, over a 10% drop in the five-day period. On July 29, notes from the same issue traded at \$83; and on September 29, \$81.625. On November 5, ten days before the enactment of the Moratorium, the same issue traded at \$65 -- a 35% discount from par value. On December 31, after the Moratorium was enacted but before it was declared unconstitutional, and twelve days before the RANs issue had been scheduled for redemption, the price of this note had declined to a low of \$55.25 -- almost a 50% drop in the value of this note since its issuance, less than one year earlier. Similar declines are shown in the trades of other City issues analyzed by the Commission staff.

There are currently outstanding approximately \$1 billion in City notes which are past redemption. There have been recent trades in some of these notes approximately at par.

VIII. THE BANK RECORDS

As part of the Commission staff's investigation, a review was made of the records of several of the banks which acted as principal City underwriters, including Chase, Bankers, Citibank, Chemical, Manufacturers, and Morgan.

The review of bank documents, originally subpoenaed in early 1976, proved to be hampered by the lack of records which one could reasonably have expected to be maintained by the banks, but which were not, and the lack of organization existing in the record-keeping systems of the banks.

The condition of each bank's records will be described below not only to highlight the difficulties encountered in the investigation, but also to

provide information which will be useful to the various federal and state authorities having regulatory responsibilities in this area.

Certain general practices were prevalent at each of the banks. Surprisingly, none of the banks maintained a standardized, systematized, easily retrievable system of recordkeeping of its trading in City notes. No overall compilations of trading were made available. Accordingly, it was necessary to utilize the underlying confirmation slips, where available, and the ledger accounts and trader account cards. These averaged approximately 20,000 documents per bank (excluding Manufacturers, which had somewhat fewer supporting documents).

A. Bankers Trust

Bankers Trust maintained typed or N.C.R. (National Cash Register Type) ledger accounts (cash accounts) on an issue by issue basis for four separate accounts: Purchase, Joint, Investment and Dealers (trading). ^{1/} Each of these accounts was posted on an individual, trade-by-trade basis. The Commission staff was advised by a bank officer that the only method of obtaining a daily position on any given day would be to total the open accounts in existence as of that day. Closed accounts, however, were sent to the bank's warehouse or other outside repository. Thus, if a review of a particular date involved accounts which had thereafter been closed, the information in those accounts would have to be retrieved from a warehouse before trades on the day in question could be analyzed.

^{1/} Purchase Accounts and Joint Accounts were syndicate accounts; these accounts were made up of securities held as part of a particular underwriting. Purchase Account and Joint Account securities were not sold directly to the public. The Dealer (Trading) Account consisted of securities held for the purpose of buying and selling to other banks, brokers and the public for profit. The Investment Account consisted of securities owned by the bank and held for investment.

The ledger account records, furthermore, did not indicate who the buyer or seller was in any given transaction. The ledger account indicated a confirmation number, and in order to determine the buyer or seller in a transaction, the staff had to locate and match the particular ledger account entry with the corresponding confirmation slip. However, confirmation slips were kept at storage facilities outside of the bank or at various locations within the bank. The staff was also advised that the City note account ledgers and related confirmation slips had to be culled from other municipal issues by bank employees in order to locate the relevant New York City issues.

After account ledgers and confirmations were located by bank employees and before they were provided to the Commission staff, it was discovered that in some cases no confirmations or account ledgers existed. This required additional search in order to locate the missing account ledgers or confirmation slips. This process continued until it appeared that all of the transactions executed by the bank had been obtained. Whether or not this method successfully accounted for all of the banks' trades is questionable. The staff was advised by a bank officer that bank personnel had expended approximately 570 man-hours in gathering the records made available to Commission staff.

B. Chase Manhattan

Chase, like Bankers, maintained ledger (cash) accounts of its trades in City notes. Unlike the Bankers Trust's records, the Chase ledgers were handwritten. Chase's dealer (trading) and investment accounts were posted on a trade-by-trade basis. Adjustments to positions, however, were written in hand and in such instances, no explanation for an entry was generally provided.

As was the case with Bankers, in order to determine the seller or purchaser on the other side of a trade, the ledger account had to be matched

with the appropriate confirmation. Confirmations were kept alphabetically by customer but had to be arranged numerically so that they could be matched against ledger entries. A large number of confirmations were missing and the staff was forced to rely on handwritten account cards (trader position cards) filled out by the traders as they executed trades. These notations were often in a shorthand, abbreviated or illegible state. An additional complication arose from the unsystematized nature of these cards. For example, initially, the Commission staff was told that yellow trader position cards were for dealer (trading) accounts and white cards were maintained for joint accounts. The staff was later told that all bank employees did not necessarily follow this system. The Commission staff was then told that any white card which had a notation "POSITION" written in red on the top of the card was actually a dealer (trading) account card. This necessitated re-evaluating all prior work which had been done based on the earlier information.

Additionally, transaction dates on the trader position cards did not always match the dates in the ledger accounts for the same transactions. Finally, the joint account position cards in some instances contained some of the same information that was on the dealer (trading) account cards. This duplication had to be detected and omitted to prevent repetition.

C. Chemical

Chemical, unlike Bankers and Chase, maintained weekly computerized records, however, such records were not maintained for dealer (trading) accounts. Chemical also maintained ledger accounts (investment, trading, joint and manager) which were all handwritten, and, as in the case of Bankers and Chase, were not kept on a trade-by-trade basis. Instead, Chemical lumped each day's purchases and sales into one or more combined entries in the ledger accounts.

The use of such combined entries greatly complicated the task of matching the ledger accounts with the confirmations, particularly since Chemical's ledger cards did not identify the confirmation slip numbers. Chemical also kept trader position cards, but the Commission staff found these to be unusable since they frequently were incomplete and illegible.

D. Citibank

Citibank had no open investment account for the time period under review. However, such accounts, referred to as tax accounts by counsel for the bank, were maintained prior to September 30, 1974.

The bank did not maintain dealer position records but did maintain typed ledger accounts similar to those maintained by Bankers. These records, as was the case at Bankers, did not reflect the names of buyers and sellers and confirmations had to be reviewed in order to attempt to obtain such information. However, hundreds of confirmations were missing so this task could not be successfully completed.

The Commission staff, in the absence of such confirmation slips, relied on the handwritten, abbreviated trader position cards maintained by the bank. In addition to the problem of legibility, the information contained on many of these cards did not match the information contained on the ledger accounts. To further complicate matters, additional trader position cards and other data pertaining to the joint accounts were kept separately and had to be integrated with the other records being reviewed. Finally, the staff also encountered instances where sets of records simply could not be located by the bank.

E. Manufacturers Hanover

Manufacturers' records were the smallest in amount. Investment account transactions were computerized, orderly and easy to verify. The bank maintained

neither joint nor manager accounts. The explanation for this was that the bank was not a manager on any of City issues covered by the Commission's staff's investigation. Thus, all trades were made through either the investment or dealer (trading) departments.

Dealer (trading) account ledgers were not kept on an issue by issue basis. These accounts, therefore, had to be recreated from the confirmation slips held by the bank. The bank, however, supplied the staff with schedules of month-end positions and schedules of total purchases and sales of City notes. These schedules had been prepared by the bank considerably after the transactions had occurred and concurrently with the staff's examination. The staff found the bank's schedules to be substantially inaccurate.

Finally, Manufacturers maintained an omnibus type account for Dealer purchases and sales of all municipal notes. Counsel for the bank advised that they had found certain of these records to be undated and incomplete and that they were thus unable to utilize or reconstruct these records.

F. Morgan Guaranty

Morgan's recordkeeping system was similar to Bankers Trust both as to type of records and completeness. However, the retrieval system at Morgan was more effective than that of the other banks.

G. Summary

No uniform system of recordkeeping or storage retention as to transactions in the City notes existed among the banks examined. Records were not only disorganized at certain banks but were also incomplete, conflicting and, often illegible. The reconstruction of trading in City notes was thus time consuming and difficult. Rapid retrieval of information concerning transactions, which

had occurred only a year earlier, became a slow and difficult process and required an extensive outlay of manpower by both the Commission and the banks. The lack of a uniform system of recordkeeping and record retrieval further complicated the task of reviewing bank trades and making comparisons.

IX. CONCLUSION

The City's financial crisis was primarily the result of insufficient revenues to meet mounting City expenses. The growing gap between City revenues and City expenses was bridged through the resort to constant and unprecedented levels of short-term borrowings. Years of questionable and unsound budgetary, accounting and financial reporting practices helped mask the City's true financial condition from public view. In the Spring of 1975, however, these policies culminated in the virtual collapse of the market for City securities, ending the City's ability to raise more funds through issuance of short-term notes.

A key role in the nationwide distribution of the City's securities was played by the City's principal underwriters: Chase, Citibank, Morgan, Manufacturers, Chemical, Bankers and Merrill Lynch. The underwriters, through their own investments and by selling the City's securities to the investing public, enabled the City to raise billions of dollars in short-term debt issues through the Spring of 1975.

Approximately four billion dollars of City notes were underwritten during the period October 1974 through March 1975, a time when the City's fiscal condition was critical. Faced with a marketing problem, caused by the saturation of the market through previous billions of dollars of

City issues and the growing doubts of the financial community as to the City's financial status, the City and the underwriters reached out for the smaller investor.

Thus, beginning in the winter of 1974, City notes began to be marketed in denominations as small as \$10,000. This had the effect, at least in part, of shifting the risk for financing the City from the City's major banks and large institutional investors to individual investors.

As the City's fiscal crisis worsened, the public was subjected to a confusing and contradictory financial picture, with the result that the public, unlike the City and its underwriters, was deprived of a basic understanding of the City's finances. While the public was left largely uninformed, the City's underwriters had an increasing awareness of the range of problems underlying the City's fiscal crisis.

During 1974 and early 1975, certain of the underwriters of City securities ceased purchasing City securities for their fiduciary accounts. Despite the shift of investment policy, they continued as underwriters to market these securities to the public. The underwriters did not disclose this significant change in their investment strategy and policy.

The problems of the City came to a head in February and March 1975. A \$260 million TAN offering in February 1975 was cancelled when the City was unable to certify certain current information that the underwriters had requested from the City. At about the same time the City's major banks informed the Mayor and the Comptroller that the underwriters would be unable to continue to support the City by taking down City securities unless the City took immediate remedial action.

The City's securities offerings were carried out without adequate disclosure. As a result, the public's principal source of information, besides the stream of confusing and contradictory statements in the press, was the representations by the City and the underwriters attesting to the safety and security of City notes.

Indeed, as one of the underwriters' attorneys stated in April 1975 to the City's principal underwriters, "the adverse information which would be required in . . . (a disclosure document) . . . would in all likelihood render the City securities unsaleable."

Despite the needs of the City for funds to meet the urgent demands of its citizenry, these needs do not justify the tapping of the public debt markets when neither the City nor its underwriters were willing or able to make adequate disclosures to investors.

APPENDIX A

NEW YORK CITY NOTE SALES

January 1974 - December 1975

<u>ISSUE DATE</u>	<u>AMOUNT AND TYPE</u>	<u>PRINCIPAL UNDERWRITERS */</u>
1/14/74	I. <u>RANs \$250,000,000</u> A. \$150,000,000 B. \$100,000,000	Chase Manhattan Bank and First National City Bank
2/28/74	I. <u>RANs \$500,000,000</u> A. \$300,000,000 B. \$200,000,000	Chemical Bank; Bankers Trust Co. First National City Bank; Chase Manhattan Bank
3/26/74	BANs \$362,270,000 I. <u>BANs \$91,000,000</u> A. \$66,000,000 B. \$25,000,000 II. <u>BANs \$271,270,000</u> A. \$200,000,000 B. \$ 56,270,000 C. \$ 15,000,000	Morgan Guaranty Co.; Merrill Lynch Chase Manhattan Bank and First National City Bank (not reoffered) Bankers Trust Co.; Chemical Bank Chase Manhattan Bank; First National City (not reoffered)
4/10/74	I. <u>\$5,100,000 Capital Notes</u>	

*/ Names represent the principal underwriters discussed in the text.

<u>ISSUE DATE</u>	<u>AMOUNT AND TYPE</u>	<u>PRINCIPAL UNDERWRITERS</u>
5/10/74	\$183,500,000 Various RANs	
	I. <u>\$178,500,000</u>	First National City Bank; Chase Manhattan Bank (only \$133.4 M reoffered)
	II. <u>\$ 5,000,000</u>	Chemical Bank; Bankers Trust Co. (not reoffered)
5/17/74	RANs <u>\$300,000,000</u>	First National City Bank; Chase Manhattan Bank
5/31/74	\$603,600,000 Various Notes	
	I. <u>RANs \$300,000,000</u>	
	A. \$250,000,000	Chase Manhattan Bank; First National City Bank
	B. \$ 50,000,000	Morgan Guaranty Trust Co. Merrill Lynch
	II. <u>BANs \$220,000,000</u>	Chase Manhattan Bank; First National City Bank
	III. <u>URNs \$ 73,345,000</u>	
	A. \$ 43,345,000	Chase Manhattan Bank; First National City Bank
	B. \$ 25,000,000	Morgan Guaranty Trust Co. Merrill Lynch
	C. \$ 5,000,000	Bankers Trust Co.
	IV. <u>URNs \$10,255,000</u>	Chase Manhattan Bank; First National City Bank
6/11/74	I. \$350,000,000 17 Day RANs	Chase Manhattan Bank (by negotiation)
6/11/74	\$431,800,000 Various Notes	Chase Manhattan Bank; First National City Bank; Manufacturers Hanover Trust Co.
	I. <u>TANs \$130,000,000</u>	
	II. <u>TANs \$187,000,000</u>	
	III. <u>RANs \$114,800,000</u>	

<u>ISSUE DATE</u>	<u>AMOUNT AND TYPE</u>	<u>PRINCIPAL UNDERWRITERS</u>
6/13/74	RANs \$150,000,000	First National City Bank; Chase Manhattan Bank; Manufacturers Hanover
7/1/74	TANs \$800,000,000	Morgan; Bankers Trust; Chemical
	<u>\$200,000,000</u>	
	<u>\$600,000,000</u>	
7/24/74	RANs \$800,000,000	
	I. \$500,000,000	Bankers Trust Co.; Chemical Bank
	II. \$300,000,000	Morgan Guaranty Trust Co.
8/23/74	\$151,255,000 Various Notes	
	I. <u>BANs \$141,000,000</u>	Chase Manhattan Bank; First National City Bank; Manufacturers Hanover Trust Co.
	II. <u>URNs \$ 10,255,000</u>	Chemical Bank; Bank of America; Morgan Guaranty Trust; Bankers Trust; Merrill Lynch
9/16/74	RANs \$600,000,000	First National City Bank; Chase Manhattan Bank; Manufacturers Hanover
	I. <u>\$200,000,000</u>	
	II. <u>\$400,000,000</u>	
9/30/74	RANs \$800,000,000	
	I. <u>\$200,000,000</u>	
	A. \$100,000,000	
	B. \$100,000,000	Bankers Trust; Chemical; Morgan Guaranty; Merrill Lynch

<u>ISSUE DATE</u>	<u>AMOUNT AND TYPE</u>	<u>PRINCIPAL UNDERWRITERS</u>
	II. <u>\$600,000,000</u>	
	A. \$200,000,000	Bankers Trust
	B. \$400,000,000	Chase Manhattan Bank; First National City Bank; Manufacturers Hanover Trust
10/18/74	\$517,760,000 Various Purposes	
	I. <u>URNs \$ 97,355,000</u>	First National City Bank; Chase Manhattan Bank
	II. <u>BANs \$420,405,000</u>	
	A. \$250,000,000	Chemical Bank; Morgan Guaranty Trust Co.; Bankers Trust; and Merrill Lynch
	B. \$170,405,000	First National City Bank; Chase Manhattan Bank
11/12/74	\$615,000,000 Various Purposes	
		Morgan Guaranty Trust Co.; Bankers Trust Co.; Chemical Bank; Merrill Lynch
	I. <u>RANs \$500,000,000 (8.00%)</u>	
	A. \$250,000,000	
	B. \$250,000,000	
	II. <u>TANs \$115,000,000</u>	
12/13/74	\$600,000,000 Various Purposes	
		Bankers Trust; Chemical Bank; Morgan Guaranty Trust; Merrill Lynch, in association with First National City Bank; Chase Manhattan; Manufacturers Hanover Trust Co.
	I. <u>RANs \$400,000,000</u>	
	II. <u>TANs \$200,000,000</u>	

<u>ISSUE DATE</u>	<u>AMOUNT AND TYPE</u>	<u>PRINCIPAL UNDERWRITERS</u>
1/13/75	RANS \$620,000,000	Chase Manhattan Bank; First National City Bank; Manufacturers Hanover Trust Co., in association with Chemical Bank; Bank of America; Morgan Guaranty; Bankers Trust; and Merrill Lynch
1/13/75	BANS \$200,000,000*	Chemical Bank; Bank of America; Morgan Guaranty; Bankers Trust; and Merrill Lynch
2/14/75	RANS \$290,000,000	Morgan Guaranty Trust; Bankers Trust; Bank of America; Merrill Lynch; and Chemical Bank
2/24/75	RANS \$170,000,000*	
3/5/75	RANS \$140,000,000*	Consortium of 10 banks headed by Chase Manhattan Bank
3/14/75	BANS \$537,270,000	Chemical Bank; Morgan Guaranty Trust; Bankers Trust; Merrill Lynch, in association with Chase Manhattan; First National City Bank; and Manufacturers Hanover Trust Co. (Negotiated purchase)
	I. <u>\$387,270,000</u>	
	A. \$ 46,000,000	
	B. \$341,270,000	
	II. \$150,000,000	
3/20/75	RANS \$375,000,000	First National City Bank; Morgan Guaranty Trust; Chase Manhattan; Bankers Trust; Chemical Bank; Manufacturers Hanover Trust; Merrill Lynch (Negotiated purchase)

* / Not publicly reoffered.

APPENDIX B

TRANSACTION PRICES OF NEW YORK CITY NOTE ISSUES

May 1975 - December 1975

<u>TRADE DATE</u>	<u>COUPON</u>	<u>MATURITY DATE</u>	<u>PRICE</u>
5/8/75	9.40	(12/11/75) 6/11/75	99.75 - 99.7
5/8	7.47	8/22/75	98.5 - 98.625
5/9	6.87	6/11/75	99.166 - 99.291
5/9	7.64	8/22/75	98.632 - 98.757
5/12	8.34	6/11/75	99.30
5/12	8.45	9/15/75	96.75
5/15	8.34	6/11/75	97.25
5/15	6.89	6/11/75	97
5/15	9.40	1/12/76	95.50
5/16	9.50	12/11/75	92
5/19	7.47	8/22/75	93.75
5/19	7.47	8/22/75	93.75
5/19	9.50	12/11/75	90
5/20	9.40	1/12/76	94.50
5/20	6.50	7/1/75	93
5/20	9.40	1/12/76	95
5/21	7.77	10/17/75	90.875
5/21	6.47	5/30/75	94.975
5/21	9.50	12/11/75	93
5/21	9.40	6/11/75	94.375
5/21	7.47	8/22/75	89

TRADE DATE	COUPON	MATURITY DATE	PRICE
5/22	9.40	1/12/76	91.75
5/22	9.40	6/11/75	96
5/23	8.75	3/12/76	89.50
5/23	6.47	5/30/75	96.125
5/23	7.55	2/13/76	89
5/27	7.55	2/13/76	89 -
5/28	9.50	12/11/75	90 -
5/28	9.40	1/12/76	90 -
6/2	8.34	6/11/75	99.125
6/2	6.85	6/11/75	97.25
6/2	8.33	11/10/75	94.50
6/2	7.80	10/17/75	93
6/2	9.40	6/11/75	97.50
6/2	8	2/1/78	89
6/2	9.40	6/11/75	99.25
6/3	9.40	1/12/76	93
6/3	8.75	3/12/76	92
6/3	8.34	6/11/75	98.63
6/4	8.33	11/10/75	95
6/4	7.64	8/22/75	93.625
6/4	7.46	8/22/75	95
6/4	7.83	10/17/75	95
6/4	9.40	1/12/76	95
6/5	8.34	6/11/75	98.80
6/5	8.34	6/11/75	98.50

TRADE DATE	COUPON	MATURITY DATE	PRICE
6/5	7.80	10/17/75	95.625
6/5	7.47	8/22/75	95.60
6/5	9.40	1/12/76	94.50
6/5	9.40	6/11/75	98.20
6/5	8.34	6/11/75	98.20
6/5	7.80	10/17/75	94.25
6/6	9.40	1/12/76	94
6/6	9.40	1/12/76	94
6/9	7.80	10/17/75	93.50
6/9	7.55	2/13/76	94.50
6/9	7.55	2/13/76	94.50
6/11	7.77	10/17/75	98.50
6/11	7.55	2/13/76	88.125
6/11	7.77	10/17/75	98.50
6/11	9.50	12/11/75	97.75
6/12	9.40	1/12/76	99.125
6/12	9.40	1/12/76	99.125
6/12	7.55	2/13/76	97.125
6/12	7.80	10/17/75	98 - 97
6/13	7.83	10/17/75	98.25
6/13	7.55	2/13/76	98.50
6/13	9.50	12/11/75	98.25
6/13	7.77	10/17/75	98.130
6/13	9.50	12/11/75	98

TRADE DATE	COUPON	MATURITY DATE	PRICE
6/13	9.40	1/12/76	98
6/16	9.40	1/12/76	98.75
6/17	9.5	12/11/75	98.50
6/17	8.10	9/11/75	97.625
6/17	9.50	12/1/75	98.15
6/17	9.40	1/12/76	98
6/17	9.40	1/17/76	98.75
6/18	9.50	12/11/75	98.25
6/18	8.75	3/12/76	96.50
6/18	9.40	1/12/76	97.50
6/18	9.40	1/17/76	98.25
6/18	9.40	1/12/76	97.625
6/18	9.40	1/12/76	97.75
6/18	9.40	1/12/76	97.75
6/18	8.33	11/10/75	96.125
6/18	9.50	12/11/75	97
6/23	7.80	10/17/75	95.879
6/26	7.43	8/22/75	99.125
6/26	7.47	8/22/75	98.75
6/30	7.80	10/17/75	96.90
6/30	9.40	1/12/76	97.60
7/2	9.40	1/12/76	97.52
7/2	9.40	1/12/76	97.77
7/2	9.40	1/12/76	97.76

TRADE DATE	COUPON	MATURITY DATE	PRICE
7/2	9.40	1/12/76	97.30
7/2	8.45	9/15/75	98.50
7/2	7.64	8/22/75	98.50
7/2	8.75	3/12/76	96.75
7/2	9.50	12/11/76	98.25
7/2	7.77	10/17/75	96.70
7/2	8.33	11/10/75	96.60
7/3	9.40	1/12/76	97.75
7/3	9.50	12/11/75	97.53
7/3	9.50	12/11/75	97.25
7/7	9.50	12/11/75	97.40
7/7	7.80	10/17/75	97.625
7/7	9.40	1/12/76	96.75
7/8	7.46	8/22/75	98.53
7/8	8.40	9/15/75	98.13
7/8	8.75	3/12/76	96.625
7/9	8.75	3/12/76	96.40
7/9	9.40	1/12/76	97.375
7/10	7.80	10/17/75	97
7/10	9.40	1/12/76	97.26
7/10	9.40	1/12/76	97.50
7/10	8.40	9/15/75	98.50
7/10	9.40	1/12/76	97.28
7/11	8.45	9/15/75	98.12
7/11	9.50	12/11/75	97.32

<u>TRADE DATE</u>	<u>COUPON</u>	<u>MATURITY DATE</u>	<u>PRICE</u>
7/15	8.75	3/12/76	95.125
7/15	8.75	3/12/76	95
7/15	9.40	1/12/76	97.07
7/15	8.75	3/12/76	94.75
7/15	8.33	11/10/75	96.
7/16	8.45	9/15/75	98.52
7/16	7.47	8/22/75	98.65
7/16	7.80	10/17/75	96.801
7/16	7.77	10/17/75	97.3
7/17	9.40	1/12/76	97.6
7/17	9.40	1/12/76	96.80
7/17	9.40	1/12/76	95.75
7/17	8.33	11/10/75	95.77
7/17	8.75	3/12/76	94.
7/17	8.75	3/12/76	94.
7/18	7.77	10/17/75	95.305
7/21	7	5/1/76	84.75
7/21	7.46	8/22/75	90.50
7/21	8.75	3/12/76	84.
7/21	7.43	8/22/75	90.50
7/21	9.50	12/11/75	89.40
7/22	7.64	8/22/75	88.
7/22	7.46	8/22/75	88
7/22	8.45	9/15/75	86.25
7/22	9.40	1/12/76	86

TRADE DATE	COUPON	MATURITY DATE	PRICE
7/23	8.45	9/15/75	88.10
7/24	8.45	9/15/75	88.30
7/24	7	5/1/76	86.875
7/25	7.80	10/17/75	88.50
7/25	7	5/1/76	86.875
7/25	7	5/1/76	86.875
7/25	9.50	12/11/75	88.50
7/28	7	5/1/76	86.875
7/28	7	5/1/76	86.875
7/28	7	5/1/76	86.875
7/29	9.40	1/12/76	83
7/29	7	5/1/76	87.25
8/5	7.64	8/22/75	95
8/7	8	1/1/76	92.75
8/12	9.50	12/11/75	91.25
8/12	8.45	9/15/75	94.25
8/12	8.	1/1/76	96
8/12	8.75	3/12/76	90.50
8/12	7.74	10/17/75	93.75
8/12	9.40	1/12/76	92.875
8/14	9.50	12/11/75	87.375
8/14	8	1/1/76	92.26
8/19	7	10/76	86.58
8/19	8	1/76	92.247

TRADE DATE	COUPON	MATURITY DATE	PRICE
8/19	7.80	10/17/75	91.
8/20	7.77	10/17/75	90.375
8/20	9.40	1/12/76	84.75
8/21	7.80	10/17/75	90.70
8/21	7.74	10/17/75	90.75
8/26	8.75	3/12/76	83
8/26	8.75	3/12/76	86
9/10	8.33	11/10/75	96.625
9/10	8.75	3/12/76	89
9/10	7.55	2/13/76	89
9/10	7.80	10/17/75	96.75
9/18	7.80	10/17/75	96.50
9/29	9.40	1/12/75	81.625
9/30	9.50	12/11/75	86
10/8	7.80	10/17/75	93.26
10/3	7.80	10/17/75	95
10/17	5.63	1/30/76	97.380
10/17	9.50	12/11/75	89.375
10/22	9.50	12/11/75	88
10/22	9.50	12/11/75	89.50
10/23	8.33	11/10/75	94.25
11/5	9.40	1/12/76	65
12/1	9.40	1/12/76	71.05
12/3	9.40	1/12/76	70.125
12/3	9.40	1/12/76	69.25

TRADE DATE	COUPON	MATURITY DATE	PRICE
12/8	9.50	12/11/75	68
12/8	7.55	2/13/76	68
12/9	9.50	12/11/75	66.50
12/10	7.55	2/13/76	68.625
12/10	9.50	12/11/75	66.25
12/10	9.50	12/11/75	66.25
12/10	9.50	12/11/75	66
12/11	9.40	1/12/76	66.50
12/11	7.55	2/13/76	66
12/12	9.40	1/12/76	66
12/12	8.75	3/12/76	66.50
12/16	9.40	1/12/76	60.75
12/16	8.75	3/12/76	61
12/16	9.50	12/11/75	61
12/19	9.40	1/12/76	60.75
12/24	9.40	1/12/76	60.25
12/24	9.40	1/12/76	63.125
12/24	9.50	12/1/75	65.125
12/24	8.75	3/12/76	65.125
12/24	9.40	1/12/76	63.125
12/24	9.40	1/12/76	60.50
12/26	8.75	3/12/76	63.50
12/26	9.40	1/12/76	62
12/26	8.75	3/12/76	61.25
12/26	9.50		60

TRADE DATE	COUPON	MATURITY DATE	PRICE
12/29	9.40	1/12/76	60
12/29	6.75	11/1/76	78.25
12/31	9.40	1/12/76	55.25
12/31	8.75	3/12/76	55.25
1/9/76	9.40	1/12/76	57.50
1/12	9.40	1/12/76	61
1/12	7.55	2/13/76	62.25
1/20	9.40	1/12/76	64.25
1/20	9.50	12/11/75	64.25
1/21	9.40	1/12/76	64.75
1/21	9.50	12/11/75	64.625
1/22	8.75	3/12/76	62.50
1/26	8.75	3/12/76	60.57



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**THE ROLE OF
THE RATING AGENCIES**

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

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Chapter Five

REPORT ON

THE ROLE OF THE RATING AGENCIES

August 26, 1977

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I. INTRODUCTION

This section of the Report examines certain activities of the rating agencies up to and including that period of time covered by the Commission's investigation into the transactions in securities of the City of New York. This section shows the impact of municipal securities ratings on investors, municipalities and underwriters, among others, and that the ratings may assume a significance disproportionate to what they actually are.

Rating agencies annually rate thousands of municipal issues involving billions of dollars of securities which enter the capital markets throughout the world. The ratings are relied upon by investors in making investment decisions and by underwriters in determining whether to underwrite a particular issue. They are an important factor in determining the interest rate a municipality will pay and investors will receive. They determine whether institutions, such as savings banks, may purchase a particular debt security or are required to divest themselves of obligations they already hold. And, they are virtually indispensable to the municipality's access to the capital markets.

During the period covered by the investigation, as shown below, billions of dollars of New York City's securities were sold and traded predicated upon ratings that were based largely upon unverified data and information furnished by the City to the two rating agencies

involved. Indeed, the agencies expressly disclaimed any responsibility for the accuracy of the information upon which they acted. Nor did they apparently recognize a responsibility to make diligent inquiry even in the face of adverse facts which came to their attention. Based upon the facts disclosed by this investigation, it can reasonably be concluded that the agencies failed to make timely adjustments to their assigned ratings of the City's securities, to the detriment of many and widespread public investors not intimately familiar with the City's affairs.

II. BACKGROUND

Three rating agencies rate securities issued by U.S. municipalities: Moody's Investors Services, Inc. ("Moody's"); Standard & Poor's Corporation ("S&P"); and Fitch Investor Services, Inc. ("Fitch"). ^{1/} In addition, several brokerage houses and banks rate municipal securities and these ratings are available to their customers. This phase of the staff's investigation focused on Moody's and S&P because these two nationally recognized rating agencies are responsible for rating the vast majority of the municipal issues that come to market each year. ^{2/} However, for certain purposes, this Report discusses particular actions taken by Fitch during the period under investigation.

^{1/} Ross, "Higher Stakes in the Bond-Rating Game," Fortune Magazine, April 1976, pages 133-134 [hereinafter referred to as "Ross"].

^{2/} Id.

Moody's and S&P are located in New York City. Moody's, a subsidiary of Dun & Bradstreet Companies, Inc., has been rating municipal issues since 1919. 1/ Moody's rates approximately 3,000 municipal issues a year. 2/ Moody's has been registered with the SEC as an investment adviser pursuant to Section 203 of the Investment Advisers Act of 1940 ("Investment Advisers Act") since 1940. 3/ In addition to its ratings, Moody's provides various services for investors and underwriters including publications concerning bonds and notes of governments, municipalities, corporations, utilities, transportation companies and others. 4/

S&P, a wholly-owned subsidiary of McGraw Hill, Inc., has been registered with the Commission as an investment adviser pursuant

1/ The Twentieth Century Fund, The Rating Game (Report of the Twentieth Century Fund Task Force on Municipal Bond Credit Ratings), 1974, 51 [hereinafter referred to as "The Rating Game"].

2/ Ross at 134; Testimony of Jackson Phillips, Executive Vice-President of Moody's [hereinafter referred to as "Phillips"] at 19 (Feb. 26, 1976).

3/ SEC File No. 801-2887 (Aug. 31, 1976).

Section 202(a)(11) of the Investment Advisers Act defines an investment adviser as any person who, for compensation, engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing or selling securities or who issues analyses or reports concerning securities. We are aware of no applicable exemptions for agencies that rate municipal obligations.

4/ Testimony of Jackson Phillips before the Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce, June 24, 1976 (Prepared Statement) [hereinafter referred to as Phillips Consumer Protection Subcommittee testimony].

to Section 203 of the Investment Advisers Act since 1940. 1/ S&P and its predecessor companies have been in business for over 115 years. 2/ The agency rates an average of 900 municipal issues each year. 3/ However, unlike Moody's, which rates bonds and notes, S&P's ratings are confined mostly to bonds. 4/ Its municipal bond ratings are published in its weekly "Bond Outlook" supplemented by a monthly "Bond Guide." 5/

III. MUNICIPAL RATING FUNCTION OF MOODY S AND S&P

At the request of an issuing municipality or its lead underwriter, Moody's and S&P undertake to examine, for a fee, economic and financial data relating to the issuer and supply the issuer with a credit rating. 6/ This rating is made to the issuer and its underwriters and then used by the underwriter in the sale of the issuer's securities. 7/ In connection

1/ SEC File No. 801-3891 (June 20, 1977).

2/ Statement of Brenton W. Harries (President, S&P) before the House Subcommittee on Consumer Protection and Finance (June 23, 1976) [hereinafter referred to as Harries' Statement].

3/ Ross at 134.

4/ As used herein, the term "notes" refers to short-term obligations; the term "bonds" refers to obligations with long-term maturities. S&P did not rate the City's notes during the period covered by the investigation. Testimony of Hyman Grossman, Vice-President of S&P [hereinafter referred to as "H. Grossman"] at 24-25 (Feb. 6, 1976).

5/ The Rating Game at 77.

6/ Phillips at 21-22 (Feb. 26, 1976); H. Grossman at 22, 33-34 (Feb. 6, 1976).

7/ The Rating Game at 2-3.

with their respective ratings, Moody's and S&P also prepare written analyses of the municipality and securities rated. These credit ratings "enjoy universal use in the municipal bond market. They assist in the marketing of the many, and otherwise highly diverse, types of securities by compressing them into a few, relatively homogeneous groupings." 1/ It is uncommon for an issue of municipal securities to be sold without a rating from Moody's or S&P. 2/

The judgment of the rating agencies is regarded as a major factor in determining the interest rate a municipality must pay to market its securities since underwriters and ultimate purchasers obviously demand a greater rate of return on securities which are deemed to involve higher degrees of risk. 3/

Moody's and S&P use alphabetical symbols to show the relative creditworthiness of municipal securities. Moody's uses Aaa to C; S&P uses AAA to D. These ratings and the associated quality characteristics are as follows:

1/ The Rating Game at 73.

2/ Phillips at 19 (Feb. 26, 1976). In this connection, it should be noted that research reports and recommendations disseminated to the investing public by underwriters and brokers relating to securities issued by the City during the period under investigation often cited the ratings of the rating services to buttress their recommendations. See, e.g., Merrill Lynch, Pierce, Fenner & Smith, "A Fresh Look at New York City" (Release dated Jan. 15, 1973); Marine Midland Municipals Release, Jan. 6, 1975.

3/ See generally The Rating Game at 43-48; Testimony of Robert Margolies, Associate Manager, Municipal Bond Department, S&P [hereinafter referred to as "Margolies"] at 13 (Feb. 9, 1976).

<u>QUALITY CHARACTERIZATION</u> 1/	<u>MOODY'S</u>	<u>S&P</u>
Prime	Aaa	AAA
Excellent	Aa	AA
Upper Medium	A, A-1	A
Lower Medium	Baa, Baa-1	BBB
Marginally Speculative	Ba	BB
Very Speculative	B, Caa	B
Default	Ca, C	D

1/ The Rating Game at 40.

Both Moody's and S&P provide fuller descriptions of the meanings of the various ratings employed. The Moody's A and Baa and the comparable S&P A and BBB ratings are described as follows:

(1) Moody's: A

Bonds which are rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future.

Baa

Bonds which are rated Baa are considered as medium grade obligations; i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

[From Moody's Investors Service, Inc., "Analytical Factors in Municipal Bond Ratings."]

(2) S&P: A - Good Grade

Principal and interest payments on bonds in this category are regarded as safe. This rating describes the third strongest capacity for payment of debt service. It differs from the two higher ratings [AAA and AA] because:

The Moody's rating for notes begins at MIG-1, the best quality short-term security, and continues down to MIG-4, the lowest quality investment grade rating. 1/ MIG is an acronym for "Moody's Investment Grade."

The ratings in the top four bond categories for both Moody's and S&P are known as investment grade ratings. All four of Moody's MIG ratings are investment grades because, if Moody's decides a note is not investment grade, it declines to give any rating. 2/ Any investment grade rating, even the lowest given by either

[Continued]

General Obligation Bonds—There is some weakness, either in the local economic base, in debt burden, in the balance between revenues and expenditures, or in quality of management. Under certain adverse circumstances, any one such weakness might impair the ability of the issuer to meet debt obligations at some future date.

* * *

BBB - Medium Grade

This is the lowest investment grade security rating.

General Obligation Bonds—Under certain adverse conditions, several of the above factors could contribute to a lesser capacity for payment of debt service. The difference between "A" and "BBB" ratings is that the latter shows more than one fundamental weakness, or one very substantial fundamental weakness, whereas the former shows only one deficiency among the factors considered.

[From Standard & Poor's Municipal Bond Ratings, "Rating Criteria," at 6-7 (hereinafter cited as "Rating Criteria")]

1/ Phillips at 14 (Feb. 26, 1976).

2/ Id. at 14-15.

agency, means that the rating agency foresees timely payment of both principal and interest by the issuer. 1/ Although rating agencies occasionally differ in their credit ratings of a particular issue, the criteria considered and the information received by the agencies, discussed below, is fairly uniform. 2/

IV. INFORMATION REQUIREMENTS

Both agencies require that certain data be supplied to them prior to the issuance of a rating 3/ including annual financial reports, budget figures, tax collection statements (including the tax levy and the taxes actually collected), long term investment plans, debt statements including maturities, assessed valuation of realty and personalty, information dealing with specific economic and legal conditions (e.g., population estimates and trends, school enrollments, building activity, etc.) as well as reports from academic sources or private research organizations with respect to the municipality. 4/ In addition to the information that is requested at the time of the initial rating, both agencies request updated information in order to ensure that their credit ratings reflect any subsequent change in the condition of the issuer. 5/ Both

1/ Id.

2/ The Rating Game at 76.

3/ Id.

4/ Id.; Phillips at 22, 25 (Feb. 26, 1976); H. Grossman at 34-36 (Feb. 6, 1976).

5/ Phillips at 20-21 (Feb. 26, 1976); Harries' Statement at 4-5.

agencies maintain that they rely on the entity submitting the data for its accuracy and do not attempt to verify the information received. 1/

New York City was obligated to prepare and publish certain information in connection with each offering. State law required that the City prepare, file, advertise and record certain documents and authorizations prior to the issuance of either bonds or notes. 2/

The City also publishes a "Notice of Sale" for both bonds and notes which recites the amount and type of the proposed offering, information with respect to the submission of bids and the form required in connection with the submission. 3/ The "Notice of Sale" for bonds is accompanied by a "Supplemental Report of Essential Facts," which contains figures reflecting the City's outstanding debt as of a recent date, its debt-incurring power as of the same date, its estimated budgetary receipts for the fiscal year in progress, and its real estate tax collections for the most recent five year period. 4/ The "Supplemental Report" also includes a listing

1/ Phillips at 124-26 (Feb. 26, 1976); Rating Criteria at 3.

2/ Local Finance Law Sections 57.00 and 60.00, and Regulations 25.1 through 25.6, 27.1 through 27.3 thereunder; General Municipal Law Section 9, and Regulations 26.0 and 26.1 thereunder.

3/ See e.g., Notice of Sale dated Feb. 15, 1975, of \$141,440,000 Serial Bonds ("Bond Notice") and Notice of Sale, dated Sept. 9 1974, of \$600,000,000 Revenue Anticipation Notes ("Note Notice").

4/ Bond Notice at 4-7.

of the principal amount of bonds maturing within the next several years, local non-property tax revenue items, bonded debt items excluded in accordance with the local finance law and funds applicable to the reduction of debt as of a recent date. 1/ The "Notice of Sale" for notes merely recites that a "Report of Essential Facts" is available upon request. 2/

V. RATING PROCESS

The procedures used by Moody's and S&P in analyzing the data and arriving at a rating appear to be similar. When a rating request is received by either agency, an analyst employed by the agency is assigned to analyze relevant data, reach a conclusion as to a rating and prepare a preliminary report for superiors. 3/

In reaching a decision on a rating, the rating analyst examines the issue and issuer with several broad areas of concern in mind, including debt factors, administrative and legal factors and a financial account analysis, i.e., an examination of balance sheet data. 4/ The adequacy

1/ Id.

2/ Note Notice at 2. Although Dr. Phillips testified that Moody's sometimes received the Report of Essential Facts in connection with note offerings, it appears that the City prepared no such reports prior to March 13, 1975. Phillips at 142-43 (Feb. 26, 1976); Report on the Role of the Underwriters at 36.

3/ Phillips at 27-28 (Feb. 26, 1976); Margolies at 11-12; The Rating Game at 76.

4/ Rating Criteria at 4-5; The Rating Game at 78-80; Phillips at 32-37 (Feb. 26, 1976).

of revenues to meet all of the obligations of the issuer, present and prospective, is examined as well. 1/

A key tool used by the rating analyst in this work is the development of various debt ratio analyses. These ratios include debt per capita, the ratio of tax-supported debt to the assessed and/or full value of taxable real property, and the computation of annual debt service as a percentage of the total current revenue budget expenditures. In addition to the above, other ratios used in the analysis of general obligation securities include the percentage of outstanding debt repaid during the prior year, the percentage of capital outlays funded by current revenue, tax collection as a percentage of assessments, overall tax rates on property by all overlapping local units and current deficits and short-term indebtedness. 2/ In short, the rating agencies consider relevant all factors that bear on the timely payment of principal and interest.

When the rating analyst completes this work, the analyst then presents a proposed rating to a rating committee. 3/ Both Moody's and S&P use the committee rating system though the number of members on the committee varies from three members at Moody's to five at

1/ Rating Criteria at 4; Testimony of Freda Ackerman, Vice-President of Moody's [hereinafter referred to as "Ackerman"] at 97.

2/ The Rating Game at 78-79.

3/ Id. at 76; Margolies at 11-12; Phillips at 28-29 (Feb. 26, 1976).

S&P. 1/ The committee system has several benefits in that it prevents individual bias and lessens the possibility of undue influence. 2/

Once a rating is established for a municipal bond or note issue, the agencies continue to monitor their ratings by examining updated data. With respect to New York City securities, both agencies annually review the Comptroller's Annual Report for the City of New York in order to ascertain if a rating change in either direction is warranted. 3/

The determination of a rating precedes the sale of the issuer's obligations. 4/ If a municipality receives a rating that it believes to be inaccurate or unfair, the issuer or the issuer's underwriter is provided the opportunity to present additional information, if any, and to request the rating committee to reconsider the rating. 5/

VI. THE RATING AGENCIES AND NEW YORK CITY

A. Background

In July 1965, Moody's lowered its rating of City bonds from A to Baa. 6/ According to Moody's, the action was based on a number of factors: (1) the City had recently proposed the issuance of a new form of debt instrument which would have required constitutional amendment by New York

1/ Phillips at 29 (Feb. 26, 1976); H. Grossman at 45 (Feb. 6, 1976).

2/ Ross at 135-36.

3/ Margolies at 16-25; Phillips at 81 (Feb. 26, 1976).

4/ The Rating Game at 76-77.

5/ Address by Brenton W. Harries before the Pacific Coast Association of Port Authorities, Sept. 25, 1976; The Rating Game at 76-77.

6/ The Rating Game at 127.

State; (2) the City was borrowing long-term to fund current operations; (3) market access had weakened; (4) few if any corrective budgetary measures were being taken; (5) pension and retirement fund obligations were determined by criteria which did not sufficiently reflect the financial costs of these systems; (6) a revenue deficiency existed and appeared to be widening; (7) there were problems in refinancing maturing City obligations; (8) City services were not self-sustaining; (9) the City did not have home rule; (10) there was a limit on the tax rate the City could impose; and (11) welfare and education costs were rising. 1/

In 1966, S&P also determined to reduce the City's bond rating from A to BBB, a rating comparable to Moody's existing Baa rating. 2/ According to S&P, the reduction was precipitated by rising municipal expenditures and a deteriorating economic situation. 3/

Although Moody's upgraded its rating slightly, from Baa to Baa-1, in 1968, the two agencies' ratings of City bonds remained unchanged until the latter part of 1972. 4/

B. The 1972-73 Ratings Increases

On December 18, 1972, Moody's raised its rating of City bonds from Baa-1 to A. 5/ According to Dr. Jackson Phillips, Executive Vice-President

1/ Phillips at 44-66 (Feb. 26, 1976); Phillips Exh. 2.

2/ The Rating Game at 146.

3/ H. Grossman at 154-55 (Mar. 1, 1976).

4/ Ross at 134.

5/ Moody's Municipal Credit Report, Dec. 18, 1972.

of Moody's, several significant factors prompted the revision. First, in 1972, the market value of taxable real estate had increased in proportion to outstanding debt. Second, there was an improvement in the relationship of current receivables to the current deficit, resulting in an improvement in the City's short-term borrowing situation. 1/ Finally, Dr. Phillips cited the importance of the so-called "first lien" on municipal revenues in favor of holders of City debt. 2/

Notwithstanding the foregoing, during that period, the City's financial condition does not appear to have improved in certain significant respects. For example, during the early 1970's, the City had negotiated a number of contracts with municipal workers which represented major increases in wage and pension benefits; 3/ the City was financing current operating expenses out of the capital budget, resulting in deferral of maintenance on City properties; 4/ and, according to Congressional testimony of City Comptroller Harrison Goldin in 1976, the City's tax base was eroding in 1972 and the City had not been successful in closing major budget gaps. 5/

1/ Phillips at 66-68 (Feb. 26, 1976).

2/ Id. at 41-42.

3/ Id. at 62-63.

4/ Id. at 57-58.

5/ Statement by H. Goldin before the House Subcommittee on Consumer Protection and Finance, June 24, 1976, at 6.

Moody's rating increase occurred one day prior to the opening of hearings before the State Senate Select Committee to Investigate the Rating of Tax Exempt Bonds. Dr. Phillips of Moody's testified at the opening day's hearings. See Phillips Exh. 1. (Statement by Jackson Phillips before the Select Senate Committee to Investigate the Rating of Tax Exempt Bonds, Dec. 19, 1972). In addition, earlier that year, two U.S. Representatives from New York scheduled hearings in connection with a bill which would provide for federal regulation of municipal bond rating agencies. The Rating Game at p. 129.

In December 1973, approximately 12 months after Moody's raised its City bond rating, S&P raised its rating as well. 1/ The new S&P "A" rating, which was the equivalent of the existing Moody's "A" rating, was apparently prompted by a number of factors. In September 1973, City Budget Director David Grossman, accompanied by Sol Lewis, Chief Accountant for the City, and John Fava of the Finance Administration, met with members of S&P and delivered a written report outlining various improvements in the City's financial, socio-economic and accounting areas. 2/ At the meeting, the discussion and documents concerned, among other things, the reduction in the growth rate of City expenditures from 15 percent to between 5 percent and 10 percent, 3/ the fact that the City had no need to go the state for special taxing authority, 4/ that the City had recently raised the water rates and could raise them again if additional revenues were required 5/ and that school enrollments were showing little growth. 6/ When asked about the City's increasing debt, the City officials attributed the increased financing to accelerated contract letting and bidding procedures on capital projects, representing that

1/ S&P Fixed Income Investor at 361-64 (Dec. 15, 1973).

2/ H. Grossman at 60-61, 65-66 (Feb. 6, 1976).

3/ H. Grossman at 26 (March 1, 1976).

4/ H. Grossman at 62 (Feb. 6, 1976).

5/ Id. at 63.

6/ Id.

this was a short-term development. 1/ At the conclusion of the meeting, S&P's analysts decided to wait until they had an opportunity to review the City's Annual Report for the prior fiscal year, which would be available in November 1973, before making a rating determination. 2/

The City's Annual Report for the period ending June 30, 1973 was received and reviewed by S&P in November 1973. 3/ The S&P analysts concluded that the information in the report indicated a steady improvement in the City's financial picture during the period 1971-73 based upon, among other things, the improvement in the City's ratio of current assets (other than cash equivalents) to current liabilities, 4/ which had increased from .83 in 1971 to .97 in 1972 to 1.00 in 1973. 5/ S&P analysts were aware at the time that the data supplied by the City was, to some extent, a product of fiscal "gimmickry," including overestimation of revenues, deferral of expenditures and acceleration of revenues from one year to the next

1/ Id. at 54-55.

2/ Id. at 89.

3/ Margolies at 34.

4/ This ratio reflects the amount of money that the City was owed as of the end of a given fiscal year as a fraction of the unpaid obligations not covered by cash and cash equivalents resulting from the prior year's activities. Margolies Exh. 3.

5/ Margolies at 66-67 (Feb. 9, 1976).

and maintaining properties on the tax rolls that were not paying taxes. 1/ However, S&P was "assured" by City officials that these abuses were being corrected, 2/ and, based on its belief in the economic strength of the City and the City's improved financial operations over the preceding two years, S&P determined that, under all of the circumstances, an increase in the City's rating was warranted. 3/

C. Events Subsequent to the 1972-73 Rating Increases

Within a short period of time following the S&P rating increases in December, a number of events occurred which raised doubts about the City's financial strength in general and about the validity of earlier optimistic assessments by the City in particular.

On December 17, 1973, the day following S&P's rating increase, The New York Times reported that advisers of Mayor Beame were projecting a budget deficit for the 1973-74 fiscal year of \$1.3 billion, the largest ever projected for the City's operating budget. 4/ On December 18, 1973, City Budget Director Grossman called John Pfeiffer of S&P to

1/ Other examples of "gimmickry" known to S&P included: (1) the inclusion of operating expenses in the capital budget; (2) budgeting for 100% property tax collections knowing that this level would not be reached; (3) initially borrowing against these taxes, then continually rolling over notes against property tax receivables that were not collectible; and (4) borrowing against state and federal aid which was not 100% collectible and including the uncollectible aid on the balance sheet. S&P Internal Memorandum, Dec. 5, 1975.

2/ Id.

3/ H. Grossman at 69, 98 (Feb. 6, 1976).

4/ The New York Times, Dec. 17, 1973, at 41-42.

thank S&P for raising its rating. Grossman told Pfeiffer not to "worry" about the announced deficit of \$1.3 billion and that the real figure would more likely be \$300 million. It appears that Pfeiffer made no further inquiry during the conversation into the reasons for the discrepancy or the basis for Grossman's conclusion. 1/

During the fiscal year 1973-74, the City was compelled to increase substantially its reliance on short-term debt. This increased reliance by the City was known to S&P and Moody's and, indeed, was the subject of comment in their respective publications. 2/

In early 1974, the City determined that it would be advisable to convert to long-term some \$520 million of short-term debt that had been maturing on a recurring basis. At this time, however, the City was approaching its constitutional debt limit and its ability to fund a substantial amount of long-term debt was in doubt. The state legislature authorized the formation of the Stabilization Reserve Corporation, an entity which could incur long-term debt outside the constitutional

1/ H. Grossman Exh. 8.

2/ See e.g., Moody's Municipal Credit Reports, May 13, 1974, May 31, 1974 and Dec. 31, 1974; S&P Fixed Income Investor, Dec. 21, 1974.

limitation for purposes of balancing the City budget, without endangering the City's ability to borrow further. 1/ Although Moody's did not approve of this practice, it nevertheless determined to maintain its rating on the City's bonds. 2/

On July 24, 1974, Fitch released an analysis detailing recent developments relating to the City's finances. The report cited a number of adverse factors including: (1) heavy use of capital budget funds to finance recurring expense items, thus jeopardizing necessary maintenance of existing properties; (2) increased tax delinquency, reducing the City's borrowing capacity; and (3) possible further erosion of the tax base through the continued exodus of upper middle income residents and business and manufacturing establishments to the suburbs. In addition, the report cited a projected \$1.5 billion budgetary gap in fiscal 1974-75, an amount five times higher than the City's projections for fiscal 1973-74. 3/

The most tangible evidence of the City's weakening financial condition in 1974 was revealed when, in November, the City issued its Annual Report for the fiscal year ending June 30, 1974. 4/ Among other things, the Report indicated the following:

1/ Ackerman at 10-12; Phillips Exhs. 3, 4.

2/ Phillips at 91 (Feb. 26, 1976).

3/ Fitch Investor Service Analysis, July 24, 1974.

4/ Annual Report of the Comptroller of the City of New York for the Fiscal Year 1973-74.

- (1) As of June 30, 1974, the City had outstanding some \$2 billion in tax and revenue anticipation notes ("TANS" and "RANS"), almost twice the amount outstanding on the same date a year earlier; 1/
- (2) Cash in the City's "rainy day" fund dropped from \$46.5 million on June 30, 1973 to \$1.5 million on June 30, 1974, virtually depleting the fund; 2/
- (3) The delinquency rate on property tax collections rose from 4.94 percent in 1972-73 to 5.59 percent in 1973-74-- the highest figure for the period of time covered by the staff's investigation; 3/ and
- (4) Finally, and perhaps most significantly, the year-end cash deficit calculated by Moody's was covered only 0.82 times by covering assets -- a drop from the 1.00 ratio calculated in the prior year and the lowest ratio in any year since at least 1970. 4/

Fitch issued an update of its July 24, 1974 analysis in which update it reported that, on October 10, 1974, it had downgraded the City's bond rating from A to BBB (medium grade) on all bonds

1/ Id. at 482.

2/ Id. at 142.

3/ See Moody's Municipal Credit Report, Dec. 31, 1974, at 19.

4/ Id. at 14. S&P calculated a similar ratio of 0.69, a figure which was lower than any other ratio calculated by S&P since at least 1967. Margolies Exh. 3.

maturing prior to January 1, 1980, and to BB (fair grade) on all bonds maturing thereafter. The report cited a "further deterioration in the City's financial operations" with specific references to (1) a 22 percent increase in real estate tax delinquencies in fiscal 1974 over 1973; (2) an increase in short-term indebtedness and associated borrowing costs; (3) the virtual elimination of cash balances in the "rainy day" fund; (4) a large increase in the annual current deficit; and (5) the possibility that the City's practice of deferred maintenance might necessitate complete reconstruction, at some future time, of many of the City's properties. 1/

Despite the adverse disclosures in the City's Annual Report and the action taken by Fitch, after separate meetings in November with Comptroller Goldin, Moody's and S&P determined to take no immediate action to reduce their respective ratings of City securities. 2/ Rather, both Moody's and S&P determined to wait to see whether steps would be taken to remedy the situation. 3/

1/ Fitch Investors Service, Update of July 24, 1974 Report.

2/ Phillips at 101-102 (Feb. 26, 1976); H. Grossman at 108-10 (Feb. 6, 1976).

3/ Id.

According to notes prepared in early November by an unidentified employee of Bankers Trust Co., pressure was also being exerted on the rating agencies during this period not to lower their ratings, in that reduced ratings would require the City's savings banks to sell their City-issued obligations. Banker's Trust Internal Memorandum, Nov. 8, 1974.

During the month of December 1974, Moody's and S&P issued rating reports on City bonds, both of which affirmed the A rating which each of the agencies then maintained. 1/ In its report, S&P informed its subscribers of specific adverse developments in the City's financial situation which had occurred since that agency had raised its rating in December 1973. This information included the facts that the ratio of current assets to current liabilities had dropped to .69 2/ from 1.00, that the City had substantially increased its short-term debt burden, and that the ability of the City to successfully market further debt issues would be dependent upon its ability to retain investor confidence by maintaining a truly balanced budget. 3/

Moody's issued a 20-page report accompanying its A rating. Significantly, in a number of respects, financial data cited in the report was substantially worse than the data cited in its earlier year-end reports. For example, from 1970 (when the City bonds were rated Baa-1) to 1974 (when the bonds were rated A), the City's current

1/ Moody's Municipal Credit Report, Dec. 31, 1974; S&P Fixed Income Investor, Dec. 21, 1974, at 190-91.

2/ As noted above, the comparable figure calculated by Moody's was 0.82. Despite the discrepancy, both figures indicated a significant reversal of the trend noted by both agencies in prior years.

3/ S&P Fixed Income Investor, Dec. 21, 1974, at 190-91.

account deficit had increased from \$829 million to \$2.5 billion; tax delinquencies had increased from 4.23 to 5.59 percent; and the ratio of current tax receivables to current debt had fallen from 1.16 to 0.82. The report did not discuss such comparisons in explaining the continued A rating. 1/

During the early part of 1975, evidence continued to mount relating to the City's difficult fiscal position. New short-term note offerings, which were beginning to experience difficulties in November-December 1974, 2/ continued to meet with market resistance. During this period, the City reduced the face amount of the instruments it issued to more effectively reach the general public. 3/ There was also a noticeable decline in the membership within the syndicates bidding on City securities. 4/

1/ Compare Moody's Municipal Credit Report, Dec. 31, 1974 with Dun & Bradstreet Municipal Credit Report, Dec. 1, 1970. (Moody's was acquired by Dun & Bradstreet in 1971.)

2/ An offering of RANS in December 1974 was accomplished at the highest rate ever paid by the City--9.5 percent. This was 250 basis points higher than similarly-rated securities then issued by other municipalities. Moody's Municipal Credit Report, April 8, 1975; News Release, Office of the Comptroller, December 2, 1974.

3/ During October, the City found it necessary to propose an issue of bonds in smaller denominations of \$10,000 in order to supplant the lack of interest in City securities by institutional investors with smaller non-institutional investors. Minutes of Comptroller's Technical Debt Management Committee, Nov. 12, 1974; News Release, Office of the Comptroller, December 2, 1974.

4/ Minutes of Special Meeting of the Comptroller's Advisory Technical Debt Management Committee, Dec. 17, 1974 (4 pp.).

In January 1975, Moody's analysts met with Comptroller Goldin to inform him that they were considering dropping the rating on the City's BANS from MIG-1 to MIG-2. Comptroller Goldin immediately responded that a drop in the rating could be a "very nearly fatal blow" to the City, and asked Moody's to defer its decision pending preparation of a presentation by the City in support of maintaining the MIG-1 rating. 1/

In February, a lawsuit was instituted (the Wein action) alleging that the City had exceeded its constitutional debt incurring limit. Specifically, the suit claimed that the debt incurred by certain of the City's public benefit corporations, including the recently-created Stabilization Reserve Corporation, were includable in the City's total outstanding debt for purposes of determining whether the debt limit had been exceeded. The effect of the suit was significant. It caused the cancellation of the SRC's initial offering, 2/ giving rise to substantial doubt about the City's ability to raise nearly \$383 million which would be necessary to fill a projected year-end budget gap. This figure represented over 10 percent of the total anticipated revenues of the City in fiscal 1974-75. The availability of these funds was one of the factors cited by Moody's in its December

1/ Phillips at 103-06. (Feb. 26, 1976).

2/ New York Daily News, Mar. 14, 1975, p. 30.

1974 bond rating in connection with the City's ability to balance its year-end budget. 1/

On February 28, 1975, the City was forced to cancel the sale of \$260 million of tax anticipation notes which had been scheduled to close that day. 2/ A bid had been made by the underwriting community on the TAN offering and accepted by the City. Moody's rated the offering MIG-2, a rating consistent with earlier ratings for these types of notes. 3/ On March 1, 1975, Comptroller Goldin was quoted in the press as stating that the cancellation came about because of "a sudden demand by the underwriters, unprecedented in the history of the city, for data that could not physically be compiled, checked and verified in the short time available." 4/ However, four days later, the press also quoted a spokesman for Bankers Trust as stating: "Counsel for all the banks and investment houses involved concurred that the City had failed to comply with the law which mandates that the tax receivables information be as of the last of the current month" and that "this was the sole reason for refusal to consummate the sale." 5/

1/ Moody's Municipal Credit Report, Dec. 31, 1974 at 13.

2/ The New York Times, March 1, 1975 at 29; New York Post, March 1, 1975 at 3, 10; New York Daily News, March 1, 1975 at 5.

3/ Phillips at 131 (Feb. 26, 1976).

4/ The New York Times, Mar. 1, 1975 at 29.

5/ Daily Bond Buyer, "Goldin Blames Cancellation of TANS on Banks Involved," Mar. 5, 1975.

Beginning at least as early as October 1974 and continuing throughout early 1975, news articles appeared on a continuing basis which discussed the financial problems of the City, including large discrepancies in the size of the projected year-end deficit. 1/ Although Moody's was aware of these articles, it took no steps to determine whether the information contained in the articles was accurate. 2/

Despite these events, during the first four months of 1975, Moody's and S&P did not revise their ratings downward. Indeed, following the cancellation of the TAN sale in late February 1975, Moody's and apparently S&P accepted the City's explanation for its action without further inquiry into the reasons for the allegedly "unprecedented request" for financial information by bond counsel or the City's inability to supply the information. 3/

1/ See e.g., Barrons, Jan. 13, 1975, p. 7; The New York Times, "Just How Did New York City's Finances Come to This," Feb. 12, 1975; The New York Times, "Fantasia", Feb. 18, 1975; New York Post, Mar. 21, 1975, 1, 62.

2/ Phillips at 125-26 (Feb. 26, 1976).

3/ Phillips at 134 (Feb. 26, 1976).

During this period, the continuation of the A rating by both agencies was cited by brokers and City officials. In January 1975, Marine Midland Municipals, a large municipal bond broker, issued a strong "buy" and "hold" recommendation with respect to City bonds. Although Marine acknowledged the recent well-publicized problems of the City, it placed heavy emphasis on the recent affirmation by both S&P and Moody's of their respective A ratings. Marine Midland Release dated Jan. 6, 1975. During this

(Footnote continued)

On March 20, 1975, two S&P analysts visited Albany to discuss the State's financial situation with the State Comptroller's Office. During the course of the meeting, the analysts were advised that, based on the existing situation, the State could not render financial assistance to the City in the event it was unable to meet principal and interest payments on its outstanding obligations. 1/ This information was in turn conveyed to senior S&P personnel. 2/ Prompted by this news, on April 2, 1975, S&P contacted the Office of the Comptroller and inquired whether the City could meet its debt service requirements without borrowing. Sol Lewis, Chief Accountant, responded negatively. Lewis also stated that, absent the ability to borrow, the City could go bankrupt. 3/

(Continued footnote)

period as well, the City, in public releases, sought to reassure public investors concerning City securities through references to the continuation of the A ratings by Moody's and S&P. Press Release, City Comptroller's Office, Dec. 30, 1974 (No. 74-143); Press Release, Office of the Mayor, No. 618-74, Dec. 23, 1974. See also Press Release, City Comptroller's Office, April 3, 1975 (No. 75-38); Press Release, Office of the Mayor, No. 124-75, April 3, 1975.

- 1/ H. Grossman at 141-44 (March 1, 1976).
2/ Margolies at 53.
3/ Interoffice Memorandum from H. Grossman to B.W. Harries dated April 3, 1975.

On April 2, 1975, S&P suspended its rating for New York City bonds. 1/ The April 5, 1975 issue of S&P's Fixed Income Investor cited the following reasons, among others, for the action: the City's inability to control expenses, the diminution in the market for City bonds and the inability to obtain financing through the Stabilization Reserve Corporation. The report concluded:

[T]he absence of a stream of current revenues to meet all financial requirements, possibly including debt service, has presented us with a unique and unprecedented problem, giving us no choice but to take this position until remedial action is more evident. 2/

Following the S&P suspension of the City bond rating, Moody's announced on April 8, 1975 that it was reaffirming its ratings for both New York City bonds and notes. Among other things, the Moody's report characterized the assumption that the City could meet its short-term debt repayment only by borrowing as "unwarranted" and stated that one of the steps available to the City included timely assistance from the State. 3/

Throughout the summer of 1975, the City's short-term liquidity situation continued to deteriorate. In June 1975, the Municipal Assistance Corporation ("MAC") was formed for the purpose of issuing

1/ Dow Jones Wire Service Release dated April 2, 1975.

2/ Standard & Poor's Fixed Income Investor, April 5, 1975, at 756-57.

3/ Moody's Municipal Credit Report, April 8, 1975.

long-term debt, the proceeds of which would be used by the City. Moody's rated the MAC offering A. 1/ The initial \$1 billion MAC offering in July, however, sold with difficulty, thereby, according to Moody's, raising doubt about MAC's ability to incur further debt. 2/

On July 1, 1975, the State made public its "Report on New York City's Budgetary and Accounting System" (the "Levitt Report"). 3/ The report detailed significant irregularities in the City's accounts, including the facts that there were substantial amounts in the City's accounts receivable which were uncollectable and that the City had been borrowing against revenues which would not be realized. 4/ Among other things, the Report concluded:

The City's accounting is inadequate and the system of internal controls is ineffective for ensuring the accuracy of its estimated supplementary revenues receivable. As a result, the data in the City's central fiscal and accounting records cannot be relied on for reporting to the Public and for management decisions as to budgetary status, accounts receivable, and borrowings against these receivables. 5/

1/ Moody's Municipal Credit Report, May 26, 1976.

2/ Moody's Municipal Credit Report, July 25, 1975 (1 p.)

3/ Report on New York City's Central Budgetary and Accounting System, Prior Year Accounts Receivable (Managerial Summary) (Report No. NYC-3-76) at 3.

4/ Id. at 3-4.

5/ Id. at 28.

On July 25, 1975, Moody's withdrew its City note ratings, citing the City's failure to take the necessary steps to restore investor confidence and doubts concerning the ability of MAC to raise funds necessary to retire maturing short-term notes. 1/ Moody's did not, however, reduce the existing A rating on City bonds. 2/

It was not until October 2, 1975 that Moody's revised its New York City bond rating from A (upper medium) to B (marginally speculative). 3/ On October 29, the rating was lowered to Caa (very speculative) 4/ as City officials acknowledged publicly that the City would default without federal aid and the federal government, through the President, stated it was opposed to such aid. As of this date, the Moody's rating remains at Caa.

VII. CONCLUSION

Moody's and S&P are the principal agencies that rate municipal obligations. Their ratings are relied upon by every segment of the investment community. These ratings have enormous impact upon the investment decisions of individual and institutional investors and the availability of access by municipalities to the capital markets. Accordingly, it is imperative that these agencies

1/ Moody's Municipal Credit Report, July 25, 1975.

2/ Id.

3/ Moody's Municipal Credit Report, Oct. 2, 1975.

4/ Moody's Municipal Credit Report, Oct. 29, 1975.

perform with independence, diligence and consistency. Based upon the record of this investigation, it appears that both Moody's and S&P failed, in a number of respects, to make either diligent inquiry into data which called for further investigation, or to adjust their ratings of the City's securities based on known data in a manner consistent with standards upon which prior ratings had been based.

Chapter Six



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

THE ROLE OF BOND COUNSEL

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

Introduction and Summary

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Chapter Six

REPORT ON THE ROLE OF BOND COUNSEL

August 26, 1977

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BOND COUNSEL

I. INTRODUCTION

Bond counsel's duties are rooted in the municipal financing excesses of the 1870's. In the zeal of the times, many bonds were improperly authorized, causing the bonds to be invalid obligations. When it was ultimately discovered that many of the bonds were illegally authorized, public confidence in the municipal bond market waned sharply, making it extremely difficult for all but the most substantial cities to raise funds in the capital market. To restore confidence in the integrity of the municipal evidence of indebtedness, independent counsel began to pass upon the validity of proposed municipal issues. Their opinions reassured investors, and while market and credit risks were still present, at least legal risks as to validity were diminished. ^{1/} Today bond counsel's opinion, generally, concerns two matters of paramount significance to investors: (1) the validity of the authorization and issuance of the municipal security; and (2) the tax-exempt nature of the security.

^{1/} Securities Industry Ass'n, Fundamentals of Municipal Bonds at 121-22 (1972).

From the period January 1973 through March 1975, four firms acted as bond counsel for various managing underwriters in connection with the offer and sale of municipal securities of the City of New York: (1) Wood Dawson Love & Sabatine ("Wood Dawson"); (2) Sykes, Galloway & Dikeman (since combined with Willkie Farr & Gallagher) ("Sykes Galloway"); (3) Hawkins, Delafield & Wood ("Hawkins Delafield"); and (4) White & Case. ^{1/}

With respect to City bonds, the law firm of Wood Dawson had been retained for every offering not only from January 1973 through March 1975, but from the 1930's to the present, with the exception of only two or three bond sales.

With respect to City notes the managing underwriters of the selling syndicates of New York City generally retained the services of one or more of the first three of the law firms enumerated above on an arbitrary basis.

Of the four firms, Wood Dawson was the most familiar with the City's procedures in issuing its municipal securities.

Wood Dawson's entire practice is confined to the area of municipal securities. White & Case had never acted as bond counsel until the end of February 1975. All of the firms, with the exception of White & Case, had a long history of acting as bond counsel both within the City and nationwide.

^{1/} A chart listing issues from October 1974 to March 1975 and identifying bond counsel for each issue is attached at Appendix A.

Hawkins Delafield began its association with the City of New York approximately in 1939, when they were first retained in connection with certain transit unification bonds. The practice of Hawkins Delafield is not limited exclusively to municipal securities.

The firm of Sykes Galloway, which was merged into Willkie, Farr & Gallagher in 1975, was a successor firm to many previous firms engaged in the practice of municipal securities laws since approximately 1956. Sykes Galloway, like Wood Dawson, practiced municipal securities law almost exclusively.

White & Case entered the arena as bond counsel when the Bankers Trust Co., a historical client, appointed them to act as bond counsel in connection with certain tax anticipation notes offered in February 1975. White & Case had no prior experience as bond counsel on general obligation securities.

The bonds of the City of New York were sold to underwriters on an all or nothing basis. One syndicate bought all the bonds, and one bond counsel provided the approving opinion as to those bonds. 1/ The notes, however, were sold as a block or severally. Therefore it was possible for several syndicates to be involved in the purchase of the notes, and, concomitantly, several bond counsel to furnish approving opinions as to those portions of the notes taken down by the several syndicates. 2/ As a result, at any given time Sykes Galloway; Hawkins Delafield; and Wood Dawson

1/ See Appendix A.

2/ Id.

could have provided approving opinions as to different amounts of the same issue.

Generally speaking, the bond counsel firms required the same background documentation as a foundation for issuing approving opinions. With some variation, such documentation included the following documents:

- (1) a copy of the Charter of the City of New York;
- (2) a certified copy of Delegation of Authority by the Mayor to the Comptroller to issue the securities;
- (3) the certificates authorizing the issuance of the securities;
- (4) a confirmation of sale;
- (5) a certificate of the chief of the Division of Municipal Securities concerning compliance with certain notice requirements;
- (6) a copy of the bids by the managing syndicates received by the City;
- (7) a certificate of award to the winning syndicates;
- (8) certificates as to the genuineness of signatures on various documents and as to the absence of litigation;
- (9) a certificate of delivery and payment;
- (10) a specimen of a security; and
- (11) an arbitrage certificate. 1/

1/ A copy of a typical closing book, including the opinion of bond counsel is attached to this section of the Report as Appendix B.

II. BOND COUNSEL FOR NEW YORK CITY SECURITIES

The staff questioned senior partners of the firms that acted as bond counsel concerning their procedures in issuing approving opinions in New York City issues. The law firms did not maintain extensive files on each issue. For the most part their files consist of copies of closing documents. What follows is a discussion of the procedures followed by the firms in issuing approving opinions and a discussion of the knowledge of the law firms of City finances during the period January through March 1975.

A. HAWKINS, DELAFIELD & WOOD

Counsel in the firm Hawkins, Delafield & Wood testified as follows with respect to the procedures used for issuing an approving opinion as to a bond anticipation note offering by the City:

Having ascertained that we would accept the retainer, we would assign an associate attorney to this issue, discuss it in general terms on a bond anticipation note, . . . following normal procedure [I] would have discussed the city's practice which I was familiar with of publishing the bond resolution authorizing the underlying bonds for a bond anticipation note in the City Record which is keyed into the Capital Budget of the City of New York which is published annually in the City Record, and then I would describe to the associate that the bond resolution, when published, is usually accompanied by a resolved expenditure for the proceeds, which is how you tie it in with the capital budget, and then it should go up to the City office . . . to check the authorization, whether this was a first issuance of a bond anticipation note or a renewal, and if it was a renewal, whether any amortizations were required under the

local finance law and constitution. We would check at the offices of the City Charter, and ascertain whether or not there had been any applicable amendments, changes in the provisions of the Charter. We would ask for a debt statement of the City and ascertain [that] the issuance of the bond anticipation note, would not cause the City to exceed its constitutional debt limit.

We would prepare the closing documents. We would look at the Notice of Sale for the issue [and] bids received to ascertain that . . . this particular issue of notes was awarded properly. We would get a copy of a successful bid. If it was a time when the notes were being printed, we would want to look at the printer's proof of the note form. We would arrange for a closing with the purchaser. We would prepare drafts of closing documents, and I believe in '73, there would be the arbitrage provision of the Internal Revenue Code and regulations. We would examine at the time . . . an executed note to make sure it was properly executed by the proper party. We would make some of the arrangements for delivery of the money and delivery of the notes between the City and the purchaser, although I guess through past practice, the two parties were pretty well accustomed as to how they worked that out, and we would prepare our opinion for delivery at the time the notes were issued and paid for. ^{1/}

In describing the firm's procedures in passing upon revenue anticipation notes as opposed to bond anticipation notes, counsel made several noteworthy distinctions:

. . . a revenue anticipation note is a merely different type of financing in that it is merely a method of getting

^{1/} Testimony of Gerard Fernandez, Jr., at 25-27.

cash for current operations as distinguished from capital projections for which bond anticipation notes would be issued

* * *

[For our purposes] I don't think, for example, a debt statement would be as important in a revenue anticipation note issue as it would be in a bond anticipation note offering because of the provisions in New York regarding revenue anticipation notes . . .

* * *

We do not get a bond resolution or a resolution for expenditure such as alluded to in regard to the bond anticipation notes. We would get a certificate of the Comptroller executed by a deputy, authorizing the issuance of the notes making a categorical reference to the type of revenue in anticipation of which the note is issued, and showing the amount to be issued and estimated amount in the expense budget, which is the City's term for its current budget as distinguished from the capital budget. The amount collected to date, the amount of notes outstanding in anticipation of the estimated revenue, and the balance against which notes may be issued, that would probably be the basic difference. The rest of the documentation is essentially the same. ^{1/}

Continuing his description of the differences in City securities, counsel described the procedure used for passing upon tax anticipation notes:

It differs slightly from the revenue anticipation note in that under the New York law,

^{1/} Id. at 39-41.

a tax anticipation note is an anticipation of the receipt of real estate taxes levied or to be levied and necessitates proof as to the amount of taxes levied or to be levied and how many notes are outstanding, the amounts uncollected, and the amount unreserved for uncollected taxes that the issuer may have. 1/

There was significant, if not exclusive, reliance on the documents furnished by the City officials for the issuance of the firm's opinion:

Each of the [closing documents] relates solely to compiling a record of proceedings establishing to our satisfaction the validity of the issue of notes pursuant to Local Finance Law and City Charter. The certificate of the Comptroller authorizing the issuance of the notes sets forth the Comptroller's estimate of taxes (revenues) to be received which is the basis upon which the notes are issued pursuant to the Local Finance Law. Since our retainer, as bond counsel, is to opine as to validity, we did so on the basis of the review of such documentation before rendering our final approving opinion. 2/

Counsel stated that the firm had no obligation to go behind the figures presented to them by the City officials because, as he said:

Well, only that I have always felt that when we get a certificate from a responsible official of the public body, that we are entitled to rely upon that. 3/

1/ Id. at 43.

2/ Memorandum to William Lawless from Gerard Fernandez, Jr., January 24, 1977 [hereinafter referred to as "Fernandez memorandum"].

3/ Testimony of Gerard Fernandez, Jr., at 55.

Counsel further amplified on this point in a memorandum:

This is particularly true where the Local Finance Law provides for and requires a statement of estimated amounts by the chief fiscal officer of revenue or expenditures. 1/

Hawkins Delafield noted the distinction between the validity of the City's debt obligations and the collectibility of taxes and revenues against which the obligations were issued.

The Local Finance Law authorizes the renewal of TANS and RANS notwithstanding that the taxes in anticipation of which they have been issued have not been collected or may not be collectible; however, such TANS and RANS are still valid obligations - collectibility is not an item of validity in such instance. 2/

Hawkins, Delafield was aware that its opinion would be relied upon not only by the underwriting banks who had retained the firm directly, but also by the ultimate purchasers of City bonds and notes:

- Q. Now, the opinion you issue, sir, I understand the underwriters pay you for it, and they are your clients, but, who actually gets the opinion?
- A. Well, I can't actually say who actually gets the opinion except any purchaser of a note is entitled to have a copy of the opinion.
- Q. Could the notes be sold without a note counsel's opinion?
- A. I am told they cannot be. 3/
- * * *
- Q. Your responsibilities extend to the ultimate investor?
- A. Yes, but the time you deliver the notes, there is a responsibility to the ultimate investor, but I don't know that you necessarily have to keep following those bonds around.

1/ Fernandez memorandum at 2.

2/ Memorandum from Fernandez to Lawless, Re: TANS and RANS of the City of New York, January 29, 1977, at 2.

3/ Testimony of Gerard Fernandez, Jr., at 47.

Q. I follow what you are saying up until the closing date you have a responsibility toward the underwriters, but you also realize you were doing the work - you must be careful -

A. It is near and dear to our hearts for the little old lady of Dubuque. 1/

On February 28, 1975, the City cancelled a proposed tax anticipation note offering of \$260,000,000 because of the unavailability of current information concerning the sufficiency of uncollected real estate taxes against which the TANS were to be issued. The cancellation of the TANS offering did not cause the firm to discuss the City's problems with their clients.

Q. Do you have any knowledge of what occurred in that instance?

A. I don't have the intimate details because we were not involved, but, as I recall it was a question of the estimate of uncollected taxes not being as up to date as counsel and the banker I guess on advice of counsel would have preferred them to be. Therefore, I think they advised their client not to take up the notes.

Q. Now, when that latter note offering failed to materialize did that have any effect on either the 12/13/74 or the 2/14/75 RANS offerings which you have been note counsel, that is, did you issue a supplemental opinion? Did you contact your client and ask them what was going on or anything of that nature?

A. No. 2/

Nor was Hawkins Delafield concerned earlier when the note denominations were lowered.

Q. Did you know that in December of 1974 for the first time the City of New York issued notes in 10,000 dollar denominations?

1/ Id. at 118-19

2/ Id. at 71.

A. Yes, I think they were 25.

Q. Do you have any idea why the City at that time chose to issue 10,000 dollar denominations?

A. Well, I don't know whether I made inquiry. I possibly deduced it myself. They were trying to make them available to the so-called smaller investor. People who could afford 10,000 dollars could not afford 25.

Q. Nobody actually discussed it with you?

A. No, I don't remember discussing it.

Q. At any time was there any discussion between yourself, some member of your firm and the banks of the City concerning the suitability of the RANS?
The RANS of 2/14/75 as investments for the so-called small investors?

A. I don't follow your question. You mean as to marketability?

Q. As to suitability, the concept investment advice.

A. No. 1/

Indeed, Hawkins Delafield did not so much as discuss the City's severe financial problems or contemplate the possibility of default in connection with the rendering of an opinion on December 13, 1974, and February 14, 1975, offerings:

Q. At the time you were rendering opinions on these two issues, was there ever any discussion of default or that the City was in serious financial difficulties within the firm?

1/ Id. at 92-93.

A. No. 1/

The Hawkins Delafield partner working on the New York City account stated he was unaware of the City's difficulties unfolding in late 1974.

Q. Were you aware that New York City was having financial difficulties in December 1974?

A. I couldn't say that I was aware that they were having financial difficulties. 2/

The vital end product of bond counsel's efforts was often produced with surprising dispatch.

Q. Was this particular RAN offering to your knowledge any different from any other RANS (sic) offerings?

A. No.

Q. About how long does it take to prepare, to do the work and prepare an opinion?

A. Well, we have precedence (sic) in the office, so, the actual time consumed is probably not much more than an hour, considering preparation, typing and review.

Q. That's just the opinion?

A. Yes. 3/

1/ Fernandez at 62-63.

2/ Id. at 53.

3/ Id. at 57.

B. SYKES, GALLOWAY & DIKEMAN

Counsel in the firm of Sykes, Galloway & Dikeman, described in his testimony before the staff the procedures used by the firm after they were notified of the retainer as bond counsel for certain notes of the City. The description given was very similar to that given by Hawkins Delafield.

Sykes Galloway, upon being notified of their retainer, submitted to the Chief of the Municipal Securities Division of the City a letter requesting all documents needed by the firm as the basis for their opinion. These documents consisted of various letters and certificates which were completed by the City. 1/ Unlike other municipal offerings in which Sykes Galloway represented the issuer and prepared these documents themselves, the firm had no such responsibility in connection with City underwritings.

In this case, because of the very different relationship [with the City] and the fact we did not represent the City [and], had no on-going relationship with them -- we, of course, had not participated in drafting any of the underlying documentation -- it was simply a question of our reviewing the legal sufficiency of what they had previously prepared. 2/

1/ Dikeman at 44.

2/ Id. at 47.

Counsel pointed out that the fees charged for rendering the approving opinion on New York City notes, were substantially less than the fees charged other municipalities. He stated the time expended was less for the New York City offerings than for other similar offerings, since his firm was not required to draft the underlying documents supporting the authorization of the notes, a function normally performed for other municipalities. Counsel also stated that the volume of securities offerings by the City was very high, permitting the firm to charge less than it would have charged given a similar offering by another municipality. 1 /

Counsel articulated the same position regarding reliance on certificates of City officials as Hawkins Delafield:

- A. We . . . relied upon the certification by the City Comptroller, and in fact, since it was a lumped estimate of a group of revenues [referring to revenue anticipation notes], there is no way in which we could have, as a practical matter, short of an intensive audit, which as lawyers . . . we do not feel we are obligated to undertake, there is no way in which we could have made a judgment on the accuracy of those figures supplied to us by the Comptroller. In other words it was our position that this certification, which incidentally is a public document required to be officially filed with the Mayor, was presumptive evidence upon which we could rely as to the correctness of the figures.

1 / Dikeman at 47-48.

- Q. Sir, am I correct then in [stating] that Sykes Galloway did not attempt to go behind any of the figures that the Comptroller certified to you?
- A. That's correct. Not only because the impossibility as a matter of time, but because of the impossibility as a matter of having the wherewithal to do so. And I might add, the first reason, I think lack of time, is self-evident, of course. 1/

The City provided bond counsel with certificates dated four to eight weeks before the proposed issue date of anticipation notes. These certificates indicated how much had been received in revenues or taxes and how much was still expected to be received. Anticipation notes could be legally issued against the uncollected revenues or taxes. Although the actual balance against which the anticipation notes could be issued was critical, the City did not provide and Sykes Galloway did not request current information as of the closing date. Counsel described an instance when the City was unable to provide updated information because of failures in their informational system:

- Q. Mr. Dikeman, I think one thing that we are interested in ascertaining is that some of these certificates of the comptroller are several days, maybe even as much as two weeks before the date of sale.

* * *

1/ Id. at 52.

The question that comes to our mind is, is it possible that in the intervening period . . . the city . . . would have collected outstanding receivables in such volume . . . that it would not have outstanding the receivables it was issuing the notes against?

- A. (Mr. Rothman) Well, I suppose it's possible. I asked Sol Lewis * * * the chief accountant for the city, who gave us his assurance it was not true.

Secondly, he could not provide the entry because the entry on their ledgers and their computer system was not to date so they could provide the information.

So what we did was make a business judgment based upon the amount still to go and the amount received and our knowledge of federal state programs as far as giving money. . . [to] the City of New York.

* * *

(Mr. Dikeman) [T]he city told us their bookkeeping system was inadequate to bring us right down to the closing date with actual collections.

* * *

[W]e had to make a judgment based upon our knowledge, one, of the patterns of payment, and the spread between the amounts actually certified as collected as of the previous day and the amount of overall collections anticipated. 1/

The firm did not see or request that Statement of Essential Facts represented by the City as being available to any purchaser upon request in connection with the sale of its notes; nor did the firm know that such statements were never made available 2/ and the firm did not

1/ Id. at 110-111.

2/ Id. at 55-56.

see or request the Annual Report of the City of New York. 1/

Counsel testified that it was his belief that it was altogether irrelevant to the function of bond counsel to know whether or not the City was employing certain budget mechanisms which could be characterized as gimmicks. As he stated:

[T]hose factors would have been viewed by me as completely irrelevant to the question of legality, which is what the opinion deals with, not the question of fiscal stability or the ability of the City to pay or the likelihood of its paying. Those are elements of marketability and . . . have no relevance to the question of legality. 2/

In responding to a question as to his knowledge of the various items which were legislatively authorized for long term funding counsel testified:

I was going to observe that . . . I was not familiar enough with the actual City budget as adopted from year to year to have first-hand knowledge as to what in fact or to what extent the City in fact had taken advantage of the state legislation which permitted them to bond certain items that they had not been permitted to bond in past years. 3/

Counsel was asked whether he was aware of the utilization of unsound financing devices by the City. He responded:

I suppose one can answer the question: 'Do I know that the City used unsound financing practices in the past?' by saying I would think that any well-read citizen would be aware of that in view of recent developments. 4/

Counsel stated he was unaware of specific reports concerning the City's financial practices:

1/ Id. at 56.

2/ Id. at 81-82.

3/ Id. at 90.

4/ Id. at 91-92.

Q. Have you in the past become familiar with the Citizens Budget Committee Reports?

* * *

A. No, I don't have any first-hand knowledge of any of their reports. I have never seen one, as a matter of fact.

* * *

Q. Have you ever read any of the Charter Revision Commission Reports?

A. No.

* * *

Q. Have you read any of the reports put out by the State Comptroller auditing New York City's financial practices?

A. No.

* * *

I have never read any of the State Comptroller's audit reports regarding the City of New York since they have been issued. And I could not give the exact date when they were first available.

Q. Have you ever read any of the transition reports put out by the Fund for the City of New York in connection with Lindsay's stepping down from office and Beame's assumption [of office]?

A. No, I have not.

Q. Have you ever read any of the reports put out by the Temporary Commission on City Finances?

A. I am not sure I know what body you are talking about, but I would presume that I have not.

* * *

Q. . . . As part of your role as bond counsel and note counsel to underwriters who purchase New York City securities, do you consider your obligation, that is, your firm's obligation, to become conversant with these various reports that I have mentioned?

A. No, I don't see that they have any relationship whatsoever to our function as bond counsel.

Q. Do you know whether the City has used what is popularly known as deficit financing to finance its operations on a yearly basis?

A. All I know is what I read in the newspapers.

Q. Have the papers told you that?

A. The papers have so indicated.

Q. When did you first learn that?

A. Probably whenever it was first reported in the press, whenever that might be.

* * *

I would assume that it was sometime in mid-'75 perhaps.

* * *

My recollection that, until after the situation developed last February—was it with the Tax Anticipation Note issue?—that there really was no sound evidence, at least so far as the public was concerned, or had come to my attention, that the City was in fact, at that juncture, suffering from a--suffering is the wrong word--was in fact encountering very serious financial difficulties,... the magnitude of which were much more than had normally been assumed.

Q. Did the vagaries of the City's financial problems concern you as note counsel at all in passing upon the notes that are offered?

- A. Well, there again, I would reiterate that our function as we see it as approving counsel is limited basically to a review and an expression of opinion upon the legality of the transaction.

* * *

Mere publication in the press of financial problems of the City is not enough to cause any undue excitement. 1/

Sykes Galloway was unaware of various accounting practices used by the City during the period under investigation:

- Q. At the time you passed upon the three note offerings in question, that is on September 9th, September 30th, 1974 and January 13th, 1975, were you aware of any the following problems which I am going to recite to you: That the City was using the accrual method of accounting for its revenues whereas it was using the cash method of accounting for its expenses?

- A. No, I was not aware of that.

* * *

- Q. Were you aware that the City was suspending certain payments that it was legally obligated to make from one year to the next so as to effectuate a balanced budget?

- A. You mean were they postponing payments from one year to the next as has been suggested by the press as to income tax refunds?

- Q. Yes.

- A. No, I suppose that unless they are reported in the press as a part of the usual budget balancing act which the City annually went through, I would note that—have taken particular notice of it. It's a . . . device which has been used by many units of governments from time to time . . . as a temporary

1/ Id. at 92-97.

expedient to bring them over a particular difficult fiscal year period, as mentioned in the case of the State of New York which was reported in the press yesterday, studying the possibility of delaying income tax refunds past April 1st in order to -- which is the beginning of its fiscal year--in order to balance outgo against income.

Q. Were you aware that the City was carrying forward deficits from year to year on a systematic basis?

A. No, I was not.

Q. Were you aware that the City was recognizing questionable receivables on its books to indicate revenues that were expected?

A. No, I was not. Of course, in that respect, I might mention that the Revenue Anticipation Notes which we approved were issued in anticipation of state and federal aid payments.

* * *

Usually one would assume to be reasonably safe sources of revenue as distinct from what I assume you are alluding to as questionable sources. Perhaps you have in mind some of the ancient tax receipts which have been mentioned in the press.

Q. Do you know whether or not the City was--I should say has established reserves for uncollected revenues in its budget?

A. No, I would have no knowledge of that. 1 /

1 / Id. at 97-99.

Counsel stated that his firm would not pass upon a security which appeared to have a good possibility of going into default. Nonetheless counsel expressed complete ignorance of the City's financial practices and status:

[If we had knowledge that [the City] in fact could not receive the revenue, we did not think it would be proper for us to approve revenue anticipation notes.

Q. You said if you had knowledge. How would you know?

* * *

A. We would not normally know. We would accept the certification of the public official.

* * *

Q. Would you think it your duty to make some attempt to find out?

A. No. Because I don't know practically how we could.

* * *

I think we as a practice--as a matter of law, I think we are entitled to rely upon the certification of the chief fiscal officer of the unit concerned.

* * *

Q. You said as a matter of law you are entitled to rely upon this certificate. Do you have any authority for the proposition?

A. No. 1/

Sykes Galloway did not pass upon any other issues offered by the City of New York after that \$620,000,000 RAN offering of January 13, 1975.

1/ Testimony of Dikeman at 103-105.

C. WOOD DAWSON LOVE & SABATINE

The firm of Wood Dawson and its predecessors have existed since the 1930's. Their national practice is confined to acting as bond counsel to municipalities and underwriters purchasing municipal securities.

It has played a pre-eminent (if not totally exclusive) role as bond counsel in connection with the issuance of general obligation bonds by the City of New York. In fact, of approximately 100 New York City bond offerings since the 1930's, Wood Dawson has acted as bond counsel with respect to all but two or three. The firm has also been retained as bond counsel in connection with the City's note offerings, although not with the same exclusivity as with the City's bond offerings. 1/

During the period January 1973 through March 1975, essentially three persons in the firm worked on New York City matters: Leroy Love ("Love"), Leo E. Sabatine ("Sabatine") and Edward J. McCormick ("McCormick"). Love is and has been the senior partner of the law firm for several years. Sabatine, with Love, was responsible for reviewing the firm's opinions concerning the City securities and for attending the many meetings between City officials and members of the banking community during the crisis period beginning February 24, 1975, through March 15, 1975. Mr. Sabatine died during the summer of 1976.

1/ To provide a better portrayal of the firm's association with the City's municipal securities offerings over the last several years, a chart of all City notes and bonds issued by the City from January 1973 to May 1975 upon which the firm provided its opinion is attached as Appendix C.

McCormick, an associate, was responsible for the preparation of the documents underlying the firm's opinions. All three attorneys testified on two occasions and also met with members of the staff on several occasions during the investigation.

Wood Dawson's association with the financings of New York City has not been confined solely to providing the opinion as to the securities sold and distributed. The firm's association with the City goes back for many years as an informal advisor to the City on aspects of municipal securities and related legislation. It has in many cases been consulted by the City's officials and employees:

From time to time . . . during the period 1970 to the present, we would confer with the Corporation Counsel and perhaps members of the staff of the City Comptroller on various matters relating to New York City's issuance of securities. These conferences dealt with technical matters, statutory interpretation [and] perhaps, on occasion, constitutional questions.

* * *

We weren't advising them. They would pose certain questions to us and request that -- whether or not we could go along with their interpretation or what they intended to do. 1/

The firm never billed and was never paid separately for such consultations. In a sense, the consultations which the City had with Wood Dawson tended to demonstrate that Wood Dawson was as much an attorney-advisor to the City as it was to the underwriters who retained them in connection with financings of New York City.

The City consulted Wood Dawson during 1970 to 1975 on many matters including, among other things, the exclusion of items from the City's debt limit, the switching of items from one debt limit to another debt limit,

1/ Testimony of LeRoy Love, at 14.

the feasibility of financing items through public benefit corporations, the capitalization of certain operating expenses, and the use of City sinking funds to acquire City obligations unrelated to the sinking funds. 1/

1. Retainer of the Firm

With respect to the bonds issued by the City, in each instance Wood Dawson was retained as bond counsel by the managing underwriters. With respect to notes issued by the City, while Wood Dawson issued a vast number of opinions, other firms were also retained to provide their opinions. 2/

Bond counsel learned of their retainer in various ways. In most instances, bond counsel was notified by a telephone call from the managing underwriter a day or two after the award of the successful bid on behalf of the

1/ Wood Dawson Love & Sabatine, General File, New York City Miscellaneous Matters.

2/ City officials preferred to work with bond counsel who understood the "practicalities" of complying with the exacting requirements of the Administrative Code and applying them to the complicated operations of the City. According to a memorandum written by Richard Peters of White & Case regarding discussions with Sol Lewis, Chief Accountant of the City of New York, Lewis told attorneys from White & Case: ". . . in his thirty years at the City, the accounting department had lived only 'within the spirit' of [the Administrative Code] regulations since strict compliance with such regulations was impossible for an operation as large as the City's. Lewis went on to say that he wanted to educate us in the way things were done with respect to accounting for tax regulations. He said that each time a new bond counsel came into the picture that the City officials would sigh and say "here we go again". White & Case internal memorandum, March 27, 1975, at 3.

syndicate. Usually this was only a few days before the delivery date set by the City. In at least one case, bond counsel learned of their retainer as a result of seeing the firm's name listed in the tombstone notice of the offering that appeared in the newspapers. 1/

On bond sales, Wood Dawson often learned of their retainer before the securities were even publicly offered for bid. Russell Aldag, head of the City's Municipal Securities Division, on many occasions notified the firm prior to any public notice of the sale of bonds so that Wood Dawson could begin to prepare the necessary documentation to be submitted to the City for completion and signature. Moreover, with respect to the proposed offering of the municipal bonds, from time to time the City would present to Wood Dawson the proposed notice of sale (without the accompanying Report of Essential Facts) to alert the firm that a sale was forthcoming and also to obtain any comments which Wood Dawson had upon the form of the notice.

[O]ccasionally, [the City] would send us a proof of a notice of sale to verify their figures and details and so on; not for substance, really, but just to check the accuracy of the figures, not the Report of Essential Facts, just the Notice of Sale. 2/

1/ See, e.g., Dikeman at 60-61 (Testimony of Rothman); Testimony of Fernandez at 23-24.

2/ Testimony of Love at 146.

Wood Dawson's retainer came in most instances from the First National City Bank ("Citibank") or the Chase Manhattan Bank ("Chase"), with the preponderance from the latter owing to the Chase's preeminence in the sale of the City's bonds. There were other underwriters who headed up syndicates that successfully purchased bonds and notes of the City who retained Wood Dawson. Among them were (1) First National Bank of Boston; (2) Ehrlich Bober; (3) Chemical Bank; (4) Bankers Trust Co.; (5) Marine Midland; and (6) Irving Trust Co. Of \$5,845,860,000 of the City's notes passed upon by the firm from January 1973 to April 1975, only \$145,100,000, or less than 2-1/2% of the total, were the subject of opinions for clients other than Chase or Citibank. 1 /

The retainer in each instance was never discussed. It was determined by tradition. While the purpose of their retainer was self-evident, the scope was not. Wood Dawson examined matters which they deemed relevant. Limitations upon the scope were simply never specified.

Q. Do you ever make any disclaimers to your clients with regard to New York City as to the scope of your retainer?

A. No. 2 /

1 / Appendix A.

2 / Id. at 55.

2. Preparation of the Opinion

Wood Dawson's procedures in preparing its opinion were standardized after many years of municipal securities practice. Members of the firm spent approximately one to one and a half days carrying out the procedures established by the firm when retained by managing underwriters to provide the approving opinion. 1/ Love, in speaking about the delegation of authority to Mr. McCormick, said:

. . . . My specific instruction to Mr. McCormick when he took over New York City's details of the New York City Bond issue [was] to become familiar with the Constitution and the statutes of the State of New York relating to the incurring of indebtedness by the City There is no specific instruction with respect to every single issue. That is just normal office procedure. 2/

The normal office procedure consisted of sending a requisition letter to Russell Aldag, Chief of Municipal Securities Division of the City, subsequent to notification to the firm of the proposed sale. The letter requested the documents needed by the firm. 3/ The documents varied with the security to be sold by the City. McCormick, in describing the procedures employed by the firm with respect to bond anticipation notes, said:

1/ New York Regional Office Memorandum for the Files, Meeting with Bond Counsel, January 20, 1976, at 4.

2/ Testimony of LeRoy Love, at 84.

3/ A copy of Wood Dawson requisition letter is attached as Appendix D.

. . . We would obtain bond authorizations, Board of Estimate approvals of mortgages, the mayoral authorization of limitation . . . the debt settlement [sic, statement] and usual closing papers, statutory certificates, receipt, arbitrage certificate. 1/

Armed with the certificates prepared in blank by Wood Dawson, and filled in by the City's officials, Wood Dawson prepared their approving opinion with respect to revenue and tax anticipation notes without investigation, verification or further authentication. 2/ McCormick gave the following testimony on this point:

- Q. And as of what date do you require such a certificate before you pass upon the legality of the offering; that is to say, how close to the sale?
- A. I think the dates vary.
- Q. Do you have any in-house policy concerning the currency of the certificates?
- A. I can't say that we do. The law provides that the amount of notes that can be issued is determined as of, as of the time of borrowing, which is a very -- a term which is not defined and [it is therefore] not possible to obtain a specific date.

1/ Testimony of LeRoy Love, at 86.

2/ In the case of bonds and bond anticipation notes, McCormick compared the City's figures as to bond authorizations and specific capital projects against the firm's copies of the City's record of authorizations and projects. The bulk of the City's short-term financing was made in anticipation of the receipt of revenues or taxes. The budget as adopted each year contained the estimates of City officials of revenues and taxes expected to be received within the fiscal year. The City was authorized by Local Finance Law to borrow against uncollected receivables. Wood Dawson received certificates signed by various City officials as to the amount of uncollected receivables as a condition precedent to the firm's issuance of its approving opinion. The certificates were dated as of the close of at least one month prior to closing.

Q. What is your practice concerning the currency or the proximity in time of the Comptroller's certificate to date the sale before you will pass upon the issue?

A. Well, due to the fact that this is a grey area and that there is no specific date that you can hold hard and fast with, and also that, under the law, that any monies that are received, any taxes that are collected really at such time as the amount of the uncollected taxes and the notes equal out should be segregated. We really usually have accepted the date which has been given to us by the Comptroller's office.

Q. Before closing, do you require an update of that particular certificate?

A. No.

* * *

Q. Did you ever request from the Comptroller a certificate more recent than the one he has given you?

A. (By Mr. McCormick) No.

Q. Did your client ever request of you to make such a request?

A. No, he did not.

Q. Has anybody ever made such a request of you?

* * *

A. No one has . . . ever made that request of me or of my firm to my knowledge.

Q. Well, let's ask that question of Mr. Love.

A. (Love) No. 1/

Wood Dawson considered the certification a proper basis for their reliance on the City's figures. Relying on the accuracy and completeness of such certificates, the firm issued its opinion without questioning the figures, or the basis for determination of the figures. Taking solace from an 1858 New York decision, the Bank of Rome case, the firm's policy has been never to challenge the accuracy of the City's figures:

We have never challenged the accuracy of the City's figures on the basis of the Bank of Rome case which says we don't have to - it has not been overruled and it's the law of the State. 2/

Q. Mr. Love did you at any time advise your clients, Chase or First National City Bank, whether they should begin questioning the validity of the certificates presented by City officials concerning sufficiency of revenues?

A. I did not. I can't recall that I ever advised them to start questioning certificates, no. 3/

1/ Love at 88-90 (Testimony of McCormick).

2/ Testimony of Leroy Love, at 123-24.

3/ Id. at 124.

Love summed up his view that bond counsel owes loyalty to the issuer:

Bond counsel owes it also to the issuer that it does not go around making funny noises, gratuitous noises, gratuitously. That might upset and cause great damage to the issuer. 1/

Love also gave the rationale for the firm's position by referring to the special loyalty which Wood Dawson has as a firm to the City of New York:

Mr. Sabatine has made remarks during this testimony, indicating that many people involved in these transactions, that we have been discussing here in this case, were not aware of the very delicate way this whole thing was balanced.

We were very conscious of it.

We are citizens of New York, and we owe loyalty as citizens of New York and a special loyalty to all parties involved, that we do not do anything that can cause irrevocable damage to the interest of the City, and therefore, to its bondholders.

We felt . . . and we felt that we did not want to be responsible, perhaps for a default of the City of New York we feel that we have an obligation more than just perhaps to the underwriter, we have that obligation to people who are holding outstanding securities, and we also have an obligation to the City to not upset its - to do anything that would have adverse impact, and especially in these times, these critical times.

. . . . we were very conscious of the need for the City to have access to the market, that what -- in this period we are getting down to cliff hanger. We didn't know where the -- these securities might end up.

1/ Testimony of LeRoy Love at 328.

. . . . [W]e were aware that the banks had been traditionally putting a large amount of . . . [City securities] away.

* * *

. . . steps had been taken in connection with the creation of the Stabilization Reserve Corporation, that at least that was an effort in the right direction to perhaps reverse some of the trends, to get in hand, better, the financial affairs of the City.

We took that a [sic] encouraging sign.

In working with certain of the people in the City, we knew that there was an awareness of the difficulties, and the need to get certain matters in hand, and that was . . . an encouraging sign.

Now, to panic when there was an attempt being made on the part of some, at least, to bring some order and so on in these affairs, while it did not color our judgment in any way rendering a legal opinion, we were very cautious not to go around borrowing or dreaming up additional problems for the City. They had enough.

Q. Additional problems, meaning making disclosure?

A. Not disclosure at all, not disclosure at all.

I mean in not gossiping or whatever.

It was just doing conscientiously what we were called upon to do, not on the matter of disclosure at all. 1/

Early in the investigation, Love was asked what should be done to remedy the problems emerging in municipal financings. In answering, Love referred to disclosure, and why he believed it was not a solution:

Q. [W]hat would you do about the apparent abuses by municipalities

1/ Id. at 328-31.

- A. I would leave well enough alone. There is already too much regulation. Disclosure is a fad and would not help the municipal securities market. 1/

3. Knowledge of the City's Fiscal Affairs

In an interview published in September 1975, Mayor Abraham Beame stated that New York City Banks and bond counsel were aware of the City's fiscal practices.

- Q. Weren't they [New York City banks] critical of certain budget practices, so-called gimmicks? Of putting certain current expenses into the capital budget. Of borrowing to balance the budget. Wasn't this a legitimate cause of anxiety on the part of the banks?
- A. It was not. I opened my discussion by telling you that the banks have been aware of these practices for years.
- Q. Is there any particular reason why they picked this time to clamp down?
- A. Let me finish. They were aware of these practices Their Bond Counsel had to approve every issue and to know what was in back of it. 2/

According to the testimony of Love, he and members of his firm were unaware of many of the fiscal mechanisms and procedures employed by the City:

- Q. Do you know whether the City borrows money in the capital market to finance budgetary deficits?
- A. I do not know.

1/ Memorandum to the Files; Subject New York City Investigation - meeting with Bond Counsel; Interview with Messrs. Love, Sabatine, and McCormick at their law offices, January 20, 1976, at 6.

2/ Interview with Abraham Beame, Challenge, September-October 1975, at 41.

Q. Do you know if the City borrows for the purpose of rolling over short term debt?

A. I do not know.

Q. Do you know if the City borrows for the purpose of financing operating expenses?

A. I don't know what you mean by that. The local finance law authorizes the City to incur indebtedness for objects or purposes which some people may regard as current operating expenses. 1/

. . .

Q. Are you familiar with the accounting procedures used by the City in the preparation of the Statement of essential facts?

A. No.

Q. Do you consider it to be necessary to be familiar with those accounting practices in order to determine whether or not its certification is correct concerning the debt incurring power?

A. No. We rely upon the certificate of the appropriate officials. 2/

When questioned more closely as to knowledge of particular practices,

Love professed ignorance in each instance:

Q. [Were you aware that] the City's payroll cost would not be debited until they were actually paid, as opposed to when they were incurred, thereby shifting costs from one fiscal year to the next?

A. I would have to say no. If you are referring to February 15th, I didn't have that in mind at all.

1/ Testimony of LeRoy Love, at 52.

2/ Id. at 153-54.

Q. Were you aware that certain expenses such as supplies, would not be debited until they were actually paid?

A. No.

Q. Were you aware that real estate taxes would be credited when they were levied and would be budgeted 100% without reserve?

A. No.

Q. Were you aware that local taxes would also be credited before collection and would be borrowed against by the use of tax anticipation notes, again without reserve?

A. No.

Q. Were you aware that Federal and State aid were similarly treated; that is to say, credited when due and budgeted, without reserve?

A. No.

Q. Were you aware that there was --

A. I never asked any such questions. It was not [necessary for us to render our approving legal opinion]

* * *

Q. Were you aware that there was year end short term borrowing to close budgetary gaps?

A. That was not one of the recited purposes which the notes or other borrowing was being resorted to. Whatever the other purposes were, when they borrowed there was always a specific authorization for that sort of borrowing in Section 11 of the Local Finance Law.

Q. Then you were aware that borrowing or not? I'm unclear of your answer.

A. No, I am not aware of -- on February 15th, aware of any of these matters. I can't say that I was.

Q. Were you aware that real estate taxes were used as collateral for tax anticipation notes without regard to their collectibility?

* * *

A. That is not relevant in the issuance of tax anticipation notes of the City of New York. Possibly their [sic, they are] general obligations, they are not payable from specific revenue. 1/

Messrs. Love and McCormick were asked questions concerning segregation of certain monies and the basis for assumptions that the monies were being segregated.

Q. I believe earlier you were discussing or we were discussing the tax anticipation notes and the issuance of tax anticipation notes in the course of the year and you indicated, I believe, if the notes were issued and the tax came in covering that particular TANS towards the end of the year, that money should be segregated, is that correct?

A. (By McCormick) Under the local finance law, that's correct.

Q. Is that money segregated in New York City?

A. (By McCormick) I have never verified that.

A. (By Love) You always assume, however, the public officials are following the dictates and mandates of the statutes and we have always felt ourselves entitled to rely upon that. 2/

1/ Id. at 76-78.

2/ Id. at 181.

According to Love, his firm would not pass upon the validity of a security if there was a significant possibility of default.

Of course we do not pass upon the economic soundness of a security. That is not our function. We, of course, our retainer is to pass on the legality of the securities, but our firm would not render an approving opinion if we felt that there was significant danger that the obligation could not be met on time and when due. 1 /

The firm's focus was not whether the City had the ability to pay its maturing obligations, but rather whether the City had the power to pledge its full faith and credit to pay its obligations. In replying to questions whether the City could validly issue notes when the City does not have sufficient revenues due, Mr. Sabatine said:

If the statutes o[r] the constitution set up a measuring device, an illusory sort of thing, it could be done, as I said before. You can draft a constitution to provide for every inch of snow. You can borrow money if the measuring device is met. The fact [that] it's illusory doesn't affect the validity. The source of payment is in the Constitution which requires the City to pledge its faith and credit on any obligation, including the notes.

Now, you can come up with all sorts of measuring devices. We point out that in many States there are no limits [on the ability to incur debt] whatsoever. 2 /

There are indications that Wood Dawson became concerned about the City's worsening financial condition. In the fall of 1974, members of the firm first began to discuss among themselves the City's problems, in particular the vital need for market access:

1 / Id. at 170.

2 / Id. at 177-78.

Q. Have your clients ever relied upon you to advise them as to sufficiency of revenues behind a note or bond issued by the City of New York?

A. No.

* * *

Q. Have you ever considered advising your clients as to such matters?

* * *

A. It was discussed in our firm in the fall of 1974.

Q. In what context?

* * *

A. Because it seemed that the short-term borrowing was getting out of hand.

Q. Why did it seem that the borrowing was getting out of hand?

A. The frequency and the amount of the offering.

Q. What was the amount then; do you recall?

A. No. I don't recall.

Q. How many times greater was it then than in previous years?

A. I would have to refer to figures, but it was significantly greater in the frequency and the amount; gradually increased over a period of time.

* * *

Q. What did you discuss [in your firm] ? . . .

A. We discussed generally the advisability of meeting informally with our clients, our traditional clients [the banks] and discussing some of our concerns about the finances of the City of New York.

Q. What was the result of those discussions?

A. We never -- events began to snowball on us and we never had time or took the time to call that meeting with our clients and to discuss these matters.

* * *

Q. Did you feel at that time that notes or bonds of the City had a good possibility of going into default?

A. We felt that if the City were unable to -- put it another way: We felt that access to the market was essential to the ability of the City to meet its obligations on time.

* * *

A. (Continuing) Furthermore, we felt that the City was making an effort to get in hand some of its financial problems with the creation of the Stabilization Reserve Corporation.

* * *

Q. Then it is my understanding that you had a discussion among yourselves because you were concerned as to the sufficiency of revenues but did not communicate your concern to your clients, is that correct?

A. It was not necessarily a concern about the sufficiency of revenues. It was a general concern about the financial affairs of the City of New York.

Q. And you say that it was --

A. I suppose that, by definition, that concern may -- it was never articulated -- may have incorporated the concern that the City might not be able, if it were cut off from market access, to meet all of its obligations on time.

Q. And your concern, if I understand it, was prompted because of the volume --

A. The volume.

Q. (Continuing) -- of short-term debt?

A. The volume, the frequency, and I suppose through our own in depth investigations that came about because of being retained as bond counsel for the Stabilization Reserve Corporation; the matters that we were investigating with respect to preparing an official statement for the Stabilization Reserve Corporation.

* * *

A. (Continuing) Our concern was further stimulated because of certain practices; the type of financing the City was resorting to, such as anticipating certain water and sewer revenues.

MR. SABATINE: In previous years.

THE WITNESS: In previous years.

MR. SABATINE: Financing lease obligations.

THE WITNESS: And financing lease obligations and other such practices. Strike "other such practices." And such practices. 1/

Love was asked later in the testimony about the firm's concern in connection with the offering of \$141,000,000 in serial bonds, which closed on February 27, 1975, the last offering of City securities upon which the firm issued a formal opinion.

A. We were not concerned about the validity of that bond issue or the inability of the City to pay those particular bonds. We were not concerned about that.

Q. . . . You were concerned with what, then?

A. We had a general, a general uneasiness about certain financial practices of the City of New York which were not legal . . . [W]e felt that certain of the practices of the City in funding and anticipating certain revenues were perhaps unsound, though we were never retained to give such advice by our clients 2/

Love asserted that certain information already in the public domain obviated the necessity to disclose:

1/ Id. at 55-60.

2/ Id. at 61.

I did not think it was my duty to tell my client anything I read in the New York Times . . . That was my whole source of my knowledge, what I read in the New York Times or in the New York Post, or other papers and, no, I did not feel a duty to tell my client what was readily available to him in the local paper. 1/

David Grossman, who was then a senior vice president of the Chase Manhattan Bank and a special assistant to David Rockefeller, Chase's chairman of the board, took handwritten notes of a meeting on March 8, 1975, of the Financial Community Liaison Group (a group composed of the City's financial leaders formed to provide short and long-term solutions to the City's financial difficulties). Those handwritten notes were later reduced to a typewritten transcription identified on the record by Sabatine and Love as generally representing what, in fact, was said at that meeting. Grossman's memorandum paraphrases the advice which the firm gave at the meeting:

Wood Dawson feel strongly that as long as City maintains it has authority based on budget appropriations the underwriters have no reason to look behind the City's statements unless they have some definite reason to suspect 'hanky-panky'. 2/

On March 11, 1975, only 12 days after the last offering opined on by the firm, Love wrote a memorandum to Ellmore Patterson, chairman of the Financial Community Liaison Group and of the Morgan Guaranty Trust Company, concerning a proposal which Love was making for a resolution of the City's fiscal problems. In the memorandum, Love demonstrated a thorough understanding of the City's fiscal problems:

1/ Id. at 135.

2/ Division Exhibit (Epley) 5, at 2.

It seems to be inescapable that any long-range solution of New York City's financial difficulties will involve, among other things, the identification of a workable method whereby the huge amount of the City's recurring short-term indebtedness can be refinanced and extended over a longer period of time

In order to accomplish this debt restructuring outside the City's constitutional debt limit — which is already narrowly close to the legal limit and, therefore, must be prudently conserved — the most probable instrument would be the creation by the legislature of a public corporation for this single, emergency purpose and with broad powers and authority to deal effectively with the problem

The corporation would be empowered to borrow money from any source, public or private, and would be authorized to issue its bonds and notes ('securities') to evidence the same. The securities could run for periods of, say, up to twenty years. The proceeds of the sale of securities would be required to be paid over to the City in trust, and could be used by the City solely for the purposes specified in agreements entered into by and between the corporation and the City.

The corporation would be authorized, as a condition precedent to making loans to the City, to obtain certain contractual commitments from the City. These commitments would call for fiscal and financial disciplines upon the City of a nature designed to assure that the efforts of the corporation in raising funds for the City would be effective to

(i) discharge the legislative functions and implement the policies and purposes for which the corporation was created, and (ii) bring about financial stability and fiscal responsibility in the administration of the affairs of the City.

The legislation, by way of example only, would require and authorize the City to agree with the corporation that, so long as any of the securities of the corporation were outstanding and unpaid, the City would not

- (a) contract indebtedness for the purpose of funding recurring operating expenses;
- (b) enter into further commitments to other public corporations, such as UDC, HFA, Battery Park City, etc., for the furnishing of facilities and services for City-related purposes;
- (c) incur bonded indebtedness to finance leases of properties and facilities; and
- (d) resort to certain budget balancing 'gimmicks' practiced in the past, such as anticipating water and sewerage charges in advance, and anticipating the receipt of certain revenues when the expectation of such receipts is questionable. 1/

Further indications of Wood Dawson's awareness of the City's fiscal problems are discussed below in the White & Case portion of the report.

1/ Division Exhibit (Love) 3, at C-4.

D. WHITE & CASE

White & Case, a newcomer in February 1975 to the practice of bond counsel for New York City's securities, quickly assumed a highly important role in New York City's finances during February and March 1975. In one month, White & Case became involved in virtually every aspect of the City's financings. They acted as (a) bond counsel; (b) underwriter's counsel; (c) syndicate counsel; and (d) Financial Community Liaison Group counsel.

White & Case is one of the largest law firms in the country. It has a multi-faceted practice covering many areas of the law. Nevertheless, prior to February 1975, they had not acted as bond counsel with respect to general obligation bonds. Some work had been done on industrial revenue bonds in the 1960's.

Although the firm may not have been familiar with the procedures employed by municipal bond attorneys, they were not ignorant of the impact of the federal securities laws upon the sale of municipal securities. Marion J. Epley, one of the attorneys in the firm who had worked on industrial revenue bonds, knew that municipal securities — all municipal securities — were not exempt from the anti-fraud provisions of the securities acts. 1/

Epley was the partner in charge of the work performed by the firm in connection with the New York City matters. A number of other members and associates of the firm became involved at various points.

1/ Testimony of Marion J. Epley, III, at 15.

Epley has had extensive experience in the field of corporate securities. He has represented many companies that have made public offerings and is conversant with the duties of underwriters, issuers, experts, and attorneys under the securities laws. 1/

Below is a chart showing the three offerings made by the City of New York during March 1975 in which White & Case was involved:

<u>Date of Issue</u>	<u>Type, Rate and Amount</u>	<u>Managing Underwriters</u>
March 5, 1975	RANs: \$140,000,000 (at 7.25%) due March 20, 1975	Private Placement with consortium of New York Clearinghouse Banks; managed by Chase.
March 14, 1975	BANs: \$537,270,000 A. \$346,270,000 for limited Profit Housing Companies Projects (at 8.10-8.75%) due September 11, 1975 and March 12, 1976 B. \$41,000,000 for Low Interest Loans to Owners of Existing Multiple Dwellings (at 8.10-8.75%) due September 11, 1975 and March 12, 1976 C. \$150,000,000 for Capital Improvement Projects (at 8.75%) due March 12, 1976.	Morgan Guaranty, Bankers Trust, Salomon, Merrill Lynch, in association with Chase, First National City Bank, and Manufacturers Hanover; managed by Chemical
March 20, 1975	RANs: \$375,000,000 (at 8%) due June 30, 1975	Morgan Guaranty, Chase, Bankers Trust, Chemical, Manufacturers Hanover, Salomon, Merrill Lynch, Ehrlich-Bober; managed by First National City Bank.

1/ Id. at 10-11.

1. The Initial Retainer

White & Case's view of the role of the bond counsel was broader than the view of Wood Dawson:

[This] ... is not to say that I thought or think that bond counsel can simply employ tunnel vision focusing on the tight legal issue of the validity or legality or (sic) notes without considering and consulting with their clients on other matters. 1/

White & Case began its first involvement in the area of general obligation municipal securities in mid-February 1975. At that time, it was asked by Bankers Trust to act as bond counsel on behalf of a syndicate headed by Bankers Trust that was about to bid upon \$260 million of Tax Anticipation Notes of the City.

Bankers Trust submitted two bids on behalf of the syndicate for two parts of the aggregate offering: one for \$100 million and one for \$160 million. Bankers Trust's bid was successful only as to \$100 million. Chase submitted the successful bid for the remaining \$160 million. The Bankers Trust syndicate consisted of six principal underwriters: Bankers Trust, Chemical Bank, Merrill Lynch, Salomon Brothers, Bank of America and Morgan Guaranty Trust Company. The opinion that White & Case was to furnish would be addressed to the entire Bankers Trust syndicate.

From the time that White & Case first agreed to accept the retainer, a number of associates and Epley began their review of the relevant statutes. 2/ Associates visited the offices of Russell Aldag of the City's Division of Municipal Securities to examine prior closing transcripts of proceedings in order to learn what background documents would

1/ Testimony of Epley at 180.

2/ Id. at 28.

be necessary for the closing of the TANs. Memoranda were prepared on aspects of the Local Finance Law.

2. Wood Dawson and White & Case - late February to late March 1975

On February 24, 1975, the City sold and delivered \$170 million in RANS to the New York City Clearinghouse Banks. 1/ The RANS were four-day notes, an extraordinarily short maturity date even for New York City which had a constant need to roll over its huge short-term debt. As McCormick was to explain later, these notes were issued because "there was evidentially [sic] some question as to whether or not the City's bank accounts were overdrawn." 2/

Wood Dawson provided the approving opinion to the City for these RANS in the evening of February 24. It was clear then that the City was

1/ The New York Clearinghouse is a voluntary association of banks located in the City. The object of the association, as stated in its constitution, is "the effecting at one place of the daily exchange between the members thereof and the settlement of the balances resulting from such exchange." There are eleven members, as follows: The Bank of New York, The Chase Manhattan Bank, Citibank, Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, U.S. Trust Company of New York, National Bank of North America. The National Bank of North America did not participate in this offering.

2/ Testimony of LeRoy Love, at 193.

experiencing severe financial dislocations. Wood Dawson, however, did not conduct any further investigation. They followed their usual procedures: prepared a requisition letter; prepared blank certificates; and furnished their opinion in connection with the sale. The opinion itself was in standard form, without limitation or qualification. ^{1/} Fortunately, the notes were pre-paid by the City one day later. But the problems did not abate. They were just beginning to surface.

On February 26, matters became more complicated. A closing was to take place the following day for the delivery of certificates representing \$141 million in serial bonds to a syndicate headed by the Chase Manhattan Bank. And another closing was to occur two days later on February 28 with respect to \$260 million in tax anticipation notes which were tentatively accepted by two syndicates: one headed by Chase and the other headed by Bankers Trust. The bond sale did in fact close, with Wood Dawson acting as bond counsel. The TAN sale did not, because in essence, White & Case acting as co-bond counsel with Wood Dawson, requested more current information than had usually been obtained concerning anticipated taxes outstanding against which the City proposed to issue the TANs.

^{1/} This RAN offering was issued in anticipation of certain proceeds, including \$260 million to have been received by the City from a proposed sale of TANs to have taken place February 28, and which was, in fact, not consummated. The Local Finance Law of New York State, however, does not appear to permit the issuance of RANs against the proceeds of TANs. There is, therefore, some question as to the legality of this February 24 RAN sale.

On February 26, there were three meetings at the office of Wood Dawson. The first was with Alexandra Altman, an attorney for the Bureau of the Budget of the City. She was there to provide the firm with certain information concerning the aggregate outstanding debt of the City's public benefit corporations. This concern was prompted by the Wein litigation. The complaint in Wein alleged, among other things, that the City had surpassed its constitutional debt limit. Wood Dawson wanted to satisfy itself through the help of Ms. Altman and a certificate from the Bureau of the Budget Director, Mel Lechner, that even if all debts of public benefit corporations were charged to the City's debt limit, the limit would still not be exceeded.

Even though many questions were raised during this time, Wood Dawson did not expand their procedures. The usual opinion of the firm was delivered to their client, Chase, in the evening of February 27 for the serial bond offering. 1/ Because of the Wein litigation, Chase asked the firm to issue a supplemental opinion. Wood Dawson complied with an opinion dated February 27, 1975, reciting that the

. . . Issue of February 15, 1975 will not be held to be void as being in excess of the constitutional debt limit of the City of New York.

In rendering this opinion we have, among other things, relied upon the annexed certificate of the Director of Management and Budget of the City of New York and attachments thereto. 2/

1/ February 27, 1975, opinion by Wood Dawson.

2/ Division Exhibit (Love) 6.

The two other meetings at Wood Dawson's offices on February 26 concerned the proposed \$260 million TAN offering. At both meetings, it was White & Case's position that the City's certification regarding the collected tax receipts had to be updated to the time of the proposed closing for the TANs. The City's prior practice was to issue certificates providing information as of a date two to eight weeks before the closing. Wood Dawson had in the past always accepted the City's certificates without requesting up-dates. It was Wood Dawson's position that the requirements set up in the Local Finance Law for certain revenues to support the issuance of the tax anticipation note was simply "a measuring device" and that ". . . if the City certified to us the records required to be kept by the City code, we were entitled to rely thereon for the purposes of rendering our opinion." 1/ For the TAN offering, the City had provided a certificate dated January 30, although closing was to take place February 28. The issue arose because White & Case had been told on February 25 by an "accountant from NYC" that there might be insufficient revenues against which the TANs were to be offered. 2/

1/ Testimony of LeRoy Love, at 203.

2/ See Eide Ex. 3; Memorandum for the files, NYC February TAN Issue, Richard Peters, March 27, 1975, at 8. These figures may have been provided by Sol Lewis. Altman testimony at 87.

The 28 day period was indeed significant. January 30 was the day before the expiration of a 30 day grace period for the payment of real estate taxes which were due January 1 by owners of real estate within New York City.

Q. How current was the certificate that was being questioned at that point in time [by White & Case]?

A. (By McCormick) It was probably--the date was four or five weeks prior to the sale--to the delivery date. That's a rough estimate . . .

Q. Was there any significance to the date upon which the figures were given?

A. The City maintains that that's as of the end of the month; where they had so-called audit figures, and that any figures after the end of the month were so-called raw figures upon which the Comptroller could not certify.

Q. Was it the City's practice to give this authorizing certificate as of the end of the month?

A. I can't say it was the City's practice, no.

Q. In connection with the note offerings that you worked on, was it their practice?

A. I don't think it was their practice necessarily, no.

Q. Was there any significance attached to the date of that particular certificate?

A. Not to my knowledge.

Q. Would the certificates have been different if it were dated several days later?

A. Well, the fact, I think it was established that if the certificate had been dated as of February 10th, they would not have adequate taxes against which they were issuing their notes.

- Q. When was the fact established?
- A. I just pulled that date . . . out of my head. I mean, it was sometime in early February.
- Q. When did it become known to you that had the certificate been dated later there would not have been sufficient taxes against which the TANS could have been issued?
- A. It came, it became known to us about two days before the notes were scheduled to be delivered and paid for.
- * * *
- Q. How is it that you became aware that there were insufficient taxes to support the proposed sale of the TANS?
- * * *
- A. . . . we were called by a lawyer from White & Case indicating that such a problem existed.
- Q. If you had treated that sale as you would normally treat a TAN sale, would you have discovered the information he [Robert L. Clare of White & Case] gave to you?
- A. Probably not, no.
- Q. Why not?
- A. Well, the certificate had been prepared by the City Comptroller using a date as of the end of the preceding month, as of which date uncollected taxes exceeded the amount of the note issue.
- Q. So you would not have asked for a certificate beyond that date?
- A. We had not asked in the past, no.
- Q. And if the sale had gone forward you would have given your opinion?
- A. I assume so. 1/

1/ Testimony of LeRoy Love, at 91-92, 93, and 110.

In efforts to resolve the problem raised by the apparent insufficiency of uncollected real estate taxes to support the proposed Tax Anticipation Note sale, Sabatine and Epley discussed the possibility of having a split closing whereby Bankers Trust would first close as to its \$100,000,000 portion of \$260,000,000 TANS, and Chase (Wood Dawson's client) would subsequently close on the balance. 1/

Messrs. Love, Sabatine and McCormick of Wood Dawson, Messrs. Wood (Comptroller's counsel), Lewis (chief accountant of the City) and Hartman (Corporation Counsel) and Ms. Altman (with the Budget Bureau) of the City attended the third meeting of February 26 at the offices of Wood Dawson.

Mr. Lewis stressed the fact that the month-end figures had always been accepted in the past and that it was impossible to get figures brought down to the closing date. Mr. Lewis went into a detailed explanation of the difficulty involved in extracting the real estate tax collections from the J-73s.

Mr. Epley then discussed the possibility of Bankers' closing prior to Chase. Messrs. Sabatine and Wood stated this would be fine with them. There was a discussion of when a new certificate would be filed, certifying the January 30, 1975 figure as of the closing date. Messrs. Wood and Dawson requested this type of a certificate. Both Mr. Epley and Mr. Sabatine agreed that there would have to be some certificate dated later than the 13th of February. Mr. Epley insisted on the closing date and Mr. Sabatine seemed to settle on the sale date.

The meeting adjourned with the understanding that Bankers would close first and the City would file a new certificate. 2/

1/ Memorandum Re Bankers Trust Co./NYC Note Offering, prepared by John E. Osnato of White & Case, undated, at 2.

2/ Id. at 3-4.

The next day, February 27, Epley called Wood (Comptroller's counsel) to discuss the form of the supplemental letter to be delivered to White & Case by the chief accountant, providing updated information as to tax collections. 1/

White & Case did not insist upon the filing of any official certificate updating the January 30th certificate, apparently in deference to Wood Dawson's intention to rely on the January 30, 1975 certificate already furnished, provided that there was nothing in the "public record" as to later collections. 2/ The issue of updating the City's certificate with respect to the uncollected taxes supporting the proposed TAN sale caused White & Case and Wood Dawson to disagree.

My recollection of the Wood Dawson position was that they affirmatively did not want any information more current than what had been provided as of January 30th.

I was never able to fully understand why they would take that position as distinct from simply saying January 30 is okay with us and you don't have to update it.

They went beyond that to say if it is updated we don't want to know about it. 3/

Our position was that the local finance law stated that there had to be--there was a formulation in the local finance law that the tests of the validity of tax anticipation notes was the amount of uncollected taxes on the date of issue.

1/ Memorandum Re Bankers Trust Company, NYC Note Offering, prepared by Robert L. Clare, February 27, 1975, at 1.

2/ Memorandum for the files, prepared by Marion J. Epley, February 28, 1975.

3/ Testimony of Marion J. Epley, at 116.

Our position was that the date of issue was the date when the notes were issued which would be February 28th and that we felt that we were entitled to get either a certification of what the uncollected taxes were on February 28th or some indication of the order of magnitude of change from the most recent date to which a firm number could be attached.

The meetings at Wood Dawson, both in the afternoon and the evening, were addressed principally to that topic 1/

When White & Case brought up the issue of the letter with Comptroller Goldin, he advised White & Case that, if the City were to issue such a letter, it would have to send a copy to Wood Dawson "regardless of any statements on their part that they had no interest in post-January 30th collections." 2/ Epley conveyed this view to Sabatine and asked Sabatine what his law firm's position would be if they should receive a copy of such a letter. After discussing the matter with the partners of the firm, Sabatine called Epley to tell him that "[Wood Dawson] . . . would not issue an opinion if they received a copy of the proposed letter to White & Case." 3/

On February 27, Sabatine advised Epley that, in municipal financings, everything is always "okay unless you ask questions," and, further, that failures to analyze statutes or other documentation are not significant in municipal financing since there is "generally plenty of fat all

1/ Id. at 115-116.

2/ Memorandum prepared by Marion J. Epley, February 29, 1975, at 3. (Hereinafter cited as Epley memo 2-28-75)

3/ Id. at 4.

over the place." 1/ This viewpoint put Epley and other members of White & Case on their guard. Further checks were made by White & Case's attorneys to reassure themselves that all matters were properly documented.

In the evening of February 27th, at a meeting in the Comptroller's office, attended by City representatives, representatives of the Chase group, representatives of the Bankers Trust group, Epley of White & Case, and members of Wood Dawson, Comptroller Goldin referred to the fact that this was White & Case's first participation in a municipal bond financing, and ... "expressed perplexity at the fact that [White & Case] was unwilling to accept the customary documentation in such transactions," and "demanded to know why White & Case was unwilling to be 'reasonable'". 2/ Labrecque of Chase, in response to an expression of "dismay [by a City official] at the fact that anyone would challenge the long-standing precedent and documentation for such financings," responded that precedents regarding acceptance of documents were "irrelevant," referring to cases in which underwriters were "sued for failure to make a proper investigation." 3/

Epley stated:

. . . perhaps since Mr. Lewis seemed to have access to those numbers, they might provide the basis for some sort of certificate or other documentation from the City as to the amount of uncollected taxes. At

1/ Epley memo 2-2-75 at 9.

2/ Id. at 7.

3/ Id. at 8.

that point the Comptroller stated quite firmly that the [Post-January 30] numbers that Mr. Lewis had provided my people were not reliable and were not supportable. 1/

At one point Epley asked Sabatine to state the relevant section of the Administrative Code so that the legal basis for Epley's request could be underscored. This section provides that the City must make daily postings of all collections it receives concerning tax receipts and must also make daily reports to the Comptroller. (Section 415(1)-6.0) This being said, the City representatives "seemed stunned" by the existence of the provision. 2/ The reports -- the so-called "J73s" -- were received daily by the Comptroller from various collecting offices. The Chief Accountant was not familiar with how current the actual postings were. 3/ The balance of the meeting concerned the ability of the City to provide information required by White & Case and possible solutions to the problems posed by what Comptroller Goldin deemed to be an unprecedented demand. 4/

On the morning of February 28th, there was another meeting among Representatives of Bankers Trust Company, White & Case, Wood Dawson, certain City officials and others. This meeting was designed to demonstrate to White & Case that there were, in fact, sufficient tax receivables yet uncollected which would support the proposed \$260 million in tax anticipation notes.

1/ Testimony of Marion J. Epley, at 130.

2/ Memorandum to the Files of Marion Epley, February 28, 1975.

3/ Id. at 7 and 8.

4/ Id. at 8 and 9.

At this meeting, City officials were unable to persuade White & Case that there was any sound basis for departing from the Administrative Code and procedures normally utilized in providing comfort to attorneys who furnish opinions on commercial transactions. Sol Lewis tried to convince White & Case that their requests for assurances were at variance with prior practice of bond counsel. 1/

Lewis described how the practicalities of the City's accounting system had to be accommodated notwithstanding certain legal requirements. He averred that any attempt by new bond counsel, White & Case, to try to conform traditional accounting practices of the Comptroller's office to the letter of the Local Finance Plan would be highly unreasonable. He represented that even though figures could not be produced in accordance with the Administrative Code, the notes would be paid when they fell due, just as they had always been paid in the past. Lewis defended the City's accounting system by analogizing to driving a car or filing a tax return: One does not exactly follow the law; however, one stays within the spirit of it. 2/

Lewis admitted:

daily collections were entered into the ledger only once a month, and that in the past bond counsel had always understood this and thus accepted certified figures for a date at the end of the month prior to the sale without further questioning. 3/

1/ Memorandum prepared by Richard Peters of White & Case, March 27, 1975 at 3.

2/ Id. at 4 and 5.

3/ Id. at 3.

Lewis furnished Robert Clare of White & Case with information which confirmed prior practices of bond counsel, but which Lewis hoped would show how illusory the updated certificate problem really was:

Sol [Lewis] said he or the comptroller would be glad to certify that there would 'be cash on hand to pay the notes as they fall due just as there always had been such cash in the past'....

Sol [Lewis] produced a file of several prior monthly budgetary statements of the City which showed that at certain points in time there were outstanding in aggregate principal amount of TANS in excess of real estate taxes then receivable. 1/

Lewis did not provide White & Case with hard numbers. Instead, he went into a long explanation of the "J73" forms upon which daily collection reports were made to various local collection offices of the Comptroller's office. There were several hundred of these reports per day, he said, which were available in unaudited form for the parties to examine. 2/

To satisfy White & Case, Lewis offered to show the forms to them for their own inspection:

Sol [Lewis] claimed that he could never stand behind an estimated figure and that in the past bond counsel had always understood this problem and thus accepted the month-end figures. White & Case had now raised what he believed to be an unreasonable request. However, he said that his people were there to provide us with what we needed; that is, that he was prepared to 'give you the J-73's, explain the coding, give you adding machines and let you reach your own independent conclusions'.3/

1/ Id. at 3 and 4.

2/ Id. at 6.

3/ Id. at 6.

Not wanting to assume the responsibility for auditing the figures, White & Case declined the offer, asking instead for the "best bottom line figure" that the City could give with respect to collections through February 28, 1975. 1/ Lewis then refused to provide any figure whatsoever because, as he said, the City could not stand behind any number for the February collection. When Lewis was pressed as to why he had been able to provide estimated February collection figures several days earlier (February 25), but was unable to do so now, Lewis replied: ". . . If I knew what you intended I would have never provided them. I cannot and will not provide February figures on any basis." 2/ White & Case wanted to end the meeting if figures would not be provided. Lewis stalled, arguing that they should wait for the arrival of Bill Scott, Third Deputy Comptroller, who would solve the problem. 3/

Scott arrived later in the morning. Scott said that he was worried that the City might be put in the apparent posture of being unwilling to cooperate. 4/ At that, Scott "ordered" Lewis to perform the review of the J-73's which Lewis himself had refused to do all morning and the previous day. Lewis then left the room to carry out Scott's orders. Thirty minutes later Scott called Lewis to accelerate the work he was performing.

At about this time, John Osnato [White & Case associate] raised the possibility with me [Peters] that this entire meeting was pre-rehearsed in an attempt to set up [White & Case] as being unreasonable. I tended to agree with John. After discussing this with Bob Clare [another White & Case associate] John left the room to call Jay Epley to bring him up to date on this development. 5/

1/ Id. at 7.

2/ Id. at 8.

3/ Id. at 10.

4/ Id.

5/ Id. at 13.

Two City accountants then came to the meeting room and explained how they would normally review tax collections taking the J-73s for February 4 and 6 for examples. Each of the J-73s used as an example had already been underlined and marked, which led the White & Case attorneys to the conclusion that the work had been previously carried out despite assertions to the contrary by Lewis. 1/ Having seen the sample J-73s, Peters, Osnato and Clare left the Municipal Building with Sabatine to give the City's accountants time to perform their review. On the way out, Sabatine remarked to them that he already knew that the City would run into problems on the figures somewhere between February 6 and February 13. 2/

A second meeting on February 28 was held at the Bankers Trust Company among the five managers of the Bankers Trust syndicate (excluding Bank of America) and additional counsel for these firms. At this meeting, a decision was reached: the syndicate would not accept delivery of the notes.

Ultimately, the proposed TAN sale was aborted. Comptroller Goldin states it was cancelled because, of "a sudden demand by the underwriters unprecedented in the history of the City for data which could not physically be compiled, checked and certified in the short time available." 3/

1/ Id. at 14.

2/ Id. at 15.

3/ Press Release of the Office of the Comptroller, February 28, 1975.

3. Expansion of the White & Case Retainer

As a result of White & Case's investigation efforts in the proposed \$260 million TAN sale, they had the consolidated support of the banks to act as bond counsel for future offerings.

On March 1, when a bridge loan was announced for \$140 million of Revenue Anticipation Notes, maturing in 15 days, between the City and a consortium of ten City clearinghouse banks led by Chase, White & Case was appointed bond counsel. The sale was made on March 5. The TANs were not distributed to the public, but rather were held by the Clearinghouse banks until maturity on March 20.

Epley believed that he made his position clear to the syndicate during the first week in March that the individual banks were to look to their own counsel for advice concerning disclosure of the implications of the Wein suit:

. . . conversations dealing with the topic of the possible inconsistency or conflict if you will between bond Counsel for syndicate and underwriter's Counsel for syndicate, arose . . . Out of statements which I had made in meetings at Chemical to the effect that White & Case in the BAN transaction for the Chemical syndicate was acting as bond Counsel for the syndicate but were not purporting to advise the syndicate with respect to any other obligations they might have with regard to publicizing the implications of the Wein suit or other matters, and that it should be understood by all of the syndicate members that they were looking to their own counsel in that regard. 1/

White & Case maintained that their involvement in many of the events and meetings of early March resulted from their retainer by Bankers Trust and the syndicate, and not from any formal or informal understanding that

1/ Testimony of Epley at 175.

they were then acting as underwriters' counsel. 1/ There was conflicting testimony on this point. Charbonneau of Chemical Bank asserted that White & Case was acting then as underwriters' counsel as well as counsel to the syndicate. 2/ Epley demurred. Asked whether he considered it within the scope of his retainer to pass upon the question of what information should be disclosed by the underwriters to their customers in connection with the BAN offering, Epley responded: "Only with regard to Bankers Trust Company as the others were represented by Counsel of their own." 3/ Somewhere, there was a failure of communication.

It was during the second week in March that the identity of the firm's clients began to crystallize, and with it, the range of responsibilities began to expand. Epley testified that on March 10 the firm announced at a meeting of the syndicate that it would assume the dual role of syndicate counsel and underwriters' counsel:

. . . the concept of having a single Counsel representing the underwriting syndicate as a group as distinct from having each underwriter rely upon his own Counsel evolved in large part from the proceedings of the previous week. . . at the office of Chemical Bank on March 5th and 6th and I think various people concluded that it would be a more efficient and effective procedure if there were a single Counsel representing the underwriters as a group. 4/

1/ Id. at 173.

2/ Testimony of Herman Charbonneau, at 143-144.

3/ Id. at 177.

4/ Id. at 275-76.

Indeed, there was little that White & Case was not involved in concerning the City and the marketing of its securities. While it entered the scene on February 20, 1975, it soon acquired as much information (and probably more) about the City as had any other counsel in the past. The banks, the Financial Community Liaison Group, the broker-dealer syndicate members, all were looking to White & Case for help during a period rife with sophisticated problems.

Wood Dawson continued to play a role in the three March 1975 anticipation note offerings, although their role was a secondary one. They were instructed simply by Chase to "stick in there." 1/ Epley gave the following testimony on this point:

My recollection is that their presence was explained in terms of there having originally been two separate syndicates proposing to bid on the BANS, and that Chase had headed the non Chemical syndicate, and had retained Wood Dawson in that connection, but that by the time this meeting convened on March 5th, the syndicates had combined, that Chemical was to be the lead manager of the combined syndicate, and that we had

1/ Testimony of LeRoy Love, at 73.

been retained by Chemical on behalf of the entire syndicate.

However, Wood Dawson did remain present, I think, both at the March 5th and March 6th meetings. 1/

In fact, Wood Dawson attended many meetings during the first two weeks of March 1975 with White & Case and had numerous phone conversations with City officials, underwriters and representatives of White & Case. Wood Dawson's participation was very much equivalent to what they would have done had they been appointed attorney of record by the purchasing syndicates. They assisted in the work performed by White & Case, they offered suggestions to White & Case and the City officials, and they prepared memoranda relating to the proceedings. Their role was very little different from White & Case's role. Wood Dawson continued to advise Chase and rendered an opinion to Chase regarding one note sale.

A series of meetings that took place on March 5, 6, 7 and 8 were attended by Love, Sabatine and McCormick. These meetings were again of critical importance in dealing with the growing City fiscal crisis. The immediate concern was the upcoming RAN and BAN sales in the aggregate amount of \$1.052 billion dollars to be sold in less than 15 days.

There were two meetings at Chemical Bank which members of Wood Dawson attended on March 5 and 6 with a large group of underwriters. As Sabatine put it:

1/ Testimony of Marion J. Epley, at 417.

It's that dreadful day that we all sat over at
* [Chemical Bank] . . . that we stewed over the
White & Case -- the form of White & Case opinion,
and in the afternoon we stewed over disclosure
. . . . [i]n the evening, we stewed over what
wording the City of New York would have to say
regarding the sale. 1/

Wood Dawson worked with White & Case during this period in grap-
pling with the issue of disclosure which was raised again and again
at the meetings. While it is not clear who first raised the issue
(both Sabatine and Love had no recollection of these matters) it is
apparent that both firms were trying to deal with its resolution. 2/
On March 5, 1975 Wood Dawson and White & Case prepared a series of
unique questions to be propounded to the City. The firms were asking
for information on:

- (1) Pension obligations of the City;
- (2) Reasons for exclusions of indebtedness from the debt
limit;
- (3) Amount of housing indebtedness that had been switched
from one debt limit to another;
- (4) Remaining borrowing authority for revenue anticipation
notes; and
- (5) Use of proceeds of anticipation notes. 3/

1/ Testimony of LeRoy Love, at 219.

2/ Id. at 219.

3/ Div. Ex. (Love) 18.

These questions were an important and serious departure from prior practice. They were truly a benchmark in bond counsel - client relationships, because they signaled the first time in which bond counsel was making an active investigation of matters concerning the City's fiscal position in connection with a municipal securities sale.

The series of questions prepared by the two firms led to the drafting of a press release by Wood Dawson, White & Case and others to be issued by the City on March 7 in connection with the sale of the \$537,270,000 bond anticipation notes on that day. The release was also a milestone in that it represented the first step towards an attempt to make disclosure of the City's precarious fiscal position.

Love described the discussions at the drafting session:

. . . there was a wide spread concern -- a general concern per (sic) -- it was pervasive, that under the circumstances of that offering, something more than the customary disclosure with respect to the financial affairs of the City of New York would be necessary in order to underwrite the offering . . . [g]enerally, as I recall, it was a type of disclosure that was to emanate from the issuer, that is, the City of New York would put on notice all those who might, from time to time, become the holders of these particular securities, the character of the financial difficulties that the City was then undergoing. 1/

But the press release fell far short of full and adequate disclosure. It only made a brief allusion to the City's financial problems by noting the "relatively high rate of interest" on the notes and stating:

1/ Id. at 236.

While solution of the City's fiscal problems is not an easy matter, Comptroller Goldin expressed his confidence that the City would, when the time comes, be in a satisfactory legal and fiscal position to sell bonds to fund these notes. 1/

The parties present at the meetings were aware of the requirements of the antifraud provisions of the Securities Exchange Act:

Q. Do you recall whether or not there was any talk of disclosure being required pursuant to the Securities Acts?

A. Well, not particularly but I did certainly hear the phrase 10b-5 being thrown around rather recklessly that day.

* * *

Q. What did that phrase mean to you at that point in time?

A. . . . with respect to material information that should be made available in the offering of securities.

Q. Did the people at that meeting feel that information had to be disseminated to the investing public to satisfy their requirements of the 10b-5?

A. As I recall, no one suggested that at that point in time it would be possible to put together an official statement as such term is understood in the industry, and that the cause of the awareness, of at least the media, of the financial difficulties under which the City was laboring at that point, their -- those securities might be underwritten with a widely publicized statement that might, I suppose, fall short of the preparation of a definitive official statement. 2/

1/ Press Release of the Office of the Comptroller, No. 75-31, March 7, 1975.

2/ Testimony of LeRoy Love, at 237-238.

Disclosure was a principal topic of discussion at the meetings and both Love and Sabatine contributed their views. Said Sabatine:

. . . I was probably asked questions about disclosure and I probably responded to them. What I said basically I don't recall. 1/

Yet, in spite of the general awareness of the antifraud provisions of the securities acts, Wood Dawson admittedly "advised" Chase on "the form of statement for release by the City Comptroller used in connection with marketing the notes," 2/ and assisted White & Case in the preparation of a press release which was far from a description of the City's fiscal situation. In that press release there was not even a rudimentary description of the problems besetting the City and the risks attendant upon an investment in the securities being offered.

The issue of investigation of the City's figures was raised in connection with the future issuance of revenue anticipation notes against questionable budget appropriations. Wood Dawson expressed their view at the meeting that as long as the City maintained it had authority to issue revenue anticipation notes based on budget appropriations, underwriters had no obligation to look behind the City's certified statements unless they have a definite reason to suspect "hanky panky". 3/

1/ Id. at 243.

2/ Div. Ex. (Love) 25.

3/ Div. Ex. (Love) 20 at 3-4.

The preparation of the Report of Essential Facts (the "Report"), a document disseminated to the public by the City beginning March 13, 1975, was yet another benchmark for the City because it constituted the first time any sort of a disclosure document had ever been prepared for the public investor in connection with the sale of the City's notes. 1/ The City had, in the past, prepared, in conformance with a State regulation, a several page document used in the sale of its bonds which was both a Notice of Sale and Report of Essential Facts, but it was not disseminated to the public and it contained barebones financial data.

The Report represented a collegial effort to provide disclosure regarding the City's finances to prospective investors.

Development of the statement involved a high degree of cooperation among staff of the Office of the Comptroller, the Bureau of the Budget, White & Case [bond counsel to the underwriters] and a task force made up of members of the Staff Committee including: Roy Anderes, Bankers Trust; William Solari, Donaldson, Lufkin; Chester Johnson, Morgan Guaranty; John Thompson, W. H. Morton; Jac Friedgut, Citibank; and Jim O'Sullivan and Walter Carroll, Chase. 2/

This Report contained a schedule of anticipated borrowings, and cash flow projections. It contained information regarding some \$3 billion in outstanding RANS without explaining that a significant percentage had been issued

1/ Letter to Richard Kezer from Marion J. Epley, April 17, 1975.

2/ Division Exhibit (Epley) 10.

against uncollectible revenues. 1/ Epley, in responding to a series of questions regarding the scope of the firm's retainer with respect to the \$375 million RAN which was bid upon March 14 and delivered March 20, stated:

It was to assist the underwriters in participating with the City in the preparation of a document of the City containing relevant information to be disseminated in connection with the sale of [\$375 million] revenue anticipation notes. 2/

. . . [I]ts use in connection with the delivery out of the BANs was simply an additional use to which it was put because it had become available by the time those deliveries were made. 3/

The decision to prepare the Report was reached at the Saturday, March 8 meeting at Chemical Bank among the managers. John Osnato was there for White & Case "to act as an observer" 4/ pursuant to a request that White & Case send someone to the weekend meetings. Said Epley:

My only recollection of [Osnato's report to me] is that White & Case had been asked to state our position with respect to feasibility with preparing some sort of disclosure document for use in connection with public offerings of securities by the City and our views as to the nature of this sort of investigation which might be appropriate in connection with the preparation of such a document on behalf of the underwriters. (Emphasis added). 5/

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- 1/ Office of State Comptroller. Report on New York City's control budgetary and accounting system. Report No: 3-76 at 2.
- 2/ Testimony of Marion J. Epley, at 266.
- 3/ Id. at 232.
- 4/ Id. at 249.
- 5/ Id. at 250.

During this meeting it was White & Case's recommendation that the City use "some sort of information sale document" for all future City offerings, without defining the form it should take.

Whether a Report was viewed as an "information sale document" or a "disclosure document," there was no mistaking its use by the underwriters: to provide investors with some information regarding the City's finances to assist them in making an investment decision.

The Report of Essential Facts] was to be supplied to persons whom the underwriters approached as prospective purchasers of the notes. . . in connection with the sale of the RANs. 1/

The Report was a nostrum, the inadequacies of which were never divulged to potential investors. During the week of March 10, White & Case assisted the Grossman Committee in the joint effort to put together the disclosure document:

During the week of March 10th there were continuing discussions, both within White & Case and between White & Case and Grossman and other analysts in the underwriting syndicate and representatives of the City as to what sources of information were available and what sort of information would appeal to be appropriate for disclosure in the documents to be used in connection with the sale of notes. 2/

According to Epley, White & Case acted primarily as an organizer of information furnished by several sources, without attempting to take active part in the drafting process:

The City was responsible for the preparation or publication of all of the information contained in the Report of Essential Facts. They supplied information, which was reviewed by the bank analysts, and which we read.

1/ Id. at 370.

2/ Id. at 267.

We attempted to coordinate comments, suggestions, recommendations, from the bank underwriter, analyst personnel, and convey those to the City. 1/

They were also a liaison between all groups.

We reviewed material as it was forthcoming from the City, asked questions and suggested comments or changes which we felt appropriate. 2/

Responding to the question of whether White & Case ever requested the City to include additional information in the Report, Epley gave this answer:

To the extent that suggestions may have been made to us by Mr. Grossman or others in the analysts group, or to the extent that information furnished by the City appeared to raise questions or suggest further information which might be relevant, I and persons at White & Case may have done so.

I have no recollection. 3/

While Epley disavowed any responsibility for the accuracy or adequacy of the Report, he did acknowledge that the firm had a clear responsibility to make efforts to ensure accuracy and adequacy:

Neither our firm nor any law firm about which I am familiar assumes legal or other responsibility for the adequacy or accuracy of disclosure documents as distinct from Counsel with their clients seeking to make those documents as accurate and as complete as possible. 4/

1/ Id. at 485.

2/ Id. at 357

3/ Id. at 369

4/ Id. at 238.

White & Case's research was on-going, with important results. An important discovery of the research was that the "first lien" guaranty, widely believed to be ironclad and referred to in the City's notices of sale for the March 1975 offerings, did not apply to anticipation notes. 1/ White & Case was aware of this information prior to the sale of the RAN offering of \$375,000,000 that was bid upon March 14, 1975. 2/ However, there was no disclosure of the first lien exception in connection with that offering. 3/

1/ According to the New York State Constitution, the obligation to make repayment of principal and interest on the City's notes and bonds constitutes a first lien on all City revenues, giving investors strong assurance of the security of their investment owing to the multiple debt service coverage produced by City revenues. There is, however, an important exception to this constitutional protection: The City is not required to annually appropriate monies to retire the principal of anticipation notes, although it is required to appropriate sums to service the interest. As a result, a holder of revenue and tax anticipation notes of the City may not bring successful suit against the the City for payment of principal from first revenues until five years after the date of the original issue. New York Constitution Article VIII, §2. For a discussion of this provision see Washburn v. Goldin, New York Law Journal, January 6, 1977, at 10.

As far back as 1971 Wood Dawson was aware of serious questions concerning the first lien exception. Letter from George K. King of Wood Dawson to Jules Merron, July 23, 1971; Testimony of Alexandra Altman, at 116, et seq.

2/ Testimony of Marion J. Epley, III, at 57.

3/ Id. at 441.

An undated memo written by a White & Case attorney discussed the first lien exception:

I called Sandy [Alexandra] Altman to discuss the "first lien" Language in Article 8, Section 2, of the New York State Constitution. I told her that it appeared BANS were not covered in that Section and yet the Notice of Sale for the March issue contained the first lien language. Sandy was aware of the problem and stated that the Notice of Sale and advertisements contained "a lot of loose language." She said that the gap in Article 8, Section 2 may have been filled by the fact that the underlying bonds have a first lien. She also stated that the first lien language had been dropped from the Notice of Sale for RANS and TANS at the request of either Hawkins, Delafield or Wood Dawson. 1/ She stated that she was not the proper person in the City to get this information from and told me to call Ken Hartman.

I called Ken Hartman today and he was also aware of the problem. He suggested that it appeared the BANS were excluded from the first lien language. He stated that there were a lot of problems in Notices of Sale and with the use of the first lien language generally. He further felt that if the City continued to use first lien language it could "get blown out of the water." He said he would do some further research in the area and get in touch with us (he said his research would concentrate on the Vanderzee case). 2/

Nonetheless neither the Report of Essential Facts nor its amendments contained any clarification or elaboration of the absence of first lien.

1/ In fact, these Notices of Sale did not drop the first lien language.

2/ See White & Case Memorandum to the files. White & Case has advised the staff that the memorandum was prepared in Mid-April, 1975.

The banks were very concerned about the disclosure issue. Epley described on the record a conversation which he had with Charles Sanford of Bankers Trust around March 24 regarding these questions:

In the course of [the March 24] conversation, what I did was outline for Mr. Sanford the groundrules under Rule 10b-5 for trading in securities.

What I told him was that, if at any time he decided that whatever information or indications he might have with regard to developments affecting the City were such that they might later be found to be material, and further, were such as not to have been generally known to the public, he should recognize that trading after that point could result in a legal exposure.

I learned sometime later, I would think perhaps sometime in April, that at some point subsequent to that conversation with Mr. Sanford, he had, in fact, made a decision to at least temporarily withdraw from the New York City market. I don't recall at anytime discussing with him either the making of that decision, or the factors which went into his judgment in making that decision.

* * *

I did not tell him that he had a problem or did not have a problem. I described for him the circumstances under which a problem might exist. 1/

One week later, on March 31, there was a large meeting at the Chase attended by Epley and many others including the principal representatives of the banks. Asked about this meeting, Epley described his position:

1/ Testimony of Marion J. Epley, at 459-61.

[T]here was, to my perception, an extreme degree of uncertainty as to just what was going to occur with respect to the continuing ability of the City to raise funds in the public capital market, and amounts and timing raising that money. And the problems I was specifically referring to [in the memo summarizing the March 31 meeting], as I recall, was the difficulty, if not impossibility, of describing adequately a totally uncertain, fluid situation. 1/

At the March 31 meeting, Epley questioned whether it was at all possible to make full and fair disclosure of the City's problems:

There was a discussion of the possibility of an underwriting of City notes to be sold and delivered on April 14, 1975. I advised the group that in our view any underwriting in which City notes were re-sold by the underwriters to the public would raise very serious problems of disclosure, and that the difficulties of the City might well render the achievement of adequate disclosure impossible. I also noted that in any event the disclosure required would probably cause serious marketing problems for any City notes. The bankers present emphasized that no decision as to any public sale had yet been made and confirmed their understanding that the disclosure problems might well be insoluble.

Mr. Kezer of First National City Bank then raised a question as to trading in presently outstanding City notes including the \$375 million of RANS offered several weeks ago. I told him that we had advised Bankers Trust that in view of developments since the issue date of those notes, sales at this point might give rise to 10b-5 liability by a selling

1/ Id. at 457-58.

underwriter. I told Mr. Kezer that we were therefore giving the same advice to all of those present and recommended that they consult their own counsel to the extent that they felt it appropriate. (Emphasis added.) 1/

The next day, April 1, Epley wrote a letter to Labrecque (of Chase) to summarize the conclusions reached at the prior day's meeting. A second letter, duplicate in all material respects save one, was sent to Ellmore Paterson (of Morgan Guarantee). A comparison of the two letters is revealing.

The April 1 letter contained the following:

While it may be possible by updating and supplementing that Report [of Essential Facts] to satisfy the applicable legal requirements with respect to future underwritten offerings, we understand from our discussions with the Banks that the adverse information which would be required in such a Report would in all likelihood render the City securities unsaleable. 2/

The letter dated April 2 deleted that sentence and substituted the following language:

It may be possible by updating and supplementing that Report to satisfy the applicable legal requirements with respect to future underwritten offerings. 3/

Epley offered the following explanation of the deletion and change:

According to Epley, members of the firm met on April 2 as a result of a phone call to the firm from Roy Haberkern (counsel to the Chase) which suggested consideration of two matters: (1) whether the April 1 letter signed

1/ Division Exhibit (Epley) 19, at 2-3.

2/ Division Exhibit (Epley) 29.

3/ Division Exhibit (Epley) 30.

by Epley should have been addressed to Patterson, as head of the Clearing-house banks, instead of Labrecque, as representative of the prospective lead managing underwriter for the April note offering, in light of the fact that the issues discussed therein transcended any particular offering; and (2) whether the last sentence of the first paragraph should have been revised to make it consistent with the true position of the banks. 1/

The Report of Essential Facts of March 13 was used in connection with the offerings of BANs and RANs in March 1975. The inadequacies of the Report of Essential Facts are detailed in the staff's report on the role of the City and its officials. The press release of March 7 and the Report were misleading and were devoid of disclosure of the material uncertainties regarding the City's financial future; nor was there any disclosure of the City's financial condition, particularly the budget devices that had brought the City to the serious state of affairs that existed in March 1975. The press release and the Report of Essential Facts were provided to the purchasers of BANs and RANs in March of 1975 and were available to investors trading in the City's securities in the secondary market.

Despite the inadequacies in the March 7 press release and the Report, White & Case raised no objection to the issuance of either document. The position of White & Case is that other counsel were present to advise the underwriters on disclosure matters and that their role did not encompass objecting to the inadequacies of the March 7 press release and the Report. Essentially, White & Case submits that the judgments reached in March, 1975 were collective judgments of a large group of professionals and lawyers.

1/ Testimony of Marion J. Epley, at 492.

III. CONCLUSION

The practice of municipal securities law is little understood by other lawyers, and probably not understood at all by the investing public. Yet, it is a role so vital that, without the closely-worded opinion provided by municipal bond counsel, municipalities would be unable to secure the tens of billions of dollars of yearly financings which they seek from the public capital markets.

Until late February, 1975 bond counsel passing upon New York City securities did little if any independent investigation and relied almost exclusively on City officials. Even during the period when events began to point to a fiscal crisis, bond counsel did not critically analyze the financial information provided by the issuer.

Bond counsel were not expected to investigate the creditworthiness of the City. However, when put on notice of circumstances that called into question matters basic to the issuance of their opinion, bond counsel should have conducted an additional investigation. And bond counsel with knowledge of information material to investors should have taken all reasonable steps to satisfy themselves that those material facts were disclosed to the public. Even in the maelstrom of the City's difficulties, some bond counsel recognized the duty of participants in the distribution to disclose material facts — and so advised them. Unfortunately, there was a gap between the recognition of that duty and its implementation.

Of course, there are others who had a key role in the disclosure process, particularly the City and its officials. This did not relieve bond counsel of the duty to obtain background information substantiating their opinions, and to take reasonable steps to bring about disclosure of material facts which were known to them. If they had taken reasonable steps to bring about disclosure and if that disclosure had not been forthcoming, bond counsel should not have associated themselves with the offering.

The Commission has indicated in another matter (In the Matter of Jo M. Ferguson, Securities Act Release No. 5523, August 21, 1974), that when the role of bond counsel is expanded to include preparation of disclosure documents such as an official statement, bond counsel is obliged to see to it that all material facts that bond counsel knew or should have known are included in the official statement.

When testifying during the investigation, at least two bond counsel stated it would not be appropriate to issue an approving opinion if there was significant danger that the City could not pay the obligation when due. But, since bond counsel relied almost exclusively on information provided by officials of the City it appears they relied on chance to determine whether that danger existed.

Nor are bond counsel relieved of their obligations because some issues were discussed in the press. The City's problems were discussed in the press but these discussions did not constitute full and fair disclosure. Bond counsel knew or should have known this. Furthermore, investors are entitled to and did rely on participants in the process for full disclosure of material facts concerning the issuer.

APPENDIX A

Securities Issued by the City of New York
October 1974 - March 1975

<u>Issue Date</u>	<u>Type of Security</u>	<u>Bond Counsel</u>
10/18/74	\$517,760,000 Various Purpose Notes	
	I. URNs \$97,355,000	Wood Dawson Love & Sabatine
	II. BANs \$420,405,000	
	A. \$250,000,000	Hawkins, Delafield & Wood
	B. \$170,405,000	Wood Dawson Love & Sabatine
10/15/74	\$475,580,000 Serial Bonds	Wood Dawson Love & Sabatine
11/12/74	\$615,000,000 Various Purpose Notes	Hawkins, Delafield & Wood
	I. RANs \$500,000,000	
	II. TANs \$115,000,000	
12/13/74	\$600,000,000 Various Purpose Notes	Hawkins, Delafield & Wood
	I. RANs \$400,000,000	
	II. TANs \$200,000,000	
1/13/75	\$620,000,000 RANs	Sykes, Galloway & Dikeman
2/14/75	\$290,000,000 RANs	Hawkins, Delafield & Wood
2/15/75	\$141,440,000 Serial Bonds	Wood Dawson Love & Sabatine
2/24/75	\$170,000,000 RANs	Wood Dawson Love & Sabatine

2/25/75	\$248,980,000 BANS	Corporation Counsel
3/5/75	\$140,000,000 RANS	White & Case
3/14/75	\$537,270,000 BANS	White & Case
3/20/75	\$375,000,000 RANS	White & Case

APPENDIX B

TRANSCRIPT OF PROCEEDINGS

\$290,000,000 The City of New York

Revenue Anticipation Notes

February 14, 1975

- ✓ 1. Copy of Charter of The City of New York (see master file.)
- ✓ 2. Certified copy of Delegation by the Mayor to the Comptroller to issue Notes.
- ✓ 3. Certificate authorizing the issuance of Tax Anticipation Notes.
4. Confirmation of Sale.
- ✓ 5. Certificate of Chief, Division of Municipal Securities, Office of the Comptroller as to compliance with Regulation XVIII.
- ✓ 6. Copy of bids received.
- ✓ 7. Certificate of Award.
- ✓ 8. Signature and No-Litigation Certificate.
- ✓ 9. Certificate of Delivery and Payment.
- ✓ 10. Specimen Note—
11. Arbitrage Certificate with opinion of Corporation Counsel.
12. Opinion of Hawkins, Delafield & Wood.

REPORT ON
ACCOUNTING PRACTICES AND
FINANCIAL REPORTING

95-040 293

(SEE MASTER FILE)



CITY OF NEW YORK
OFFICE OF THE MAYOR
NEW YORK 7, N.Y.

I, ROBERT F. WAGNER, Mayor of The City of New York, exercising the powers of a finance board pursuant to section 8c of the New York City Charter, effective January 1, 1963, as amended by Chapter 998 of the Laws of 1962; and

Pursuant to Section 30.00 of the Local Finance Law of the State of New York, I hereby delegate to the Comptroller the power to authorize the issuance and the renewals thereof of Bond Anticipation Notes, Tax Anticipation Notes, Revenue Anticipation Notes and Urban Renewal Notes; and

Pursuant to Section 50.00 of the Local Finance Law of the State of New York, I hereby delegate to the Comptroller such powers and duties pertaining to the sale and issuance of obligations of The City of New York as are prescribed in Sections 57.00, 58.00, 59.00, 60.00, 62.00 and 63.00 of the Local Finance Law of the State of New York, and any other powers or duties pertaining or incidental to the sale and issuance of obligations; and

I hereby delegate to the Comptroller the power to prescribe the terms, form and contents of such Bonds and Notes.

and pursuant to Section 61.00 of the Local Finance Law of the State of New York, I hereby authorize that all Bond Anticipation Notes, Tax Anticipation Notes, Revenue Anticipation Notes, Capital Notes, Budget Notes, Urban Renewal Notes and evidences of indebtedness to be issued to the State with respect to projects undertaken pursuant to Section 55.00 of the Public Housing Law be executed in the name of the municipality by the Comptroller with his manual signature or with his facsimile signature, duly authorized; or by a Deputy Comptroller with his manual signature, and shall be under seal of the City and attested by the City Clerk or his Deputy; and

I hereby authorize that all definitive serial bonds and corporate stock when required to be issued shall be in registered form or in coupon form, or both; the coupon bonds to be of the denomination of \$1,000 each and/or of the denomination of \$5,000 each, which coupon bonds shall be executed by the Mayor and by the Comptroller on behalf of the City, with their facsimile signatures duly adopted by them as their true and genuine signatures and shall be sealed with the common seal of the City and attested by the City Clerk or his Deputy, and the coupons attached thereto to be authenticated by the Comptroller, with his facsimile signature and the registered cert-

ificates thereof to be of any denomination that is a multiple of \$1,000 and which registered certificates shall be executed by the Mayor and by the Comptroller with their facsimile signatures duly authorized, and shall be sealed with the common seal of the City and attested by the City Clerk or his Deputy; and

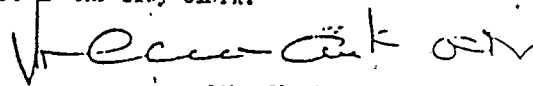
I hereby authorize that all serial bonds and corporate stock, when required to be issued in interim form pending the printing or engraving and delivery of serial bonds or corporate stock in definitive form, shall be executed in the same manner herein prescribed for the execution of definitive serial bonds and corporate stock issued in coupon form, and may be issued with or without coupons attached thereto.

New York, N. Y.
February 21, 1963


MAYOR

I HEREBY CERTIFY that the within authorization, consisting of three pages, is on file in the Office of the City Clerk.

Dated: New York, N. Y.
APR 7 - 1965


City Clerk.



HIRSHON J. GOLDIN
COMPTROLLER
"Accountancy"

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
MUNICIPAL BUILDING
NEW YORK, N. Y. 10007

TELEPHONE 566.

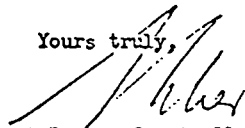
February 5, 1975

Hon. Abraham D. Beame
Mayor, The City of New York

Dear Mr. Mayor:

Pursuant to Section 30.00 of the Local Finance Law, I herewith transmit Certificate 29-75, which is to be filed with you, authorizing the issuance of \$290,000,000 of Revenue Anticipation Notes on February 14, 1975, pursuant to the provisions of Section 25.00 of the Local Finance Law.

Yours truly,


First Deputy Comptroller



HARRISON J. GOLDIN
COMPTROLLER

THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
MUNICIPAL BUILDING
NEW YORK, N. Y. 10007

TELEPHONE 566.

CERTIFICATE NO. 29-75

AUTHORIZING the ISSUANCE of REVENUE ANTICIPATION NOTES

I, SEYMOUR SCHER, FIRST DEPUTY COMPTROLLER of The City of New York, do hereby certify that, on February 21, 1963, the Mayor of the City of New York, exercising the powers of a finance board, pursuant to Section 8c of the New York City Charter effective January 1, 1963, granted to the Comptroller pursuant to Section 30.00 of the Local Finance Law, the power to authorize the issuance of Revenue Anticipation Notes which authority is still in full force and effect, and has not been modified, amended or revoked; and I further

CERTIFY that, in accordance with such authority and pursuant to the provisions of Section 25.00 of the Local Finance Law, I have authorized the issuance of Revenue Anticipation Notes as hereinbelow stated, and prescribed the terms, form and contents thereof, which Revenue Anticipation Notes are to be issued in anticipation of the receipt of moneys from the State or United States Government to become due in the fiscal year 1974-1975; the amount of such revenues as estimated in the annual budget for the fiscal year 1974-1975; the amount thereof collected or received, the balance thereof against which said Revenue Anticipation Notes may be issued, the amount of such notes to be issued hereunder and the amount of notes outstanding is as follows:

(In Millions)

Type of <u>Revenue</u>	Amount of Notes to be <u>Issued</u>	Estimated Amount in Expense <u>Budget*</u>	Collec- tions	Notes Out- standing	Balance Against Which Notes may <u>be Issued</u>
State Aid	\$290.0	\$2,296.6	\$401.1	\$1,500.0	\$395.5

*Excludes General Fund

CERTIFICATE NO. 29-75

and I further

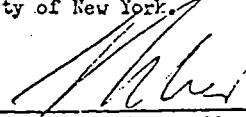
CERTIFY that the amount of Revenue Anticipation Notes to be issued hereunder is \$290,000,000:

<u>Date of Issuance</u>	<u>Date of Maturity</u>	<u>Amount Authorized</u>
February 14, 1975	February 13, 1976	\$290,000,000

and I further

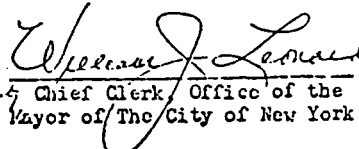
CERTIFY that the proceeds of these notes are to be used to meet expenditures under appropriations duly made by the City of New York.

Dated: February 5, 1975


First Deputy Comptroller

I HEREBY CERTIFY that the above certificate is on file in the Office of the Mayor of The City of New York.

Dated: February 10, 1975


Chief Clerk, Office of the Mayor of The City of New York

THE CITY OF NEW YORK -- OFFICE OF THE COMPTROLLER
 NOTICE OF SALE
 \$ 290,000,000. OF REVENUE ANTICIPATION NOTES

INTEREST EXEMPT FROM ALL PRESENT FEDERAL, NEW YORK STATE AND NEW YORK CITY INCOME TAXES

SEALED PROPOSALS will be received by The Comptroller of The City of New York at his office, Room 530, in the Municipal Building, in the Borough of Manhattan, in The City of New York,

Until 11 o'clock a.m., Eastern Standard Time

on

Tuesday, the fourth day February, 1975

at which time and place they will be publicly opened and announced for the purchase at not less than par and accrued interest of \$ 290,000,000, principal amount of The City of New York Revenue Anticipation Notes, to bear interest to be payable at maturity on February 13, 1976, and to be dated February 14, 1975, without option of redemption prior to maturity. Interest will be paid for the exact number of days calculated on the 365 day year.

Principal and interest of said Notes are payable in lawful money of the United States of America at the Office of The Comptroller of The City of New York, in The City of New York, New York. Notes will be in bearer form without interest coupons. The Notes for each \$ 1,000,000 shall be issued 4 for \$ 100,000 each, and 18 for \$ 25,000 each, and 15 for \$ 10,000 each.

1160	Notes for \$ 100,000 each =	\$ 116,000,000.
5220	Notes for 25,000 each =	130,500,000.
4350	Notes for 10,000 each =	43,500,000.
		<u>\$ 290,000,000.</u>

Notes will be general obligations of The City, all the taxable real property within which will be subject to the levy of ad valorem taxes to pay said Notes and the interest thereon, without limitations as to rate or amount. Payment of debt service shall be the first lien on all the City's revenues. The State Constitution requires the City to pledge its faith and credit for the payment of the principal of the Notes and the interest thereon.

The said Revenue Anticipation Notes are issued pursuant to Section 25.00 of the Local Finance Law in anticipation of moneys from the State or United States Government due in the fiscal year 1974 - 1975. The amount of such Notes to be issued, and the type and amount of uncollected Revenue against which said Revenue Anticipation Notes may be issued, are as follows:

TYPES OF REV.	AMOUNT TO BE ISSUED	EST. AMOUNT IN EXP. BUDGET *	COLLECTIONS TO DATE	NOTES OUT-STANDING	BALANCE AGAINST WHICH REV. ANT. NOTES MAY BE ISSUED
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1974 - 1975 EXPENSE BUDGET (IN MILLIONS)

State Aid	\$ 290.0	\$ 2,296.6	\$ 401.1	\$ 1,500.0	\$ 395.5
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* EXCLUDES GENERAL FUND

Bidders shall name the rate of interest which the Notes offered for sale are to bear, which rate shall be a multiple of one one hundredth of one per centum, not exceeding the maximum interest rate permitted by law. Proposals shall be for a minimum of \$ 1,000,000 of Notes. Separate proposals are required for each portion of said Notes for which a different interest rate is bid. Bids must remain firm until 3 o'clock p.m., of the day on which the bid is opened and announced.

Notes will be awarded at the lowest rates offered in the proposals, without reference to premium, provided, however, that as among proposals specifying the same lowest interest rate, award will be made on the basis of the highest premium per dollar principal amount of Notes specified at such lowest interest rate in such proposals.

In the event it becomes necessary so to do, a bidder may be required to accept such portion of the amount of Notes for which he bid, as may be allotted to him. If the amount of Notes awarded is less than the amount of Notes bid for in the proposals, the premium offered in such bid shall be prorated.

The right is reserved to reject any or all bids, and any bid not complying with this Notice of Sale will be rejected; provided, however, that bidders may condition their proposals upon opinion of recognized municipal bond attorneys as to validity of issuance, such opinion to be obtained at the expense of the purchaser. Each bid must be enclosed in a sealed envelope addressed to the undersigned Comptroller of The City of New York, and should be marked on the outside "Proposals for Notes". Such bids may be hand-delivered and deposited in the box provided for this purpose and located in the Board Room of The Office of The Comptroller, prior to 11:00 a.m., on the date of sale, or, if mailed, must be in this office not later than the close of business on day preceding date of sale.

Bearer Notes without interest coupons will be delivered to the purchasers at the Office of The Comptroller of The City of New York, Room 830, Municipal Building, Centre and Chambers Streets, New York, New York, on February 14, 1975. Payment must be made in Federal Funds.

A report of essential facts will be furnished to any interested bidder upon request.

Proposals for the purchase of said notes shall be in the form set out in this Notice of Sale.

The City of New York
Office of The Comptroller
January 29, 1975



COMPTROLLER
THE CITY OF NEW YORK

P R O P O S A L

REVENUE ANTICIPATION NOTES TO MATURE ON FEBRUARY 13, 1976

Honorable Harrison J. Goldin
Comptroller
The City of New York

Dear Sir:

For _____ DOLLARS (\$ _____)
principal amount of The City of New York Revenue Anticipation Notes, to be dated
February 14, 1975, and to be payable on February 13, 1976, without option of redemption
prior to maturity, bearing interest at the per annum rate of

_____ PER CENTUM (_____ %)
we will pay the par value thereof, and accrued interest to the date of delivery of the
Notes, plus premium of

_____ DOLLARS (\$ _____)
for Notes described in the Notice of Sale.

This proposal is subject to our being furnished, at our expense, with the
unqualified opinion of our attorneys,

_____ approving the validity of the Notes. It is understood that sufficient evidence will
be furnished to enable our attorneys to render such opinion at the time of, or prior
to the delivery of the Notes.

Bidder's Bond Attorney may be designated herein, or such designation may
be made after the Notes are awarded. Each successful bidder, who has not designated
an attorney, agrees to advise the Comptroller of the name and address of the attorney
designated, not later than 2 p.m., on the date hereof.

Notes shall be of the denomination set forth in the Notice of Sale.

Very truly yours,

New York, N. Y.
February 4, 1975

Address: _____ By: _____

_____ Tel. No. _____



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
MUNICIPAL BUILDING
NEW YORK, N. Y. 10007

— 4667
TELEPHONE 866-

I, RUSSELL T. ALDAG, CHIEF, Division of Municipal Securities, Office of The Comptroller, DO HEREBY CERTIFY, that pursuant to Regulation XXXV, adopted by The Comptroller of The State of New York on June 10, 1960, as revised August 10, 1967, caused to be mailed on January 29, 1975, a Notice of Sale of

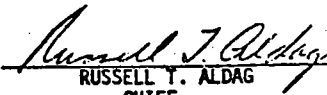
\$ 290,000,000. Revenue Anticipation Notes

of The City of New York, dated February 14, 1975, a copy of which Notice is being attached, to the following:

Hon. Arthur Levitt
State Comptroller
Albany, New York

All the financial newspapers, publications and services set forth in the list attached to Regulation XVIII.

All the persons, firms and corporations listed as Part 1, Bond Dealers of the appendix annexed to Regulation XVIII.


RUSSELL T. ALDAG
CHIEF
DIVISION OF MUNICIPAL SECURITIES

Dated: New York, N. Y.
January 29, 1975

STATE OF NEW YORK
CITY AND COUNTY OF NEW YORK

Legislator's Certificate

Journal of The City of New York, published daily except Sundays and legal holidays; that the advertisement hereto annexed has been regularly published in SIX (6) successive issues of The City Record, commencing on the 29TH day of JANUARY, 1975.

Sworn to before me, this 30th day of February, 1975
day of February, 1975

Harriet Katz
HARRIET KATZ
Commissioner of Deeds
City of New York, Room 60.02
Certificate filed in New York County
Commission Expires Feb. 1, 1977

OFFICE OF THE COMPTROLLER
NOTICE OF SALE

\$290,000,000 OF REVENUE ANTICIPATION NOTES
INTEREST EXEMPT FROM ALL PRESENT FEDERAL,
NEW YORK STATE AND NEW YORK CITY INCOME TAXES

SEALED PROPOSALS WILL BE RECEIVED BY THE COMPTROLLER
of The City of New York, at his office, Room 530, in the Municipal Building, in the
Borough of Manhattan, in the City of New York.

NO 2



THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
MUNICIPAL BUILDING
NEW YORK, N. Y. 10007

TELEPHONE 866- 4667.

COPY OF BIDS RECEIVED

I, HARRISON J. GOLDIN, COMPTROLLER of The City of New York, DO HEREBY CERTIFY that pursuant to Notice of Sale of \$ 290,000,000. Revenue Anticipation Notes of The City of New York, issue of and dated February 14, 1975, bids for which were received and opened at 11:00 o'clock a.m., Tuesday, February 4, 1975, that I received Four (4) bids therefor, a copy of each of which is hereto attached. The bids were opened and awarded as follows:

Morgan Guaranty Trust Company

<u>Principal</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Premium</u>
\$ 290,000,000.	7.55%	February 13, 1976	\$ 2,001,00


COMPTROLLER
THE CITY OF NEW YORK

Dated: New York, New York
February 4, 1975

Approved

P R O P O S A L

REVENUE ANTICIPATION NOTES TO MATURE ON FEBRUARY 13, 1976

Honorable Harrison J. Goldin
Comptroller
The City of New York

Dear Sir:

For Two Hundred Ninety Million DOLLARS (\$ 290,000,000.00)
principal amount of The City of New York Revenue Anticipation Notes, to be dated
February 14, 1975, and to be payable on February 13, 1976, without option of redemption
prior to maturity, bearing interest at the per annum rate of
Seven and 55/100 PER CENTUM (7.55 %)
we will pay the par value thereof, and accrued interest to the date of delivery of the
Notes, plus premium of

Two Cent and Two Thousandths DOLLARS (\$ 2.001.00)
for Notes described in the Notice of Sale.

This proposal is subject to our being furnished, at our expense, with the
unqualified opinion of our attorneys,

To BE DESIGNATED

approving the validity of the Notes. It is understood that sufficient evidence will
be furnished to enable our attorneys to render such opinion at the time of, or prior
to the delivery of the Notes.

Bidder's Bond Attorney may be designated herein, or such designation may
be made after the Notes are awarded. Each successful bidder, who has not designated
an attorney, agrees to advise the Comptroller of the name and address of the attorney
designated, not later than 2 p.m., on the date hereof.

Notes shall be of the denomination set forth in the Notice of Sale.

Very truly yours,

New York, N. Y.
February 4, 1975

Address: 23 WALL STREET

N.Y. N.Y. 10015

483-5913

Morgan Guaranty Trust Company of New York
Bank of America N.T. & S.A.
Bankers Trust Company
Chemical Bank
Salomon Brothers
Merrill Lynch Pierce Fenner & Smith Inc.

George R. Hinman, Jr.
by: George Hinman, Jr., Asst. Vice Pres.
Morgan Guaranty Trust Company of New York

(2)

P R O P O S A L

REVENUE ANTICIPATION NOTES TO MATURE ON FEBRUARY 13, 1976

Honorable Harrison J. Goldin
Comptroller
The City of New York

Dear Sir:

For One hundred Eighty Million DOLLARS (\$ 180,000,000)
principal amount of The City of New York Revenue Anticipation Notes, to be dated
February 14, 1975, and to be payable on February 13, 1976, without option of redemption
prior to maturity, bearing interest at the per annum rate of
Seven and 1/8 PER CENTUM (7.68)
We will pay the par value thereof, and accrued interest to the date of delivery of the
Notes, plus premium of
Five hundred fifty five and 1/100 DOLLARS (\$ 555⁰⁰)
for Notes described in the Notice of Sale.

This proposal is subject to our being furnished, at our expense, with the
unqualified opinion of our attorneys,

Sykes, Galloway & Dikeman

annoying the validity of the Notes. It is understood that sufficient evidence will
be furnished to enable our attorneys to render such opinion at the time of, or prior
to the delivery of the Notes.

Bidder's Bond Attorney may be designated herein, or such designation may
be made after the Notes are awarded. Each successful bidder, who has not designated
an attorney, agrees to advise the Comptroller of the name and address of the attorney
designated, not later than 2 p.m., on the date hereof.

Notes shall be of the denomination set forth in the Notice of Sale.

Very truly yours,

First National City Bank, New York/
Chase Manhattan Bank, N.A.
& Associates

New York, N. Y.
February 4, 1975

Address: First National City Bank
95 Wall St.
New York, N. Y. 10005

By: [Signature]
Tel. No. 825-2725

(3)
+

P R O P O S A L

REVENUE ANTICIPATION NOTES TO MATURE ON FEBRUARY 13, 1976

Honorable Harrison J. Goldin
Comptroller
The City of New York

Dear Sir: *William H. McMillan*

For DOLLARS (\$ 110,000,000)
principal amount of The City of New York Revenue Anticipation Notes, to be dated
February 14, 1975, and to be payable on February 13, 1976, without option of redemption
prior to maturity, bearing interest at the per annum rate of

Six and 7/100 PER CENTUM (7.72%)
we will pay the par value thereof, and accrued interest to the date of delivery of the
Notes, plus premium of

Six hundred fifty and 00/100 DOLLARS (\$ 750⁰⁰)
for notes described in the Notice of Sale.

This proposal is subject to our being furnished, at our expense, with the
unqualified opinion of our attorneys,

Sykes, Galloway & Bikeman

announcing the validity of the Notes. It is understood that sufficient evidence will
be furnished to enable our attorneys to render such opinion at the time of, or prior
to the delivery of the Notes.

Bidder's Bond Attorney may be designated herein, or such designation may
be made after the Notes are awarded. Each successful bidder, who has not designated
an attorney, agrees to advise the Comptroller of the name and address of the attorney
designated, not later than 2 p.m., on the date hereof.

Notes shall be of the denomination set forth in the Notice of Sale.

Very truly yours,

First National City Bank, New York/
Chase Manhattan Bank, N.A.
& Associates

New York, N. Y.
February 4, 1975

Address: First National City Bank

95 Wall St.
New York, N. Y. 10005

By: *[Signature]*
Tel. No. 825-2725

(4)
X

P R O P O S A L

REVENUE ANTICIPATION NOTES TO MATURE ON FEBRUARY 13, 1976

Honorable Harrison J. Goldin
Comptroller
The City of New York

Dear Sir:

For Five Million..... DOLLARS (\$5,000,000.00)
principal amount of The City of New York Revenue Anticipation Notes, to be dated
February 14, 1975, and to be payable on February 13, 1976, without option of redemption
prior to maturity, bearing interest at the per annum rate of

Seven and eighty-nine hundredths PER CENTUM (7.89 %)
we will pay the par value thereof, and accrued interest to the date of delivery of the
Notes, plus premium of

Three hundred and sixty-five DOLLARS (\$ 365.00)
for Notes described in the Notice of Sale.

This proposal is subject to our being furnished, at our expense, with the
unqualified opinion of our attorneys,

Wood, Dawson, Love & Sabatine

New York City, New York

approving the validity of the Notes. It is understood that sufficient evidence will
be furnished to enable our attorneys to render such opinion at the time of, or prior
to the delivery of the Notes.

Bidder's Bond Attorney may be designated herein, or such designation may
be made after the Notes are awarded. Each successful bidder, who has not designated
an attorney, agrees to advise the Comptroller of the name and address of the attorney
designated, not later than 2 p.m., on the date hereof.

Notes shall be of the denomination set forth in the Notice of Sale.

Very truly yours,

New York, N. Y.
February 4, 1975

European-American Bank & Trust Company

Address: 77 Water Street

By: Ronald J. Gleusner
Ronald J. Gleusner, Investment Officer

New York, New York 10005 Tel. No. 212 437-4260

CERTIFICATE OF AWARD

I, HARRISON J. GOLDIN, Comptroller of The City of New York, in the County of New York, State of New York, HEREBY CERTIFY that I am the duly elected, qualified and acting Comptroller of The City of New York and in the exercise of the power delegated to me on February 21, 1963 by the Mayor of The City of New York, exercising the powers of a finance board, pursuant to Section 8c of the New York City Charter effective January 1, 1963, pursuant to Section 30.00 of the Local Finance Law, which power is in full force and effect and has not been modified, amended, rescinded or revoked, DO HEREBY AWARD AND SELL TO MORGAN GUARANTY TRUST COMPANY OF NEW YORK, New York, New York, at the price bid of \$290,002,001.00 and accrued interest at the rate borne by the notes from the date of the Notes to the date of payment of the purchase price, the \$290,000,000 principal amount of REVENUE ANTICIPATION NOTES of The City of New York, dated February 14, 1975, maturing February 13, 1976, authorized to be issued pursuant to the following Certificate: Certificate No. 29-75 Authorizing the Issuance of \$290,000,000 Revenue Anticipation Notes, executed by the First Deputy Comptroller on FEBRUARY 5, 1975 and filed in the office of the Mayor of said City of FEBRUARY 10, 1975.

The terms, form and details of said Notes shall be as follows:

Amount and Title:	\$290,000,000 Tax Anticipation Notes Issued Pursuant to Section 25.00 of the Local Finance Law
Dated:	February 14, 1975
Mature:	February 13, 1976
Interest:	7.55%

H.A.P. No. 11
SIGNATURE OF NO-LITIGATION CERTIFICATE

We, the undersigned officers of The City of New York, in the County of New York, State of New York, HEREBY CERTIFY that, on the 11th day of February, 1975, we officially signed and properly executed the obligations of said City, payable to bearer, described as follows:

Amount and Title: \$290,000,000 Revenue Anticipation
Notes Issued Pursuant to Section
25.00 of the Local Finance Law

Dated: February 14, 1975

Mature: February 13, 1976

Interest: 7.55%

<u>Type of Revenues</u>	<u>Numbers (inclusive)</u>	<u>Denomination</u>
State Aid	RC 18,981 to RC 20,180	\$100,000
	RY 58,561 to RY 62,560	\$ 25,000
	RX 35,801 to RX 42,800	\$ 10,000

and that at the date of such signing and on the date hereof we were and are the duly chosen, qualified and acting officers authorized to execute said obligations, holding the respective offices indicated by the official titles set opposite our signatures below.

I, the undersigned Comptroller of said City, FURTHER CERTIFY that the facsimile signature of Harrison J. Goldin affixed upon said obligations has been duly authorized and is hereby adopted as my true and lawful signature in my capacity as Comptroller of said City.

WE FURTHER CERTIFY that except for the action entitled "Leonard Edward Wein, Plaintiff, against The City of New York, et.al.", Supreme Court of the State of New York, County of New York, Index Number 2162/75, wherein plaintiff demands inter alia a permanent injunction restraining the City of New York from hereafter contracting debt beyond the constitutional debt limit, no litigation of any nature is now pending or to our knowledge threatened (either in State or Federal Courts) restraining or enjoining the issuance or delivery of said obligations or the levy or collection of taxes to pay the interest on or principal of said obligations, or in any manner questioning the authority or proceedings for the issuance of said obligations, or affecting in any way the validity of said obligations or the levy or collection of said taxes, or contesting the corporate existence or boundaries of said City or the title of any of the present officers thereof to their respective offices; and that no authority or proceedings for the issuance of said obligations have or has been repealed, rescinded or revoked.

<u>Type of Revenues</u>	<u>Numbers (inclusive)</u>	<u>Denomination</u>
State Aid	RC 18,981 to RC 20,180	\$100,000
	RY 58,561 to RY 62,560	\$ 25,000
	RX 35,801 to RX 42,800	\$ 10,000

IN WITNESS WHEREOF, I have hereunto
set my hand as of this
14th day of February, 1975.




Comptroller

WE FURTHER CERTIFY that the seal which is impressed upon this certificate has been affixed, imprinted or reproduced upon each of said notes and is the legally adopted, proper and only official corporate seal of the Issuer.

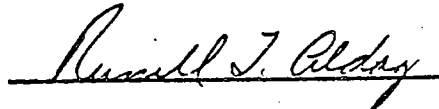
WITNESS our hands and said corporate seal

this 14 day of February, 1975

Signature	Official	Term of Office Expires
-----------	----------	------------------------

	Comptroller	December 31, 1977
	Deputy and Acting City Clerk	Indefinite

I HEREBY CERTIFY that the signatures of the officers of above named City which appear above are true and genuine and I know said officers and know them to hold the respective offices set opposite their signatures.



CERTIFICATE OF DELIVERY AND PAYMENT

I, HARRISON J. GOLDIN, Comptroller of The City of New York, in the County of New York, State of New York, HEREBY CERTIFY as follows:

1. On the 14th day of February, 1975, I delivered to MORGAN GUARANTY TRUST COMPANY OF NEW YORK, in the City, County and State of New York, the purchaser thereof, the following obligations of said City:

Amount and Title:	\$290,000,000 Revenue Anticipation Notes Issued Pursuant to Section 25.00 of the Local Finance Law
Dated:	February 14, 1975
Mature:	February 13, 1975
Interest	7.55%

<u>Type of Revenues</u>	<u>Numbers (inclusive)</u>	<u>Denomination</u>
State Aid	RC 18,981 to RC 20,180	\$100,000
	RY 58,561 to RY 62,560	\$ 25,000
	RX 35,801 to RX 42,800	\$ 10,000

2. At the time of said delivery I received from said purchaser payment for said obligations in accordance with the contract of sale, computed as follows:

Contract price	\$290,002,001.00
Accrued interest	<u> -0- </u>
Amount received on delivery of obligations	\$290,002,001.00

IN WITNESS WHEREOF, I have hereunto
set my hand this 14th day
of February, 1975.


Comptroller

No. RC \$100,000

UNITED STATES OF AMERICA
STATE OF NEW YORK

THE CITY OF NEW YORK

REVENUE ANTICIPATION NOTE

OF THE FISCAL YEAR 1974 - 1975

THIS NOTE IS ISSUED PURSUANT TO SECTION 25.00 OF THE LOCAL FINANCE LAW IN ANTICIPATION OF THE COLLECTION OF

STATE AID SPECIMEN 7.55%

AUTHORIZED ISSUE \$200,000,000

DATED FEBRUARY 14, 1975 - DUE FEBRUARY 13, 1978

1975
ISSUE

THE CITY OF NEW YORK, a municipal corporation of the State of New York, hereby acknowledges itself indebted and for value received promises to pay to the BEARER the sum of

1. — ONE HUNDRED THOUSAND DOLLARS, —

on the date specified above in lawful money of the United States of America, at the office of the Comptroller of The City of New York, in The City of New York, and to pay interest thereon from the date of this Revenue Anticipation Note in like money, at said office, at the rate per annum specified in the title of this Note at maturity, upon presentation of this Revenue Anticipation Note for notation thereon of such interest payment.
This Revenue Anticipation Note is issued in anticipation of the collection of revenues to become due the City in the Fiscal Year beginning July 1, and ending June 30, specified in the title of this Note.

IT IS HEREBY CERTIFIED, RECITED AND DECLARED that all acts, conditions and things required to happen, exist or be performed, precedent to and in the issuance of this Revenue Anticipation Note, have happened, exist and have been performed in due time, form and manner, as required by the Constitution and Statutes of the State of New York, including among others, the New York City Charter; that the total indebtedness of the City, including the indebtedness represented by this Revenue Anticipation Note, does not exceed any constitutional or statutory limitations thereon; and that for the punctual payment of the principal and interest of this Revenue Anticipation Note, at the same become due and payable, the faith and credit of the City are hereby irrevocably pledged.

IN WITNESS WHEREOF, THE CITY OF NEW YORK has caused this Revenue Anticipation Note to be signed by its Comptroller, and its Corporate Seal to be hereunto affixed and attested by the City Clerk or his Deputy, and this Revenue Anticipation Note to be dated as of and to bear interest from the issue date specified above.

ATTEST:



Handwritten signature

DEPUTY AND ACTING CITY CLERK

COMPTROLLER OF THE CITY OF NEW YORK

No. RY

\$25,000

UNITED STATES OF AMERICA
STATE OF NEW YORK

THE CITY OF NEW YORK

REVENUE ANTICIPATION NOTE

OF THE FISCAL YEAR 1974 - 1975

THIS NOTE IS ISSUED PURSUANT TO SECTION 25.00 OF THE LOCAL FINANCE LAW IN ANTICIPATION OF THE COLLECTION OF

19th
ISSUE

STATE AID

SPECIMEN 7.55%

AUTHORIZED ISSUE \$290,000,000

DATED FEBRUARY 14, 1975 - DUE FEBRUARY 13, 1976

THE CITY OF NEW YORK, a municipal corporation of the State of New York, hereby acknowledges itself indebted and for value received promises to pay to the BEARER the sum of

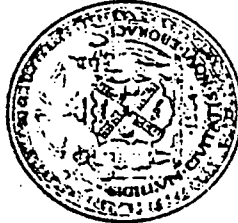
— TWENTY-FIVE THOUSAND DOLLARS, —

on the due date specified above in lawful money of the United States of America, at the office of the Comptroller of the City of New York, in the City of New York, and to pay interest thereon from the date of this Revenue Anticipation Note in the money, at said office, at the rate per annum specified in the title of this Note at maturity, upon presentation of this Revenue Anticipation Note for notation thereon of such interest payment.
This Revenue Anticipation Note is issued in anticipation of the collection of revenues to become due the City in the Fiscal Year beginning July 1, and ending June 30, specified in the title of this Note.

IT IS HEREBY CERTIFIED, RECITED AND DECLARED that all acts, conditions and things required to happen, exist or be performed, precedent to and in the issuance of this Revenue Anticipation Note, have happened, exist and have been performed in due time, form and manner, as required by the Constitution and Statutes of the State of New York, including among others, the New York City Charter; that the total indebtedness of the City, including the indebtedness represented by this Revenue Anticipation Note, does not exceed any constitutional or statutory limitations thereon; and that for the punctual payment of the principal and interest of this Revenue Anticipation Note, as the same become due and payable, the faith and credit of the City are hereby irrevocably pledged.

IN WITNESS WHEREOF, THE CITY OF NEW YORK has caused this Revenue Anticipation Note to be signed by its Comptroller, and its Corporate Seal to be hereunto affixed and attested by the City Clerk or his Deputy, and this Revenue Anticipation Note to be dated as of and to bear interest from the issue date specified above.

ATTEST:



DEPUTY AND ACTING CITY CLERK.

COMPTROLLER OF THE CITY OF NEW YORK.

Handwritten signature: Dawson J. P. ...

No.RX

\$10,000

UNITED STATES OF AMERICA
STATE OF NEW YORK

THE CITY OF NEW YORK

REVENUE ANTICIPATION NOTE

OF THE FISCAL YEAR 1974 - 1975

THIS NOTE IS ISSUED PURSUANT TO SECTION 25.09 OF THE LOCAL FINANCE LAW IN ANTICIPATION OF THE COLLECTION OF

1974
ISSUE

STATE AID

AUTHORIZED ISSUE \$280,000,000

7.55%

SPECIMEN

DATED FEBRUARY 14, 1975 - DUE FEBRUARY 13, 1978

THE CITY OF NEW YORK, a municipal corporation of the State of New York, hereby acknowledges itself indebted and for value received
promised to pay to the BEARER the sum of

TEN THOUSAND DOLLARS,

on the date specified above in lawful money of the United States of America, at the office of the Comptroller of The City of New York, in The City of New York, and to pay interest thereon from the date of this Revenue Anticipation Note in like money, at said office, at the rate per annum specified in the title of this Note at maturity, upon presentation of this Revenue Anticipation Note for notation thereon of such interest payment.

This Revenue Anticipation Note is issued in anticipation of the collection of revenues to become due the City in the Fiscal Year beginning July 1, and ending June 30, specified in the title of this Note.

IT IS HEREBY CERTIFIED, RECITED AND DECLARED that all acts, conditions and things required to happen, exist or be performed, precedent to and in the issuance of this Revenue Anticipation Note, have happened, exist and have been performed in due time, form and manner, as required by the Constitution and Statutes of the State of New York including among others, the New York City Charter; that the total indebtedness of the City, including the indebtedness represented by this Revenue Anticipation Note, does not exceed any constitutional or statutory limitations thereon; and that for the punctual payment of the principal and interest of this Revenue Anticipation Note, as the same become due and payable, the faith and credit of the City are hereby irrevocably pledged.

IN WITNESS WHEREOF, THE CITY OF NEW YORK has caused this Revenue Anticipation Note to be signed by its Comptroller, and its Corporate Seal to be hereunto affixed and attested by the City Clerk or his Deputy, and this Revenue Anticipation Note to be dated as of and to bear interest from the issue date specified above.

ATTEST:



Handwritten signature of Dawson J. Padin

DEPUTY AND ACTING CITY CLERK.

COMPTROLLER OF THE CITY OF NEW YORK.



LAW DEPARTMENT
MUNICIPAL BUILDING
NEW YORK, N. Y. 10007

W. BERNARD RICHLAND,
Corporation Counsel

February 14, 1975


Honorable Harrison J. Goldin
Comptroller
City of New York
Municipal Building
New York, New York 10007

Dear Mr. Goldin:

I have reviewed your certification dated February 14, 1975 with respect to \$290,000,000 principal amount of Revenue Anticipation Notes of the City of New York sold on February 4, 1975, maturing on February 13, 1976, and taken up and paid for by the purchasers thereof on February 14, 1975. Based upon my examination of law and review of said certification, the facts, estimates and circumstances are sufficiently set forth in said certification to satisfy the criteria which are necessary under section 103(d) of the Internal Revenue Code and the proposed regulations thereunder to support the conclusion that the aforementioned notes will not be arbitrage bonds.

No matters have come to my attention which make unreasonable or incorrect the representations made in your certification.

Sincerely,


JOHN R. THOMPSON
Acting Corporation Counsel

ARBITRAGE CERTIFICATE

I, HARRISON J. GOLDIN, Comptroller of the City of New York, and as such responsible for determining the nature and term of obligations of The City of New York and arranging for the issuance thereof and charged with the duty of approving the expenditures of the proceeds of said obligations, hereby certify as follows:

A. This certificate is issued with respect to the \$290,000,000 principal amount of Revenue Anticipation Notes of The City of New York, New York (the "City"), delivered to the purchasers thereof on February 14, 1975 (the "Notes") and maturing on February 13, 1976. This Certificate shall constitute and be a document related to all of the Notes.

B. The Notes are issued in anticipation of the collection of revenues due to the City from the State of New York during the fiscal year 1974-1975, the proceeds of which are to be expended for the purposes for which such revenues, when collected, may be expended.

C. Certain moneys are due the City as State aid for the fiscal year 1974-1975. These moneys will be payable from time to time to the City. The City is reliant upon such moneys together with revenues from other sources for the payment of its expenses. The City projects its expenditures for a given period and projects its revenues to be received from all sources for such period. Such projection is based upon the City's experience in previous years as well as the known expenditures and receipts for such period.

D. Said Notes will not be outstanding after a period ending 6 months after the date on which the City expects to receive such revenues, but in any event said Notes will not be outstanding after a period ending 30 months after said Notes are issued.


Estimated expenses, expenditures and cumulative surpluses or deficits of the City for the 3 month period commencing December, 1974 is as follows:

	<u>Estimated Receipts</u>	<u>Estimated Expenditures</u>	<u>Cumulative Surpluses or Deficits</u>
February 1975	\$1,036,900,000	\$1,235,500,000	\$198,600,000
March 1975	1,077,700,000	1,341,900,000	264,200,000
April 1975	1,669,900,000	1,765,400,000	95,500,000

The amount reasonably required to be kept on hand at all times is \$1,235,500,000. Based on such estimates, it is projected that the amount of the Notes will not exceed at any time the amount necessary to pay expenditures which would ordinarily be paid out of or financed by such moneys due the City as State aid in the Fiscal Year 1974-1975, together with cash available therefor in an amount equal to such expenditures for one month after such time, and less all moneys available for such expenditures.

On the basis of the foregoing facts, estimates and circumstances it is not expected that the proceeds of the Notes will be used in a manner that would cause the Notes to be arbitrage bonds under Section 103 (d) of the Internal Revenue Code and the proposed regulations prescribed under that section. To the best of my knowledge and belief there are no other facts, estimates or circumstances which would materially change such expectation.

Dated the 14th day of February, 1975, the same being the date of delivery of and payment for the Notes.


 HARRISON J. GOLDIN
 Comptroller, of The City of New York

Hawkins, Delafield & Wood
67 Wall Street, New York 10005

February 14, 1975

Morgan Guaranty Trust Company of New York
23 Wall Street
New York, New York

Dear Sirs:

We have examined a record of proceedings relating to the issuance of \$290,000,000 Revenue Anticipation Notes of The City of New York, a municipal corporation of the State of New York, issued pursuant to Section 25.00 of the Local Finance Law. Said Notes are dated February 14, 1975 and are 23,000 in number, are issued in anticipation of State aid, and bear interest at the rate of 7.55% per annum payable at maturity and mature on February 13, 1976. Said Notes are numbered and in the denominations as set forth below:

<u>Numbers</u> <u>(inclusive)</u>	<u>Denomination</u>
RC 18,981 to RC 20,180	\$100,000
RY 58,561 to RY 62,560	25,000
RX 35,801 to RX 42,800	10,000

Said Notes are payable as to both principal and interest at the office of the Comptroller of The City of New York in the City of New York, New York, are payable to bearer without coupons, and are issued pursuant to the provisions of the Local Finance Law, constituting Chapter 33-a of the Consolidated Laws of the State of New York, and Certificate 29-75 authorizing the issuance of \$290,000,000 Revenue Anticipation Notes.

In our opinion, said Revenue Anticipation Notes are valid and legally binding general obligations of The City of New York and, unless paid from other sources, are payable from ad valorem taxes levied upon all the taxable real property within the City to pay said Notes and interest thereon, without limitation as to rate or amount.

In expressing such opinion, we have considered the action entitled: "Leonard Edward Wein, Plaintiff, against The City of New York, et. al. commenced in the Supreme Court of the State of New York, County of New York (Index No. 2165/75), wherein plaintiff demands, inter alia, a permanent injunction restraining The City of New York from hereafter contracting any debt beyond its constitutional debt limit. In our opinion, any order issued by a court of final jurisdiction in such action as instituted will not affect the validity of said Notes.

We have examined executed Notes numbered RC 18,981, RY 58,561 and RX 35,801 of said issue and, in our opinion, the form of said Notes and their execution are regular and proper.

Very truly yours,

Hawkins, Delafield & Wood

APPENDIX C

<u>Date</u>	<u>Amount of Issue</u>	<u>Amount Approved by Wood Dawson</u>	<u>Client</u>
<u>TAX ANTICIPATION NOTES</u>			
06/14/73	\$265,000,000	\$265,000,000	CHASE
11/13/73	100,000,000	100,000,000	CHASE
06/11/74	317,000,000	317,000,000	FNCB
07/01/74	800,000,000	NONE*	
08/01/73	331,075,000	331,075,000	CHASE
11/01/73	369,770,000	369,770,000	FNCB
02/01/74	349,130,000	349,130,000	CHASE
03/01/74	436,620,000	436,620,000	CHASE
10/15/74	475,580,000	475,580,000	CHASE
02/15/75	141,440,000	141,440,000	CHASE
<u>CAPITAL NOTES</u>			
04/24/73	4,700,000	4,700,000	FNCB
05/08/74	5,100,000	5,100,000	EHRlich-BOBER
<u>URBAN RENEWAL NOTES</u>			
05/31/73	100,035,000	100,035,000	FNCB
05/31/74	83,600,000	58,600,000	CHASE (\$53.6M) BANKERS TRUST (\$5M)
10/18/74	97,355,000	97,355,000	FNCB

* Approved for the Chase at a later date an exchange of \$35,600,000, \$100,000 denomination notes for smaller (\$25,000 and \$10,000) denomination notes.

<u>Date</u>	<u>Amount of Issue</u>	<u>Amount Approved by Wood Dawson</u>	<u>Client</u>
<u>BOND ANTICIPATION NOTES</u>			
05/31/73	\$175,000,000	\$ 21,000,000	MARINE MIDLAND (\$20M) FNCB (\$1M)
08/15/73	282,270,000	200,000,000	FNCB
09/11/73	50,000,000	10,000,000	IRVING TRUST
03/26/74	362,270,000	81,270,000	CHASE
05/31/74	220,000,000	220,000,000	CHASE
08/23/74	141,000,000	141,000,000	CHASE
10/18/74	420,405,000	170,405,000	FNCB
03/14/75	537,270,000	NONE*	
<u>SERIAL BONDS</u>			
01/01/73	293,980,000	293,980,000	CHASE
05/01/73	285,360,000	285,360,000	CHASE

* Rendered an opinion to the Chase with respect to the legality of the notes and the form of opinion rendered by White & Case.

<u>Date</u>	<u>Amount of Issue</u>	<u>Amount Approved by Wood Dawson</u>	<u>Client</u>
08/01/73	331,075,000	331,075,000	CHASE
11/01/73	369,770,000	369,770,000	FNCB
02/01/74	349,130,000	349,130,000	CHASE
03/01/74	436,620,000	436,620,000	CHASE
08/01/74	324,900,000	324,900,000	CHASE
10/15/74	475,580,000	475,580,000	CHASE
02/15/75	141,440,000	141,440,000	CHASE

Chapter Seven



STAFF REPORT
ON

**TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK**

**ANALYSIS OF QUESTIONNAIRES
SENT TO INDIVIDUAL INVESTORS,
SYNDICATE MEMBERS AND
MANAGING UNDERWRITERS**

August 26, 1977

SECURITIES AND EXCHANGE COMMISSION

STAFF REPORT

ON

TRANSACTIONS IN SECURITIES
OF THE CITY OF NEW YORK

Introduction and Summary

Chronology of Events

October 1, 1974 - April 8, 1975 Chapter One

Report on Accounting Practices
and Financial Reporting

Chapter Two

Report on the Role of the City
and Its Officials

Chapter Three

Report on the Role of the Underwriters

Chapter Four

Report on the Role of the Rating Agencies

Chapter Five

Report on the Role of Bond Counsel

Chapter Six

Analysis of Questionnaires Sent to
Individual Investors, Syndicate
Members and Managing Underwriters

Chapter Seven

Chapter Seven

**ANALYSIS OF QUESTIONNAIRES SENT TO INDIVIDUAL INVESTORS,
SYNDICATE MEMBERS AND MANAGING UNDERWRITERS**

August 26, 1977

I N T R O D U C T I O N

This Report contains an analysis of the responses received from questionnaires sent to individual investors, syndicate members and managing underwriters in connection with the investigation into transactions in securities of the City of New York.

ANALYSIS OF QUESTIONNAIRES SENT TO INDIVIDUAL INVESTORS

THE INDIVIDUAL INVESTORS

As part of its investigation into transactions in securities of the City of New York ("the City"), the staff distributed a Questionnaire to a selective sampling of individual investors believed to have purchased City obligations (See "Method of Inquiry"; infra). According to one estimate, no less than 160,000 individual investors owned the major portion of the City's outstanding long-term bonds prior to the moratorium. 1/

Over 500 investors responded to the Questionnaire. The Questionnaire was designed to determine, among other things, the information made available to investors about the City, their understanding of the City's financial condition at the time of their respective transactions and their motives for investing in City securities.

Over 60% of those responding indicated that they had not previously invested in municipal bonds or notes. 2/ More than 25% of investors queried about their income indicated that they earned less than \$20,000 per year. 3/ Over 16% of the respondents were retirees. 4/

1/ See excerpt from an investor analysis made by Lebenthal & Co., attached as Appendix D. A partial list of the communities, within the United States, outside of New York State, in which purchasers of City notes subject to the moratorium resided is attached as Appendix E.

2/ Question 10.

3/ This question was included only in the second of two questionnaires (question 16).

4/ Question 15.

Overwhelmingly, investors who responded to the Questionnaires indicated that they believed or understood that the City was in good or excellent financial condition: 1/

Financial Condition

Excellent	Over 29%
Good	Over 46%
Fair	Over 14%
Poor	Over 3%

Over 92% of responding investors noted as a factor in their investment decision the fact that the investment was "safe and secure". 2/ Investor assessment of risk at the time of purchase was as follows: 3/

Little or no Risk	Over 83%
Normal Risk	Over 13%
High Risk	Over 1%

Over 81% of those asked indicated that they understood or had been advised at the time of purchase that payment of principal and interest on the notes was a first lien on all of the City's revenues. 4/ Several of those responding commented that they believed they would be paid before City employees were paid.

1/ Question 6.

2/ Question 9(d).

3/ Question 6(b).

4/ Question 7(a). This question was asked specifically with respect to notes only in the second questionnaire. The first questionnaire, the results of which are not reflected in the above percentage, posed the question with respect to both bonds and notes.

A number of the polled investors volunteered additional comments concerning their own experiences with these investments. The great majority of these comments were overwhelmingly negative — and indicated that they had been misled. We have included as Appendix A a number of these comments.

The Questionnaire was important to determine the adequacy of disclosure regarding the City's financial condition at the time of its securities offerings. Since the City did not utilize prospectuses or other comparable disclosure documents, the staff sought to ascertain what means of communication, if any, were employed to bring relevant and material information concerning, among other things, the fiscal condition of the City to the attention of prospective purchasers.

The investigation has shown that in late 1974 and early 1975 the City's financial condition was precarious and its ability to remain fiscally solvent was greatly dependent upon continued access to the capital markets. Responses received from the Questionnaires, however, do not indicate that this was the perception held by investors at this time. In this regard, certain questions were designed to elicit the extent of the investors' knowledge of certain acts or practices of the City prior to their most recent purchase of City notes or bonds.

First, investors were asked whether they were aware that "[i]tems traditionally considered to be expense items, since they would reoccur on an annual basis, were included in the capital budget." Of the responses

received, approximately 88% indicated that investors were not aware of this, and approximately 12% indicated that they were. 1/ Second, investors were asked if they had been aware that "[t]he City had incurred short-term debt to provide funds required to close the gap between uneven streams of expenses and revenues." 2/ Approximately 66% of the responses to this question were negative, while approximately 34% were positive. The investors were then asked if they had been aware that "[t]he City's expense budget was prepared without creating any reserves for non-collection of tax revenues." 3/ Of the responses to this question, approximately 97% were "no" whereas approximately 3% were "yes." When asked if they were aware that "[t]he City included on its tax rolls properties not subject to taxation," approximately 96% of the responses were "no", while approximately 4% were "yes." 4/ The final question in this group asked whether the investor was aware that "[t]he City had used non-recurring revenues as a technique for producing a balanced budget in prior fiscal years." 5/ Approximately 95% of the responses were negative while approximately 5% were positive.

A further demonstration of the degree to which the majority of investors were either uninformed or misinformed as to the true nature of the City's affairs is contained in the responses to one question which asked the investors

-
- 1/ Question 8(a).
 - 2/ Question 8(b).
 - 3/ Question 8(c).
 - 4/ Question 8(d).
 - 5/ Question 8(e).

for their opinion of the City's bookkeeping and accounting practices at the time of their purchases of City notes or bonds. 1/ More than 80% of the responses indicated that such practices were considered "excellent" or "good," while over 11% classified them as "fair" and less than 8% as "poor." Our investigation has shown that, in fact, the City's bookkeeping and accounting practices were unsound and unclear.

Method of Inquiry

In early 1976 Questionnaires were distributed to investors selected from a list of those persons who had exchanged City securities for MAC bonds and to those who had inquired at the New York Regional Office about the City investigation. Approximately 284 completed Questionnaires were received and tabulated by the staff.

A second set of investors was sent Questionnaires containing minor revisions but similar in substance to the first. These investors had been selected from two classes: investors whose names appeared on confirmations of sales of City securities subpoenaed by the Commission from Chemical Bank, Bankers Trust, Citibank, Manufacturers Hanover, and Chase Manhattan Bank and investors who had contacted the New York Regional office concerning this matter. As of July 5, 1977, 218 completed Questionnaires

1/ Question 6(a). A large number of investors (over 20%) did not respond to this question.

had been returned by investors. Each set of Questionnaires was separately tabulated so that the responses could be analyzed. The Questionnaire forms, with tabulated responses where possible, are included as Appendices B and C. 1/

1/ In Appendices B and C, the total number of each of the responses received by the staff has been inserted beside the question to which it pertains. In some instances, the total number of responses to a question may exceed the number of investors polled because more than one response was called for or the investor had been involved in more than one transaction.

APPENDIX ASELECTED INVESTOR COMMENTS AND COMPLAINTS

"At the time of purchase I believed that the financial position of New York City was excellent. At no time did I ever envision the problems that the city encountered. I believed that the accounting practices of the city vis a vis the Comptroller's Office were sound and truthful. I was informed that these notes were backed by the full 'faith and credit' of the city, and that they had first lien on all city revenue. As far as I was concerned, my investment was sound and very safe.

"I am a young married man with an expectant family and this default/moratorium by the city has left me in a very poor financial position. I am not a "fat cat" but a small investor who thought that the return was excellent, the investment safe and secure, and the one year maturity date suitable for my needs...."

* * *

"Monies involved were an accumulation of the earnings of a lifetime on which Federal, State and City taxes had been paid. In reliance in the honor and integrity of a great city I made an investment purported to be risk free, after so being advised by my banker. Instead I have since learned that some of the City's practices, had they been engaged in by a private businessman. . .would result in his being prosecuted.

"In effect, the City, its leaders, the Federal and State governments and regulatory bodies, and last but certainly in the forefront with their advice, my bankers, have converted a potentially affluent retirement into more years of hard work and a frustrated old age."

* * *

"...My husband and I are too old to convert to ten, and now fifteen, year bonds. We have no other moneys. We have no estate or descendants. Our dreams of retirement utterly shattered. Why are we oldsters being tortured so; in the words of Watergate, 'left swinging in the wind,'? (no promise, no provisions being made for payment or amortization of this debt of honor.)"

* * *

"I will be 71 years old on May 5, 1977. My years are numbered now. I have no children. I cannot say to myself, 'So what, my children will (maybe??) get the money in the notes 20 years from now.'

"I need the money now for my own personal uses. I was hoping to buy a small apartment in a retirement village. Now I cannot do so.

"I have been cheated and misled as have thousands of others who bought the notes...." [Emphasis in original]

* * *

"I am convinced that in this matter I am a victim of 'swindlers'. These notes were well rated; there were no warnings given; or else I certainly would not have risked all the various family member's money as well as my own.

"I am no speculator; I bought these as a short term investment; I was led to believe that with a 'AA' rating, with an opinion that these were legal notes, and that the issuer, the largest city in the U.S.A., this was a prudent investment.

"Now, here I am. I, for one, would refuse to convert to long term papers, for I need these monies now - and in the next five years to put three children through college...."

* * *

"It is my opinion that the city should not have been allowed to sell these notes and bonds. There was no way that an investor like myself had available to me any information regarding the financial difficulty of the city....

"An ordinary uninformed investor was easily swayed by the large full page ads offering these notes and bonds for sale and especially by the list of prestigious underwriters (like Merrill Lynch and many of the large banks). The high interest rate was especially attractive and considering the ads and list of underwriters etc. was instrumental in influencing the purchasers.

"The full page advertisement advertising the city notes with the list of prestigious underwriters such as Merrill Lynch and many others led me to believe that my investments would be sound and without risk...."

* * *

"We are very disillusioned by this breach of faith and integrity by the City of New York. We are a working couple who, while raising a family, found it impossible to accumulate any funds for our future retirement. It was only after our children married that we began to diligently try to save for our old age. Towards that end my wife continued to work past an age when most women are ready to take a well earned rest. Accumulating money is a difficult and formidable task in this era of high prices and rising inflation.

"We were raised and grew up to believe that certain guarantees are beyond doubt and are given as a matter of simple faith and integrity....

"We need the money...."

* * *

"Our belief in the first lien of our bonds on the City was insurmountable. We were shocked that the City could abrogate their obligation to note-holders."

* * *

"My investment for one year notes represents most of my life savings. I am retired and depend on the income in order to live. I would rather starve than go on relief. When I read the ad in the New York Times financial pages I figured that this was an opportunity to get some income slightly more than was paid by the U.S. Treasury. I took money from matured U.S. Securities and from my savings bank and made the investment in 'One of the safest investments in the world.' This was the almost universal opinion. Mayor Beame is a C.P.A. He had a reputation as a man who had watched the city finances for over 30 years. As a C.P.A., I felt he had had an opportunity to make improvements in the accounting system. I had complete confidence in his ability as Budget Director and as the Comptroller of the City of New York. He knew what was going on all the time...." [Emphasis in original.]

* * *

"These RANS of 12/11/74 should not have been marketed by the City of New York....I had to postpone my retirement at age 68 because of this default."

* * *

"I am 59 years old and in good faith, based upon the offering by New York City, I invested a substantial portion of my savings, which I now am unable to use. I am a builder and have encountered very hard times and as a result was seriously affected by the nonpayment of my money...."

* * *

"As owner of a \$10,000 Revenue Anticipation Note of the City of New York, dated 1/13/75 and due 1/12/76, I hereby PROTEST the Breach of Contract imposed upon me by the State of New York, the City of New York, and the involved Banks and Brokers who sold them by assuring us that these notes would be honored as written.

"My note is specific in its clearly defined and binding terms. I quote here a very pertinent condition contained therein, '-and that for the punctual payment of the principal and interest of this Revenue Anticipation Note as the same become due and payable, the faith and credit of the City are hereby IRREVOCABLY pledged.' With the above statement plus all the other parts which guarantee these notes, I cannot understand the right of any government authority to usurp these existing bona fide contracts. My note says 'irrevocably pledged' which permits no one, in any position to change or modify any part of this contract. This means not the due date nor the rate of interest....

"As a Senior Citizen - Retired - and with inflation continually reducing my fixed pension, I find it necessary to change my way of life. I need this money now to pay for all my resettlement problems...." [Emphasis in original]

* * *

"We did not know that the city government would make a distinction to redeem bonds but not their notes...."

* * *

"I must reiterate what was previously said. I have had two heart attacks. My company dismissed me after my last attack when I could no longer actively produce as before. The funds I received in workmens compensation in settlement as well as my pension on reaching 65 was placed in short term city notes so I could retire the following year...."

* * *

"My husband and I were, and are, very unsophisticated regarding financial investments other than Savings Banks. Despite my having endured serious illnesses involving large medical expenses on a small income, we have always managed to be dignified and self-supporting. In recent years, with my enjoyment of better health, and a still modest but increased income, we have been able to save some money by continuing a modest, somewhat stringent life-style. Our goal was to buy either a home, cooperative or condominium and thus now, in our middle years, enjoy a more desirable living environment. The rigors of living in a Manhattan rent-controlled apartment are becoming increasingly difficult despite the increasing rent. We began to consult financial pages of newspapers and magazines reading articles such as the one enclosed (telling of the advantages of municipal bonds) along with information promulgated via the press about the current good financial solvency of the City of New York.

"We were not interested in any long-term investment and the New York City Notes seemed to answer our purpose. An investment for one year for our down-payment on a home or apartment would give us just the right amount of time to look around while accruing a better return on the amount saved for that purpose."

* * *

"I purchased my note because I was over 60 years old, had no pension from the firm I now work for, and resented bitterly having to pay income tax on the interest from the money I saved as a hard-working, thrifty citizen.

"I thought a one year note would help...."

* * *

"...I took out my hard earned money from its safe place in a savings bank where I was guaranteed satisfaction to invest in the City. Now it is not guaranteed and there is no excuse in the world why I shouldn't have my money. I want it back immediately. I am a hard working individual who works for his money and I have always payed taxes to the City without any questions...."

* * *

"...Had I known of the city's financial condition prior to purchase, even an interest rate of double digit proportions would not entice me to buy these notes...."

"...[T]hey added insult to injury by changing the law in the middle of the game by declaring a default, a moratorium...."

* * *

"When the moratorium was declared we felt thoroughly defrauded and misled by the information reported in the newspapers which quoted politicians, bankers and other financial market people prior to the moratorium. Especially after these same people and/or sources indicated by their comments after the moratorium was set up that they were well aware of the financial condition of the city well before these notes were peddled (and I use that word advisedly)."

* * *

"I personally feel that the city had no right to even think of issuing these notes. It is just beyond belief that the city didn't know that they couldn't meet these obligations. This issue was a 'hoax'. Never, never, in this country did I ever think this could happen."

APPENDIX B

1. With respect to each City note and bond that you purchased, please indicate in the appropriate columns set forth below:
 - (a) the name of the bank or brokerage firm from whom you purchased each note or bond;
 - (b) the date(s) of purchase(s);
 - (c) the date(s) of maturity(ies);
 - (d) the rate(s) of interest on the notes or bonds; and
 - (e) the name(s) of the salesperson(s)* of the banks or brokerage firms who assisted you in purchasing these notes or bonds.

If confirmation(s) of your purchase(s) indicates the above information, you may send us the confirmation(s) in lieu of answering this question. We shall return such confirmations to you promptly.

* Salesperson, Account Executive or Registered Representative.

DO NOT SEND US YOUR BONDS OR NOTES

<u>Firm</u> (a)	<u>Date of Purchase</u> (b)	<u>Date of Maturity</u> (c)	<u>Rate of Interest</u> (d)	<u>Account Executive or Salesperson</u> (e)
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2. Please state in detail all the conversations you had with account executive or salespersons at and prior to each purchase by you of these notes or bonds.

(If more than one conversation please continue on a separate piece of paper and identify which purchase goes with each conversation)

3. Did you learn of the offering of these bonds or notes as a result of:
- (a) Published articles about the proposed offering of bonds or notes of the City. [185]
 - (b) Recommendation by your bankers or broker. [108]
 - (c) Recommendation by a friend, relative or business associate. [34]
 - (d) Some other way. Please specify. [29]

NO RESPONSE - 2

4. Did you receive any of the documents or reports referred to below before paying for the bonds or notes:

(a) A "Report of Essential Facts" for the City of New York:

Yes [13]

No [269]

NO RESPONSE

- (b) The "Notice of Sale" describing the offering in which you were participating:
- | | | |
|----------|----------|------------------|
| Yes [39] | No [230] | No Response - 15 |
|----------|----------|------------------|
- (c) A published or reported opinion of counsel dealing with the tax exempt features of the bonds or notes being purchased:
- | | | |
|----------|----------|------------------|
| Yes [74] | No [197] | No Response - 14 |
|----------|----------|------------------|
- (d) The fiscal newsletter for the City of New York:
- | | | |
|----------|----------|------------------|
| Yes [10] | No [264] | No Response - 10 |
|----------|----------|------------------|
- (e) A confirmation of your purchase(s) sent to you by your bank or broker:
- | | | |
|-----------|---------|-----------------|
| Yes [253] | No [22] | No Response - 9 |
|-----------|---------|-----------------|
- (f) Literature about the bonds or notes prepared or distributed by your bank or broker:
- | | | |
|----------|----------|-----------------|
| Yes [30] | No [245] | No Response - 9 |
|----------|----------|-----------------|
- (g) A credit analysis on the City prepared by Moody's Investor Service, Inc.: Yes [15] No [248] No Response - 21
Standard & Poors Corp.: Yes [13] No [242] No Response - 29
any other rating service: Yes [7] No [228] No Response - 49

Please identify

(h) If you did not receive a credit analysis were you aware of or were you informed of the rating given to such notes or bonds:

Yes [121] No [151] No Response - 13

If your answer is yes, please indicate below what your understanding was of such rating, what such rating meant to you and identify the firm which furnished this rating.

(i) Other information relating to or describing the notes or bonds being purchased:

Yes [32] No [203] No Response - 49

If the answer to (i) is yes, please describe this material in the space below.

If the answer to part 4(f) or 4(i) of this question is yes and such materials are still in your possession, please enclose duplicate copies of the materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES.

5. Did you receive any of the documents or reports referred to in Item 4 above immediately after you paid for your notes or bonds?

Yes [73]

No [173]

No Response - 38

If your answer is "yes" please identify such documents or reports.

Again, if the appropriate materials are still in your possession, please enclose duplicate copies of such materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES.

6. At the time you purchased your bonds or notes what was your understanding of the City's financial condition?

Excellent [90] Good [146] Fair [38] Poor [10] No Response-13

Please explain in detail the source(s) of information that led you to believe the City's condition was as you have indicated.

(a) The City's bookkeeping and accounting practices were:

Excellent [56] Good [110] Fair [29] Poor [21] No Response-73

What was the source(s) of information that led you to believe the City's practices were as you have indicated?

(b) What degree of risk, if any, did you perceive to be involved in a purchase of City notes or bonds?

High [4] Normal [25] Little [70] None [180] No Response-7

(c) What were you told if anything regarding a secondary or trading market in City notes and bonds?

7. (a) At the time you purchased your bond(s) or note(s) of the City, were you advised or was it your understanding that payment of principal and interest shall be a first lien on all of the City's revenues?

Yes [255] No [17] No Response - 12

- (b) If your answer to the above is yes, please identify the source of your advice or understanding.

- (c) If your answer in (a) is yes, please indicate below the information you received or your understanding of what is meant by a first lien.

8. Prior to the time of your most recent purchase of notes or bonds of the City of New York were you aware of any of the following acts or practices of the City, as identified by New York State Comptroller Levitt in his audits with respect to New York City:

- (a) Items traditionally considered to be expense items since they would reoccur on an annual basis were included in the capital budget;

Yes [31] No [231] No Response - 22

- (b) The City had incurred short term debt to provide funds required to close the gap between uneven streams of expenses and revenues;

Yes [90] No [175] No Response - 19

- (c) The City's expense budget was prepared without creating any reserves for non-collection of tax revenues;

Yes [4] No [258] No Response - 22

- (d) The City included on its tax rolls properties not subject to taxation;

Yes [6] No [257] No Response - 21

- (e) The City had used non-recurring revenues as a technique for producing a balanced budget in prior fiscal years;

Yes [13] No [246] No Response - 25

9. Please indicate which of the following items were factors in your investment decision to purchase City note(s) or bond(s):

- (a) Higher rate of interest payable than in other investments:

Yes [202] No [63] No Response - 19

(b) Tax exempt status with respect to income derived from an investment in City bond(s) or note(s):

Yes [272] No [3] No Response - 9

(c) Favorable rating given to such bonds or notes:

Yes [222] No [28] No Response - 34

(d) A safe and secure investment:

Yes [269] No [6] No Response - 9

(e) Maturity date of the bond(s) or note(s) met your investment needs:

Yes [254] No [13] No Response - 17

(f) If there were other reasons, please summarize them below:

- (a) I am holding these notes and anticipate that I will continue to hold them until the expiration of the moratorium: [140]
- (b) I sold these notes: [8]
- (c) I exchanged these notes or intend to exchange these notes for the obligations of the Municipal Assistance Corporation: [124]

OTHER 1
NO RESPONSE 29

14. Please indicate your highest level of academic study:

Post-Graduate [108]
College Graduate [84]
High School Graduate [71]
Other [27]
NO RESPONSE 9

15. Please indicate your area of employment at time of your last purchase of New York City's bonds or notes:

Self-Employed [68]
Professional [108]
White-Collar Employee [60]
Laborer [3]
Retired [58]
Unemployed [8]
OTHER 9
NO RESPONSE 1

16. Please indicate your marital status:

Single	[33]
Married	[215]
Divorced	[7]
Widow or Widower	[25]
NO RESPONSE	4

17. I would be willing to discuss my situation in further detail with a representative of the Securities and Exchange Commission.

Yes []

No []

Name _____

Home Address _____

Business Address _____

Home Telephone Number _____

Business Telephone Number _____

APPENDIX C

1. With respect to each City note and bond that you purchased, please indicate in the appropriate columns set forth on page 2:
 - (a) The name of the bank or brokerage firm from whom you purchased each note or bond;
 - (b) The date(s) of purchase(s);
 - (c) The date(s) of maturity(ies);
 - (d) The rate(s) of interest on the notes or bonds; and
 - (e) The name(s) of the salesperson(s)* of the bonds or brokerage firms who assisted you in purchasing these notes or bonds.

If confirmation(s) of your purchase(s) indicates the above information, you may send us the confirmation(s) in lieu of answering this question. We shall return such confirmations to you promptly. In any event, please state the principal amount of the bond or note purchased.

* Salesperson, Account Executive or Registered Representative.

2.

DO NOT SEND US YOUR BONDS OR NOTES

<u>Firm</u>	<u>Date of Purchase</u>	<u>Date of Maturity</u>	<u>Rate of Interest</u>	<u>Account Executive or Salesperson</u>
(a)	(b)	(c)	(d)	(e)
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

2. Please state in detail all the conversations you had with salespersons at and prior to each purchase by you of these notes or bonds.

(If more than one conversation took place, please continue your description on a separate piece of paper and identify which purchase goes with each conversation.)

3.

3. Did you learn of the offering of these bonds or notes as a result of:

- | | |
|---|-------|
| (a) Published articles about the proposed offering of bonds or notes of the City? | [130] |
| (b) Recommendation by your banker or broker? | [71] |
| (c) Recommendation by a friend, relative or business associate? | [28] |
| (d) Some other way? Please specify. | [24] |
| NO RESPONSE | 2 |
-
-
-
-

4. Did you receive any of the documents or reports referred to below before paying for the bonds or notes:

- | | | | |
|---|----------|-------------|----|
| (a) A "Report of Essential Facts" for the City, i.e., a 2-3 page document prepared by the Comptroller's office? | | | |
| Yes [7] | No [201] | No Response | 10 |
| (b) The "Notice of Sale" describing the bonds or notes, i.e., the official several page notice of the Comptroller's office? | | | |
| Yes [6] | No [199] | No Response | 13 |
| (c) A published or reported opinion of counsel dealing with the tax-exempt features of the bonds or notes being purchased? | | | |
| Yes [35] | No [172] | No Response | 12 |

- (d) The fiscal newsletter for the City of New York published by the Finance Administration of the City?
- | | | |
|---------|----------|----------------|
| Yes [2] | No [201] | No Response 15 |
|---------|----------|----------------|
- (e) A confirmation of your purchase(s) sent to you by your bank or broker?
- | | | |
|-----------|---------|---------------|
| Yes [183] | No [28] | No Response 7 |
|-----------|---------|---------------|
- (f) Literature about the bonds or notes prepared or distributed by your bank or broker?
- | | | |
|----------|----------|----------------|
| Yes [14] | No [194] | No Response 10 |
|----------|----------|----------------|
- (g) A credit analysis on the City prepared by Moody's Investor Service, Inc.?
- | | | |
|---------|----------|----------------|
| Yes [4] | No [204] | No Response 10 |
|---------|----------|----------------|
- or Standard & Poor's Corp.?
- | | | |
|---------|----------|----------------|
| Yes [4] | No [203] | No Response 12 |
|---------|----------|----------------|
- any other rating service?
- | | | |
|---------|----------|----------------|
| Yes [2] | No [205] | No Response 12 |
|---------|----------|----------------|

Please identify

- (h) If you did not receive a credit analysis, were you aware of or were you informed of the rating given to such notes or bonds?
- | | | |
|----------|----------|----------------|
| Yes [71] | No [133] | No Response 15 |
|----------|----------|----------------|

5.

If your answer is yes, please indicate below

- (i) The rating;
- (ii) Your understanding of the meaning of the rating, and
- (iii) How you learned of the rating.

- (i) Other information relating to or describing the notes or bonds being purchased?

Yes [22] No [137] No Response 59

If the answer to (i) is yes, please describe this material in the space below.

If the answer to part 4(f)-(i) of this question is yes, and such materials are still in your possession, please enclose duplicate copies of the materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES

6.

5. Did you receive any of the documents or reports referred to in Item 4 above immediately after you paid for your notes or bonds?

Yes [42]

No [148]

No Response 28

If your answer is "yes" please identify such documents or reports.

Again, if the appropriate materials are still in your possession, please enclose duplicate copies of such materials with your completed questionnaire.

DO NOT SEND US YOUR BONDS OR NOTES

6. At the time you purchased your bonds or notes, what did you believe the City's financial condition to be?

Excellent[65] Good[110] Fair[39] Poor[8] No Response 8

Please explain in detail the source(s) of information that led you to believe the City's condition was as you have indicated.

(a) At the time you purchased your bonds or notes, what did you believe the City's bookkeeping and accounting practices to be?

Excellent [55] Good [107] Fair [18] Poor [9] No Response 32

What was the source(s) of information that led you to believe the City's practices were as you have indicated?

(b) At the time you purchased your bonds or notes, what degree of risk, if any, did you perceive to be involved in a purchase of City notes or bonds?

High [2] Normal [42] Little [44] None [132] No Response 2

(c) What were you told, if anything, regarding a secondary or trading market in City notes and bonds?

8.

7. (a) If you purchased notes, were you advised or was it your understanding at the time of purchase, that payment of principal and interest of the notes shall be a first lien on all of the City's revenues?

Yes [177]

No [22]

No Response 19

- (b) If your answer to the above is yes, please identify the source of your advice or understanding.

- (c) If your answer in (a) is yes, please indicate below the information you received or your understanding of what is meant by a first lien.

8. Prior to the time of your most recent purchase of notes or bonds of the City, were you aware of any of the following acts or practices of the City, as identified by New York State Comptroller Levitt in his audits with respect to the City:

- (a) Items traditionally considered to be expense items, since they would reoccur on an annual basis, were included in the capital budget;

Yes [18]

No [191]

No Response 9

- (b) The City had incurred short term debt to provide funds required to close the gap between uneven streams of expenses and revenues;
- Yes [69] No [136] No Response 13
- (c) The City's expense budget was prepared without creating any reserves for non-collection of tax revenues;
- Yes [6] No [200] No Response 12
- (d) The City included on its tax rolls properties not subject to taxation;
- Yes [12] No [192] No Response 14
- (e) The City had used non-recurring revenues as a technique for producing a balanced budget in prior fiscal years;
- Yes [9] No [195] No Response 14

9. Please indicate which, if any, of the following items were factors in your investment decision to purchase City notes or bonds:

- (a) Higher rate of interest payable than in other investments;
- Yes [171] No [30] No Response 18
- (b) Tax exempt status with respect to income derived from an investment in City bonds or notes;
- Yes [210] No [4] No Response 4
- (c) Favorable rating given to such bonds or notes;
- Yes [132] No [49] No Response 37
- (d) A safe and secure investment;
- Yes [197] No [9] No Response 12
- (e) Maturity date of the bonds or notes met your investment needs;
- Yes [205] No [5] No Response 8

10.

(f) If there were other reasons, please summarize them below:

10. Was your investment in City notes or bonds your first investment in municipal notes or bonds?

Yes [132]

No [80]

No Response 6

11. Apart from City notes or bonds, had you previously purchased any of the following:

Corporate Stock [181]

Corporate Bonds [90]

Other Municipal Bonds [72]

Other Municipal Notes [28]

I had not previously purchased other securities [17]

NO RESPONSE 13

12. At the time that you purchased your notes or bonds, were you advised that the City might defer its obligations to certain of its noteholders through the enactment of a moratorium law?

Yes [0]

No [214]

No Response 4

11.

13. If you held any notes of the City coming due beginning in December of 1975, and subject to the moratorium law, please check the appropriate box below:

- | | |
|--|-------|
| (a) I am holding these notes and anticipate that I will continue to hold them until the expiration of the moratorium; | [120] |
| (b) I sold these notes; | [13] |
| (c) I exchanged these notes or intend to exchange these notes for the obligations of the Municipal Assistance Corporation; | [54] |
| (d) I plan to sell the notes prior to maturity. | [3] |
| NO RESPONSE | 38 |

14. Please indicate your highest level of academic study:

- | | |
|----------------------|------|
| Post-graduate | [89] |
| College Graduate | [57] |
| High School Graduate | [61] |
| Other | [20] |
| NO RESPONSE | 5 |

15. Please indicate your area of employment at the time of your last purchase of the City's bonds or notes:

- | | |
|-----------------------|------|
| Self-employed | [68] |
| Professional | [88] |
| White-Collar employee | [37] |
| Laborer | [2] |
| Retired | [33] |
| Unemployed | [4] |
| OTHER | 5 |
| NO RESPONSE | 4 |

16. Please indicate your annual income bracket at the time you purchased your bonds or notes (optional):

Less than \$10,000	[12]
\$10,000 - \$20,000	[44]
\$20,000 - \$40,000	[79]
Above \$40,000	[62]
NO RESPONSE	22

17. I would be willing to discuss my situation in further detail with a representative of the Securities and Exchange Commission

Yes [] No []

Name _____

Home Address: _____

Business Address: _____

Home Telephone Number: _____

Business Telephone Number: _____

APPENDIX D

Written Statement, in Part, of James A. Lebenthal,
Executive Vice President, Lebenthal & Co.

Consequences of New York City Default on Individual Bond Owner

Nobody claims to know who the owners of New York City's bonds are, and that is just one of the enormous difficulties in visualizing in human terms the consequences of default by the second largest borrower in our capital society.

The Municipal Bond firm of which I am Executive Vice President, Lebenthal & Co., Inc. with offices located at 1 State Street Plaza, New York, NY 10004, may be in a unique position to supply some hard statistics on the ownership of New York City bonds.

Since 1925, Lebenthal & Company has been specializing in Municipal Bonds, catering almost exclusively to the individual investor.

An analysis of the business records of our firm leads me to the estimate that no less than 160,000 small individual investors own the major portion of New York City's outstanding long term bonds. New York City has a total of \$7,350,610,000 bonds outstanding. I would place the combined ownings of these 160,000 households at approximately \$4,895,000,000, two thirds of the debt outstanding*.

But because the tax free coupon interest from municipal bonds need not be reported and the Treasury Department has no record of municipal bond ownership...because the federal reserve figures are preoccupied with bank ownership and it is only through a process of elimination that we have any governmental figures at all on ownership of households of \$62.3 of the \$207 billion state and local debt outstanding...and because of the natural reticence of people to speak openly about their money, the impression could exist that Municipal Bonds are the private preserve of banks and a few Park Avenue millionaires.

That is not the picture I am now going to present or that is supported by the more than 300 letters Lebenthal & Co., Inc. has received in reply to a request for bondholders on our mailing list to come forward, write and be identified, a small sample of which are appended hereto.

The typical owner of New York City Bonds is on in years.

The bonds represent the family's savings, accumulated over a lifetime. Payment is usually made by check drawn on savings accounts. The bonds are savings.

The average transaction is \$10,000. The average portfolio is less than \$35,000.

* * *

October 15, 1975

* This analysis of the ownership of New York City debt by individuals is limited to funded debt, bonds only, of which Lebenthal & Co., Inc. had been a major underwriter and marketer. Not having been an underwriter of the city's notes, the company has played a negligible role in the marketing of notes and does not possess the expertise to analyze individual ownership.

APPENDIX E

THE FOLLOWING IS A PARTIAL LIST OF THE COMMUNITIES,
WITHIN THE UNITED STATES, OUTSIDE OF NEW YORK STATE,
IN WHICH PURCHASERS OF CITY NOTES SUBJECT TO THE
MORATORIUM RESIDED.

ALABAMA

Fyffe

Talladega

Union Town

Altalla

Sulligent

Fort Deposit

Birmingham

Point Clear

Clayton

Montevallo

Southeast Decatur

ARIZONA

Tucson

ARKANSAS

West Memphis

CALIFORNIA

San Anna

Encino

Downey

Oakland

Beverly Hills

Los Angeles

San Francisco

COLORADO

Denver

CONNECTICUT

Hartford	Bridgeport
Stamford	Norwalk
Southbury	Westport
Old Saybrook	Norfolk
Orange	Rowayton
Byram	Old Greenwich
Fairfield	Weston
Greenwich	West Hartford
New Canaan	Woodmont
Waterbury	Waterford
Newington	Danbury
Salisbury	<u>DELAWARE</u>
Essex	Wilmington
Springdale	New Castle
Darien	<u>DISTRICT OF COLUMBIA</u>
Bloomfield	Washington, D.C.

FLORIDA

Miami Beach
 Surfside
 Hollywood
 Homestead
 West Palm Beach
 Lake Worth
 Coral Gables
 North Miami Beach
 Highland Beach
 Sarasota
 Fort Lauderdale
 Palm Beach
 Boca Raton
 North Miami
 St. Petersburg
 Juno Beach
 Delray Beach
 Margate

Vero Beach
 Sunrise
 Hallandale
 Satellite Beach
 Miami

Key West
 Naples
 Bal Harbour

GEORGIA

Atlanta
 Dalton
 East Alton

ILLINOIS

Chicago
 Evanston
 Park Ridge
 Northbrook
 Highland Park

Wilmetta

INDIANA

Indianapolis
 Bedford
 East Chicago
 Munster

IOWA

Britt
 Manly
 Newton

Balmond

KANSAS

Great Bend
 Dighton
 Clay Center

KENTUCKY

Cadiz

LOUISIANA

Monroe

MAINE

Portland

Lincoln

MARYLAND

Bethesda

Baltimore

Denton

Potomac

Silver Spring

Hancock

Rockville

Chevy Chase

MASSACHUSETTS

Boston

Wellesley Hills

Newton Centre

Newton

Gloucester

Everett

Chestnut Hill

Belmont

MASS. cont.

Medford

Brookline

Cambridge

Dedham

Lexington

Chilmark

Wayland

Amherst

Melrose

Needham

Marblehead

Wenham

Andover

Worcester

MICHIGAN

Detroit

Ionia

MINNESOTA

Minneapolis

MISSISSIPPI

Tupelo

Gary

MISSOURI

St. Louis

Chesterfield

NEBRASKA

Holdrege

NEW HAMPSHIRE

Center Harbor

NEW JERSEY

Teaneck	Cliffside Park	Englewood
Franklin Lakes	Short Hills	Ridgewood
Whippany	Harrington Park	Nutley
Hawthorne	Tenafly	N. Plainfield
Bayonne	South Orange	Milford
Upper Montclair	Saddle Brook	Aldine
Highland Park	Clifton	Elberon
Maplewood	Perth Amboy	Irvington
Saddle River	Oradell	Oakhurst
North Brunswick	Englewood Cliffs	Union
Montclair	Millburn	Weehawken
Newark	Bayonne	Fort Lee
Hackensack	Jersey City	East Orange
Roselle Park	New Milford	Little Falls
Elizabeth	Livingston	Franklin Lakes
Basking Ridge	Rutherford	Trenton
Patterson	Orange	Summit
Springfield	Rahway	Sumerset
Westfield	Morganville	

NEW JERSEY con't.

Deal	West Orange	West New York
Union City	Closter	Edgewater
Mountainside	Madison	Wyckoff
Haworth	Eatontown	Englishtown
Hillsdale	Belleville	Kinnelon
Verona	Essex Falls	Oakhurst
Tinton Falls	Kearney	Morristown
Matawan	Linden	Cresskill
Glen Park	Harrington Park	Asbury Park
Princeton	Trenton	Fairfield
Wayne	Paramus	West Allenwest
Demarest	Lincroft	Upper Montclair
New Providence	Woodbridge	North Arlington
Scotch Plains	Passaic	Palisade
Lincoln Park	Fair Lawn	Wayne
North Caldwell	Florham Park	Gillette
Chatham	Long Branch	Glen Ridge
Mount Vernon	Colonia	Bernardsville
Red Bank	East Brunswick	Morris Plains
Upper Saddle River	Cherry Hill	Bradley Beach
Springfield		

NEW JERSEY cont

Dover

Paterson

River Vale

Edison

Lyndhurst

Colts Neck

Lakewood

Garfield

Ridgefield

North Bergen

Iselin

Hoboken

Keasbey

West Paterson

Bridgewater

Murray Hill

Voorhees

Bergenfield

NEW MEXICO

Santa Fe

NORTH CAROLINA

Eden

Raleigh

Charlotte

NORTH DAKOTA

Wimbledon

OHIO

Tiffin

Columbus

Hamilton

Cincinnati

Fremont

PENNSYLVANIA

Philadelphia

Cheltenham

Dowington

Allentown

Pa. cont.

Bla Cynwyd

Mt. Lebanon

Yardley

Pittsburg

Dallas

Easton

Jennerstown

Mansfield

Havertown

Millersburg

Ellwood City

Chambersburg

State College

Morristown

Wayne

Newton

RHODE ISLAND

Barrington
Providence
Wakefield
Cranston
Johnston
Woonsocket
Little Compton
Bristol
Warwick

TENNESSEE

Dunlap
Columbia
Brentwood
Nashville
Madison

TEXAS

Houston
Greenville
Huntington
San Antonio

VERMONT

Burlington
E. Thetford
Morrisville

VIRGINIA

Newport News
Richmond
Charlottesville
Alexandria
Virginia Beach
Williamsburg

WASHINGTON

Williamson

WISCONSIN

Racine
Oregon
Milwaukee

ANALYSIS OF QUESTIONNAIRES SENT TO SYNDICATE MEMBERS

August 26, 1977

As part of the Commission's investigation, those institutions that participated in the underwriting and sale of City securities were requested to respond to a Questionnaire. The names of the participating organizations were obtained from tombstone advertisements in the newspapers, The Daily Bond Buyer and from other relevant sources. The Questionnaire was mailed to approximately 304 organizations participating in the sale or distribution of the Notes or Bonds between April 4, 1973 and June 30, 1975. ^{1/} The following report represents a compilation obtained from the responses of ninety-three organizations which returned the Questionnaire.

The report focuses on the responses in the following areas: understanding or belief concerning the duties of the managing underwriter and bond counsel; investigation and analysis of information concerning the underwriting of New York City Notes or Bonds; the decision to participate; customer sales; and conclusory remarks.

^{1/} Approximately seven organizations which returned the Questionnaire were not a part of the tabulation of results (as of June 20, 1977). Question One (regarding the extent of individual syndicate members' participation), Question Thirty-four (regarding the monthly position of the accounts of the individual syndicate members during January 1, 1973 to May 30, 1975), and Question Thirty-one (concerning the participation in the underwriting of Revenue Anticipation Notes ("RANs") and Tax Anticipation Notes ("TANs")) are not a part of the report. The text of these Questions is included in Exhibit A.

I. UNDERSTANDING OR BELIEF OF THE DUTIES OF THE MANAGING UNDERWRITER AND BOND COUNSEL

This section encompasses the responses to Questions Ten, Eleven and Twelve of the Questionnaire.

Question Ten states:

What was your organization's understanding as to the role or duties of the managing underwriter in connection with the underwriting of the Notes or Bonds? For example,

- (A) Did you believe that the managing underwriters had or assumed the responsibility to verify or investigate the accuracy, completeness, or veracity of the information prepared and presented to them by the City and/or received by them from other sources (1) Before inviting your organization to be a syndicate member; (2) Before the pricing meetings; or (3) Before sale and distribution of the Notes or Bonds to the public?
- (B) Did your organization understand or believe that the managing underwriters had an obligation to bring to your attention any negative aspects relating to the Notes or Bonds?
- (C) Did your organization understand or believe that the managing underwriters' decision to underwrite the Notes or Bonds was in and of itself an express or implied approval of the creditworthiness of the City's fiscal position and its Notes or Bonds?

In each instance, state the basis for the understanding or belief.

- (D) In any event, please reflect your understanding or belief of the managing underwriters' role or duties.

* * * *

The majority of the syndicate members relied upon the managing underwriters and expected that they would fulfill those duties described in Question Ten; however, a few organizations qualified their statements. For example, one firm noted that it believed that managing underwriters did not necessarily have an obligation to bring any negative aspects relating to the Notes or Bonds to the attention of the syndicate members. The firm also stated its belief that many negative aspects are opinion. ^{1/}

^{1/} Response No. 1 to the Syndicate Members Questionnaire (hereinafter cited, e.g., "Response No. ___").

Another firm observed:

. . .but other members of the syndicate also exercise the responsibility to report developments which have come to their attention. 1/

One response reflects not only the ability of the syndicate member but also that of the customer to assess the risks.

We do not believe that another organization can be held responsible for the activities of our firm. We believe we have a responsibility to monitor our own actions and we believe that our sales of these securities were, in the main, to customers who were capable of assessing the risks themselves although admittedly inadequate information was provided by the City. 2/

In response to Question Ten (D) the members of the underwriting syndicates do not agree as to the limitations or the scope of the duties of managing underwriters.

Without stating the basis, certain organizations narrowly perceived the duties of the managing underwriter. For instance, one organization believed the duties of managing underwriters were merely to organize the selling group. Other organizations emphasized the managing underwriters' managerial capacity such as, e.g., duties to ...

Form syndicate, Pricing, Book presale orders for account, Submit bid, Run the books. 3/

Duties to form the underwriting group, to analyze the information provided, and to prepare the circular in the manner normally presented to prospective investors, to determine the bid, to allocate the bonds, to manage the closing, and to distribute profits, if any. 4/

1/ Response No. 2.

2/ Response No. 3.

3/ Response No. 4.

4/ Response No. 5.

Other replies emphasized, in effect, that the duties were more than merely managerial:

The manager's prime function is to syndicate and submit a bid and if he is aware of a major problem in the issuer's finances, it should be pointed out to the syndicate members. 1/

One bank emphasized the essential research to be completed prior to the organization of the syndicate:

This is a Cardinal Rule that applied to all new issues regardless of name. The obligation of the managing underwriter is to ascertain that the issue has been legally authorized and that its credit worthiness has been fully verified by its municipal research staff before any syndicate membership is organized. 2/

Another syndicate member replied as follows:

It is our opinion that the managing underwriter was and is responsible for managing the account from the point of view and with the implied understanding that he would not form or re-activate an underwriting syndicate for a potentially defaulting issuer. 3/

One bank characterized the role of the managing underwriter as follows:

The managing underwriters were in effect structuring accounts which, if successful, would be offering the bonds to institutions and the general public therefore becoming the responsible architect of such offerings. 4/

The various duties of the managing underwriter were described by a major banking institution as follows:

1/ Response No. 6.

2/ Response No. 7.

3/ Response No. 8.

4/ Response No. 9.

The managing underwriter's first responsibility is to make an appropriate credit analysis of all relevant credit factors concerning the issuer. If, based on that analysis, the managing underwriter concludes that the issuer has the ability to pay its obligations at maturity, its next responsibility is to contact those institutions that generally bid with the syndicate and to ascertain their interest in participating in the syndicate. After the syndicate is formed, the managing underwriter's principal responsibility in a competitive bid offering is to represent the syndicate in making the best possible bid for the securities. If the syndicate is successful in winning the bid, the managing underwriter's role is to ensure maximum participation from the members and to effect complete distribution of the securities. The managing underwriter is also responsible for maintaining records of the account and reporting any profit or loss to the syndicate. 1/

In the description of the duties of the managing underwriter, some prominent institutions attributed greater responsibility to the rating services or to the City than to the managing underwriter. One firm states:

The manager had the right to believe in the accuracy and veracity of figures prepared by the City. We dropped when we feared this trust was misplaced. 2/

1/ Response No. 10.

2/ Response No. 12.

We also believed in the security of general obligation notes and bonds, the pledge of the full faith and credit of the issuer, and the federal statutes regarding the sanctity of the contract. 1/

The nature of the relationship between the City and the managing underwriters was thought to be a key to the duties of the managing underwriters.

We felt that because of the close relationship of Chase Manhattan to New York City's fiscal affairs that they would have kept syndicate members informed of any deleterious news. 2/

Another firm indicated:

Chase Manhattan had maintained a unique relationship with the City to be in a position to easily assume these responsibilities. The Bank certainly had the staff capability. 3/

Some firms clearly recognized the important responsibilities of the managing underwriters in municipal securities offerings. As one financial institution put it, the managing underwriters had a duty...

To utilize their substantial research staff to investigate the credit worthiness of municipal credits before forming an underwriting syndicate. 4/

Another concluded, the managing underwriter had the duty. . .

To delve as deeply as possible into the figures supplied, including the negatives but probably not to call the government employees "liars". 5/

One organization presents an historical overview describing the relationship between the New York banks and the City officials:

The managing underwriters of the syndicates in which [we] participated were New York banks. Historically, those banks took the largest percentage of each City underwriting and frequently

1/ Response No. 13

2/ Response No. 14

3/ Response No. 15

4/ Response No. 16.

5/ Response No. 17.

purchased City securities for their portfolios. Further, representatives of those banks were members of committees, such as Technical Advisory Committee on City Debt Management, that advised and worked with the City in connection with its debt offerings. 1/

Another response emphasized significant acts of the managing underwriter that formed a basis for the reliance of syndicate members:

Also relied on the fact that managing underwriters were also lending to the City separate and apart from the particular underwritings. 2/

* * *

In addition to Question Ten's request for a description of the duties of the managing underwriter, Questions Eleven and Twelve requested the organizations to describe their understanding of the role of bond counsel.

Question Eleven states:

Please describe your understanding of the role or duties of Bond Counsel in connection with the underwritings of Notes or Bonds.

* * *

Generally, the understanding of the syndicate members was that bond counsel performed "legal duties" although the basis for such assessment was rarely articulated.

One organization evaluated the role of bond counsel as follows:

Our understanding is Bond Counsel('s) duty to render that the bonds are in fact being legally issued. 3/

Another organization described the role as follows:

Our understanding of the role of Bond Counsel is that he verifies the legality of the issue, its tax exempt status and its situation with respect to pending litigation. 4/

1/ Response No. 18.

2/ Response No. 19.

3/ Response No. 20.

4/ Response No. 21.

Others characterized the legal duties of bond counsel as a:

Duty to . . . approve legality. 1/

Duty to . . . pass only on the legality of the proceeding, sale, etc., as they affect the bonds. 2/

Duty . . . to make sure bonds are issued in accordance with the Constitution and local finance laws of New York State. 3/

One organization thought that if the issue is validly executed, bond counsel need not make a financial analysis. It stated:

. . . we believe it is Bond Counsel's obligation to determine that any state or local law or constitutional requirements have been complied with at the issuance. Analysis of financial material and ability to repay the issue was validly executed and constituted the valid obligation of the issuer. 4/

A Chicago organization in its cover letter submitted the following pertinent observation:

I can add this sidelight. I entered this industry with our firm in mid-1974 when we were in the process of developing a negotiated underwriting department. I found a great deal of resistance to the concepts of due diligence and full disclosure. I can remember many battles in which our firm insisted on disclosure which was resisted by others (including both lawyers and large underwriting firms). Needless to say, 2 1/2 years later, the procedures we were fighting for then are virtually universally accepted now. The change has been that dramatic. 5/

* * *

1/ Response No. 22.

2/ Response No. 23.

3/ Response No. 24.

4/ Response No. 25.

5/ Response No. 26.

Question Twelve states:

To your knowledge, did Bond Counsel, prior to rendering its approving opinion, verify or investigate the accuracy, completeness, or veracity of the figures and textual information prepared and presented by the City in conjunction with the underwritings of the Notes or Bonds?

If Bond Counsel did any of the above, state the basis for your knowledge.

* * *

There were few comments in response to this question. Few organizations had actual knowledge of whether bond counsel, prior to rendering its approval, verified or investigated the accuracy, completeness or veracity of the figures and textual information prepared by the City in conjunction with the underwritings of the notes or bonds. They assumed bond counsel had enough information to render an opinion.

Generally, the syndicate members indicated that the managing underwriters' and the bond counsel's performance of their duties would eliminate the need for their own inquiry and analysis. This was based in part on the assumption that New York City underwriters and the City officials had a close relationship. The syndicate members stated that in deciding whether to participate in the offering of City securities they relied upon their confidence in the managing underwriters, the rating services and the approval of bond counsel.

**II. INVESTIGATION AND ANALYSIS OF INFORMATION CONCERNING THE
UNDERWRITING OF NEW YORK CITY NOTES AND BONDS**

This segment deals with questions relating to the scope of the syndicate members' independent investigation of the offering of City securities.

Question Three states:

Has your organization had, or does your organization have, a municipal research department, or designated employees who do municipal research? If so, please provide the following information:

- (A) The approximate date when such department or activity was begun;
- (B) The number of employees engaged in such research;
- (C) The number of employees engaged in such research at the time your organization participated in the sale of the Notes or Bonds;
- (D) The background of each employee described in response to (B) and (C) above.

* * *

Approximately seventy firms reported that they did not have a municipal securities research department at the time of their participation. However, approximately ten of them reported that they now have municipal research departments. A few organizations had municipal research departments at the time of their participation. For instance, one organization reported that it had a municipal securities research department that was formed in 1954 and consisted of two employees, both with underwriting and credit analysis backgrounds. Three firms reported municipal securities research departments that had been in existence since 1968. One institution started a department in 1969; two in 1971.

* * *

Question Seven states:

Specifically describe any independent inquiry your organization made prior to your participation in the underwritings of the Notes or Bonds with respect to:

- (A) Fiscal information prepared and presented by the City; and
- (B) Fiscal information concerning the City prepared and presented by any other sources (identifying the sources).

Few organizations responded affirmatively to this Question. Some of them answered by referring to the City's Notice of Sale, a phone call to the managing underwriter, or to the receipt of the published ratings. The majority of firms, however, reported that they did not engage in any independent analysis, prior to participation in the underwritings of the notes or bonds with respect to fiscal information prepared and presented by the City and fiscal information concerning the City prepared and presented by other sources. One organization explained its inaction by stating that independent inquiry is not part of the standards for municipal underwriting. Only a few organizations stated that they had conducted their own analysis. As an explanation to a negative response some respondents indicated a reliance on the managing underwriter to provide the necessary inquiry.

* * *

Question Eight states:

Prior to your participation in the underwritings of the Notes or Bonds, did your organization consult with any outside technical experts, such as accountants, or municipal securities analysts, with respect to:

- (A) The subject matters referred to in question 4?
- (B) The feasibility of engaging in the underwritings of the Notes or Bonds?
- (C) The fiscal affairs or status of the City?

Specify who was consulted, the dates of consultations, and the action, if any, taken or conclusions reached.

* * * *

With few exceptions, the organizations responding stated that they did not consult with any outside technical experts, such as accountants, or municipal securities analysts, prior to participation in the underwritings of the Notes or Bonds.

Question Nine states:

Who in your organization analyzed or verified the veracity, completeness, or accuracy of the figures and textual information prepared and presented by the City in the Notices of Sale and Reports of Essential Facts in connection with your participation in the underwritings of the Notes or Bonds?

* * * *

The majority of organizations stated that no one person performed this function, or that they relied on the managing underwriter.

* * * *

Question Thirty-two states:

Subsequent to January 1, 1970, did your organization receive, compile or obtain statistical information with respect to the adopted or modified expense budget of the City?

[N.B. This calls for information distinct from question 4(E)(4)]
If yes, please indicate:

- (A) The type of information received, compiled or obtained;
- (B) The source of any information received;
- (C) Whether the information was of estimated figures;
- (D) The persons who received this information;
- (E) The uses, if any, which you made of any information received.

* * * *

No firm explicitly reported that it received statistical information subsequent to January 1, 1970 with respect to the City's adopted or modified expense budgets.

* * * *

Question Thirty-three states:

Subsequent to January 1, 1970, did your organization receive, compile, or obtain statistical information with respect to the General Fund of the City? If yes, please indicate:

- (A) The type of information received, compiled or obtained;
- (B) The uses, if any, which you made of any information received.

* * * *

No syndicate member responding received statistical information with respect to the General Fund of the City. However, a few mentioned that they received the Notice of Sale or the Rating Services reports in response to this question to indicate that those who prepared these reports received the statistical information with respect to the General Fund.

* * * *

Question Four, subsections (A)-(D) states:

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

- (A) Relied upon its own independent research of the fiscal affairs and condition of the City;
- (B) Received, utilized, or relied upon information or studies, etc. prepared and distributed by the managing underwriter (i.e., the underwriter who formed and organized the selling group). Please indicate when such information or studies, etc. were received (before or after your commitment) and also provide the Commission with copies thereof;
- (C) Received, utilized, or relied upon the information and data contained in the Notices of Sale and Reports of Essential Facts prepared and issued by the Office of Comptroller of the City;
- (D) Received, utilized, or relied upon the reports and ratings prepared and published by:

- (1) Moody's Investor Services, Inc.;
- (2) Standard and Poor's Corporation; and
- (3) Fitch's Investors Service.

* * * *

The majority of firms reported they did not rely upon independent research of the fiscal affairs and conditions of the City. Twelve institutions reported that they relied upon some independent research, and four firms reported that they relied extensively upon independent research.

The majority of firms did not receive, utilize, or rely upon information or studies prepared by the managing underwriter. Of those firms which reported that they received information or studies, only a few stated they received the information before their commitment.

One firm explained the significance of any written information.

As in any other underwritings we sought to align ourselves with a syndicate comprised of members who could distribute bonds. So from the standpoint of written information, we referred to our syndicate's ability to successfully underwrite and distribute. 1/

The majority of the firms stated that they received the Notices of Sale; however, the extent of utilization was not made clear. A majority also stated that they received and greatly relied on the reports and ratings prepared and published by the rating services, primarily Moody's and Standard and Poor's.

* * * *

1/ Response No. 27.

Question Four (E) states:

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

(E) Received, utilized, or relied upon any of the following material:

- (1) Monthly Statements prepared by the Office of the Comptroller of the City summarizing the City's Cash Receipts and Disbursements;
- (2) The Annual Report of the Comptroller of the City with respect to the City;
- (3) The Fiscal Newsletter of the City;
- (4) The Executive Budget of the City;
- (5) The Capital Budget of the City;
- (6) The Reports of the Comptroller of the City issued pursuant to Sections 113, 212, and 220 of the City Charter;
- (7) Audit Reports of the Comptroller of the State of New York with respect to the City;
- (8) Newspaper articles, or articles in other periodicals relating to the City's budgetary process and fiscal condition.

[Feel free to elaborate in your own words in answering items (4)(E)(1) to (8).]

With respect to Question 4(E)(8), specifically describe the extent to which your organization (I) Maintained a file of such articles; (II) Referred to such articles for original or basic information; (III) Viewed such articles as accurate or reliable; and (IV) Viewed such articles as full and fair disclosure regarding the City's fiscal condition, events, or problems, etc.

* * * *

With the exception of The Fiscal Newsletter of the City and articles from newspapers or periodicals, only one or two firms stated that they did receive and utilize the material listed in Question Four (E).

Approximately 20% of the firms answered that they received, utilized or relied upon the Fiscal Newsletter of the City.

Approximately forty-three of the ninety-three firms reported that they received, utilized, or relied upon newspaper articles, or articles in other periodicals relating to the City's budgetary process and fiscal condition. Few, however, maintained a file of such articles and few described the extent to which they referred to such articles for original or basic information, or viewed such articles as full and fair disclosure of the City's fiscal condition.

One organization reported:

...The major publications do in fact offer full and fair disclosure regarding the City's fiscal condition, events and problems. 1/

Another organization responded in this way:

During the period in question many conflicting articles appeared in the papers and other periodicals. The political and conflicting statements made by public officials produced contradictory stories which could not be accurately assessed without having had access to the City's financial record. No file of such material was maintained.

Still another institution stated:

We viewed these articles as no more reliable than any other news articles, and did not view them as a disclosure vehicle for the City. News articles are subject to varying interpretations of the same facts by different authors. Full disclosure by the City may only be made by direct releases of the City over which they have control and not via third parties. 3/

* * * *

Question Four (F) stated:

1/ Response No. 28.

2/ Response No. 29.

3/ Response No. 30.

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

(F) Relied upon any of the following statements contained in the Notices of Sale and Reports of Essential Facts:

(1) Bonds (and notes) will be valid and legally binding general obligations of the City, all the taxable real property within which will be subject to the levy of ad valorem taxes to pay said bonds (and notes) as well as the interest thereon without limitation as to rate or amount;

Yes [] No []

(2) The State Constitution requires the City to pledge its full faith and credit for the payment of the principal of its bonds (and notes) and the interest thereon and to make annual appropriations for the amounts required for the payment of such interest, and the redemption of its bonds;

Yes [] No []

(3) Payment of debt service shall be the first lien on all the City's revenue;

Yes [] No []

(4) If . . . the appropriating authorities fail to make the required appropriations for the annual debt service on the bonds and certain other obligations of the City, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied for such purposes;

Yes [] No []

* * * *

The overwhelming answer of the financial institutions was that they relied upon the statements contained in the Notices of Sale and Reports of Essential Facts describing the issues of bonds or notes.

* * * *

Question Four, subsection (G) stated:

Regarding your organization's decision to participate in any of the underwritings of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

(G) Relied upon the belief or understanding that the managing underwriter had made an investigation, study, or analysis of any of the following areas prior to the formation of the selling syndicate:

(1) The credit worthiness of the City's Notes or Bonds;

Yes [] No []

(2) The fiscal soundness of the City;

Yes [] No []

(3) The sufficiency of revenues of the City to meet its maturing obligations;

Yes [] No []

If your answers to the foregoing questions of item 4 are that your organization did receive, rely and utilize the information, etc. referred to, please elaborate as to the importance or relevance of such information to your organization's decision to participate in the underwritings of the Notes or Bonds.

To the extent that there were written reviews, summaries, or analyses prepared by your organization with respect to the information described in item 4, please furnish copies thereof, and indicate whether such reviews, summaries, or analyses were for internal or external use.

* * * *

In answer to Question Four, subsection (G), a few organizations had a negative response such as:

The question is biased and unfair. All underwriters should make credit decisions. All of us act on facts given to us. Questions such as this, if answered in the negative would

certainly hinder our lead underwriters in the future.
Questions such as these merely look for a scapegoat. 1/

However, the majority of the firms had an affirmative response. One such response follows:

Having worked in the bond department of a large bank in a large City I know that we were fairly up to date on the finances of the City (Chicago) and the other political subdivisions surrounding and involving the City; I assume the New York Banks would have the same information about their City. 2/

The ordinary expectation was that the managing fee included payment for a credit analysis.

One responding firm said ...

A managing fee was charged by the managing underwriters and we would have assumed that such a fee was paid, in part, for analysis of the credit for the benefit of the account. 3/

Another offered this view:

If we had not relied on the managing underwriters' analysis of the credit worthiness of the City's Notes and Bonds, etc. we would not have underwritten the Bonds. 4/

One organization summarized its reasons why it made no independent analysis in this way:

It was our belief and understanding that the Notes and Bonds were prior liens on New York City's revenue sources which did give ample coverage. The decision to underwrite was further buttressed by the rating agencies to rate the Bonds and Notes as investment grade and by

1/ Response No. 31.

2/ Response No. 32.

3/ Response No. 33.

4/ Response No. 34.

the belief that the New York managers had stayed close to the fiscal situation. No independent reviews by our organization were made.... All sales and purchases were conducted through other broker-dealers with one exception.... 1/

* * * *

Question Five states:

To your knowledge, what investigation or analysis did the managing underwriters make with respect to the City's overall fiscal affairs and structure prior to deciding to underwrite the Notes and Bonds and before inviting your organization to participate in the underwriting?

* * * *

The majority of the syndicate members believed that prior to deciding to underwrite the Notes and Bonds and before forming the syndicate the managing underwriters had made some investigation or analysis with respect to the City's fiscal affairs and structure. However, most of them reported that the basis for this belief was assumption or speculation. A substantial number of firms reported that even though they relied upon the managing underwriters they had no knowledge of any investigation.

One organization stated:

Our belief was that our standing syndicate majors were in constant contact with City officials due to the frequency of City debt offerings and their banking relations. We further believe that before taking on their usual heavy commitments when underwriting these bonds these majors would use their sources to update their analysis of the City. As a member of a standing syndicate no invitation to participate in the underwriting of the certain bonds was necessary. 2/

Generally, the syndicate members believed that the managing underwriter performed the necessary investigation and analysis of information concerning

1/ Response No. 35.

2/ Response No. 36.

the underwriting of New York City Notes or Bonds. The limited extent of receipt, utilization, or reliance on any of the published information buttressed such an assumption. This assumption supported the continued participation in the underwriting by the syndicate members even though they had no actual knowledge of the managing underwriter's investigation or analysis.

III. THE DECISION TO PARTICIPATE

This phase of the report deals with the factors that were relevant to the decisions of the syndicate members to participate in the underwriting of City Notes and Bonds. Generally, the responses indicate the absence of any independent investigation by syndicate members and the presence of an historical relationship between syndicate members and the managing underwriters. It is clear that the syndicate members had a long history of participation in New York City securities offerings and that this was an important factor in their continued participation.

One syndicate member offered this view of the New York City bond market:

In the later 1960's and early 1970's the market for New York City Bonds (and in fact the municipal bond market generally) became quite volatile and beginning in about 1972 we decided to participate in the underwriting accounts involving New York City bonds only. In anticipation of an underwriting profit only. It was our impression at the time (and still is) that the New York State Constitution would probably protect the bond holder ultimately but an inherent investment risk and in particular marketability risk of New York City bonds prohibited us from selling to our public clients. In the 30 years this company has been in business it has always been the company's policy to sell bonds with much higher investment characteristics than those of the City of New York. It should be noted that we have never participated in the underwriting of any of the various notes issued by the City of New York, since it was our impression at the time that the enormous amount of notes being issued practically resembled a "pyramid scheme" and it appeared that the only way they could be paid off was by some form of "rollover" and if the day ever came when nobody would buy new notes there would undoubtedly be trouble. 1/

1/ Response No. 37.

Question Two states:

Describe the factors which your organization took into account in deciding to participate in the underwriting of the Notes or Bonds. If possible, in your response to this question, list in descending order of importance the factors which you deemed the most relevant in your decision-making process.

* * * *

The order in which the factors were most often mentioned is as follows:

- (1) profitability;
- (2) favorable ratings;
- (3) customer demand;
- (4) general market and resale market conditions;
- (5) historical relationship with the underwriter;
- (6) historical participation in New York City bonds;
- (7) reliance on the managing underwriter;
- (8) New York City's reputation;
- (9) reliance upon legal requirements;
- (10) favorable pricing;
- (11) favorable information supplied by the City;
- (12) exclusive dealing in Municipal Bonds; and
- (13) the tax exemption.

One relevant factor mentioned frequently by the syndicate members was favorable bond ratings by independent rating services. The basis for the syndicate members' reliance upon the rating services was their view that the rating services would investigate the City's published information and accounting practices before issuing a favorable rating. The rating services' actions in this regard are discussed in a separate section of this report.

* * * *

Question Sixteen states:

Did anyone in your organization ever meet with or have any discussions with any of the City's accountants, or employees of the Comptroller's office to discuss accounting practices and procedures of the City?

If yes, give details as to dates, parties attending, and highlight the matters discussed.

* * * *

The syndicate members' belief in the rating service studies explains the fact that only five organizations reported any discussions with the City's accountants or employees of the Comptroller's Office. The vast majority of syndicate members reported that there was no consultation by them with the City officials as to the City's accounting practices.

* * * *

Question Thirteen states:

During the time period January 1, 1975 through May 30, 1975, did any employees of your organization attend any meetings with

(A) Other syndicate members (other than marketing and price meetings);

Yes [] No []

(B) City officials;

Yes [] No []

(C) Or Bond Counsel

Yes [] No []

with respect to the underwritings?

If yes, to the extent that your organization or its employees has maintained records, give details as to dates, parties attending, the matters discussed, including whether the Notice of Sale or Report of Essential Facts was discussed.

* * * *

Few organizations reported meetings with other syndicate members other than for purposes of marketing or pricing.

* * * *

Question Seventeen states:

Was any person in your organization, at any time after January 1, 1970, a member of any advisory group which sought to give advice, suggestions, etc., to the City or its officials with respect to either the City's overall fiscal affairs or the issuance of its Notes or Bonds? If yes, state the names of the individuals so involved, the name and purpose of the advisory group, and dates of service.

* * * *

Only three organizations of ninety-three firms responding to this question reported affiliation with any advisory group which provided advice to the City. The extent of affiliation and relation to the advisory group was unclear.

* * * *

Question Twenty-seven states:

When your organization participated in the underwritings of the Notes or Bonds, were you aware of any of the following observations made by New York State Comptroller Levitt in his audits of the City:

(A) Items traditionally considered to be expense items were included in the capital budget;

Yes [] No []

(B) The accounts receivable from State and Federal governments for the years ended June 30, 1973 and 1974 by the City had been over-stated;

Yes [] No []

- (C) Such over-statement referred to in (B) above enabled the City (1) to incur expenditures without having additional revenue sources, and (2) to borrow against these "over-stated receivables";
- Yes [] No []
- (D) In several instances, the City's recorded receivables were less than the amounts borrowed by the City;
- Yes [] No []
- (E) The City's expense budget was prepared without creating any reserve for non-collection of tax revenues;
- Yes [] No []
- (F) The City included on its tax rolls significant amounts of property which were not subject to real estate taxes or for which taxes could not be collected;
- Yes [] No []
- (G) The City has used non-recurring revenues as a method for producing a balanced budget;
- Yes [] No []
- (H) The City's accounting system did not provide for a General Fund "fund balance" account which would show each year the annual and cumulative results of the City's operating budget;
- Yes [] No []
- (I) The City had recorded the sum of \$150 million as a General Fund "source of revenue" in 1974 and the sum of \$370 million in 1975 as receivables due to the miscellaneous revenue accounts, such recordings were allegedly based upon anticipated borrowings from the Stabilization Reserve Corporation?
- Yes [] No []

* * * *

Generally, the syndicate members were unaware of the above information.

One syndicate member explained:

Information provided by NYC [sic] was extraordinarily voluminous—so much so, that it was difficult to focus

an analysis in detail before the sale date. The criteria was whether the Notes or Bonds would pay. The information provided seemed to indicate there would be money for this payment. In this sense the information seemed adequate. For example, the Notes' repayment was based upon budget projections of revenues flows which showed an adequate margin for their repayment—especially as it was thought that they stood ahead of other NYC [sic] obligations. "Rollovers" of the Notes was an accepted practice, and like the Federal debt it was believed that the practice could continue. Even, if a drastic loss of confidence by investors and the "Street" over NYC's [sic] ability to pay occurred—preventing issuance of "rollovers"—the belief was there that the existing obligations would be honored no matter the circumstances.

A first lien on revenues is a first lien, and coupled with the full faith and credit pledge of the City to honor these obligations to the taxing extent necessary, there was no question as to the City having the ability to pay. Subsequently, political decisions of the City have rendered these suppositions invalid, leastways for the Notes. 1/

* * * *

Question Twenty-eight states:

- (A) In your opinion did you or do you consider the matters referred to in Item 27 to be material or significant?
- (B) If you were aware of the State Comptroller's "observations" as set forth above, what evaluation did you give to such "observations" in determining to participate in such underwriting and to offer the Notes and Bonds to your customers?

* * * *

Nearly all of the syndicate groups agreed that the information in the Levitt audits were material or significant. A few indicated that their view was with the benefit of hindsight.

Those few syndicate members who were aware of the State Comptroller's observations apparently gave little or no evaluation to such "observations" in determining whether to participate in any underwriting.

* * * *

1/ Response No. 38.

Question Twenty-nine states:

When your organization participated in the underwritings of the Notes or Bonds, were you aware that the accounting principals and procedures in effect for the City accounts during the fiscal year ending June 30, 1975, and prior years, generally employed a cash basis for recognizing expenses and an accrual basis for recognizing revenues?

Yes [] []

If your answer is yes, describe how you knew.

* * * *

Most of those who participated in such underwritings were not aware of the indicated accounting principles and procedures in effect for the City accounts during the fiscal year ending June 30, 1975 and prior years.

* * * *

Questions Twenty-five and Twenty-six state:

At the time your organization sold the Notes or Bonds to your public customers, what was your understanding of the City's financial condition? Did you believe that the condition was

Excellent [] Good [] Fair [] Poor []

Please elaborate.

At the time your organization sold the Notes or Bonds to your public customers, what was your understanding of the City's bookkeeping and accounting practices? Did you believe that they were

Excellent [] Good [] Fair [] Poor []

Please elaborate.

* * * *

The syndicate members, in response to the above questions, generally rated the City's financial condition "fair" and the bookkeeping and accounting practices "good."

One syndicate member explained its response as follows:

...Good tax collections, general obligation bonds, high property values, vitality, both business and cultural. New York City was the largest and richest city in the world, as well as being the financial and business capital of the world. 1/

....

Auditors of both New York City and New York State were checking and cross-checking each other's work and certifying findings to the federal government among others.

Other institutions stated:

We felt the accounting procedures were old fashioned and needed to be upgraded. 2/

Assessment of the financial condition...was Good.

The difference between that opinion and our later opinion was the large number of bonds and the frequency with which they were coming to market. 3/

And another syndicate member put it this way:

After late 1974 it became apparent that the City was increasing the size and frequency of its Note offerings. In early 1975 Mayor Beame announced that it would not be necessary to maintain that size or frequency of Note offerings. While that was a favorable sign, it was short-lived. After the February and March 1975 pricing meetings it became apparent that the City's financial condition was in question. 4/

But, the majority of the organizations did not question the City's accounting practices. As one firm stated:

Until the February and March 1975 pricing meetings it was [our] understanding and belief that the City's accounting practices were sufficient to justify reliance on its book as an accurate indicator of the true financial position of the City. 5/

Another view was expressed as follows:

-
- 1/ Response No. 39.
 - 2/ Response No. 40.
 - 3/ Response No. 41.
 - 4/ Response No. 42.
 - 5/ Response No. 43.

We felt that the debt was high and that the City probably had problems, but that the importance of this City in terms of the entire Country was so great that default was considered a remote possibility.

From our distance, there was no reason to believe that the financial information published was anything but accurate. 1/

* * * *

Question Fifteen stated:

Did your organization believe that the City provided sufficient financial information and other data concerning its affairs as to the Notes or Bonds being offered and sold, to enable your organization to make an informed judgment of creditworthiness of the City and its Notes and Bonds?

Nearly all the responses expressed the view that the City was creditworthy.

As one syndicate member stated:

...we trusted the integrity of the City's financial statements. 2/

Several institutions based their view on the ratings provided by the major rating services. Thus, one syndicate member stated:

Prior to our final decision to participate in the issue Moody's had determined to rate the bond within its top four rating categories. We relied upon this information in reaching our decision to remain in the underwriting syndicate. 3/

Another indicated:

Yes at that time. This was based upon the opinion as to legality of the issue rendered by Bond Counsel, the assumed discharge of responsibility by the Account Manager and the continuance of market grade ratings by the major rating services led us to believe that the City had provided sufficient information for us to make a proper judgment with regard to the creditworthiness of the City. 4/

1/ Response No. 44.

2/ Response No. 45.

3/ Response No. 46.

4/ Response No. 47.

A few members questioned the adequacy of the information being provided by the City. An example:

What we received was very limited and certainly not enough to do an in-depth analysis and come to an informed judgment. 1/

* * * *

Question Fourteen states:

At the time of your organization's participation in the underwritings of the Notes or Bonds, please describe your understanding of the purpose of the Notices of Sale and Reports of Essential Facts, which were prepared and distributed by the City. For example, did your organization expect that, if there were,

- (A) Any material changes in accounting practices and policies by the City, they would have been described therein?
- (B) Any developments of material matters affecting the City's financial condition one way or the other, they would have been described therein?
- (C) Any overestimates of revenues for prior years from the Federal or State Governments to the City, or from real estate tax sources, such would have been disclosed therein?
- (D) Any renewals or "rollovers" or Notes, the need for or the reasons therefor would have been described therein?
- (E) Any budget gaps, budget deficits, cash deficits, or deficit financing then in existence, such would have been disclosed therein?

If you did not expect to find the information referred to immediately above and other relevant information in the Notices of Sale and Reports of Essential Facts, did your organization find such information in any other source?

Yes [] No []

If yes, please describe such source.

* * * *

One firm provided this response:

The degree and quantity of information was no different from that being furnished at the time by other issuers of general obligation bonds. Thus the answer in that context is yes, without giving a great deal of thought or consideration as to whether the financial information was adequate. We assumed it was sufficient and reasonably accurate. That is the way the municipal bond market functioned at that time. 1/

Generally, the syndicate members were unaware of the accounting practices of New York City. They indicated that normally the managing underwriter and bond counsel or the rating services were the entities with the responsibility for acquainting themselves with information concerning the City's accounting practices. However, the syndicate members reported negative information was not conveyed to the syndicate members by the managing underwriter, bond counsel or by the independent rating services.

1/ Response No. 49.

IV. CUSTOMER SALES

Question Six states:

Did your organization prepare any "sales literature" with respect to the Notes or Bonds? If so, identify the person(s) in your organization responsible for its preparation, and indicate whether it was in fact distributed or given to your customers. Please furnish copies thereof.

* * * *

The majority of the syndicate managers responding to this question indicated they did not prepare any "sales literature" with respect to the Notes or Bonds.

* * * *

Question Thirty states:

At the time that your organization sold the Notes or Bonds to your public customers, did you and your salesmen advise such customers about the possibility that the City might defer or be compelled to defer meeting its obligation to certain of its noteholders through the enactment of a moratorium law?

* * * *

Almost every syndicate manager reported that no advice was given by salesmen to their public customers concerning the possibility that the City might defer or be compelled to defer meeting its obligation to certain of its noteholders through the enactment of a moratorium law.

* * * *

Question Eighteen states:

In selling the Notes or Bonds to your customers, did your organization recommend the purchase of such Notes or Bonds?

If yes, set forth

- (A) The approximate dates (periods) when such recommendations were made; and
- (B) In detail, the basis for such recommendations.

* * * *

Thirty-six syndicate members reported they had recommended the purchase of securities; forty-seven reported they made no recommendation.

The bases given by the organizations which recommended New York City Notes or Bonds are: rating services; profitability; reputation of the underwriter; independent evaluation; information supplied by the City; and, favorable market conditions. Before responding to whether a recommendation was made one organization commented:

It is difficult for us to understand what is meant by "recommendations." In trying to recollect correctly, some at the bank contend we never "recommended" New York City to our customers; others argue to the contrary, since we did in fact buy New York City bonds for our own portfolio. Our portfolio purchases, as well as any recommendations, "were made on the mistake or assumption that all was being properly reflected by the City to various underwriters and purchasers of their bonds." 1/

The ratings provided by the major rating services were set forth as a basis for the recommendations of City Notes or Bonds. Particularly significant was the fact that Moody's upgraded the ratings from "Baa" to "A" in 1972. Additionally, one organization stated:

There were many favorable comments from various respected City officials about the underlying value and essential soundness of New York City. From time to time our customers were aware that by purchasing New York City

1/ Response No. 50.

Bonds they could get an "A" rated bond which afforded them a generous yield compared to other "A" rated credits. 1/

* * * *

Question Nineteen states:

In connection with any recommendations made to your public customers with respect to the Notes or Bonds, what instructions, if any, did your organization give to its salesmen regarding the type of statements or representations you considered permissible, and those that you considered impermissible, if any?

* * * *

The majority of the syndicate's members reported that the question was inapplicable because no recommendations were made to public customers. Others reported that no specific instructions were given to prospective and actual purchasers. Some syndicate members did not respond, stating that no instructions were given because no recommendations were made.

One organization elaborated with respect to its instructions to its sales personnel:

Since we are a fairly small dealer bank operation, we are dependent on many correspondents for our business. Recognizing the time it takes to develop this loyalty and its importance to our continued profitability we have always instructed our sales people to emphasize quality in building a portfolio. In the past, as is the case today, we think it important not to bear heavily on a customer to buy bonds which would detract from upgrading his portfolio. We have always instructed our sales people that the following three things, listed in order of their importance, should be stressed: safety, maturity and yield. 2/

Another syndicate member pointed to the higher yield and impossibility of default of City Notes or Bonds as the basis for its recommendation:

1/ Response No. 51.

2/ Response No. 52.

The risk as we saw it at the time which we underwrote New York City bonds related basically to downgrading and loss of some marketability. At that time, we thought that the higher yields available on New York City obligations were a result of the high number of bonds outstanding in the market and that possibly these bonds could be downgraded. We did not think there was any possibility at that time of a New York City default. 1/

* * * *

Questions Twenty and Twenty-one state:

What degree of risk, if any, did your organization believe was involved in the investment in the City's Notes or Bonds compared to other municipalities general obligation securities of similar rating and maturity?

Specifically describe the risks, if any, which your salesmen were instructed to relate to your public customers regarding the Notes or Bonds?

* * * *

Notwithstanding the fact that New York City notes and bonds had a higher yield, most of the organizations responded that they believed the degree of risk involved in the investment in the City's notes and bonds was similar to that of other municipalities with general obligation securities of a similar rating.

* * * *

Question Twenty-two states:

What steps did your organization take to determine if the Notes or Bonds were suitable for the investment needs and objectives of your public customers in accordance with Rules 15b10-3 and 15c1-7 of the Rules and Regulations promulgated under the Securities Exchange Act of 1934; or in accordance with the applicable rules of the National Association of Securities Dealers or Stock Exchanges?

* * * *

1/ Response No. 53.

In answer to this question, twenty-seven syndicate members indicated that they relied upon "normal procedure" but it was not clear whether "normal procedure" included a consideration of the rules specified. Some of them responded that the question was inapplicable without specifying a reason or by stating no response was necessary because they had no public customers.

Some simply did not answer. A few other organizations offered the following comments:

The most frequently repeated quotation that we heard from investors buying New York City Bonds was, "If New York City bonds aren't good, what is?" 1/

New York City bonds were not singled out for separate or special suitability determinations. As is the case with all securities transactions recommended to [our] customers, registered representatives are not permitted to solicit transactions if they have reasonable ground to believe that the recommendation is unsuitable for the customer in light of his investment objectives, financial situation and needs. The Branch Manager reviews customers' accounts on a periodic basis and considers among other things, suitability of a particular investment in regard to the customer's investment objective and economic status. 2/

* * * *

Question Twenty-three states:

Did your organization obtain any indications of interest from your public customers with respect to the Notes or Bonds before the actual sales were consummated? If yes, indicate:

- (A) When such indications of interest were "firmed up";
- (B) How these indications were "firmed up";
- (C) Whether confirmations were sent to customers; and

1/ Response No. 54.

2/ Response No. 55.

(D) Whether and when Notices of Sale and the Report of Essential Facts were sent to customers.

* * * *

The majority of organizations claimed that they did not obtain indications of interest from public customers with respect to the Notes or Bonds before the actual sales were consummated.

Those few who reported obtaining indications of interest stated such indications were "firmed up" after the award was made to the underwriting syndicate. The indications of interest were confirmed by telephone and most of the organizations sent a written confirmation only on request. One firm reported the procedures it used as follows:

Although [we do not obtain] 'indications of interest' in the sense that they are obtained in registered public offerings of corporate securities, the Firm does from time to time obtain presale orders from public customers in connection with public offerings of municipal securities. It did obtain certain presale orders with respect to the Notes and Bonds, which were "firmed up" when the Notes and Bonds were bought by the underwriters and sold to the public. The manner in which such a presale order was 'firmed up' was for the Firm to forward a 'when-issued confirmation' confirming the purchase. Subsequently, when the Notes or Bonds were ready for delivery, the Firm sent a "money confirmation" to each such purchaser, indicating that payment for the securities purchased must be made. The Firm did not send copies of the Notices of Sale or Reports of Essential Facts to its customers. ^{1/}

Another stated:

Indications of interest were ordinarily solicited prior to submission of a bid by the underwriting group in which we participated. If the bid was successful, we solicited firm orders and sent a "when, as, and if" confirmation to each customer who gave a firm order. Prior to the closing, and at the earliest date at which it was possible to compute

^{1/} Response No. 56.

the precise amount due, each customer was sent a final confirmation. Copies of the circulars prepared by the lead managing underwriting were not sent to customers. Subsequent to December 31, 1975 [we] revised [our] procedures to require that offering circulars be sent to all customers who place firm orders for municipal securities. 1/

* * * *

Question Twenty-four states:

Did there come a time when your organization instructed its salesmen to cease recommending the purchase of the Notes or Bonds to the public? If so, state when, and why such recommendation was made at that time.

* * * *

Eighteen organizations (of the thirty-six who made recommendations) did not submit a date when the organization instructed its salesmen to cease recommending the purchase of City Notes or Bonds to the public. Those syndicate members that responded affirmatively said that they stopped recommending City securities sometime between early 1974 and the default of 1975. Some syndicate members stated that purchases of City securities were executed strictly upon the buyer's order. There was one organization which printed a "no solicitation" legend on the confirmations sent to its customers. The basis for a continued recommendation was described by one organization as follows:

We felt and still do feel that New York City will continue to pay principal and interest on its outstanding obligations. 2/

1/ Response No. 57.

2/ Response No. 58.

V. CONCLUSORY REMARKS

In essence, it would appear that the syndicate member organizations believed that the financial information published by the City was sufficient to enable them to make a judgment of creditworthiness as to the City's securities. Their belief as regards the adequacy of the information furnished by the City was not grounded upon independent investigation. The syndicate members claim that they relied on the managing underwriter's investigation to provide the independent investigation of the City's financial condition and accounting practices. Yet, the majority were unaware that any such investigation had occurred.

The syndicate generally believed the rating services did investigate the City's financial condition.

One syndicate member indicated it was in a precarious position describing its plight as follows:

At a N.Y. City syndicate meeting with a few hundred members, we are presented with a price and profit scale. As a participant we are not able to voice our opinion as to price, profit margin, couponing etc. since we have just a fraction of one per cent participation. Our sole alternative is to accept the terms or drop from the underwriting. 1/

The syndicate members indicate they had minimal, if any, control in the underwriting process. For a syndicate member to have requested additional information or to have pursued any independent investigation would have required that it have the ability to accomplish this objective. No syndicate member had such ability. Their alternatives were limited — to accept the offering or to drop it.

1/ Response No. 59.

Exhibit A

1. If your organization ever participated in the underwriting of any of the notes or bonds of the City of New York (the "City") listed in the Appendix (the "Notes or Bonds"), please supply the following information:
 - (A) The Date of Sale;
 - (B) The Total Amount of the Offering;
 - (C) The Amount of Your Participation;
 - (D) The Amount of Your Take-Down;
 - (E) The Amount Placed in the Portfolio or Investment Account; *
 - (F) The Amount Placed in Fiduciary Accounts; * and
 - (G) The Amount Sold to Your Public Customers. **

31. With respect to each revenue anticipation note ("RAN") or tax anticipation note ("TAN") of the City which your organization underwrote, please indicate if and to what extent your organization was aware of the following:
 - (A) The source, basis, and purpose of the revenues or tax which supported the issuance of each such RAN or TAN;
 - (B) The date that the revenues or taxes were due or would become due;
 - (C) The manner in which the revenues or taxes to be received were determined, i.e. whether it was by estimate, formula, audit, or confirmation;
 - (D) How proceeds from each RAN or TAN issue were actually utilized;
 - (E) Whether the revenues or taxes to be received against the issuance of the RAN or TAN were, in fact, received in their entirety;
 - (F) If any portion of the revenues to be received was not actually received, the fiscal remedial steps taken, if any, by the City;

* As of the date of completion of each underwriting of the Notes or Bonds in which your organization participated.

** Please provide this office with a list containing the names of all public customers and their addresses who purchased the Notes and Bonds from your organization.

- (G) If any portion of the revenues or taxes to be received was not received, the manner in which the City paid off the RAN or TAN at maturity.
34. Provide the Commission with information showing the monthly position of your organization's portfolio and dealer accounts in the Notes or Bonds, for the period January 1, 1973 to May 30, 1975 as of each monthly closing trade or settlement date (Specify which).?

ANALYSIS OF QUESTIONNAIRES SENT TO
-MANAGING UNDERWRITERS

This Section of the Report is a summary and analysis of responses to the Securities and Exchange Commission's Questionnaire for Managing Underwriters, dated January 31, 1977, received from Bankers Trust Company ("Bankers Trust"), the Chase Manhattan Bank ("Chase"), Weeden and Co., Incorporated ("Weeden"), Citibank, N.A. ("Citibank"), Merrill Lynch, Pierce, Fenner & Smith, Incorporated ("Merrill Lynch"), and Chemical Bank ("Chemical"). The Questionnaire was prepared in connection with the staff's investigation into the sale and distribution of certain notes and bonds issued by the City of New York.

Questionnaires were sent to a group of organizations that acted as the principal underwriters of City Notes and Bonds during the period under investigation. These Questionnaires differed from those sent earlier to non-principal participants in the selling syndicates for New York City's securities, because syndicate members had previously indicated that they had placed virtually total reliance on the managers of the syndicate for review, research and appraisal of the City's financial condition.

Chase and Citibank participated as the managing underwriters in the majority of the issues of New York City's bonds, and as managing or principal underwriters for many issues of the City's notes. Therefore, their responses are particularly important for an understanding of the role of the managers. Manufacturers Hanover Trust Company did not respond

to the Questionnaire. 1/

The Questionnaire for managing underwriters consisted of fourteen questions. This portion of the report will present, in numerical order, the text of each question followed by an analysis of the responses.

If your organization ever participated in the underwriting of any of the notes or bonds of the City of New York (the "City") listed in the Appendix (the "Notes or Bonds"), please supply the following information:

- (A) The Date of Purchase;
- (B) The Date of Closing or Delivery;
- (C) The Total Amount of the Offering;
- (D) The Amount of Your Participation;
- (E) The Amount of Your Take-Down;
- (F) The Amount Placed in your Portfolio or Investment Accounts;*
- (G) The Amount Placed in your Fiduciary Accounts;* and
- (H) The Amount Sold to Your Public Customers.

* As of the date of completion of each underwriting of the Notes or Bonds. Also, if any of the Notes or Bonds placed in these Accounts were sold out of the Accounts prior to maturity or redemption, indicate the amounts and dates of such sales, and the reasons therefor.

* * *

The responses to Question One did not permit any general conclusions to be drawn as to the extent of participation by each of the organizations in underwriting City Notes and Bonds. For the most part, no response was given to Question One. It was asserted that the staff had already examined

1/ In brief, after considerable delay the bank refused to respond to the Questionnaire and, finally, a Commission administrative subpoena. More recently, Manufacturers Hanover Trust has responded to the Questionnaire in a letter by referring the Commission to testimony taken of one of its officers. The staff has concluded that the references were insufficient as responses to the Questionnaire. The subpoena remains outstanding. Because of the need to complete this and other parts of the Report, the decision was made to defer recommendation of action.

documents from which the staff could ascertain the answer to Question One. Those organizations responding to Question One generally indicated that, in response to part (G), no City Notes or Bonds were placed in fiduciary accounts maintained by that organization.

Question 2

Please describe the factors which your organization took into account in deciding to participate in the underwriting of the Notes or Bonds. List, in descending order of importance, the factors which were deemed the most relevant in the decision-making process.

* * *

Generally, in no particular order, the factors cited by the organizations were (1) marketability, (2) profitability (including both primary and secondary markets), (3) history of participation in New York City notes or bonds, (4) history of participation as an underwriter of Municipal notes or bonds, (5) redeemability, (6) credibility of the City information, (7) legality, (8) history of participation in the particular selling syndicate, (9) rating, (10) tax exemption, (11) public media information, (12) maintenance of New York City as the financial center, (13) the well being of New York City citizens.

The responses of the organizations were, in relevant part,

(Weeden) If one were obliged to describe the factors which Weeden took into account in deciding to participate in the underwriting of City paper, and then attempt to put those factors in descending order of importance, the answer would include by rank soundness of credit, price, market conditions and customer interest. The problems with the question and therefore the answer are first that it assumes these elements are capable of separation and evaluation, let alone ranking, and second, that one can re-create one's state of mind several years ago. The realities "pre-crisis" of New York City paper were that when managing underwriters invited Weeden to join in a syndicate to make a bid we were pleased to be asked to join and when we did join we assumed that honest data given out by the City and analyzed by the expert staffs of the managing underwriters and their bond counsel and by the rating agencies which followed the City's financial affairs carefully would result in a price which fully reflected all of the so-called "factors" ranging from soundness of credit to customer interest.

* * *

(Chase) No particular factor can be identified as most important in the process of determining to underwrite a particular issue of Bonds or Notes; each decision was made in light of the facts and circumstances known at the time. As in the case of all underwriting decisions, the relevant factors considered in deciding whether to underwrite issues of Notes or Bonds included investment quality, market acceptance, yield, general market conditions and internal funding requirements.

* * *

(Citibank) Citibank considered all available relevant factors. The factors were numerous and varied from issue to issue. They were contained in from time to time the City's Notices of Sale and Reports of Essential Facts, various City annual and monthly reports relating to its fiscal condition, independent rating service reports, newspaper and magazine articles and other public media sources relating to the City's fiscal condition. It is not possible to specify generally, in their descending order of importance, those factors which Citibank deemed the most relevant in the decision-making process.

* * *

(Bankers Trust) Bankers Trust is unable to list the factors it took into account in deciding to participate in the underwriting of Notes and Bonds or to rank such factors by their relative importance. Among the factors which played a role, however, were: (a) Bankers Trust's historical participation in New York City underwritings; (b) New York City's satisfactory history of debt repayment; (c) the marketability of the Notes and Bonds, and (d) Bankers Trust's reasonable belief that the Notes and Bonds would be paid when due.

* * *

(Merrill Lynch) Merrill Lynch took the following factors, which are listed in their order of importance to Merrill Lynch, into account in deciding whether to participate as a member of a syndicate that would offer and sell Notes or Bonds: (1) the Notes and Bonds were backed by the full faith and credit of the City, and bond counsel would deliver a legal opinion to that effect at the closing; (2) the rating of the Notes and Bonds; (3) indications of interest by institutional and retail investors in purchasing the Notes and Bonds; (4) the condition of the municipal bond market in general and, in particular, the market for the City's Notes and Bonds; and (5) the effective yield and maturity of the Notes and Bonds.

* * *

(Chemical Bank) It is impossible specifically to list or quantify all of the factors which the Bank or its representatives took into account in deciding to participate in the underwriting of an issue or issues of the Notes or Bonds. Moreover, to give any meaningful ranking of the importance of such factors is just not feasible. Such factors were and are in many respects of a subjective nature and their individual relevance and relative importance varied over time and from issue to issue. Although it is thus not possible meaningfully to describe all the factors taken into account by the Bank in its participation in underwriting City Notes and Bonds, as requested by Question 2, the Commission may be aided by the following summary of general considerations which may have been subject(s) of review by the Bank or its representatives in connection with any particular underwriting of City Notes or Bonds: The long-standing position of the Bank as a leading or

participating underwriter in issue of the City of New York, and its belief in the intrinsic worth of such securities as evidenced by its portfolio holdings thereof; the requirements of Federal, State and local law, primarily dealing with the fact that the Bank can only underwrite U.S. Government and direct obligations of State and municipal securities; the Bank's desire to remain active in the market for municipal securities, and the circumstance that City Notes and Bonds were an extremely important component of the market; the Bank's assessment of the market for City Notes or Bonds (which as indicated constituted a substantial portion of the market for municipal obligations), the obvious attraction under the Federal tax laws of holding tax exempt obligations and consequent prospects for profit or loss to the Bank (which in relation to total net profits or losses of the Bank was not material) resulting from its participation in such underwriting; the composition at any point in time of the Bank's portfolio and the desirability of including City Notes and Bonds in its portfolio from the standpoint of both long- and short-term liability management; the competitive position of the Bank; the Bank's desire to maintain the City's position as a financial center and the consequent benefit not only to the Bank's business, but also the well-being of the City and its citizens.

The Commission is also referred to the responses to Questions 4, 5, 6, 8, 10, 11, 12, 13, and 14.

Question 3

At the time of your organization's participation in the underwriting of the Notes or Bonds, did it have a municipal research department, or designated employees who did municipal research? If so, please provide the following information:

- (A) The approximate date when such department or activity was begun;
- (B) The number of employees engaged in such research;
- (C) The background of each such employee.

* * *

Responses to this question are quite significant in that most members of the underwriting syndicates indicated that they relied, to a great extent, upon the managing underwriters to analyze and investigate data furnished by the City. ^{1/} However, none of the managing underwriter organizations indicated that they had done any extensive research at the time of any participation although certain of them reported increased activity in their municipal research departments in late 1974 and 1975.

Chase identified a Public Finance Group which was formally begun in 1971 and which included six employees who engaged in municipal research during the years 1973-1977. However, three of those employees were transferred to "another area of Chase" in February, April and June of 1974.

Citibank reported that during the designated time of participation two employees "followed certain events pertaining to the offering of municipal securities."

Chemical reported that no formal research department existed although two unnamed employees, one with seventeen and the other with three years of experience, had responsibilities that included research and analysis relating to the activities of the Bank's Investment Division respecting municipal securities.

^{1/} See, e.g., the Analysis of Questionnaire sent to Syndicate Members.

Merrill Lynch had a research department which was organized prior to 1970. The portion of that department which analyzed municipal securities was staffed by two employees.

The creation of Weeden's municipal research department is described by Weeden as follows:

Weeden participated in the October 16, 1974 City Bond offering and lost over \$1 million for our efforts. That jolting loss, plus the New York Daily News editorial of October 22, 1974, and similar disclosures in the press were the competent producing causes of our decision to hire someone able to research municipal paper. Accordingly, in late December 1974, David Breen was hired as Weeden's municipal research analyst, to commence work January 1, 1975. Mr. Breen had previously worked for Fitch Investors Service (January 15, 1974 to December 31, 1974) and Standard & Poor's (April, 1971 to January 4, 1974). Weeden was attracted to Mr. Breen by his prior writings on the City, as well as the recommendations of his employers.

Question 4

Regarding your organization's decision to participate in the underwriting of the Notes or Bonds, specifically describe the extent, if any, to which your organization:

- (A) Relied upon its own independent research of the fiscal affairs and condition of the City (cf. item 6, infra);
- (B) Received, utilized, or relied upon the information and data contained in the Notices of Sale and Reports of Essential Facts prepared and issued by the Office of Comptroller of the City;
- (C) Received, utilized, or relied upon the reports and ratings prepared and published by:
 - (1) Moody's Investors Service, Inc.
 - (2) Standard and Poor's Corporation; and
 - (3) Fitch's Investors Service.

Please indicate whether the reports ever caused you to question the ratings, and if so, why.

- (D) Received, utilized, or relied upon any of the following material:
- (1) Monthly Statements prepared by the Office of the Comptroller of the City summarizing the City's Cash Receipts and Disbursements;
 - (2) The Annual Report of the Comptroller of the City with respect to the City;
 - (3) The Fiscal Newsletter of the City;
 - (4) The Executive Budget of the City;
 - (5) The Capital Budget of the City;
 - (6) The Reports of the Comptroller of the City issued pursuant to Sections 113, 212, and 220 of the City Charter;
 - (7) Audit Reports of the Comptroller of the State of New York with respect to the City;
 - (8) Newspaper articles, or articles in other periodicals relating to the City's budgetary process and fiscal condition.

[Feel free to elaborate in your own words in answering items (4)(D)(1) to (8)].

With respect to item 4(D)(8), specifically describe the extent to which your organization (I) Maintained a file of such articles; (II) Referred to such articles for original or basic information; (III) Viewed such articles as accurate or reliable; and (IV) Viewed such articles as full and fair disclosure regarding the City's fiscal condition, events or overall problems, etc.

- (E) Relied upon any of the following statements contained in the Notices of Sale and Reports of Essential Facts:
- (1) Bonds (and notes) will be valid and legally binding general obligations of the City, all the taxable real property within which will be subject to the levy of ad valorem taxes to pay said bonds

(and notes) as well as the interest thereon without limitation as to rate or amount;

Yes [] No []

- (2) The State Constitution requires the City to pledge its full faith and credit for the payment of the principal of its bonds (and notes) and the interest thereon and to make annual appropriations for the amounts required for the payment of such interest; and the redemption of its bonds;

Yes [] No []

- (3) Payment of debt service shall be the first lien on all the City's revenues;

Yes [] No []

- (4) If ... the appropriating authorities fail to make the required appropriations for the annual debt service on the bonds and certain other obligations of the City, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied for such purposes.

Yes [] No []

* * *

Generally, the organizations reported that they received, relied upon or utilized the data listed in the question. For instance, Citibank stated:

Citibank generally received the material described in sub-paragraphs 4(B) through (D), and utilized and relied on some of it, together with the material described in subparagraph 4(A), to varying degrees in deciding whether to participate in the underwriting of the Notes or Bonds. It is not possible, however, to state whether a specific item was utilized or relied on by Citibank in its decision concerning any given issue of the Notes or Bonds.

Citibank maintained a file of newspaper articles relating to the City's budgetary process and fiscal condition. Employees in the Credit Supervision Section of Citibank's Money Market Division referred to this file from time to time for information regarding the City's budgetary process and fiscal condition.

Chemical similarly asserted that it received, utilized, and relied upon most of the information specified. Chemical pointed out that the practice of the underwriting industry was to rely primarily upon the rating agencies. Where time permitted, Chemical supplemented such information with data provided by the City. Newspapers were thought to provide a great deal of material information for the potential purchasers and sellers of City Notes and Bonds, although Chemical did not place "total credence" in such articles. Chemical further indicated that:

With respect to the matters itemized in subparagraphs (E)(1)-(4) of Question 4, the Bank understands that each of the statements concerns legal requirements of the New York State Constitution and Local Finance Law; and the Bank's activities with respect to the City's Notes and Bonds were premised upon the applicability of, and compliance by all parties concerned with the requirements of, those laws.

Chase's views were similar to those of Chemical and Citibank.

Banker's Trust, however, was unable to state the "extent" if any to which it "relied" on the information sources referred to in Question Four either in general or in connection with any particular securities issue at any particular time, subject to the following:

- A. Bankers Trust at all times took into account the views of its personnel engaged in municipal securities research and of those experienced in the municipal securities field.
- B. New York City did not make Reports of Essential Facts available in connection with Note offerings until the BAN offering of March 14, 1975. In connection with that offering and the BAN offering of March 20, 1975 the availability of the Report of Essential Facts was a material factor in the Bank's decision to participate as an underwriter of those issues.
- C. Bankers Trust did not subscribe to the reports or ratings of Standard & Poor's or Fitch's Investors Service.

D. Bankers Trust is unable to state whether any specific document listed in items (1) through (8) of subparagraph (D) were "relied upon" with respect to any specific issue. However, the documents, reports and information listed therein, with the exception of items (6) and (7), were generally received by Bankers Trust and reviewed by it in the course of an on-going examination of the fiscal condition of New York City. With respect to item (8), Bankers Trust did maintain a file of such newspaper and periodical articles. The reliability and accuracy of such articles was evaluated separately with respect to each article, and it is, therefore, impossible to state whether such articles were generally viewed as accurate or reliable. Such articles constitute substantial evidence that information concerning New York City's financial condition was in the public realm and generally known.

E. Bankers Trust believed and understood, at the time of each underwriting of Notes and Bonds, that all statements contained in the Notice of Sale and/or Report of Essential Facts in connection with such Note or Bond issue were true and accurate. Bankers Trust is unable to state the extent to which it "relied" on any such statement.

Merrill Lynch wrote:

Merrill Lynch's decision to participate in a syndicate that would offer and sell the Notes or Bonds was based upon the factors enumerated in Merrill Lynch's answer to Question 2 and, in particular, upon the fact that the Notes and Bonds were backed by the full faith and credit of the City.

Merrill Lynch received and reviewed the Notices of Sale and had available to it the Reports of Essential Facts. Merrill Lynch also received and reviewed the ratings and reports prepared by Moody's Investors Service, Inc. and Standard & Poor's Corporation, but it did not receive the ratings and reports of Fitch's Investors Service. With respect to subsection (D) of Question 4, Merrill Lynch received and reviewed the Annual Report of the Comptroller of the City and the Fiscal Newsletter, but Merrill Lynch did not regularly receive the documents referred to in subsections (D)(1), (4), (5), (6) and (7).

Mr. Jean Rousseau, Vice President and Manager of the Municipal Bond Department of Merrill Lynch, regularly read articles relating to the City that appeared in the following

publications: The New York Times, The Daily News, The New York Post, The Wall Street Journal and The Daily Bond Buyer. To the extent that Mr. Rousseau or any other employee of Merrill Lynch who worked on matters relating to the Notes or Bonds maintained a file of newspaper articles relating to the City, Merrill Lynch has turned such documents over to the Commission in response to the Commission's subpoena to Merrill Lynch. Merrill Lynch considered the newspaper coverage relating to the City to be effective and comprehensive dissemination of current information relating to the City's fiscal affairs to the investing public.

Merrill Lynch's answer is "Yes" to subsections (E)(1), (2), (3), and (4) of Question 4.

Weeden's response to Question four is as follows:

4. A. Prior to Mr. Breen joining Weeden in early January 1975 we did no independent research on New York City paper or on any other security we trade as market makers other than keeping ourselves posted (i) on what the rating agencies were writing in respect of bonds, (ii) what was publicly available in the general and financial press on both the debt and equity issues we trade and (iii) faithfully attending meetings called by the managing underwriters of syndicates of which we were members.

B. We have no present record of having received from the City in the Pre-Breen period Notices of Sale or Reports of Essential Facts, but we assume the underwriters did obtain such Notices and Reports, as did the rating agencies and bond counsel upon whom we relied. Whether information and data contained in such Notices and Reports were "utilized" or "relied upon" by Weeden would depend primarily upon whether the managers, the rating agencies or bond counsel incorporated any such information or data in the materials furnished Weeden as a member of the syndicate. That was Pre-Breen. Obviously, once Mr. Breen was on board he sought on his own all the information and data he could and reached his own conclusions, witness his widely publicized January 10, 1975 speech before the City Club of New York... After that speech and the extraordinary response by the Mayor and the Comptroller, Weeden approached the underwriting of City paper with our suspicions aroused and with much greater reliance on bond counsel rather than rating agencies.

C. Weeden has long been a subscriber to Moody's and Standard & Poor's; and until Mr. Breen joined Weeden, we relied heavily on the rating agencies as the prime investigators of the City's fiscal practices. Weeden never had any reason to question the adequacy of their data or their ratings until we took a beating on the October 16, 1974 Bond offering and began reading items

D. Judging from the files which exist today, it would seem that Pre-Breen, Weeden did not itself seek out any of the materials listed in items 1 through 7 which is not to say none were received, utilized or relied upon. Obviously we tried to keep posted on materials in the newspapers and the various financial periodicals which focus on municipal paper. With respect to items 1 through 8 Weeden apparently did not keep files of materials received in any systematic way although it is very possible that much was thrown out when Weeden moved its entire trading operation from New York to Jersey City in early 1976. In any case, Post-Breen we do seek, utilize and rely upon all information that we can reasonably get and maintain files of the same, but even now the research done on a competitive underwriting is quantitatively and qualitatively different from that done on a negotiated underwriting, a critical distinction which is nowhere mentioned in this questionnaire.

E. Pre-Breen the answer is "Yes" to all four questions. Post-Breen we came to Question 3.

The organizations had been asked to specifically describe the extent, if any, to which they relied, received or utilized various types of information. Most of the organizations did not state the extent to which they relied or utilized various information. For instance, in the 4(A) category concerning reliance upon its own independent research, Chase stated:

On the basis of the information published by the City, the Municipal Research Division conducted Credit research and analysis with respect to the City. Chase officials relied upon the Division's work product.

Similarly, Bankers Trust and Citibank were unable to state the extent they took into account the views of their personnel who were

engaged in municipal research; and Weeden did no independent research prior to 1975.

Generally, the organizations relied upon the rating services and the full faith and credit of the City.

Question 5

Specifically describe the analysis or study, if any, which your organization made of the matters set forth below (1) Before submitting bids for the Notes or Bonds; (2) Before inviting other organizations to join the syndicate for the purchase and re-sale of the Notes or Bonds; (3) Before taking down any of the Notes or Bonds; (4) Before re-sale of the Notes or Bonds:

- (1) The creditworthiness of the City's Notes or Bonds;
- (2) The fiscal soundness of the City;
- (3) The sufficiency of revenues of the City to meet its maturing obligations;
- (4) The financial data or information presented by the City in the Notices of Sale and Statements of Essential Facts; and
- (5) Deficits or budget gaps, if any, of the City.

If your organization's procedures for analysis or study of the above matters changed at any time(s) during the time frame in which it participated in the sale of the Notes or Bonds, described when, why and how they changed.

* * *

The organizations generally treated the matters listed in (1)-(5) as indistinguishable in the decision to participate and either did not distinguish the stages in the underwriting process indicated in the Question or only discussed one stage.

For instance, Chase reported:

A weekly memorandum containing the Municipal Research Division's assessment, based on published information, of the investment quality of various municipal securities for which bids were to be submitted, including from time to time Bonds and Notes, was made available to the Municipal Securities Division of Chase prior to bids being submitted. Such information was therefore available at about the time of formation of any underwriting syndicate and prior to submission of a bid, takedown of any securities from a syndicate, or resale of securities taken down. In reaching an assessment of investment quality, the factors listed in question 5 were considered.

The weekly memoranda submitted by Chase are twelve memoranda prepared between December 4, 1973 and April 11, 1974, 19 memoranda prepared between January 23, and December 2, 1974; and 2 memoranda prepared between January 7, 1975 and February 4, 1975. Generally, these memoranda identify the issue, rating service rating, credit ratings, City's debt per capita, Debt Est./ Full Value, Debt Service/Revenues, Taxes/Est. Full Value, and the Current Tax delinquency. Commentary captioned: "Purpose and Status"; "Economic Bases"; "Financial Management"; and "Credit" followed. Numerical information within these sections changed with each memorandum. The "Purpose" and "Status" sections changed with each memorandum generally to identify the issue. However, for the most part the substance of each section remains the same.

The information within the captions includes a general consideration of the matters listed in subsections (1)-(5). However, Chase did not state how this "analysis" bore upon its decision to participate in the underwritings.

As to the responses of the other organizations, three of the six banks referred the Commission to answers given in Questions Two and Four, documents already submitted to the Commission, stated that they were never a lead managing underwriter, or employed a combination of these responses. Parts of the more extensive answers indicated that there was little, if any, distinction between the time periods of the underwriting process which would warrant further analysis.

Bankers Trust reported that the factors (1) - (5) were inseparable in an assessment of creditworthiness, and that the analysis conducted could not be distinguished as to time frame. Bankers Trust stated that it made use of all available information in "all phases of the underwriting process."

Bankers Trust believes that the items referred to in subparagraphs (1) through (5) are inseparable elements to be considered in assessing the creditworthiness of the issuer. The fiscal soundness of New York City, the sufficiency of its revenues to meet its maturing obligations, budget deficits and financial data reflecting its fiscal condition are all factors which have an impact on the public assessment of the creditworthiness of the City's Notes and Bonds. Also, since New York City was regularly issuing Notes and Bonds, it is impossible to distinguish between the amount of study and analysis conducted by Bankers Trust in any of the four particular time frames mentioned in question number 5. Bankers Trust conducted an on-going study of the fiscal condition of New York City and its securities, making use of publicly available information through all phases of the underwriting process.

Beginning in approximately February 1975 Bankers Trust's analysis and study of the creditworthiness of New York City securities intensified with the situation.

Chemical Bank answered in a similar vein:

Chemical reviewed and analyzed the City's creditworthiness and fiscal soundness on a continuing basis; such review and analysis was based in large part upon the information described in the response to Question 4, and in light of those factors summarized in the response to Question 2. Such review and analysis was neither limited to nor necessarily entailed or focused upon any of the individual matters set forth in paragraph (1) through (5) of Question 5. Chemical's basic procedures for review and analysis of these matters did not change over time.

Merrill Lynch's answer was similar to Chemical's, referred to factors already stated in response to Questions Two and Four and further noted:

Merrill Lynch was never the "lead manager" of a syndicate that offered and sold the Notes or Bonds; accordingly, Merrill Lynch never invited other firms to join any such syndicate, but rather was itself invited by the lead manager to join certain of such syndicates. The factors that Merrill Lynch analyzed in deciding whether to participate in a syndicate that would offer and sell the Notes or Bonds are enumerated in Merrill Lynch's answer to Question 2. Merrill Lynch also received and reviewed certain material described in its answer to Question 4. All of the factors enumerated in Merrill Lynch's answer to Question 2 were analyzed prior to the submission of a bid, the taking down of any Notes or Bonds, or the re-sale of any Notes or Bonds by Merrill Lynch. Merrill Lynch regarded the fact that the Notes and Bonds were legally backed by the full faith and credit of the City and that City officials repeatedly assured that such obligations must be honored first among all claims against or obligations of the City as the overriding and paramount consideration in deciding whether to participate as a member of a syndicate that would offer and sell the Notes or Bonds, rather than the matters enumerated in Items (1) through (5) of Question 5 or any other matters. Merrill Lynch's procedure for analysis, as set forth in this answer, did not change at any time during the time in which Merrill Lynch participated as a member of a syndicate that offered and sold the Notes or Bonds.

Weeden added:

Since Weeden was never a managing underwriter of any City paper during the crisis period of June 1974 to March 1975, these questions are out of focus, as

would be our answers. The facts, of course, remain the same. Pre-Breen we relied on the City to supply accurate figures and for the managing underwriters, the rating agencies and bond counsel to carefully analyze such data for the benefit of all parties, including ourselves and the public. Following the report on the broad tape of Breen's speech of January 10, 1975, ... and the extraordinary press release by the Mayor and the Comptroller in response ... and the subsequent exchange of correspondence with the Mayor ... we no longer gave much credence to information given by the City and focused instead on the advice of new bond counsel.

Question 6

Specifically describe any independent investigation or inquiry your organization made prior to participation in the underwriting of the Notes or Bonds with respect to:

- (A) Fiscal information prepared and presented by the City; and
- (B) Fiscal information concerning the City prepared and presented by any other sources (identifying the sources).

Please provide the staff with any written reports made by employees, members or officers of your organization regarding the Notes or Bonds in this context.

* * *

In response to this Question, Chase, Citibank, Bankers Trust and Merrill Lynch referred the Commission to information and documents already submitted or to responses already submitted in answer to another question in the Questionnaire.

For instance, Chase responded as follows:

Various sources of published information were reviewed from time to time by the Municipal Research Division, in assessing the investment quality of City Bonds and Notes. The most important of such sources are listed in the response to Question 4 herein. In addition, materials published by the Citizens Budget Commission were used on a regular basis to supplement sources of information prepared by the City. Weekly Reports of the Municipal Research Division which referred to the City have been previously furnished to the SEC.

Chemical stated:

The Bank relied on bond counsel with respect to verification of fiscal information concerning issuance of City Notes and Bonds, and, in addition, attempted to verify such information in its possession as it does with all other information with regard to municipal issues. Primarily, it compared new items of information coming into its possession with similar information received from other sources and with similar information previously in its possession. Given the complexities of the budgetary and fiscal affairs of entities like the U.S. Government, the State of New York or the City of New York, accurate independent verification is almost impossible. For example, sources of funds quite often are found by government officials which were not known to be available to the private sector. Any written reports in the Bank's possession respecting such matters have previously been produced to the Commission. The Commission is also referred to the responses to Questions 2 through 5 and 8 through 14 and to the testimony of Bank officers given in this proceeding.

Generally, the organizations stated that they reviewed the information that was prepared by the City. Chemical Bank reported that it compared current information with past information. However, in answer to Question Six, no organization reported that it questioned the information published by the City or by another source.

Question 7

Did your organization prepare any sales literature, brochures, write-ups, etc. with respect to the Notes or Bonds for delivery to customers or others? If so, identify the person(s) in your organization responsible for its preparation, and indicate whether it was in fact distributed or given to your customers. Please furnish copies thereof.

* * *

Traditionally, sales literature may be prepared to advertise aspects of the securities issue and to stimulate interest. Generally, the responses to Question Seven indicated that there was little sales literature prepared by the managing underwriters. Chase, Bankers Trust, and Chemical Bank prepared no sales literature. Citibank referred the Commission to documents already submitted.

Only Merrill Lynch submitted an extensive report as to the sales literature it prepared. Its answer stated:

Yes, Mr. John S. de Graffenried was the Manager of the Municipal and Corporate Bond Sales Development Department and, in such capacity, had ultimate responsibility for the content of any such sales literature and its distribution to Merrill Lynch's customers. With respect to any such advertisements placed by Merrill Lynch in newspapers or magazines the Advertising Department of Merrill Lynch would approve the format of such advertisements.

The following materials were distributed by Merrill Lynch to its account executives who made such materials available to customers:

- (1) a brochure, dated January 15, 1973, entitled "A Fresh Look at New York City";
- (2) a brochure, dated August 16, 1973, entitled "Discount Tax-Exempt Municipal Bonds - 'A Way to Increase Your Yield'";
- (3) a brochure, dated August 16, 1973, entitled "Advantages of Discount Tax-Exempt Notes";
- (4) a brochure, dated April 5, 1974, entitled "A Fresh Look at New York City"; and
- (5) a brochure, dated February 5, 1975, entitled "Tax-Exempt Notes - The Long and Short of It."

The following advertisements relating to the Notes or Bonds were placed in newspapers or magazines by Merrill Lynch:

- (1) an advertisement, run in January, 1973 entitled "New York taxpayers: Merrill Lynch tells how you could get a 3-way tax exemption with upgraded New York City bonds";
- (2) an advertisement relating to the offering of \$620,000,000 principal amount of Revenue Anticipation Notes; and
- (3) an advertisement run in December, 1973 and another advertisement run in April 1974, both entitled "Merrill Lynch is bullish on New York City tax-free bonds."

Such materials have been produced to the Commission by Merrill Lynch in its response to the Commission's subpoena.

Question 8

Prior to your organization's participation in the underwriting of the Notes or Bonds, did it consult with any outside technical experts, such as accountants, or municipal securities analysts, with respect to:

- (A) The subject matter referred to in item 5?
- (B) The feasibility of engaging in the underwriting of the Notes or Bonds?
- (C) The fiscal affairs or status of the City?

Specify who was consulted, the date of consultations, and the action, if any, taken or conclusions reached.

* * *

Three organizations -- Chase, Merrill and Weeden -- reported no consultation with outside technical experts. Chase stated:

Chase did not independently consult outside technical experts, although reports and ratings of Moody's Investors Service, Inc. and Standard & Poors Corporation (referred to in response to question 4(C) above) were reviewed.

Weeden noted:

Prior to or in conjunction with accepting an invitation to join a syndicate for the purpose of bidding on City paper we were the beneficiaries of whatever information the manager, the rating agencies and bond counsel elected to give out. We were never invited to join the Mayor's Committee or the Comptroller's Committee, nor did any member of either committee undertake to brief us on what was going on. Weeden did not engage or seek out "outside technical experts" nor are we confident we understand the terms as used in the questionnaire nor even whether such "experts" exist, let alone whether they would have spoken to us and talked freely if questioned.

The three banks which reported consultations with outside technical experts submitted no other information. For instance, Citibank stated:

During the course of Citibank's participation in the underwriting of the Notes or Bonds, it consulted with persons, experts and non-experts, concerning the subject matters referred to above.

It is not possible to specify who was consulted, the dates of consultation, or the action, if any, taken or conclusions reached.

And, Bankers Trust stated:

As has been stated previously in response to question number 5, the matters referred to in subparagraphs (A), (B) and (C) are considered by Bankers Trust to be interrelated elements which affected its decision to participate in an underwriting of New York City securities. Therefore, it is impossible to distinguish consultations with outside technical experts with respect to any particular matter referred to therein. At various times, Bankers Trust did discuss the financial condition of New York City with issuers of reports on municipal securities and analysts at other banks and brokerage firms.

Chemical Bank stated:

Except for its normal business discussions with other members or potential members of underwriting groups, the Bank only consulted with outside public sources of information to supplement its review and analysis. The Bank does not know whether some or any of such public sources of information might be considered by the Commission to be "technical experts" as that term is used in Question 8, but the Commission is referred in this respect to documents previously produced to the Commission and to the testimony of Bank officers given in this proceeding.

Question 9

What was your organization's understanding as to the role or duties of a managing underwriter in connection with the underwriting of the Notes or Bonds? For example,

- (A) Did your organization believe that a managing underwriter had or assumed the responsibility to verify or investigate the accuracy, completeness or veracity of the information prepared and presented to them from other sources?
- (B) Did your organization understand or believe that a managing underwriter had an obligation to bring to the attention of the syndicate any negative aspects relating to the Notes or Bonds?
- (C) Did your organization understand or believe that a managing underwriter's decision to underwrite the Notes or Bonds was in and of itself an express or implied approval of the creditworthiness of the City's fiscal position and its Notes or Bonds?

In each instance, state the basis for the understanding or belief.

- (D) In any event, please reflect your understanding or belief of a managing underwriter's role or duties in this connection.

* * *

The typical response from syndicate members, when asked to describe the extent of their independent investigation prior to participation in the underwriting syndicate, was that they relied upon the managing underwriter to investigate the creditworthiness of the Notes or Bonds, and generally expected to be notified of any negative aspects relating to the Notes or Bonds. Generally, the managing underwriters did not understand the

duties of the managing underwriter to include those referred to in Question Nine, sections (A), (B) and (C). Chase understood its duty to include a responsibility to disclose material non-public information, if known, or to abstain from the offering. However, Chase submitted that this situation did not occur. Chase stated:

As managing underwriter of a syndicate formed to bid for Notes or Bonds, Chase assumed the responsibilities set forth in the syndicate agreement. Chase did not believe that the decision of a managing underwriter to underwrite Notes or Bonds constituted approval of the credit worthiness of such securities, or that the managing underwriter assumed the responsibility for verifying or investigating the veracity of information prepared by third parties. Of course, if Chase actually had known of material non-public information about the City at the time of an offering of Bonds or Notes, it would have assumed a responsibility to either disclose such information or abstain from participation in such offering. This situation did not, however, occur.

Citibank stated:

We believe this question to be inappropriate in the present context. We understand that the staff is in the process of preparing a report for the Commission, which report might comment adversely upon New York City and others involved in the sale of its securities and might conceivably recommend enforcement action against them. Citibank would be happy to respond to this question in the context of a rulemaking or other proceeding in which the Commission was generally studying the municipal securities market and considering whether some new legislation or regulation was necessary or appropriate in connection therewith.

In addition, this question is inappropriate in that it calls for a legal opinion and/or conclusion of law.

Citibank answered Questions 9, 10, 11 and 12 with the same response.

Bankers Trust's response was a composite of that received from Chase and Citibank:

Bankers Trust understands that the managing underwriter had a duty at all times to comply with the law, and that it had a duty at all times not to knowingly misrepresent facts concerning securities it underwrote or knowingly to omit material facts regarding such issues. To the extent that item 9 would require Bankers Trust to express an opinion or to state its belief as to what the legal requirements applicable to municipal securities underwritings are or were, we believe that such a request is inappropriate in the context of an investigation conducted for enforcement (as distinct from regulatory) purposes.

Chemical referred to syndicate agreements previously submitted to the Commission. These agreements describe the contractual duties of the managing underwriter, but do not address the description of duties in Question Nine subsections (A), (B) and (C). Chemical noted:

The Bank's understanding as to the role and duties of a managing underwriter in connection with the underwriting of City Bonds is contained in contracts among members of Bond underwriting groups, copies of which in the possession of the Bank have previously been produced to the Commission; and the Bank understands the role of a managing underwriter of a Note underwriting group had similar responsibilities. The Bank believes that pursuant to these contracts a managing underwriter would have brought to the attention of the other members of an underwriting group any materially negative aspects relating to the issue not thought to be known to such members of which the managing underwriter became aware and understands that the participation of the managing underwriter in any issue implies its belief in the creditworthiness of the obligations being underwritten.

Merrill Lynch stated:

The lead managing underwriter had the responsibility of organizing the syndicate, communicating the syndicate's bid to the City, coordinating the selling activities of the syndicate after having ascertained that the appropriate closing documents would be obtained, including the legal opinion from bond counsel to the effect that the Notes or Bonds were validly issued and backed by the full faith and credit of the City.

(A) Merrill Lynch does not understand what "information" and what "other sources" the Commission is referring to in Question 9. Merrill Lynch assumes that the Commission is asking whether Merrill Lynch believed that the managing underwriter had the responsibility to verify or investigate the accuracy of statements made in the Notices of Sales and the Reports of Essential Facts. The Notices of Sales and the Reports of Essential Facts were public official documents prepared by the City. The Notice of Sale was not a disclosure document, but simply an advertisement by the City for bids on a proposed offering that would set forth the terms of the proposed offering. Merrill Lynch did not regard the Report of Essential Facts as a disclosure document, but rather as a document that contained only certain information about the City. Therefore, Merrill Lynch did not believe that the managing underwriter had the responsibility to verify the accuracy of statements made in these public official documents. Merrill Lynch did believe that the managing underwriters had the duty to verify that the Notes or Bonds were validly issued and backed by the full faith and credit of the City and that such duty was satisfied by obtaining a legal opinion to that effect from bond counsel.

(B) Merrill Lynch did not believe that a managing underwriter had an obligation to bring to the attention of the other syndicate members adverse information regarding the City's fiscal condition because such information was already in the public domain. Merrill Lynch did, however, believe that any member of a syndicate would have the responsibility of informing the other syndicate members of any non-public, adverse information of which it had knowledge that related to the City.

(C) No.

The basis for Merrill Lynch's answer to this Question 9 is standard industry practice.

Instead of answering "yes" or "no" to the description of duties of the managing underwriter in Question Nine, sections (A), (B) and (C), Weeden ordered its response to state that it relied in the first instance upon the City and in the second instance upon the managing underwriter, bond counsel and rating services. Weeden responded:

There were but two syndicates bidding on City paper during the 1974-75 crisis period and the managing underwriters of each had employees (some former City employees) whom Weeden believed were extremely knowledgeable about the City's fiscal affairs. Accordingly, we relied completely in the first instance on the City to give out accurate facts and then on the managing underwriters, along with bond counsel and the rating agencies to analyze such facts and keep us fully advised. After the Breen speech, the broad tape excerpt of it, the Mayor's and Comptroller's press release and the letter exchange with the Mayor, we had little faith in the information being given out by the City and relied instead upon the investigation of new bond counsel. In fact, of course, there was very little City paper issued after the Mayor's letter of February 25, 1975 in which, at that late date, he was still insisting that Mr. Breen was "yelling fire" in a crowded theater when there is no fire.

Bankers Trust submitted one characterization of the extent of the duties of a managing underwriter: "The managing underwriter had a duty at all times to comply with the law and it had a duty at all times not to knowingly misrepresent facts... or omit material facts." Other responding organizations similarly recognized an obligation to disclose material, non-public adverse information in their possession relating to the City's fiscal affairs.

One point worth noting is that while Chase believed that its decision to be a managing underwriter of the City's Notes or Bonds did not constitute approval of the creditworthiness of such securities -- a view to which Merrill subscribed -- Chemical stated:

... the participation of the managing underwriter in any issue implies its belief in the creditworthiness of the obligations being underwritten.

Further, those organizations responding uniformly believed that a managing underwriter did not have a responsibility independently to verify or investigate information received from sources outside the organization.

Question 10

Please describe your understanding of the role or duties of bond counsel in connection with the underwritings of Notes or Bonds. And specifically discuss the following:

- (A) Did you believe that designated bond counsel had a duty to disclose to the underwriters who purchased the Notes information which was brought to their attention concerning the sufficiency of revenues or taxes behind the Notes?
- (B) Did you believe that designated bond counsel had a duty to make some investigation as to the basis for the City's estimates of revenues to be received against which the City was issuing Tax Anticipation Notes and Revenue Anticipation Notes?

* * *

Generally, the managing underwriters responded that they had believed bond counsel had the duties described in Question 10.

Chase believed that subsections (A) and (B) described bond counsel's duties and stated:

It was Chase's understanding that bond counsel was to provide a legal opinion as to the validity of Notes or Bonds, as the case may be. It was further assumed that bond counsel would receive from the City such data as bond counsel required to enable

it to determine in connection with rendering its opinion that there were taxes or revenues in anticipation of which tax anticipation notes or revenue anticipation notes could be issued under the relevant provisions of the State's Local Finance Law. Chase believed that bond counsel would call to Chase's attention any material facts concerning the sufficiency of such taxes and revenues. Chase was aware that Bond counsel dealt directly with various City officials in the process of preparing to render its opinion, but was not aware of specific steps taken to verify information obtained.

Citibank and Bankers Trust did not respond to Question Ten. Bankers Trust stated:

We believe that such a request is inappropriate in the context of an investigation conducted for enforcement (as distinct from regulatory) purposes.

Merrill Lynch expected that bond counsel would do whatever was necessary to provide or to deliver a legal opinion to the effect that the notes or bonds were validly issued, backed by the full faith and credit of the City and exempt from taxes.

Merrill Lynch wrote:

It was the responsibility of bond counsel to deliver an opinion at the closing substantially to the effect that the Notes or Bonds had been validly issued by the City, were backed by the full faith and credit of the City, and the interest on the Notes or Bonds was exempt from Federal, New York State, and New York City income taxes. It would be the responsibility of bond counsel to do whatever was necessary to enable them to render such an opinion. If bond counsel were not able to render such an opinion, bond counsel would have to explain to the syndicate members the reasons for not being able to do so.

Chemical's response was similar to that of Merrill Lynch.

Weeden distinguished the investigation necessary for a competitive underwriting from the investigation necessary for a negotiated underwriting and stated:

Yes to both A and B, but we are not clear on the extent of the investigation appropriate or feasible in competitive underwritings of exempt securities as distinguished from negotiated underwritings of non-exempt securities. In any given week Weeden can participate in from 20 to 40 competitive underwritings of exempt securities.

Generally, the responses were formulated to suggest that the managing underwriters had an understanding that bond counsel had a duty to perform an independent investigation, although the extent of independent investigation expected was unclear. The managing underwriters stated that they believed that the bond counsel, rather than they, had the duty to investigate the sufficiency of revenues or taxes and the basis of the City's estimates.

Question 11

At the time of your organization's participation in the underwritings of the Notes or Bonds, please describe your understanding of the purpose of the Notices of Sale and Reports of Essential Facts which were prepared and distributed by the City. For example, did your organization expect that, if there were

- (A) Any material changes in accounting practices and policies by the City, they would have been described therein?
- (B) Any developments of material matters affecting the City's financial condition one way or the other, they would have been described therein?

- (C) Any overestimates of revenues for prior years from the Federal or State Governments to the City, or from real estate tax sources, such would have been disclosed therein?
- (D) Any renewals or "rollovers" of Notes, the need for or the reasons therefor would have been described therein?
- (E) Any budget gaps, budget deficits, cash deficits, or deficit financing then in existence, such would have been disclosed therein?

If you did not expect to find the information referred to immediately above and other relevant information in the Notices of Sale and Reports of Essential Facts, did your organization find such information in any other source?

Yes []

No []

If yes, please describe such source and what you found.

* * *

Generally, the stated understanding regarding the Notices of Sale was that they were a mere advertisement or notification of a future offering. The managing underwriters stated that they did not expect the information referred to in this Question to be included in the Notices or in Reports of Essential Facts. In contrast, the syndicate members deemed the matters referred to in subsections (A)-(E) to be material and expected that these matters would be included in the Notices of Sale and the Reports of Essential Facts.

Chase did not respond to the question directly but stated:

It was Chase's view that Notices of Sale and Reports of Essential Facts were designed to notify prospective purchasers of a competitive offering of Notes or Bonds. It was Chase's assumption that the contents of such Notices and Reports were in accordance with the requirements of the State's Local Finance Law and regulations issued thereunder.

Information published by the City, including that referred to in response to Question 4, was Chase's source of information regarding the topics referred to in paragraphs (B) through (E) of Question 11. The information on these topics contained in such sources, was referred to, in general terms, in weekly reports of the Municipal Research Division and the reports of the Municipal Research Division to the Municipal Credit Portfolio Review Committee, copies of which have been furnished to the SEC. No information with respect to material changes in accounting practices and policies of the City as such was disclosed in materials reviewed by the Municipal Research Division.

Bankers Trust reported that a reason why the Reports of Essential Facts were not reliable sources for material information was that they were not prepared in connection with Note issues until March 14, 1975.

It was Bankers Trust's understanding during its participation in the underwriting of the Notes and Bonds that the primary purpose of the Notice of Sale was to announce the sale to the public and to provide a summary statement of the City's authority to issue a particular security.

Reports of Essential Facts were not prepared in connection with Note issues until March 14, 1975. Bankers Trust did expect such Reports when issued by the City to contain such facts, including those outlined in subparagraphs (A) through (E), as might be essential to an evaluation of the creditworthiness of the security being issued at that point in time. Prior to February, 1975, it was Bankers Trust's understanding that a Report of Essential Facts prepared in connection with a bond issue would contain reference to material changes in accounting practices and policies by New York City, but would not be expected to provide information as to the matters described in subparagraphs (B) through (E). Any information obtained by Bankers Trust with respect to such matters was publicly available information.

Merrill Lynch reported:

The Notices of Sale were the means by which the City advertised for bids on a proposed issue of Notes or Bonds, and such Notices of Sale set forth certain terms and conditions with respect to the proposed offering. The Reports of Essential Facts were public official documents prepared by the City that contained certain information about the City. Merrill Lynch did not regard the Reports of Essential Facts as disclosure documents. Merrill Lynch did not distribute the Reports of Essential Facts to its customers, except that Merrill Lynch did distribute to its customers the Report prepared by the City in connection with an offering of revenue anticipation notes on March 7, 1975, because a majority of the members of the syndicate had agreed that all syndicate members should distribute that Report, as supplemented by press release from the Comptroller, to the purchasers of the Notes.

Merrill Lynch's answer is "No" to subsections (A) through (E) of Question 11. Merrill Lynch found the information referred to in subsections (A) through (E), as well as other relevant information relating to the City, in the publications referred to in Merrill Lynch's answer to Question 4.

Chemical Bank reported:

The Bank understands that the Notice of Sale was in substance a form on which an upcoming issue of City Notes or Bonds was announced and that the Report of Essential Facts was a summary of basic statistical and debt information respecting the upcoming issue. More detailed information as to such matters as those referred to in subparagraphs (A) through (E) of Question 11 might be reflected in some or all of the other sources referred to in the response to Question 4....

Weeden (which was not a managing underwriter) reflected the response of the syndicate members, which was contrary to the stated expectations of the managing underwriters.

We do not believe that Notices of Sale and the Reports of Essential Facts were in fact "distributed by the City." They may have been available either before or after the fact to those knowledgeable enough to know whom to ask and determined enough to keep asking until they got them. Passing those problems with the question, the answer is "yes" to A through F and "no" on the use of other sources before Mr. Breen was hired.

Chemical Bank, Merrill Lynch and Chase reported that the City publications (e.g. Monthly statements; Annual Report, etc.) listed in Question Four were the sources for the accounting practices information. However, Chase submitted that:

No information with respect to material changes in accounting practices and policies of the City as such was disclosed in materials reviewed by the Municipal Research Division.

Bankers Trust submitted that:

Any information obtained by Bankers Trust with respect to such matters (A)-(G) was publicly available information.

Question 12

Did your organization believe that the City provided sufficient financial information and other data concerning its affairs as to the Notes or Bonds being offered and sold to enable your organization to make an informed judgment of the creditworthiness of the City and its Notes or Bonds. If your answer is in the affirmative, state why.

* * *

With certain caveats to their answers, two of the three responding managing underwriters believed that the City provided sufficient financial

information to allow an informed judgment of creditworthiness to be made.

Chase noted:

During the relevant period it was the belief of the Municipal Research Division that the City was providing sufficient financial information which would enable the Municipal Research Division to make a reasonably informed judgment of the creditworthiness of the City's Notes and Bonds. This belief was grounded on the fact that published information contained information of the type contained in reports by other municipalities and of the type usually used as a basis for analysis of municipal credits. Of course, Chase had no opportunity to verify such published information since the actual records and books of the City were not available to Chase.

Chemical Bank reported that the information available was assumed accurate and that its own analysis and the rating services' analysis did not find the information questionable. It stated:

Based on the assumption that the financial information and other data provided by the City on which the Bank relied in its analysis was accurate and in the absence of any clear and convincing source of information described in the response to Question 4, 5 and 6 ... (including reports of the rating services and other publicly available information), which would come to the Bank's attention in the course of its own review and analysis, calling into question information and data provided by the City, the Bank believed that it was in a position to make an informed judgment of the creditworthiness of the City and its Notes and Bonds.

Merrill Lynch reported that it relied on the full faith and credit of the City, the New York State Constitution, the legal opinion of bond counsel and the verbal assurances of the Mayor and Comptroller as the basis for its judgment of creditworthiness, rather than the published financial information.

Citibank and Bankers Trust refused to respond to the question.

Question 13

With respect to each revenue anticipation note ("RAN") or tax anticipation note ("TAN") of the City which your organization underwrote, please indicate if and to what extent your organization was aware of the following:

- (A) The source, and method of computation of the revenue or taxes which supported the issuance of each RAN or TAN;
- (B) The date that the revenues or taxes were due or would become due;
- (C) The manner in which the revenues or taxes to be received were determined, i.e. whether it was by estimate, formula, audit, or confirmation;
- (D) How proceeds from each RAN or TAN issue were actually utilized;
- (E) Whether the revenues or taxes to be received upon which the issuance of the RANS or TANS were based, were, in fact, received in their entirety;
- (F) If any portion of the revenues to be received was not received, the manner in which the City paid off the RAN or TAN at maturity.

* * *

Citibank stated, in response to this Question:

It is not possible to specify the state of Citibank's awareness with respect to each of these matters for each particular issue of revenue anticipation notes and tax anticipation notes.

Chase stated:

Chase was aware of the matters set forth in question 13 insofar as (1) it assumed on the basis of Bond Counsel's opinion that the computation of anticipated taxes or revenues was in accordance with the relevant provisions of the Local Finance Law, (2) the source of anticipated taxes or revenues was identified in the relevant notice of sale, (3) the Certificate of Award signed by the Comptroller of the City in connection with each issue of Notes specified anticipated taxes or revenues; and (4) the Municipal Research Division

was able to determine on an aggregate basis from examination of information published by the City (a) amounts and due dates of anticipated taxes and revenues, (b) whether portions of such taxes and revenues remained uncollected at the end of a fiscal year, and (c) the apparent method of reserving for or financing any such taxes and revenues remaining uncollected.

Bankers Trust stated that it believed that the items identified in subparagraphs (A) through (E) were covered in the investigation of bond counsel. Bankers Trust therefore stated that it considered it reasonable to rely on bond counsel's conclusions as to these matters. As to the balance of the items, Bankers Trust, although purportedly maintaining a constant general review of the City's fiscal condition, did not consider investigation with respect to those items as "...appropriate to its function as an underwriter...."

Chemical Bank stated:

The Bank understood and was aware of the fact that the source and method of computation of City revenues or taxes were subject to the provisions of the New York State Constitution. The Bank understood and was aware of the fact that property tax collection schedules are published by the City and actual receipts and monthly cash value were reported by Moody's as part of their "MIG" reports and in the monthly report of the Comptroller. With respect to the manner in which anticipated revenues were determined, the Bank understood that State and Federal aid to the City was usually determined by a formula or by way of reimbursement under certain aid programs. The Bank's awareness of the other matters referred to in Question 13 was premised on publicly available information contained in sources described in the response to Question 4, ...

Merrill Lynch reported:

It was Merrill Lynch's understanding that TANS were issued against real estate taxes levied and due during the fiscal year in which such TANS were issued and that RANS were issued against specifically identified revenues

from state and federal sources due during the fiscal year in which such RANS were issued. As to compliance with legal requirements in connection with the issuance of TANS and RANS, Merrill Lynch relied upon the opinion of bond counsel. With respect to the matters referred to in subsections (D) through (G) of Question 13, Merrill Lynch did not regard such post-closing events as relevant inasmuch as the TANS and RANS were backed by full faith and credit of the City.

Weeden, placing reliance on bond counsel, the City, rating agencies and the managing underwriters, also emphasized that the frequency of rollover of Notes "...obscured the specifics of any given issue."

Question 14

- (A) What was your organization's understanding of the type of accounting system employed by the City of New York during the period January 1973 to May 1975?
- (B) Please provide the staff with any reports, whether intended for internal or external use, made by employees, members, or officers of your organization regarding the City's accounting system during such period.

* * *

Merrill Lynch's, Chemical Bank's and Weeden's response were as follows:

It was Merrill Lynch's understanding that the City accounted for revenues on an accrual basis and for expenditures on a cash basis. Any such report referred to in subsection (B) of Question 14 would have been produced by Merrill Lynch to the Commission in its response to the Commission's subpoena.

* * *

Chemical Bank understood that the City's accounting system was subject to requirements of State law and was premised on a modified cash basis approach. Reports made within the Bank regarding the City's

accounting system, if any, have been produced to the Commission pursuant to the subpoena addressed to the Bank dated January 16, 1976.

* * *

Weeden used to believe the City employed generally accepted accounting procedures. The New York Daily News editorial...destroyed that myth; and the letter exchange with the Mayor in January and February 1975 left little doubt that those in charge were unwilling publicly or privately to concede the gravity of the problem.

Chase, a principal underwriter of many New York issues wrote:

Chase is unable to respond to this question because no information fully stating the basis of the accounting system employed by the City was made available. (Reports if any, are already submitted).

Citibank wrote:

- (A) This question is so general, vague, and ambiguous that Citibank is unable to frame a response.
- (B) The information requested is reflected in the documents produced by Citibank pursuant to SEC subpoena.

Bankers Trust stated:

Bankers Trust does not understand the meaning of the phrases "type of accounting system" and therefore is not able to respond to subparagraph A. All documents which would be responsive to subparagraph B have previously been furnished to the Staff.

CONCLUSION

While conclusions with respect to the role which the managing underwriters played in connection with the collapse of the City's finances are drawn elsewhere, we believe that it is important to note that the organizations responding to the Questionnaire did little, if any, independent investigation relating to the financial affairs or creditworthiness of the City in connection with the underwriting process. Rather, reliance was purportedly placed by the managing underwriters on, among other things, the City's "full faith and credit" and investigation by bond counsel and the rating services.

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