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U.S. Securities and Exchange Commission

43rd Annual Report of the SEC

1977

for the fiscal year
ended September 30, 1977
and
the transition quarter-
July 1, 1976-September 30, 1976

SECURITIES AND EXCHANGE COMMISSION

Headquarters Office
500 North Capitol Street
Washington, D.C. 20549

COMMISSIONERS

HAROLD M. WILLIAMS, *CHAIRMAN*
PHILIP A. LOOMIS, JR.
JOHN R. EVANS
IRVING M. POLLACK
ROBERTA S. KARMEL

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CHAIRMAN'S LETTER OF TRANSMITTAL

The Honorable Walter F. Mondale
President, U.S. Senate
Washington, D.C. 20510

The Honorable Thomas P. O'Neill, Jr.
Speaker, U.S. House of Representatives
Washington, D.C. 20515

Gentlemen:

I am pleased to transmit to Congress the *Annual Report of the United States Securities and Exchange Commission* for the period July 1, 1976, to September 30, 1977. Those 15 months were a time of virtually unprecedented activity and accomplishment for the Commission, and the *Annual Report* reflects that fact. Our report is comprehensive and detailed and will, I am confident, be an important aid to Congress in understanding the Commission's work.

The latter half of the period treated in this report coincided with the first several months of my term as Chairman of the Commission. For that reason, although the report itself is essentially a record of past achievements, I believe its transmittal affords a valuable opportunity for me to offer my perspective on the future. Accordingly, I have outlined briefly below some of the major issues which I expect the Commission will be addressing during the balance of my term as Chairman.

Investor Confidence and Capital Formation. Congress's fundamental objective in enacting the federal securities laws was to promote public confidence in the securities markets in order to foster the vital process by which the capital is marshalled from the public and channelled into growth of our economy. Accordingly, while the Commission's primary responsibility is to protect investors, the discharge of that responsibility results, in a broad sense, in stimulation of investors' willingness to provide the new capital necessary to fuel our private enterprise system. The interrelationship between investor confidence and capital formation has several important consequences.

First, the Commission must be sensitive to the effects of its

activities on the capital formation process and must ensure that Commission regulation under the federal securities laws does not inadvertantly impair capital formation. In that vein, for example, the Commission recently announced a broad-scale re-examination of the impact of its regulations on small businesses with an eye toward easing that burden whenever possible, consistent with the Commission's statutory responsibility. Similarly, we will strive to be alert to other facets of the economic consequences of our regulatory actions.

Second, the Commission also has a responsibility to understand the forces that might distort or impair the efficiency with which the market allocates capital to competing investment opportunities. Whether those forces are directly under the Commission's jurisdiction or arise in other areas—such as the federal tax system–the Commission's familiarity with the dynamics of the securities markets obligates us to analyze their impact. The Commission's views on these matters can be of assistance to Congress and to other arms of the federal government whose activities impact on capital formation.

Third, although the Commission is not charged with maintaining the economic health of the securities industry, we have an obvious responsibility to understand the industry's economic condition and to endeavor to ensure that the Commission's discharge of its regulatory responsibilities is not inconsistent with a financially strong and stable industry. If the securities business were to become unprofitable and unable to attract talent and capital, the injurious consequences would be felt in every segment of the American economy.

Finally, the Commission's role in fostering efficient capital formation turns on the effective utilization of its statutory powers in order to assure the public confidence necessary for healthy securities markets. Several components of that role are treated below.

Development of the National Market System. The first requisite to public confidence is fair, efficient, and orderly securities markets. In that connection, Congress, in the Securities Acts Amendments 1975, directed that the Commission facilitate the development of a national market system for securities. The national market system, when fully implemented, will tie together a network of highly diverse and complex individual market centers and will represent the most significant restructuring of the United States securities markets ever undertaken. During the next several years, the Commission will complete the task, already well under way, of putting the components of that system into place. Our philosophy has been to move deliberately, in order to insure that the consequences of the Commission's actions are those we anticipate and that the end product is consistent with the objectives of the 1975 Amendments.

The Securities Exchange Act, as amended, characterizes the securities markets as "an important national asset which must be preserved and strengthened" and spells out Congress's goals in broad terms. For example, Subsection 11A(a) states:

"The linking of all markets for qualified securities through

communications and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investor orders, and contribute the best execution of such orders."

Similarly, in the legislative history, Congress emphasized that

"[i] vestors should be able to obtain the best, most economic and fair execution of their orders and be assured that, because of open competition among market makers, the total market for each security is as liquid and orderly as the characteristics of that security warrant."

Facilitating a national market system is among the most difficult and challenging of the many tasks that Congress has assigned to the Commission. The costs and consequences of change frequently seem so substantial—and, paradoxically, so difficult to quantify—that the Commission must weigh carefully, in each instance and in advance, the workability and feasibility of each proposed system change.

After the close of the period covered in this *Annual Report,* the Commission issued a comprehensive policy statement setting forth its views as to those initiatives necessary to facilitate the establishment of a national market system. The Commission believes that this blue-print provides the opportunity for the securities industry to move ahead. The thrust of the plan is to provide a framework within which the industry can marshall its own efforts, not to displace or replace industry initiative. The Commission is, however, prepared to act aggressively to fill any void.

Our capital markets are today the finest in the world. Nothing in the restructuring that those markets are currently undergoing is inconsistent with maintaining and enhancing that pre-eminence. Indeed, the development of the national market system is an integral part of assuring the continued strength of, and confidence in, our securities industry and the private enterprise system it supports. Our obligation—both the industry's and the Commission's—is to get on with the task of building a future for our securities markets which will ensure that their strength, liquidity, vitality, and fairness endure.

Corporate Accountability. A second important element contributing to confidence in our capital markets is public trust in the stewardship which is exercised over publicly-owned enterprises. On April 28, 1977, the Commission announced a broad re-examination of its rules relating to shareholder communications and to shareholder participation in the corporate electoral process and corporate governance generally. In that proceeding, the Commission is studying such issues as the role of disclosure in supporting a more effective accountability system, the extent to which the Commission's authority under the federal securities laws can be used to strengthen the corporate accountability process, and whether it would be appropriate for the Commission to recommend any additional legislation in this area.

In my view, the Commission's goal should be to foster an environment

in which corporate managers are subject to meaningful oversight, by an independent board of directors, of the manner in which they discharge their stewardship responsibilities. Our objective should be to stimulate that scrutiny, not to draw lines which confine or restrain it. The area does not readily lend itself to solution by prescription, and the Commission's chief aim will be to encourage the private sector to utilize the opportunities available to it to enhance and maintain public trust.

Accounting Matters. The independent accountant is the cornerstone of the financial reporting system and thus is a crucial element in investor protection and in fostering confidence in the fairness of the securities markets. Because of the role which accountants play under the federal securities laws, the Commission, in turn, has a special commitment to insuring that the Nation continues to be served by a strong and independent accounting profession.

The accounting profession is in the midst of fundamental and far-reaching changes. For example, accountants are engaged in creating a self-regulatory process designed to enhance public confidence in auditor independence, in the integrity of the audit process, and in the vehicles through which accounting and auditing standards are promulgated. There is no pre-existing model which the profession can emulate in working toward these goals. Thus, the development of a self-regulatory structure and process is, by its nature, experimental and will involve a certain amount of trial and error. In my view, the SEC Practice Section has the potential to meet the objectives Congress and the Commission share in this area. Whether or not that experiment ultimately succeeds is one of the central questions which must be answered during my term as Chairman.

Representatives of the private sector are working to address a broad spectrum of issues touching on the theoretical underpinnings of accounting and auditing. The Financial Accounting Standards Board's conceptual framework project is a central focus of that effort. One area which will prove to be especially important, and which has implications in the corporate accountability area, is the role of "soft information" in augmenting the traditional focus of financial statements. Accordingly, the Commission intends to work closely with the profession as it seeks to develop the conceptual framework for accounting.

Disclosure. In enacting the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress adopted the philosophy of full disclosure as the lynch-pin of investor protection. The Commission has traditionally been sensitive to the need periodically to re-evaluate its rules, particularly in the dynamic and changing field of disclosure, in order to insure that its requirements harmonize with the changing realities of the market-place and impose no unnecessary burdens on the capital formation process. Most recently, during 1976, the Commission appointed an Advisory Committee on Corporate Disclosure to examine the disclosure system and, on November 3, 1977, that

committee concluded 21 months of intensive effort with the transmittal to the Commission of its final report. This report provides the Commission with valuable insights and, because of the significance of the Advisory Committee's work, the Commission will carefully consider, and act as rapidly as possible, on the committee's recommendations.

The Commission is also sensitive to the fact that its disclosure requirements can serve to influence corporate conduct. This power requires that the Commission be mindful of both the objectives which Congress sought to attain in the federal securities laws and of the public's expectations concerning corporate conduct. The Commission will act judiciously in this area.

Investment Company Deregulation. Another goal which I have set for the Commission to accomplish during my term as Chairman is to revise the investment company regulatory structure to place a fuller measure of responsibility on fund management while at the same time insuring that management will be held responsible for the consequences of its stewardship. With this objective in mind, the Commission, after the close of the fiscal year, announced its intention to undertake a systematic review of the Investment Company Act and the rules, regulations and interpretative positions which have developed under it over the years. The major objective of the study will be to develop a system of rules which are consistent, comprehensive, and designed to give reasonably clear guidance to prudent fiduciaries. The result should be a regulatory system which relies primarily on funds and their managers—rather than on the Commission—to discharge their duties properly but which preserves a strong oversight function for the Commission.

Options Trading. The burgeoning growth of trading in standardized options has strained the Commission's ability to keep abreast of developments in this new component of our securities markets. The area is an especially difficult one since, on the whole, potential trading strategies are more complex and investor sophistication less well developed than in the traditional equity markets. As a result of rapid developments in this field, during mid-1977 the Commission instituted a moratorium on the further expansion of options trading and initiated a comprehensive review extending to all aspects of the trading of standardized options and the regulation of that trading. The Commission's study includes an inquiry into the adequacy of existing Commission and self-regulatory rules to govern trading and selling practices and the surveillance capabilities to prevent and detect fraudulent and manipulative acts and practices in connection with options trading, and exploration of the relationship between the development of standardized options markets and the development of the national market system for securities.

The Commission has assembled a talented and diversified staff from its various Offices and Divisions to conduct this study, and I anticipate that their work will be concluded during fiscal 1979. The intellectual and regulatory complexities inherent in overseeing

large-scale options trading will, however, undoubtedly continue to demand considerable Commission resources in the coming years.

Enforcement. The Commission is committed to maintaining the vigor, effectiveness and credibility of its enforcement program. The enforcement tools which Congress has conferred upon the Commission are potent and can have profound effects both on those against whom action is taken and on those who look to those actions to provide an educative process concerning the Commission's conception of the standards of corporate conduct which the federal securities laws impose. Accordingly, while the Commission will continue aggressively to investigate and prosecute all categories of violations of the federal securities laws, we will also periodically channel a portion of our enforcement effort into specific problem areas. The Commission's experience has demonstrated that systematic enforcement attention in a given area encourages voluntary compliance with the federal securities laws and thus, in the long run, reduces the degree to which the Commission must rely on enforcement efforts to accomplish its investor protection goals.

My fellow Commissioners and I recognize that every authorization of enforcement proceedings demands a careful exercise of our judgment. We will continue to direct the development and implementation of an enforcement program which serves the ends embodied in the federal securities laws and which maintains a reasoned balance between enforcement remedies and regulatory devices as the means to those ends.

Resource Management. As this description of the Commission's priorities illustrates, there has probably never been a period in the Commission's history when its resources have been devoted to so many demanding projects with far-reaching consequences. In order to enhance the efficiency with which our resources are utilized, we have undertaken several important efforts to strengthen the Commission's internal management and data-handling capabilities.

For example, the Commission's personnel management program is receiving increased attention. One of our most fundamental goals in this area is to develop a comprehensive and meaningful performance evaluation system for the Commission's staff. We are seeking to develop objective criteria for evaluating the work of Commission personnel and for apprising them of their strengths and of the areas in which improvement is warranted. This is an especially challenging task since attorneys comprise the bulk of the Commission's professional staff, and there have been few attempts objectively to evaluate attorney performance on which we can build. A strengthened evaluation system should, however, pay significant dividends, both in terms of more effective management capability and reduced turnover.

In conjunction with the performance evaluation system, the Commission intends to develop an expanded training program in order to develop and foster the specific skills most closely related to the Commission's work. Training which emphasizes both skills and overall

management techniques can be of considerable benefit to our staff. An expanded training program will also aid us in our upward mobility program by which individuals in lower skill positions can become qualified for more sophisticated and higher paying positions. Further, a more coherent performance evaluation system will assist recruiting efforts by permitting the Commission to identify the abilities and attributes important in various phases of the Commission's work. This, in turn, will contribute to a more meaningful and effective affirmative action program.

Fundamentally, the Commission's stock-in-trade is information. Accordingly, we have begun implementing a long-range program to convert the existing and cumbersome paper record system to a micrographics file. Ultimately, the micrographics file will incorporate a computerized access and retrieval system and should yield significant savings in both manpower and time. The Commission is also significantly upgrading its computer facilities in order to keep pace with the development of advanced market surveillance techniques, work flow tracking systems, information retrieval, and other demands inherent in effective regulation of the securities markets.

* * *

While the foregoing touches briefly on the highest priority matters with which the Commission can anticipate dealing over the next few years, it is, of course, impossible to outline in a brief letter all of the important challenges facing the Commission or to predict the areas in which new market developments will demand Commission attention. I am, however, confident that the close and supportive relationship which the Commission has enjoyed in the past with those Congressional committees concerned with our work will continue. The Commission stands ready to provide additional information concerning its work to Congress whenever necessary to aid the legislative process.

Sincerely,

Harold M. Williams
Chairman

COMMISSIONERS AND PRINCIPAL STAFF OFFICERS
(As of April 1, 1978)

COMMISSIONERS	Term expires June 5
HAROLD M. WILLIAMS of Calif., Chairman	1982
PHILIP A. LOOMIS, JR., of Calif.	1979
JOHN R. EVANS of Utah	1978
IRVING M. POLLACK of New York	1980
ROBERTA S. KARMEL of New York	1981

Secretary: GEORGE A. FITZSIMMONS

Executive Assistant to the Chairman: RALPH C. FERRARA

PRINCIPAL STAFF OFFICERS

BENJAMIN MILK, Executive Director

RICHARD H. ROWE, Director, Division of Corporation Finance
- FRANCIS T. VINCENT, JR., Associate Director
- WILLIAM C. WOOD, Associate Director
- MARY E. T. BEACH, Associate Director

STANLEY SPORKIN, Director, Division of Enforcement
- WALLACE L. TIMMENY, Deputy Director
- IRWIN M. BOROWSKI, Associate Director
- THEODORE SONDE, Associate Director
- DAVID P. DOHERTY, Associate Director
- THEODORE A. LEVINE, Associate Director

ANDREW M. KLEIN, Director, Division of Market Regulation
- SHELDON RAPPAPORT, Deputy Director
- LLOYD H. FELLER, Associate Director
- KATHRYN B. MCGRATH, Associate Director

SYDNEY H. MENDELSOHN, Director, Division of Investment Management
- MARTIN C. LYBECKER, Associate Director
- LEE B. SPENCER, Associate Director

AARON LEVY, Director, Division of Corporate Regulation
- GRANT GUTHRIE, Associate Director

HARVEY PITT, General Counsel
- PAUL GONSON, Associate General Counsel

DAVID FERBER, Solicitor to the Commission

ANDREW L. ROTHMAN, Director, Office of Public Affairs
CHILES T. A. LARSON, Deputy Director
A. CLARENCE SAMPSON, Acting Chief Accountant
J. RICHARD ZECHER, Director of Economic and Policy Research
ROGER W. SPENCER, Deputy Director
(VACANT), Director, Office of Opinions and Review
WILLIAM S. STERN, Associate Director
HERBERT V. EFRON, Associate Director
WARREN E. BLAIR, Chief Administrative Law Judge
LAWRENCE H. HAYNES, Comptroller
RICHARD J. KANYAN, Service Officer
JAMES C. FOSTER, Director, Office of Personnel
(VACANT), Director, Office of Reports and Information Services
FRANKLIN E. STULTZ, Associate Director
JOHN D. ADKINS, Director, Office of Data Processing

REGIONAL AND BRANCH OFFICES

REGIONAL OFFICES AND ADMINISTRATORS

Region 1. New York, New Jersey.—William D. Moran, 26 Federal Plaza, New York, New York 10007.

Region 2. Massachusetts, Connecticut, Rhode Island, Vermont, New Hampshire, Maine.—Michael J. Stewart, 150 Causeway St., Boston, Massachusetts 02114.

Region 3. Tennessee, Virgin Islands, Puerto Rico, North Carolina, South Carolina, Georgia, Alabama, Mississippi, Florida, part of Louisiana.—Jule B. Greene, Suite 788, 1375 Peachtree St., N.E., Atlanta, Georgia 30309.

Region 4. Illinois, Indiana, Iowa, Kansas City (Kansas), Kentucky, Michigan, Minnesota, Missouri, Ohio, Wisconsin.—William D. Goldsberry, Room 1204, Everett McKinley Dirksen Bldg., 219 S. Dearborn St., Chicago, Illinois 60604.

Region 5. Oklahoma, Arkansas, Texas, part of Louisiana, Kansas (except Kansas City).—Richard M. Hewitt, 503 U.S. Court House, 10th & Lamar Sts., Fort Worth, Texas 76102.

Region 6. North Dakota, South Dakota, Wyoming, Nebraska, Colorado, New Mexico, Utah.—Robert H. Davenport, Two Park Central, Room 640, 1515 Arapahoe Street, Denver, Colorado 80202.

Region 7. California, Nevada, Arizona, Hawaii, Guam.—Gerald E. Boltz, Suite 1710, 10960 Wilshire Boulevard, Los Angeles, California 90024.

Region 8. Washington, Oregon, Idaho, Montana, Alaska.—Jack H. Bookey, 3040 Federal Building, 915 Second Ave., Seattle, Washington 98174.

Region 9. Pennsylvania, Maryland, Virginia, West Virginia, Delaware, District of Columbia.—Paul F. Leonard, Room 300, Ballston Center Tower No. 3, 4015 Wilson Boulevard, Arlington, Virginia 22203.

BRANCH OFFICES

Cleveland, Ohio 44113.—1020 Standard Bldg., 1370 Ontario St.

Detroit, Michigan 48226.—1044 Federal Bldg.
Houston, Texas 77002.—Room 5615, Federal Office & Courts Bldg., 515 Rusk Ave.
Miami, Florida 33131.—Suite 1114 DuPont Plaza Center, 300 Biscayne Boulevard Way.
Philadelphia, Pennsylvania 19106.—Federal Bldg., Room 2204, 600 Arch St.
St. Louis, Missouri 63101.—Room 1452, 210 North Twelfth St.
Salt Lake City, Utah 84111.—3rd Floor, Federal Reserve Bank Bldg., 120 South State St.
San Francisco, California 94102.—450 Golden Gate Ave., Box 36042.

COMMISSIONERS

HAROLD M. WILLIAMS, *Chairman*

Chairman Williams was born on January 5, 1928, in Philadelphia, Pennsylvania. He received his B.A. from UCLA in 1946, graduating Phi Beta Kappa at the age of 18. Three years later he was awarded his J.D. degree from Harvard University Law School. He joined a Los Angeles law firm in 1949 where he specialized in tax and corporation law and remained until 1955 except for an interruption to serve as a U.S. Army legal officer during the Korean emergency. He joined Hunt Foods and Industries, Inc., in 1955 as Associate Tax Counsel. He subsequently became Tax Counsel, Vice President-Finance and Executive Vice President. In 1964, he became President of Hunt-Wesson Foods, Inc. In 1968, he was elected President of Hunt Foods and Industries, Inc., and with the formation of Norton Simon, Inc., later that year—resulting from consolidation of Canada Dry Corporation, Hunt Foods and Industries, Inc., and McCall Corporation—he was named Chairman of the new company's Finance Committee. In 1969, he assumed the additional post of Chairman of the Board of Norton Simon, Inc. In July of 1970, Mr. Williams became the Dean and Professor of Management of the UCLA Graduate School of Management. During his administration, the School achieved national ranking, including recognition as the leading graduate business school in a public university. During the 1973 energy crisis, Mr. Williams took leave to serve as full-time Energy Coordinator for the City of Los Angeles. While at UCLA, Mr. Williams also served as Director of Norton Simon, Inc., Phillips Petroleum Company, ARA Services, Inc., CNA Financial Corporation, Signal Companies, Inc., and Montgomery Street Income Securities, and as a Trustee of the Aerospace Corporation. In his service to the community, Mr. Williams acted as Co-Chairman for the Public Commission on Los Angeles County Government, a subcommittee chairman of the Mayor's *ad hoc* Committee on Los Angeles City Revenues, a member of the State of Cali-

fornia Commission for Economic Development and of the California Citizens Commission on Tort Reform, and a member of the SEC Advisory Committee on Corporate Disclosure.

PHILIP A. LOOMIS, JR.

Commissioner Lommis was born in Colorado Springs Colorado, on June 11, 1915. He received an A.B. degree, with highest honors, from Princeton University in 1938 and an LL.B. degree, cum laude, from Yale Law School in 1941, where he was a Law Journal editor. Prior to joining the staff of the Securities and Exchange Commission, Commissioner Loomis practiced law with the firm of O'Melveny and Myers in Los Angeles, California. Commissioner Loomis joined the Commission's staff as a consultant in 1954, and the following year he was appointed Associate Director and then Director of the Division of Trading and Exchanges. In 1963, Commissioner Loomis was appointed General Counsel to the Commission and served in that capacity until his appointment as a member of the Commission. Commissioner Loomis is a member of the American Bar Association and the American Law Institute. He received the Career Service Award of the National Civil Service League in 1964, the Securities and Exchange Commission Distinguished Service Award in 1966, and the Justice Tom C. Clark Award of the Federal Bar Association in 1971. He took office as a member of the Securities and Exchange Commission August 13, 1971, and is now serving for the term of office expiring June 5, 1979.

JOHN R. EVANS

Commissioner Evans was born in Bisbee, Arizona, on June 1, 1932. He received his B.S. degree in Economics in 1957, and his M.S. degree in Economics in 1959 from the University of Utah. He was a Research Assistant and later a Research Analyst at the Bureau of Economics and Business Research at the University of Utah, where he was also an instructor of Economics during 1962 and 1963. He came to Washington in February 1963, as Economics Assistant to Senator Wallace F. Bennett of Utah. From July 1964 through June 1971 Commissioner Evans was minority staff director of the U.S. Senate Committee on Banking, Housing and Urban Affairs and served as a member of the professional staff from June 1971 to March 1973. He took office as a member of the Securities and Exchange Commission on March 3, 1973, and is now serving for the term expiring June 5, 1978.

IRVING M. POLLACK

Commissioner Pollack was born in Brooklyn, New York, on April 8, 1918. He received a B.A. degree, cum laude, from Brooklyn College in 1938 and an LL.B. degree, magna cum laude, from Brooklyn Law School in 1942. Prior to joining the

Commission's staff he engaged in the practice of law in New York City after serving nearly four years in the United States Army, where he gained the rank of Captain. Mr. Pollack joined the staff of the Commission's General Counsel in October 1946. He was promoted from time to time to progressively more responsible positions in that office and in 1956 became an Assistant General Counsel. A career employee, Mr. Pollack became Director of the Division of Enforcement in August 1972 when the SEC's divisions were reorganized. He had been Director of the Division of Trading and Markets since August 1965, and previously served as Associate Director since October 1961. In 1967 Mr. Pollack was awarded the SEC Distinguished Service Award for Outstanding Career Service, and in 1968 he was a co-recipient of the Rockefeller Public Service Award in the field of law, legislation and regulation. Mr. Pollack took the oath of office on February 13, 1974 as a member of the Securities and Exchange Commission, and is now serving for the term expiring June 5, 1980.

ROBERTA S. KARMEL

Commissioner Karmel was born May 4, 1937, in Chicago, Illinois. She received a B.A. from Radcliffe College in 1959 and an LL.B. from New York University School of Law in 1962. From 1962 to 1969, Mrs. Karmel worked in the New York Regional Office of the Securities and Exchange Commission as an attorney, then attorney branch chief, then assistant regional administrator. From 1969 to 1972 she was an associate with Willkie, Farr & Gallagher in New York. Mrs. Karmel was a partner in Rogers & Wells from 1972 through September 1977, and an adjunct professor at Brooklyn Law School from 1973 through 1977. She has been a member of the American Bar Association Federal Regulation of Securities Committee since 1973. She has also served on the Association of the Bar of the City of New York Committee on Securities Regulation, Committee on Administrative Law, and Committee on Professional Responsibility. She is the author of numerous articles in legal journals. Mrs. Karmel took the oath of office as a member of the Securities and Exchange Commission on September 30, 1977, for a term expiring on June 5, 1981.

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Part 1
Important Developments

Part 1 Important Developments

MARKET REGULATION

During fiscal year 1977 and the Transition Quarter,[1] the Commission undertook several actions of far-reaching importance to the securities industry, the securities markets and the investing public. These Commission actions reflected primarily efforts to implement the Securities Acts Amendments of 1975 (1975 Amendments),[2] which significantly revised and expanded the Securities Exchange Act of 1934 (Exchange Act).

A major element of the 1975 Amendments was the Congressional direction to the Commission to facilitate the establishment of a national market system for securities. The creation of a national market system is a complex task which involves the efforts of the Commission, the self-regulatory organizations and the members of the securities industry. During the fiscal period, significant steps were taken in certain areas toward the implementation of a national market system. The Commission reviewed, and announced a proceeding to consider amending existing exchange rules which continue to limit or condition the ability of members to effect transactions in securities otherwise than on an exchange. The Commission also continued to consider proposals for implementation of certain contemplated components of the national market system in addition to the existing consolidated transaction reporting system, including a composite quotation system and limit order protection and market linkage systems.

Off-Board Trading Rules

Section 11A(c)(4) of the Exchange Act, as amended by the 1975 Amendments, directs the Commission to review rules (off-board trading rules) of all exchanges "which limit or condition the ability of members to effect transactions in securities otherwise than on such exchanges." That Section further directs the Commission to report the results of its review to the Congress and to commence a proceeding, pursuant to Section 19(c) of the Exchange Act, "to amend any such rule imposing a burden on competition which does not appear to the Commission to be necessary or appropriate in furtherance of the purposes of [the Exchange Act]." On September 2, 1975, the Commission reported the results of its initial review pursuant to Section 11A(c)(4) to the Congress.[3] In that report, the Commission stated that certain off-board trading rules impose burdens on competition which the Commission was not prepared to conclude were necessary or appropriate in furtherance of the purpose of the Ex-

change Act. Accordingly, the Commission simultaneously issued a release (September 1975 Release) instituting a proceeding, pursuant to Section 19 (c), to determine whether to modify or eliminate those off-board trading rules.[4]

The September 1975 Release proposed, and solicited comment on, three alternative forms of a Commission rule amending (to various degrees) exchange rules imposing off-board trading restrictions on members and announced that the proceeding would seek to determine: (a) the extent to which existing off-board trading rules engendered significant anti-competitive effects; (b) whether, if such rules were anti-competitive, there were countervailing considerations which outweighed the need to eliminate or revise such rules at that time; and (c) whether such rules could appropriately be modified so as to further the purposes of the Exchange Act.[5]

The Commission held eight days of public hearings concerning its proposals to amend off-board trading rules during October 1975 and received numerous written submissions concerning these proposals and related issues from representatives of the securities industry, government agencies and the public. On December 19, 1975, the Commission issued a release (December 1975 Release) announcing the adoption, effective March 31, 1976, of Exchange Act Rule 19c–1.[6] Rule 19c-1 reflected the Commission's determination that certain aspects of then existing off-board trading rules imposed burdens on competition which could not be justified in terms of the regulatory objectives of the Exchange Act.

Rule 19c–1 amended exchange off-board trading rules in order to eliminate prohibitions that prevented exchange members from effecting over-the-counter agency transactions in listed equity securities with third market makers and non-member block positioners.[7] The Commission determined that other off-board trading restrictions, which precluded members from executing over-the-counter transactions in listed securities as principal, or as agent, in "in-house" agency crosses or otherwise, had anti-competitive effects. Although the Commission believed those effects to be significant, particularly in the case of off-board principal restrictions, the Commission determined to allow exchange rules imposing those restrictions to remain in effect pending further review.[8] While the Commission found that off-board principal restrictions deprive the markets of the benefits which could be derived from improved market maker competition, the Commission concluded in the December 1975 Release that there was a need, before amending or abrogating those restrictions, for further study concerning the timing of the elimination of those restrictions and concerning the implementation of additional regulatory and technological changes to ensure that market maker competition would develop in a fair and orderly manner.[9] The Commission stated, however, that it would reconsider this decision in 1977 after it had had the benefit of the conclusions and advice of the National Market Advisory Board(NMAB) and had evaluated the progress by that date toward a national market system. The Commission further stated that if, at that time, it still appeared appropriate, the Commission would establish a firm date for removal of off-board trading restrictions.[10]

As to remaining off-board agency restrictions, the December 1975 Release recognized that it remained for

the Commission to determine whether those restrictions are anti-competitive in significant ways and what, if any, action should be taken with respect to them.[11] The Commission stated, however, that it would devote further study to the restrictions and solicited comment on them from the NMAB.

In September 1976, the NMAB supplied its views to the Commission with respect to remaining off-board agency restrictions applicable to "in-house" agency crosses.[12] A majority of the NMAB's members concluded that existing restrictions on such transactions either do not impose a significant burden on competition, or, to the extent that they do, that burden is outweighed by countervailing policy considerations.[13] Four members of the NMAB concluded that those restrictions are anti-competitive and that the alleged adverse consequences from their removal are speculative and have been exaggerated.[14]

In February 1977, the NMAB expressed its tentative conclusions with respect to off-board trading restrictions.[15] In its letter, the NMAB noted that the Commission had found that off-board trading restrictions are basically anti-competitive and concluded that the purposes of the Exchange Act do not justify the maintenance of such restrictions generally and indefinitely by the exchanges.[16] The NMAB also indicated that it favored removing such restrictions gradually and with caution.

In May 1977, the NMAB delivered to the Commission a full statement of its recommendations with respect to off-board trading restrictions, including an extensive discussion of various issues associated with their removal.[17] The NMAB affirmed its tentative conclusion that the purposes of the Exchange Act do not justify maintenance of off-board trading restrictions generally and indefinitely. The NMAB also expressed its belief, however, that removal of those restrictions might have a profound effect on the manner in which listed securities are traded and, therefore, that such restrictions should be removed only after certain additional facilities and rules are in place.[18] The NMAB noted that there were divergent views among the NMAB's members as to whether and when particular restrictions should be removed, and as to which facilities and rules must be in place before such removal.[19]

In particular, the NMAB identified the following as appropriate collateral steps in conjunction with the possible removal of off-board trading restrictions: (a) implementation of a composite quotation system; (b) consideration of the need to adopt rules and develop facilities to enhance limit order protection to the maximum practical extent; (c) examination of the need to adopt rules to protect retail customers in their transactions with dealers; (d) revision of Commission and self-regulatory rules to achieve "equal regulation" of exchange specialists and off-board market makers; (e) review of brokers' "best execution" responsibilities; and (f) reconsideration of the current practice of reporting last sale prices in the consolidated transaction reporting system without giving effect to commissions, comission equivalents or differentials.[20]

In June 1977, after considering the views of the NMAB and progress toward a national market system since adoption of Rule 19c–1, the Commission issued a release (June 1977 Release) announcing the commencement of a proceeding, pursuant to Section 19(c), to consider (1) rulemaking to amend existing exchange off-board trading rules and (2) in the

event off-board trading rules are amended, rulemaking to govern over-the-counter transactions in listed securities between dealers and certain categories of persons.[21] In the June 1977 Release, the Commission reaffirmed its belief that exchange off-board trading restrictions impose burdens on competition and requested persons believing that such restrictions should be retained to present views, data and arguments for the Commission's consideration.

In the June 1977 Release, the Commission published for comment proposed amendments to Exchange Act Rule 19c−1 and proposed Rule 19c−2. The proposed amendments to Rule 19c−1 would revise the existing rule to permit an exchange member to effect over-the-counter agency transactions in listed equity securities with any other person not also represented as agent by that member (*i.e.*, precluding only "in-house" agency cross transactions). Proposed Rule 19c−2 would, after December 31, 1977, permit an exchange member to effect over-the-counter principal and "in-house" agency cross transactions in listed equity securities reported in the consolidated transaction reporting system ("reported securities").

To govern over-the-counter transactions in reported securities between dealers and certain categories of persons in the event existing off-board trading rules are amended, the Commission proposed alternative Exchange Act Rules 15c5−1[A], [B], [C] and [D]. These rules are designed to prevent exchange members from dealing unfairly with customers with respect to reported securities after the removal of off-board principal restrictions.

(a) Rule 15c5−1[A] would preclude any dealer from effecting over-the-counter transactions in reported securities as principal with any person other than a broker, dealer, or financial institution.

(b) Rule 15c5−1[B] would permit any dealer effecting over-the-counter transactions in reported securities with any person other than a broker, dealer, or financial institution to do so only at a price at least as favorable to such person as the highest bid (in event the dealer is buying) or lowest offer (in the event the dealer is selling), in a size equal to or greater than the transaction size reflected in a display of quotation information disseminated pursuant to proposed Exchange Act Rule 11Ac1−1.

(c) Rule 15c5−1[C] would require confirmation disclosure of the highest bid and lowest offer made available to quotation vendors in accordance with proposed Rule 11Ac1−1 and displayed on a terminal or other display device at the time of any over-the-counter principal transaction in a reported security with any person other than a broker, dealer, or financial institution.

(d) Rule 15c5−1[D] would require dealers effecting over-the-counter transactions in reported securities with any person other than a broker, dealer, or financial institution to do so at prices no less favorable to such persons than they know (or reasonably should believe), under all the relevant circumstances, could be obtained for such persons if they were to act for them in an agency capacity.

The Commission held nine days of public hearings in August 1977 (August 1977 Hearings) on its proposed rulemaking and received numerous written submissions concerning these proposals and related issues from representatives of the securities industry, government agencies, members of the Congress and the public. Persons appearing at the August 1977 Hearings, and other commentators on

the June 1977 Release, strongly urged the Commission to take a more affirmative role in facilitating establishment of a national market system. Many commentators also expressed concern over removal of off-board trading rules prior to implementation of appropriate market linkage facilities. At the end of the fiscal period, the Commission was engaged in studying the issues related to off-board trading rules and market linkage facilities and in evaluating the responses to the rule proposals announced in the June 1977 Release.

Composite Quotation System

In both its 1972 *Future Structure Statement*[22] and 1973 *Policy Statement*,[23] the Commission indicated its support for a composite quotation system (CQS) which would make quotations from all market makers universally available and its belief that a CQS would facilitate the development of a national market system. The Commission initiated the development of a CQS by proposing in 1972,[24] and reproposing in 1974,[25] Exchange Act Rule 17a–14. As reproposed, that rule would have required that quotations be "reported" by self-regulatory organizations (and certain broker-dealers) pursuant to a plan (similar to that required by Exchange Act Rule 17a–15 for the consolidated transaction reporting system), that would be filed with and declared effective by the Commission and would provide for the availability of such quotations to vendors of market information on a real-time, current and continuing basis.

Following reconsideration of proposed Rule 17a–14, the Commission determined to adopt a different approach to enhancing the availability of quotation information and announced that it had requested that all exchanges eliminate by May 11, 1975, any of their rules or practices which restricted access to or use of quotation information disseminated to quotation vendors.[26] In announcing that all exchanges had complied with its request, the Commission stated that such compliance would facilitate the development of a national market system.[27]

During 1976, however, it became increasingly apparent that the lack of reliable quotation information from the various markets was impeding private and self-regulatory organization efforts to establish a CQS, the absence of which, in turn, was perceived as impeding the development of a national market system. On July 29, 1976, the Commission proposed for comment Rule 11Ac1–1 under the Exchange Act (July 1976 Proposal), which would have required exchanges to collect from their specialists, and the National Association of Securities Dealers, Inc. (NASD) to collect from third market makers, quotations (with size if indicated) to be disseminated by those self-regulatory organizations to quotation vendors.[28] Although the proposed rule neither specified the manner in which, nor the frequency with which, the quotations were to be collected, processed, and made available, it would have required specialists and third market makers to communicate their quotations promptly in accordance with procedures established by the particular exchange or the NASD for timely dissemination to quotation vendors.

The proposed rule would have required, subject to certain exceptions, that covered quotations be "firm." In particular, any specialist or third market maker who was presented with an order for the purchase or sale of any eligible security (other than an odd-lot order) would have been required to stand ready to execute a transaction in that security in any amount

up to his published quotation size (or, in the event no quotation size was disseminated, a normal unit of trading) at a price at least as favorable to the buyer or seller as his most recently published bid or offer. That requirement would not have applied if, after dissemination of his published quotation but before the specialist or third market maker received an order, (1) a transaction in that security was effected either on the floor of the particular exchange or by the third market maker, or was reported in the consolidated transaction reporting system, or (2) the specialist or third market maker had communicated a superseding quotation. If, however, the specialist or third market maker had not communicated his superseding quotation within three minutes after a transaction or a report of a transaction, he would have been obligated to buy or sell that security in accordance with the general rule as to firmness.

On June 14, 1977, the Commission issued a release publishing a revised version of proposed Rule 11Ac1–1.[29] Under the revised proposal, the basic regulatory approach of the July 1976 Proposal would be retained. As reproposed, Rule 11Ac1–1 would require that the exchanges and the NASD establish and maintain procedures for collecting, processing and making available to quotation vendors quotation information relating to reported securities. Similarly, the proposed rule would continue to require that brokers and dealers subject to its provisions supply quotations to their exchanges or the NASD for dissemination to quotation vendors (although dissemination of size greater than a normal unit of trading would continue to be optional). Finally, the proposed rule would retain the requirement that quotations made available to and displayed by quotation vendors be firm up to the size displayed, subject to the same exceptions contained in the July 1976 Proposal (*i.e.*, for revised quotations, intervening transactions and trade reports) and a new exception intended to accommodate unusual market conditions.

The principal change in reproposed Rule 11Ac1–1 from the July 1976 Proposal relates to the manner of collecting quotation information from exchanges. Under the revised proposal, an exchange would be responsible for making available a single quotation for each reported security (with size if indicated) reflecting the highest bid and lowest offer communicated at the location (or locations) designated for trading of that security on the exchange floor. That quotation would not necessarily be the quotation of a specialist, but would reflect the buying and selling interest of all brokers and dealers (responsible brokers and dealers) expressing their interest as bids or offers. If, for example, the single quotation made available by an exchange reflected the bid of a specialist acting as agent for an order on his book and the offer of a broker in the crowd, the responsibility for that quotation (in terms of the firmness requirements of the Rule) would be shared — the specialist would be responsible for execution of orders to sell at his bid and the broker in the crowd would be responsible for orders to purchase at his offer. The revised rule would not make any significant change in the requirements for collection of quotations of third market makers, who would be deemed to be "responsible brokers or dealers" with respect to their bids or offers for reported securities. Third market makers would be responsible for their quotations in a manner similar to responsible brokers or dealers who were exchange members.

At the end of the fiscal period, the

Commission was analyzing comments received regarding the revised proposal, as well as examining the national market system issues associated with the development of a CQS.

Composite Limit Order Book

In the December 1975 Release announcing the adoption of Rule 19c–1, governing off-board trading by exchange members, the Commission indicated that it was considering steps to provide comprehensive limit order protection consistent with the public interest. The Commission expressed its belief that public limit orders and the methods by which they are kept play an important role in the securities markets. The Commission found, however, that existing exchange mechanisms for the storage of limited price orders are intrinsically unable to provide full protection for those orders and that regulatory devices employed to ensure execution of limit orders create certain adverse effects which outweigh their laudable objectives. The Commission indicated that the solution to these problems appeared to lie in the utilization of existing advanced technology to construct a computerized central limit order repository (composite book) designed to provide comprehensive limit order protection to investors.

In March 1976, the Commission and the NMAB jointly solicited public comment on these issues, including the policy and technical questions associated with certain specified characteristics of any composite book, and on possible alternative facilities to a composite book.[30] Extensive written comments were received from numerous individuals, firms and self-regulatory organizations. In addition, the NMAB, following extensive deliberations on issues associated with the development of (and alternatives to) a composite book, provided comprehensive written comments on these issues to the Commission in January 1977.[31]

At the time of its initial proposal, a composite book was perceived primarily as a means of protecting public limit orders in a market environment characterized by off-board trading by exchange members. Since that time, however, the composite book has come to be viewed as capable of performing a comprehensive order integration function, thereby addressing certain market fragmentation concerns associated with removing the remaining off-board trading rules.[32] Such a market linkage facility also would, in the view of some commentators, enhance market making competition. Other commentators believed that a composite book with certain characteristics would lead to the eventual demise of exchanges, thereby eliminating rather than enhancing competition among exchanges and between exchanges and markets other than exchanges. As the fiscal period ended, the Commission was actively considering the issues associated with implementation of a composite book, particularly in the context of its consideration of the removal of off-board trading rules.

Consolidated Transaction Reporting System

The Commission assisted in the implementation of the consolidated transaction reporting system (consolidated system), which became fully operational in 1976. As previously reported,[33] the consolidated system developed as a result of the Commission's adoption in 1972 of Exchange Act Rule 17a–15. The consolidated system disseminates, over its Network A, last sale reports of transactions executed in all reporting markets for securities listed on the New York Stock Exchange (NYSE) and, over its Network B, reports or trans-

actions in all reporting markets for securities listed on the American Stock Exchange (Amex) and selected regional listings. Last sale reports in both Network A and Network B securities are disseminated by means of a high speed data transmission line which enables investors and market professionals to have such information available on a real-time basis regardless of any delays in the low speed ticker network during periods of heavy trading. During the fiscal period, the consolidated system operated smoothly, substantially free of reporting disruption due to system failure.

During the period since the enactment of the 1975 Amendments, the Commission staff has met frequently with securities information processors who disseminate consolidated last sale information and with the Consolidated Tape Association (CTA), an association of self-regulatory organizations which oversees the operation of the consolidated system and is registered under Section 11A(b) of the Exchange Act as a securities information processor. Other developments include:

(a) The Commission's granting of conditional exemptions to certain foreign securities information processors from the display requirements of Rule 17a-15.[34]

(b) The Commission staff's continuing study of whether the existing prohibition on retransmission by securities information processors of consolidated last sale information on a continuous basis should be modified or eliminated in light of the standards now contained in Section 11A of the Exchange Act.

(c) The Commission staff's consideration of the related issues of whether market identifiers should be displayed on the low speed ticker network and whether vendors should be required to display consolidated last sale information, rather than last sale information from any single market center, on interrogation devices by means of the easiest access routine.

(d) The Commission staff's consideration of the continued appropriateness of exemptions from the general reporting requirements applicable to transactions in eligible securities.

(e) The CTA's study of the occasional problem of late reporting on the low speed ticker network during periods of unusually active trading.

(f) The CTA's study of new procedures to govern reporting by the consolidated system during regulatory trading halts in certain market centers.

Market Linkage Systems

During the August 1977 Hearings, various commentators urged that off-board trading rules not be removed without the establishment of an appropriate electronic linkage among existing market centers. In addition to evaluating the need for development of a composite book,[35] certain commentators suggested that the Commission carefully consider existing industry proposals to develop an intermarket execution system (IME) or an automated regional market system (RMS). During the fiscal period, the Commission also received a request from the Midwest Stock Exchange (MSE) for access to the Common Message Switch (CMS), which forms part of a communications system linking the Amex and the NYSE to their member firms.[36] In addition, the Commission has monitored the expansion of exchange automated order routing and formula pricing services.

The IME proposal, first announced by the National Market Association and subsequently endorsed by the NYSE,[37] involves a communications linkage which would permit orders to be sent from one market center to

another. A broker in one market center seeing a favorable quotation displayed in the CQS would be able to use the IME to send an order to the market center displaying the favorable quotation. Each market center would process orders received through the IME in the same manner as other orders originating outside of the market center. The IME would also accommodate the exchange of information among market centers before the opening. At the August 1977 Hearings, the NYSE and Pacific Stock Exchange (PSE) announced an agreement in principle to develop an IME, participation in which would be open to all market centers.

In addition to the IME proposal, certain regional exchanges advised the Commission during the August 1977 Hearings of their informal agreement to develop the RMS, which would use, with certain modifications, the WHAM automated trading system operating on the Cincinnati Stock Exchange.[38] The RMS would permit, but not require, limit orders for selected securities to be entered into the system from any participating exchange and would permit automatic execution of such limit orders through the system. At the close of the fiscal period, the pilot phase of RMS operation was commencing.

In March 1977, as more fully discussed below,[39] the MSE applied to the Commission under Section 11A(b)(5) of the Exchange Act for review of an alleged denial of access to the CMS by Securities Information Automation Corporation (SIAC), which operates the CMS for the Amex and the NYSE.[40] The CMS is a computer facility which provides an interface between the order routing systems of various brokerage firms and the trading and data processing facilities of the Amex and the NYSE. In May 1977, the Commission's staff by letter requested that the NMAB comment on the CMS access request by the MSE.[41] On October 4, 1977, the Commission by letter requested that the MSE, the Amex, the NYSE and SIAC respond to specified policy and jurisdictional issues posed by the MSE application.[42]

National Market Advisory Board

The 1975 Amendments directed the Commission to establish the NMAB, to be comprised of fifteen members, a majority of whom must be associated with brokers and dealers. The initial membership of the NMAB was announced by the Commission in August 1975, and the NMAB has conducted monthly public meetings since September 1975. The initial terms of the NMAB members would have expired on September 30, 1977, but the Commission extended those terms until December 31, 1977.

The 1975 Amendments directed the NMAB to furnish to the Commission its views on significant regulatory proposals made by the Commission or any self-regulatory organization concerning the establishment, operation and regulation of the securities markets. The NMAB was also directed to recommend to the Commission the steps it finds appropriate to facilitate the establishment of a national market system and to study the possible need for modifying the Exchange Act's scheme of self-regulation so as to adapt it to a national market system, including the possible need to establish a new self-regulatory organization to administer the national market system. The NMAB was directed to report, and did report, the results of its study on self-regulation to the Congress by December 31, 1976.[43]

In December 1975, in adopting Rule 19c–1 governing off-board trading by members of national securities exchanges, the Commission requested

the NMAB to study three specific problems: (1) in-house agency cross transactions, (2) off-board principal trading restrictions, and (3) the development of a composite book. The NMAB furnished its views to the Commission on in-house agency crosses in September 1976, on the development of a composite book in January 1977, and on off-board trading restrictions in February and May 1977.[44] At the end of the fiscal period, the NMAB was engaged in developing final views on various issues related to the development of a national market system.

Short Sale Regulation

On December 21, 1976, the Commission announced that it had ordered a public investigatory and rulemaking proceeding to determine whether regulation of short sales of the type currently provided by the Commission's primary short sale rule, Exchange Act Rule 10a–1, was needed in the current regulatory environment.[45] In connection with that proceeding, the Commission published for comment three versions of proposed temporary Exchange Act Rule 10a–3(T) and proposed Exchange Act Rule 10b–11. The alternative versions of proposed Rule 10a–3(T) would partially suspend, in varying degrees, the operation of the "tick" test provisions of Rule 10a–1, while proposed Rule 10b–11 would establish explicit borrowing requirements in connection with short sales. The Commission at the same time published for comment a revised version of proposed Exchange Act Rule 10b–21 (together with amendments to Rule 17a–3),[46] restricting short sales of securities before and during underwritten public offerings of securities for cash and establishing certain additional recordkeeping requirements with respect to short sales. Proposed Rule 10b–21 is designed to prevent manipulative short selling practices in connection with underwritten public offerings of securities of the same class as outstanding securities. The Commission was at the close of the fiscal period, reviewing comments on its various short sale proposals and considering whether any alteration of the present regulatory scheme is appropriate.

Regulation of the Options Markets

At the beginning of fiscal year 1977, four national securities exchanges listed standardized call options for trading under pilot programs approved by the Commission in prior years.[47] The Chicago Board Options Exchange, (CBOE), had initiated the listing of standardized options for trading in April 1973; the Amex and the Philadelphia Stock Exchange (Phlx), began listing options in January and June 1975, respectively; and the PSE began such listing in March 1976. During the fiscal year, all four exchanges expanded their options programs to accommodate an enlarged trading volume indicative of increasing public interest in this investment vehicle. In addition, the MSE began listing options in December 1976, and the Commission received formal rule change proposals from the NASD and the NYSE to initiate pilot programs for the trading of standardized options through their facilities by their members.[48]

In 1977, the Commission for the first time allowed each of the five national securities exchanges which list standardized call options under pilot programs (the Options Exchanges) to initiate carefully controlled and strictly limited pilot programs for the listing of standardized put options[49] on those exchanges.[50] The put option proposals provided that put options would be traded in the same manner, and subjected to the same types of regulation and exchange surveillance, as call options. To permit careful monitoring of the pilot

programs, however, put option trading on each exchange was limited to five option classes.[51] Although each of the Options Exchanges listed the maximum number of five put option classes, no exchange listed any put option classes on underlying securities whose options were already listed on another exchange.

At the close of the fiscal year, the CBOE had 1,309 members trading listed options on 95 underlying securities. Its average daily trading volume reached 92,305 contracts (compared to 89,000 in the previous fiscal year).[52] On the Amex, 512 members had options trading privileges and listed options on 64 underlying stocks, with average daily trading volume increasing to 39,332 contracts from approximately 35,000 contracts in fiscal year 1976.[53] The Phlx had 231 members authorized to trade in options on 37 underlying securities. Its average daily trading volume was 7,977 contracts (compared to 2,600 in the preceding fiscal year).[54] In its first year of operation, the PSE had 460 members qualified for options trading and its average daily trading volume was 5,685 contracts on 33 underlying securities.

On December 8, 1976, the Commission approved a proposal by the MSE to implement a pilot program for the listing and trading of standardized option contracts.[55] Trading on the MSE options floor commenced on December 10, 1976, and, through the end of fiscal year 1977, 304 members traded an average daily volume of 1,850 contracts on 17 underlying securities.

During the fiscal year, the Commission approved proposals by the Options Exchanges to revise the minimum qualification standards relating to the underlying securities for listed options in light of experience with the listed options markets. The listing standards contained in the MSE proposal to trade options[56] were substantively identical to the revised standards proposed by the other Options Exchanges.[57] These standards, which establish minimum requirements for the initial and continued qualification of a stock as an underlying security for listed options, include requirements relating to the issuer of the underlying security (regarding issuer deficits, net income, defaults on certain payments, and meeting of reporting requirements under the Federal securities laws) and to the quality of the market for the underlying security (regarding volume of trading, market price per share, number of publicly held shares and number of public shareholders).

The MSE's option contracts, like those of other Options Exchanges, are made fungible through standardization of such contract variables as the expiration date and striking price. The MSE and other Options Exchanges are participants in The Options Clearing Corporation, which issues, guarantees and files a registration statement (in compliance with the Securities Act of 1933) for all exchange-traded options, and which clears and settles all transactions in such options. The MSE reports transactions occurring on its options floor to the consolidated system for reporting last sale information on all listed options administered by the Options Price Reporting Authority. In an attempt to limit the number of transactions which do not result in completed contracts between the parties to a trade because of disagreement as to the terms of the execution, the MSE, like the PSE and the Phlx, has instituted procedures permitting direct floor comparison of order tickets by the buyer and seller for each option trade before the trade is given to the MSE for clearance and settlement.

Option trading on the MSE is conducted in a manner similar to trading on the CBOE and the PSE. Thus, on

the MSE the agent (broker) and principal (dealer) functions of the traditional unitary specialist are divided between two categories of individuals: (1) employees of the MSE called Order Book Officials (agents), corresponding to the CBOE's "Board Brokers," and (2) competing market makers (dealers).[58]

During the fiscal year, there was a significant increase in the number of call option classes listed and traded on more than one Options Exchange. (dually listed options).[59] Currently, a dually listed option class must have the same expiration dates and exercise prices on every exchange on which it is listed.[60] Because of the other features of standardization, this permits trading of such options on any exchange on which they are listed, and provides brokers with the opportunity to "shop markets" to obtain the best available price.

The dual listing of option classes has produced competition between the Options Exchanges for public order flow, and that competition may have resulted in greater liquidity and narrower market quotations in those classes. At the same time, however, dual listing of options has given rise to inappropriate trading behavior including trading activity by exchange members which is apparently designed solely to inflate artificially the volume of trading in a dually listed class.[61] Such trading was designed to attract to the exchange the order flow of brokers whose selection between competing options markets on behalf of their public customers is based largely (if not solely) on the relative aggregate options trading volume of each market. The Commission warned that such trading by exchange members may violate Sections 9 and 10 of the Exchange Act, and cautioned brokers against relying solely on aggregate volume in making selections among competing market centers.[62] The Commission also expressed its expectation that affected Options Exchanges would take appropriate steps to discipline members responsible for such trading and would institute improved surveillance procedures to prevent its recurrence.[63] In addition, the Commission inspected the Options Exchanges' surveillance programs[64] to determine their adequacy to monitor questionable trading practices, and held three conferences with surveillance personnel from the Options Exchanges to discuss surveillance related matters.[65]

The Options Moratorium

At the end of the fiscal year, there were pending before the Commission several proposed rule changes by the Options Exchanges, the NASD and the NYSE designed either to expand existing programs for the trading of options or initiate new programs (the Expansion Proposals). For example, each Options Exchange requested the Commission's authorization both to expand the maximum number of securities on which it could list call options[66] and to include on its list of eligible underlying securities those which are listed solely in the over-the-counter market.[67] In addition, the NASD and the NYSE formally proposed rule changes to initiate pilot programs for the trading of standardized options.

While the Commission had approved several previous proposals that expanded the trading of standardized options, circumstances indicating the occurrence of abusive practices in the trading of standardized options, and the apparent inability of the existing self-regulatory programs to address the incidence of such abuses, caused the Commission to become increasingly concerned that existing self-regulatory programs might be strained unacceptably if the Commission approved the

Expansion Proposals.[68] Accordingly, on July 18, 1977, the Commission requested that the Options Exchanges refrain from expanding their options programs through the addition of new classes of options not already listed for trading, and announced that it had determined to initiate an overall review of standardized trading since the commencement of the first pilot program for such trading in 1973 on the CBOE.[69] The Commission also stated that it did not expect to approve any of the Expansion Proposals until it had completed the review.

In announcing its review, the Commission set forth several areas that it would consider, including: (1) the implications and effects of option trading, (2) whether self-regulatory and Commission oversight programs with respect to those matters have kept pace adequately with the dramatic expansion of standardized options trading, and (3) whether those programs are adequate for the prevention of fraudulent and manipulative acts and practices, for the maintenance of fair and orderly markets and for the protection of investors.[70]

After a brief and preliminary review of problems in the options markets, the Commission reaffirmed its decision to conduct a review of options trading by announcing the commencement of its investigation and study of the adequacy of options regulation.[71] The Commission also proposed Exchange Act Rule 9b−1(T), which would defer the expansion of existing options trading programs and the initiation of new programs until the study is completed.[72] At the same time, the Commission announced the commencement of consolidated disapproval proceedings with respect to the Expansion Proposals.[73] Although the Commission had not completed its investigation and study at the end of the fiscal period, it announced its intention to do so as expeditiously as possible, and stated that it expected to require, and would anticipate receiving, the cooperation of the affected self-regulatory organizations in achieving that goal.[74]

Unlisted Trading in OTC Securities

The 1975 Amendments added Section 12(f)(1)(C) to the Exchange Act, which permits exchanges, based upon standards set forth in new Section 12 (f)(2) of the Act to obtain unlisted trading privileges in securities traded solely over-the-counter (OTC). On March 25, 1977, the PSE submitted an application for unlisted trading privileges in the common stock of Pacific Resources, Inc. (PRI),[75] the first such application to be considered by the Commission pursuant to Section 12(f)(1) (C). On June 22, 1977, the Commission ordered a hearing by written submission on the PSE application.[76] Submissions were received from the PSE, PRI and the NASD.

The PSE argued in its submission that there had not been any problems arising from the dual market in PRI stock. It provided evidence that a grant of unlisted trading privileges to the PSE, which would allow a continuation of the then current environment, would not have any adverse effect on the existing market for PRI stock.[77] The PSE suggested a denial of the application could impair the marketability of PRI stock by eliminating competition between markets. Since it would allow a continuation of mixed exchange and OTC trading in PRI stock, the PSE further contended, a grant of unlisted trading privileges would be a step toward the development of a national market system. The PSE also asserted that, if the application were to be approved, transactions in PRI stock should not be exempted from the requirements of

Exchange Act Rule 17a-15 and the Consolidated Tape Plan with respect to last sale reporting.

The NASD and PRI contended, on the other hand, that the PSE had failed to meet the requirements of Section 12(f)(1)(C) of the Act or to demonstrate that substantial progress has been made toward a national market system. They also asserted that the PSE's denial of direct access to the PSE floor to non-member dealers constitutes an unjustified barrier to competition since it prevents a non-member dealer from obtaining best execution when an opportunity for such execution existed on the PSE. The lack of a composite quotation system, they further argued, is a further reason for the Commission to disapprove the application. The NASD argued that if the application were granted, the last sale reporting requirements should not apply to OTC transactions in PRI stock, because of (1) the burden such requirements would impose upon OTC dealers; (2) the differences in pricing policies between the exchange and OTC markets; and (3) the impact such requirements would have on market-making interest and the attendant depth and liquidity of the market in PRI stock.

At the end of fiscal year 1977, the PSE application and the submissions received during the hearing were under consideration by the Commission, while trading in PRI stock continued both over-the-counter and on the PSE.

Trading by Exchange Members

Section 11(a)(1) of the Exchange Act prohibits, with certain specified exceptions (such as market-making activities), any member of a national securities exchange from effecting any transaction on that exchange for its own account, the account of an associated person, or an account with respect to which it or any of its associated persons exercises investment discretion. Under Section 11(a), the Commission has broad authority, in keeping with the overall Congressional proposes, to fashion either more flexible or more restrictive standards in light of changing conditions. Section 11(a)(3) provides that the prohibitions in Section 11(a)(1) do not apply before May 1, 1978, to transactions effected on an exchange by those who were members of that exchange on May 1, 1975.

As the Commission reported in its last annual report,[78] the Commission published a release in January 1976 adopting a temporary rule to implement the statutory exemption for certain proprietory transactions by members (Exchange Act Rule 11a1-1(T), proposing a rule exempting certain transactions for members' associated persons (proposed Exchange Act Rule 11a1-2), and raising several broad policy questions.[79] On March 18, 1977, the Commission published a second release on Section 11(a)[80] which (1) discussed the background concerning institutional membership and the development of Section 11(a), (2) proposed three new rules under Section 11(a) and other provisions of the Exchange Act, and (3) summarized the comments received in response to its 1976 rule proposals and request for comments.

The rule proposals announced in March 1977 would affect a significant amount of trading currently effected on the exchanges. Proposed Exchange Act Rule 11a2-1 would prohibit all proprietary trading by exchange members (other than odd-lot dealers' transactions) unless, among other things, such transactions yielded priority on the basis of time of entry to non-members' orders. Proposed Exchange Act Rule 11a1-3 would, in effect, exempt agency transactions by

an exchange member for a managed institutional account if the member did not charge that account any separate fee based on transactions. The last proposal set forth in that release, Exchange Act Rule 11a2–2, would permit any member to effect transactions for an account that is subject to the general prohibition under Section 11(a)(1) so long as an unaffiliated member executed the transaction on the exchange floor and neither the member initiating the transaction nor any of its associated persons participated in the execution of the transaction after the order had been transmitted to the exchange floor. Each of the proposed rules published in March would have required that, before any transaction could be effected on an exchange under the terms of the rule proposals, that exchange would have to have filed and secured Commission approval of a plan for access to the exchange. Such a plan would address the availability of membership and access to member and exchange services as well as the scope of regulation over members' associated persons. At the end of the fiscal period, the Commission was analyzing the comments received in response to the March release and formulating a final determination on the rule proposals pending under that provision, as well as any legislative recommendations that might be appropriate.[81]

Enforcement Obligations of National Securities Exchanges and Associations

Section 19(g) of the Exchange Act requires each self-regulatory organization to comply with the Act, the rules and regulations thereunder and its own rules, and, absent reasonable justification or excuse, to enforce compliance therewith by its members and persons associated with its members. Section 19(g)(2) authorizes the Commission to adopt rules relieving any self-regulatory organization of its enforcement obligations with respect to specified provisions of the Exchange Act or the rules and regulations thereunder. Following the guidance provided by the Congress in the legislative history of the 1975 Amendments, the Commission published for comment on May 26, 1976,[82] proposed Exchange Act Rule 19g2–1. That rule set forth proposed standards for relieving national securities exchanges and associations[83] of certain enforcement responsibilities, primarily with respect to persons associated with members who are neither controlled by those members nor engaged in securities transactions subject to the self-regulatory organization's direct surveillance.

On November 18, 1976, the Commission adopted Rule 19g2–1.[84] As adopted, it establishes three classes of persons "associated with" a member and, depending upon the classification, relieves exchanges and associations from the obligation of taking specified kinds of enforcement action against them. For the most part, the rule does not relieve exchanges and associations of their enforcement obligations with regard to members and "securities persons," which are generally defined as general partners, officers (or persons occupying a similar status or performing similar functions) or employees of a member, or a registered broker-dealer which is associated with a member, if such persons effect transactions in securities through the member by use of facilities supervised or maintained by the exchange or association. Moreover, persons who control a member are similarly left within the scope of exchange or association enforcement obligations.[85]

Rule 19g2–1 does relieve exchanges

and associations of any enforcement obligations under Sections 12 (other than Sections 12(j) and 12(k)), 13, 14 (other than Sections 14(b)), 15(d) and 16 of the Exchange Act and the rules thereunder, except for actions normally taken with respect to any person who is not a member or associated with a member. Similarly, under the rule, exchanges and associations are relieved of qualification, examination, report filing, and routine inspection and examination requirements with respect to all associated persons except securities persons whose functions are not solely clerical or ministerial.

Allocation of Regulatory Responsibilities Among Self-Regulatory Organizations

Section 17(d)(1) of the Exchange Act authorizes the Commission to allocate the regulatory responsibilities of self-regulatory organizations with respect to members or participants of more than one self-regulatory organization (dual members). Allocation of regulatory responsibilities is intended to promote cooperation and coordination among self-regulatory organizations and to remove impediments to and foster the development of a national market system and a national system for the clearance and settlement of securities transactions.

On October 28, 1976, the Commission adopted Exchange Act Rule 17d-2,[86] which establishes a procedure to promote an allocation of regulatory responsibilities based upon an assessment by self-regulatory organizations of their own capabilities. The rule permits any two or more self-regulatory organizations to propose jointly to the Commission a plan for allocating specific duties for dual members. Plans declared effective by the Commission would relieve self-regulatory organizations of specific responsibilities designated to another party under the terms of the plan. If the proposed plans filed with the Commission do not establish a comprehensive program of regulation, the Commission, on its own motion after due consideration of the statutory criteria, may designate a self-regulatory organization to bear specific responsibilities with respect to dual members.

As of the close of the fiscal year, the self-regulatory organizations had filed 21 plans with the Commission pursuant to Rule 17d-2. Of the plans received by the Commission, 15 embody agreements between two exchanges with respect to dual members. In general, these plans expand the responsibilities currently assigned to the exchange which is the designated examining authority (DEA) under Rule 17d-1 and Section 9(c) of the Securities Investor Protection Act of 1970.[87] Under the plans the DEA generally would review financial reports, inquiries, complaints, and public communications and would conduct specified examinations, investigations and disciplinary actions with respect to dual members, except for those related to transactions in listed options and transactions on the floor of the exchange.

In addition, the Commission received proposed agreements executed by the NASD with four national securities exchanges—the BSE, the CSE, the MSE and the PSE. These plans would effect a transfer of regulatory responsibility, other than the regulation of floor and options activities, from the regional exchanges to the NASD. Further, the NASD's agreements with the PSE and the MSE would assign to the NASD the responsibility to enforce compliance with rules related to options transactions.

The five Options Exchanges have filed a single plan which would establish a mechanism for allocating the

enforcement responsibility relating to options transactions. Any exchange member qualified to conduct a non-member business on more than one Options Exchange would be assigned a "primary regulator." Where an Options Exchange has been designed as the DEA, that exchange would be the primary regulator; where an Options Exchange has not been designated as the DEA, the responsibilities of primary regulator would be assigned to Options Exchanges on an annual basis.

Under the plan, customer inquiries and complaints relating to more than one marketplace would be reviewed by the exchange initially receiving the complaint. Investigations, including those for terminations of registered personnel for cause, concerning more than one marketplace, would be conducted by the primary regulator unless that responsibility were assigned to another Options Exchange. The primary regulator also would conduct, at a minimum, an annual sales practice examination of each broker or dealer for which it was responsible.

At the close of the fiscal period, the Commission had not approved any of the proposals for allocation but was analyzing the provisions of the plans, considering recommendations for their amendment, reviewing comments received, and evaluating the manner in which the plans might be integrated into a comprehensive and effective program of regulation.

Regulation of Securities Information Processors,Access to Order-Routing Systems

In fiscal year 1976, the Commission commenced its regulatory program pursuant to Section 11A(b) of the Exchange Act with respect to the operations of exclusive securities information processors.[88] During fiscal year 1977, the Commission granted the registration of one additional exclusive securities information processor and exempted another such processor from registration. The additional registration was granted to NASDAQ, Inc. (which temporarily had been exempted from registration).[89] The additional exemption from registration was granted to Bradford National Clearing Corporation (Bradford).[90] Bradford had entered into a facilities management agreement with P.C. Service Corporation (PCSC), a wholly-owned subsidiary of the PSE, pursuant to which Bradford undertook to perform, among other functions, the securities information processing services then performed by PCSC on an exclusive basis for the PSE.[91]

As discussed above, in fiscal year 1977, the Commission received its first request under Section 11A(b)(5), which was added to the Exchange Act by the 1975 Amendments, to review a limitation of access to the services of a registered securities information processor.[92] In that request, the MSE applied to the Commission for review of an asserted denial of access by SIAC, a registered securities information processor jointly owned by the NYSE and the Amex, to the Common Message Switch (CMS).

The CMS is an automated data processing device which receives orders from NYSE and Amex members' offices, "translates" these orders into language acceptable to terminals on the floor of either exchange, routes the orders directly to specialists' post on the NYSE or Amex, and, finally, transmits execution reports back to originating brokers. In its request to SIAC, the MSE sought to link to the CMS to enable brokerage firm subscribers to designate orders for delivery to the MSE floor, as an alternative to sending their orders either to the NYSE or Amex floor.[93] In denying the MSE's request, SIAC stated that in its operation of the

CMS it was not acting as a "securities information processor" within the meaning of Section 11A(b)(5) of the Exchange Act and, in any event, lacked contractual and proprietary authority to provide the requested access to a system owned by the NYSE and the Amex.

In May 1977, the Commission's staff, by letter, requested that the NMAB comment on the CMS access request by the MSE.[94] In view of a number of threshold jurisdictional questions raised by the MSE application for Commission review, the Commission, on October 4, 1977, requested the MSE, SIAC, the NYSE and the Amex to submit their views on such questions. At the same time, the Commission noted that, under Section 11A(c)(1)(E) of the Exchange Act, it has plenary rulemaking authority to ensure that "exchange members, brokers and dealers direct orders ...in a manner consistent with the establishment and operation of" a national market system. Accordingly, the Commission also requested the parties to address certain questions to assist the Commission in ascertaining whether the linking of the MSE and other market centers to the CMS would help perfect the mechanism of a national market system. The Commission intends to complete its review of the issues associated with the alleged denial of access during the early part of fiscal year 1978.

Notices by Self-Regulatory Organizations of Disciplinary Sanctions and Other Actions

Before adoption of the 1975 Amendments, the Commission's authority under the Exchange Act regarding disciplinary sanctions imposed by a self-regulatory organization upon its members was limited to review by the Commission of disciplinary and certain other adjudicatory actions taken by a registered securities association, *i.e.*, the NASD. The Commission lacked comparable authority to review disciplinary actions taken by national securities exchanges. Nor did the Commission have authority, except as to the NASD, to review other penalties imposed by a self-regulatory organization, including summary suspensions or limitations of membership, participation or association with a member, denials of membership or of association with a member, or prohibitions or limitations of access to services.

The 1975 Amendments expanded the Commission's jurisdiction to review disciplinary sanctions and denials of membership, participation, or association imposed by a self-regulatory organization (including clearing agencies for which the Commission is the appropriate regulatory agency). Section 19(d) of the Exchange Act requires a self-regulatory organization taking any such action to file a notice with the Commission in such form as the Commission, by rule, may prescribe. Any action requiring the filing of notice may be reviewed either on the motion of the appropriate regulatory agency (the Commission, except with respect to bank participants in bank clearing agencies) or on the application of any person aggrieved by such action. On the other hand, appeals taken to the Commission do not automatically stay an action, as previously was the case in appeals to the Commission from an NASD action, although the Commission may grant stays where appropriate.

Finally, under the 1975 Amendments, persons subject to a "statutory disqualification" may be barred from membership or participation in a self-regulatory organization. While a statutory disqualification does not necessarily bar a person from membership or

participation in a self-regulatory organization, it permits the self-regulatory organization to deny or condition such a person's membership or participation or association with a member and the Exchange Act requires the self-regulatory organization to take such action if the Commission so orders. A self-regulatory organization proposing to admit to membership, participation, or association a person subject to a statutory disqualification must give notice to the Commission 30 days before admission.

On July 8, 1977, the Commission adopted several rules setting forth notice and application requirements for self-regulatory organizations imposing disciplinary sanctions.[95] Exchange Act Rule 19d-1 prescribes the form and content of notices that those self-regulatory organizations for which the Commission is the appropriate regulatory agency must file with the Commission in connection with certain actions ordered by the self-regulatory organization including all final disciplinary actions, all denials of membership, participation or association with a member, all prohibitions or limitations of access to services, and all summary suspensions or limitations of membership, participation, or association. Exchange Act Rule 19d-2 prescribes the form and content of applications to the Commission for stays of final disciplinary sanctions and summary actions of self-regulatory organizations. Exchange Act Rule 19d-3 prescribes the form and content of applications to the Commission for review of final disciplinary sanctions, denials of membership, participation or association with a member, and prohibitions or limitations of access to services imposed by self-regulatory organizations. Finally, Exchange Act Rule 19h-1 prescribes the form and content of notices by self-regulatory organizations of proposed admissions to or continuances in membership, participation or association of any person subject to a statutory disqualification and applications to the Commission for relief from a statutory disqualification.

Registration and Regulation of Clearing Agencies

Section 17A(b) of the Exchange Act, which became effective on December 1, 1975, requires a clearing agency[96] to register with the Commission if it perfórms any clearing agency functions for any security other than an exempted security. The Commission must publish notice of the filing of an application for registration so that interested persons may comment on it and, within specified periods, must either grant registration by order or institute proceedings to determine whether registration should be denied.

By December 1, 1975, 13 clearing agencies had applied for registration. The registrations were declared effective as of that date for a period of 18 months, after the Commission determined that the operations and rules of those clearing agencies provided adequate safeguards for funds and securities in their custody or control.[97] The approach to registration incorporated in Rule 17Ab2-1 was intended to permit clearing agencies in operation before December 1, 1975, to be registered on an interim basis upon a finding that their operations were safe. At the same time, that approach was designed to afford the Commission sufficient time to consider fully the issues involved, particularly those pertinent to the establishment of a national clearance and settlement system, before making all the determinations called for by subparagraphs (A) through (I) of Section 17A(b)(3).

On September 1, 1976, the Commission instituted proceedings to de-

termine whether to make permanent the interim registrations previously granted to the 13 clearing agencies.[98] On June 1, 1977, the Commission proposed for public comment standards for making the determinations required by the Exchange Act in connection with the registration of clearing agencies.[99] In general, the proposed standards pertain to: participation requirements; fair representation; capacity to enforce rules; disciplinary actions and fair procedures; safeguarding of securities and funds; obligations to participants; participant charges; equitable allocation of reasonable dues, fees and other charges; and competitive consideration. These standards are intended to facilitate the establishment of a national clearance and settlement system by ensuring that all clearing agencies registered under the Exchange Act have the capacity, organization and rules necessary to participate in, and to advance the objectives of, that system. In response to its request for public comments, the Commission received letters commenting upon the proposed standards for permanent registration and was reviewing those standards at the end of the fiscal period.

Since December 1, 1975, four additional entities have applied to the Commission for registration.[100] One of these is the New England Securities Depository Trust Company (NESDTC). On September 24, 1976, the Commission granted the application of NESDTC for registration as a clearing agency on the same basis as it granted registration to the 13 clearing agencies registered with the Commission on December 1, 1975.[101]

Another entity which filed an application for registration as a clearing agency was the National Securities Clearing Corporation (NSCC), an entity formed to combine the clearing operations conducted by three registered clearing agencies in New York: the Stock Clearing Corporation, the American Stock Exchange Clearing Corporation and the National Clearing Corporation. In order to determine whether to grant or deny NSCC's application, the Commission, during fiscal year 1976, sought and received comments on many of the issues basic to the establishment of a national clearing system and the role of NSCC in that system.

On June 16-18, 1976, the Commission held public hearings at which representatives of the NASD, stock exchanges, brokerage firms, clearing agencies and other interested persons presented their views and responded to questions of the Commision and its staff. In addition, numerous letters of comment and other materials were received in connection with the hearings.[102]

In November 1976, after reviewing comment letters and the transcripts of public hearings, the Commission announced that it was considering approving, subject to four proposed conditions, the application of NSCC for registration as a clearing agency and requested public comment on the proposed conditions.[103] On January 13, 1977, the Commission granted NSCC's registration subject to certain conditions.[104]

Bradford National Clearing Corporation and Bradford Securities Processing Services, Inc., have appealed to the United States Court of Appeals for the District of Columbia Circuit to reverse the order granting registration to NSCC. Those entities, the Commission and certain other parties have filed briefs in the case, which was pending before the Court at the end of the fiscal year.[105]

Fourteen applications for exemption from registration as a clearing agency

were pending at the end of the fiscal period.[106] Since these applications are the first under the new clearing agency regulatory program, they present novel policy questions which will be resolved after the completion of the clearing agency permanent registration proceedings.

Transfer Agent Rules

Section 17A(c) of the Exchange Act, adopted as part of the 1975 Amendments, requires a transfer agent to register with its appropriate regulatory agency if it acts as a transfer agent for any security registered under Section 12 of that Act or for any security which would be registered but for the exemptions from registration for securities of registered investment companies (Section 12(g) (2) (B)) and for securities issued by insurance companies (Section 12(g) (2) (G)).

At the beginning of the fiscal year, the Commission's staff was evaluating the comments received on a series of transfer agent rules that had been proposed for comment pursuant to Section 17A(c).[107] On the basis of the review, the Commission published revised rules for public comment on February 24, 1977.[108] After evaluating the comments received, Exchange Act Rules 17Ad–1 through –7 were adopted on June 16, 1977.[109]

These rules, the first substantive rules in the transfer agent regulatory program, provide a comprehensive structure for the transfer of securities from one record owner to another. Rule 17Ad–2 treats most requests for the transfer of securities as routine items and requires registered transfer agents to cancel 90 percent of the old certificates presented and to issue new certificates within three business days. The remaining ten percent must be transferred promptly thereafter. Certain requests for transfer cannot be treated as routine, however, since they require special review, additional documentation from the person making the request, or an opinion of counsel before the securities can be transferred. Since the time required to accomplish most of these special steps is beyond the transfer agent's control, the rule does not set specific time limits for completing these requests but requires transfer agents to give them diligent and continuous attention and to complete the transfer as soon as possible.

Rules 17Ad–6 and –7 prescribe various recordkeeping and record retention requirements which are necessary to enable registered transfer agents to monitor their own activities, construct their records, if necessary, and to permit regulatory authorities to determine compliance with the adopted rules.

The Commission has continued to coordinate its plans for a transfer agent regulatory program with those of the three Federal bank regulatory agencies.[110] The Commission has also adopted, for transfer agents registered with the Commission, a rule and related form to be used for the withdrawal of registration.[111]

Rule 17Ad–3 provides that a registered transfer agent which repeatedly falls below the minimum performance level may not acquire new accounts or expand its transfer agent activities until it has demonstrated the ability to handle its current transfer agent workload in a timely fashion. Furthermore, a registered transfer agent may be required to provide notice of its performance failures to its appropriate Federal regulatory agency and to the issuers of securities for which it acts.

Rule17Ad–5 sets time periods within which registered transfer agents must respond to inquiries from investors. broker-dealers, or other persons con-

cerning the status of items presented for transfer and the status of shareholders accounts. This rule is designed to fulfill more completely the needs of investors who deal with transfer agents, to promote prompt identification of lost securities and to assist broker-dealers undergoing examination or seeking to comply with requirements relating to control of customer securities and net capital.

Single Denomination Stock Certificates

On October 7, 1976, the Commission approved a rule proposal of the NYSE to permit its listed companies to use, along with or in place of existing stock certificates, a new single denomination stock certificate (SDSC).[112] The three traditional forms of stock certificates include in the upper left and right hand corners an engraving that limits the share denomination represented by the certificate. An odd-lot certificate is designated "less than 100 shares," a single round-lot certificate is designated "100 shares" and the third type of certificate is designated "more than 100 shares."

The NYSE proposal permits companies to add a new SDSC that contains no corner denomination limitations. Instead, the SDSC must either have an engraved punch-out panel, with the share denomination indicated by punching out numbers in the panel, or must indicate the share denomination (1) in numbers in the share counter (the small box area currently used), (2) in numbers in a five-position matrix in the "open throat" area,[113] and (3) in words in the open throat area. All such share information must be printed with penetrating ink on top of fine-line intaglio engraving.

Proponents of the SDSC believe it permits new certificates to be issued more efficiently and inexpensively. Issuers using the SDSC need not maintain inventories of three different stock certificates and pay the cost of three engraving plates; similarly, a transfer agent using the SDSC does not have to handle three different types of certificates to issue new certificates of varying amounts. Moreover, because the SDSC can be fed through a computer-controlled high-speed printer, the proper number of shares and other information for each new certificate can be imprinted rapidly, and certificates of varying denominations can be printed without interruption.

Form TA–1

On March 21, 1977, the United States Court of Appeals for the Second Circuit upheld in *Continental Stock Transfer and Trust Company v. SEC*[114] the decision of the Commission to deny confidential treatment to the information supplied on Schedule B of Form TA–1 by a transfer agent when applying for registration. The issue presented was whether the exclusion from disclosure under the Freedom of Information Act[115] of trade secrets, commercial or financial information and privileged or confidential information, covers the issuer lists contained on Schedule B. The Court agreed with the Commission that, although the list of issues for which an applicant performs transfer agent functions is commercial information within the meaning of the statute, such lists already are available to the public and hence are not confidential. The Court held that neither the Commission's demand for the information nor the disclosure thereof constituted an abuse of discretion.

Street Name Study

The 1975 Amendments required the Commission to examine the practice of recording the ownership of securities

in other than the name of the beneficial owner (commonly referred to as "street" and "nominee" name registration) in order to determine whether the practice is consistent with the purposes of the Exchange Act and whether issuer-shareholder communications could be improved while retaining the benefits of the practice. A Preliminary Report was filed with Congress in December 1975, and a Final Report in December 1976.[116]

In the Final Report, the Commission examined the benefits of the practice and concluded that the use of street and nominee name registration is essential to the establishment of a national system for the clearance and settlement of securities transactions and the facilitation of securities processing generally. At the same time, the Final Report, while recognizing that the practice makes issuer-shareholder communications somewhat circuitous, concluded that the existing system for transmitting communications from issuers to beneficial shareowners is, on the whole, effective. The Final Report, however, recommended several steps to improve the performance of the system, including (1) requiring issuers to make more timely inquiries concerning the number of beneficial owners broker-dealers represent, (2) requiring broker-dealers to respond promptly to those inquiries, (3) requiring issuers to supply requested proxy materials and annual reports in a timely manner and, (4) requiring broker-dealers to forward those materials to their customers promptly. The Commission recently adopted Exchange Act Rule 14b–1 and amendments to Exchange Act Rule 14a–3(d) to implement those recommendations.[117]

The Final Report also examined the effects of the practice on the disclosure and dissemination of information regarding beneficial owners of securities. It concluded that current approaches to disclosure may not satisfy fully the objective of making publicly available information identifying shareowners who potentially may influence corporate management or affect the market in an issuer's securities. In this regard, the Final Report recommended implementation of a more comprehensive system for gathering and disseminating this information and legislation which would require those owners of more than five percent of an issuer's securities who are not covered currently by the ownership reporting requirements of the Exchange Act to file with the Commission a short statement providing certain ownership information.

In March 1977, Senate Bill 305 (S.305) was amended to effect the recommendations of the Final Report. Under S.305, disclosure would be required of, among other things, the person's identity, the number of shares, the nature of the interest and the time and manner of acquisition. Another section of that bill would require the Commission, within 30 months of enactment, to report to Congress on the effectiveness of the ownership reporting requirements and on the desirability and feasibility of reducing or otherwise modifying the current reporting thresholds. S.305 was signed by the President on December 20, 1977.[118]

Finally, the Report examined the effect of the practice on jurisdictional provisions of the Exchange Act which are based, in part, on shareholder-of-record standards. It concluded that the increased use of nominee and street name registration has not had the effect of excluding or removing issuers from the jurisdiction of the Exchange Act. The Final Report recognized, however, that the anticipated

increased registration of securities in the name of nominees of securities depositories might affect those jurisdictional standards in the future. To prevent this possibility, the Final Report recommended that the Commission use its authority under Section 12(g)(5) of the Exchange Act to propose a rule defining the term "held of record" to mean, for the purposes of the jurisdictional standards of subsection 12(g), that securities held by a depository or its nominees be considered to be held of record by the depositor of the securities. The Final Report also recommended that Section 15(d) of the Exchange Act be amended to clarify the Commission's authority to define "held of record" for purposes of that section. The recommended amendment to Section 15(d) was enacted into law as part of S.305.

Proposed Legislation to Amend the Securities Investor Protection Act

In July 1977, a bill to amend the Securities Investor Protection Act of 1970 (the SIPC Act) — H.R.8331, 95th Cong., 1st Sess. — was introduced and referred to the House Committee on Interstate and Foreign Commerce. Originally based on a 1974 Special Task Force Report to the Board of Directors of the Securities Investor Protection Corporation (SIPC),[119] the legislation was developed and refined over several years[120] and would effect important improvements in the SIPC Act. H.R.8331 is designed principally to afford public investors greater protection against the financial failure of stock brokers and to provide SIPC and the Federal courts with speedier and more flexible procedures to deal with difficulties created thereby.

In addition to raising the dollar limits of protection afforded under the SIPC Act, the bill would require that customer claims for securities be satisfied, to the maximum extent practicable, with securities rather than cash payments. To that end, a trustee would be permitted to purchase securities, as well as to reclaim securities pledged by the broker-dealer. In appropriate cases, the trustee could transfer all or part of the customer accounts to other SIPC members. To expedite the liquidation process, the bill would authorize SIPC to designate itself or one of its employees as trustee in particular cases. In certain small cases, SIPC would be permitted to avoid the necessity of court-supervised proceedings and to make payments directly to customers.

The Commission re-emphasized its support for the legislation and offered comments at hearings held by the House Subcommittee on Consumer Protection and Finance. By the end of the fiscal period, H.R.8331 was reported out by the Committee on Interstate and Foreign Commerce and, on November 1, 1977, it was passed by the House of Representatives.

NASD Underwriting Recapture Rules

On June 24, 1976, Judge Frankel of the Southern District of New York, in *Papilsky v. Berndt*,[121] held that underwriting recapture, a term which refers to arrangements through which the dealer distributing a new issue of securities arranges to return part of the underwriting "spread" to the purchaser, is available and legal, absent a ruling from the NASD or the Commission to the contrary. Although the court reached that conclusion after consideration of Article III, Section 24 (Section 24), of the NASD's Rules of Fair Practice,[122] the NASD, in response to requests from several broker-dealers, issued several opinions to the effect that Section 24 does prohibit underwriting recapture.

On February 17, 1977, the Commis-

sion requested that the NASD submit its interpretation of Section 24 to the Commission as a "proposed rule change." The NASD responded on April 1, 1977, by requesting that the Commission reconsider its position and by stating that its interpretation of Section 24 was merely an expression of the section as written. The NASD also requested an opportunity to address the Commission regarding its interpretation of Section 24, and a meeting with the Commission was held on May 26, 1977. In its statement before the Commission at that meeting, the NASD reasserted its prior position and further urged the Commission not to call into question Section 24 in order to avoid creating confusion and uncertainty with respect to the distribution of new issues of securities.

In a subsequent letter to the Commission dated June 13, 1977, the NASD announced that, through an *ad hoc* committee on Section 24, it was charting a program for the consideration of various aspects of the underwriting and distribution process. The NASD also stated at that time that the committee's conclusions would be expressed in the form of proposed rule changes, new rules, or interpretations. On September 23, 1977, the NASD circulated among its membership proposed rule changes and interpretations concerning securities distribution practices. These proposals generally reflect the determination by the NASD that underwriting recapture should be prohibited. The NASD projected that proposed rule changes would be submitted to the Commission during fiscal year 1978.

Independent Audit Committees

On March 9, 1977, the Commission, pursuant to Section 19(b) of the Exchange Act and Rule 19b–4 thereunder, approved an NYSE rule proposal that would require each domestic company with common stock listed on the NYSE, as a condition of initial and continued listing on that exchange, to establish not later than June 30, 1978, and maintain thereafter, an independent audit committee.[123] The audit committee is required to be comprised solely of directors independent of management and free from any relationship that, in the opinion of the board of directors, would interfere with the exercise of independent judgment as a committee member. Any domestic company not currently listed would be required to comply with the independent audit committee requirement upon listing.

The NYSE, the accounting profession, major corporations and others, including the Commission, have for many years recognized the advantages of corporate audit committees.[124] Stronger support for audit committees independent of management developed in the wake of recent revelations of questionable and illegal corporate payments.[125] In particular, the Commission has urged strengthening of independence and vitality of corporate boards of directors and has suggested that, at least initially, those principles could be implemented by amending the listing requirements of the NYSE and other self-regulatory organizations, rather than by direct Commission action.[126] Following preliminary study by the NYSE staff, a proposal was submitted to the NYSE Board of Directors in November 1976. The NYSE Board approved the proposal in principle and circulated it for comment by senior executives of listed companies and other interested parties. After revising the proposal in response to the comments received, the NYSE filed its rule as a proposed rule change under Section 19(b)(1). In approving that proposed rule change, the Commission requested the other national

securities exchanges and the NASD to consider adopting a similar rule for issuers whose securities are traded through the facilities maintained by the other exchanges and the NASD.

Confirmations

On September 16, 1976, the Commission announced a proposal to adopt Exchange Act Rule 10b–10 to establish revised delivery and disclosure requirements for confirmation slips sent to customers by brokers and dealers following the execution of a customer's order to buy or sell a security.[127]

The announcement of proposed Rule 10b–10 represented the beginning of an effort by the Commission to review confirmation requirements which, in large measure, had remained unchanged since the 1930's when the Commission adopted Exchange Act Rule 15c1–4. In proposing Rule 10b–10, the Commission pointed out that since the costs of regulation designed to promote investor protection are in the final analysis paid for, in large part, by the investor, it was seeking to adjust regulatory requirements for which compliance costs appear to be disproportionate to the practical benefits of investor protection thereby obtained. The Commission observed that its review would focus not only on the impact of new regulations on traditional business practices but also on the impact on emerging business practices of regulations drawn for an earlier era.

Proposed Rule 10b–10 reflected a number of changes, including (1) uniform application of the confirmation requirements to all brokers and dealers regardless of the marketplace where transactions are effected, (2) an adjustment of confirmation delivery requirements so that brokers and dealers could, under certain circumstances, deliver monthly or quarterly statements in lieu of confirmations sent immediately following the execution of an order, (3) the application of new disclosure requirements to dealers who trade as principals with their customers and (4) the modification of disclosure requirements applicable to brokers who act as agents for their customers.

After considering the views of numerous commentators, the Commission, on May 5, 1977, announced, effective January 1, 1978, the adoption of Rule 10b–10.[128] At the same time, the Commission announced that it would publish for comment shortly thereafter, as proposed amendments to Rule 10b–10, additional changes in confirmation requirements.

In adopting Rule 10b–10, the Commission provided that (1) the rule would not apply to transactions in municipal securities pending further consideration by the Municipal Securities Rulemaking Board of possible amendments of the Board's confirmation rule and (2) brokers could send quarterly statements in lieu of immediate confirmation in connection with transactions effected pursuant to certain periodic stock purchase plans. The Commission also adopted various revised disclosure requirements applicable to brokers who act as agents for customers.

Subsequently, the Commission published for comment several new or revised amendments to Rule 10b–10.[129] Those proposed amendments included (1) disclosure requirements, applicable to all brokers and dealers, relating to odd-lot differentials and the best bid and offer entered in the NASDAQ quotation system at the time of the transaction, (2) revised disclosure requirements applicable only to dealers trading for their own account with customers, and (3) a procedure for the use of quarterly statements in lieu of immediate confirmations in connection

with certain transactions in securities issued by investment companies. The comment period for the proposed amendments expired on September 9, 1977, and the Commission is considering the comments received.

Lost and Stolen Securities

Section 17(f)(1) of the Exchange Act, added by the 1975 Amendments, directs the Commission to formulate a program for the reporting of missing, lost, counterfeit and stolen securities, and to establish rules for making inquiry with respect to securities coming into the possession or control of certain financial institutions, in order to determine whether such securities have been reported as missing, lost, counterfeit, or stolen.[130] On December 6, 1976, the Commission adopted Exchange Act Rule 17f−1, establishing reporting and inquiry requirements under that section.[131] Following the adoption of certain technical amendments,[132] and the proposal of further amendments to the section regarding the role of transfer agents in the Lost and Stolen Securities Program,[133] a final, amended version of the rule was published on August 4, 1977.[134]

Section 17(f)(A) of the Exchange Act requires that reports and inquiries regarding missing, lost, counterfeit, or stolen securities be made to the Commission or a "person designated by the Commission." In order to implement the reporting and inquiry requirements of Rule 17f−1 in an efficient manner, the Commission instituted a pilot program, ending December 31, 1978, in which a private entity would be designated to perform several functions under the Commission's direction. The Commission published "Criteria for a Lost and Stolen Securities Reporting and Inquiry System" and solicited submissions of proposed systems from entities interested in serving as the Commission's designee during the pilot program.[135] After analysis of the submissions, the Commission designated the Securities Information Center, Inc. (SIC), a subsidiary of ITEL AutEx, Inc.,[136] to receive reports and respond to inquiries on behalf of the Commission regarding all securities other than United States Government or Agency securities.[137] At the conclusion of the pilot program, the Commission will evaluate the effectiveness of Rule 17f−1 and the SIC reporting and inquiry system.

The reporting and recordkeeping provisions of Rule 17f−1(b) became effective on October 3, 1977. That paragraph sets forth specific time periods within which reports of thefts, losses, suspected counterfeiting, or recoveries of securities must be made. Reports must be made to a registered transfer agent for the issuer as well as to SIC and, in cases where criminal misconduct is suspected, additional reports must be made to the appropriate law enforcement agency. All reports must be made on Form X−17F−1A, "Missing, Lost, Stolen, Counterfeit Securities Report,"[138] although preliminary reports may be made by telephone or telex.

The inquiry and other provisions, set forth in Rule 17f−1, will become effective on January 2, 1978. The rule requires various financial institutions to determine whether securities coming into their possession or being held by them under certain circumstances have been reported as missing, lost, counterfeit, or stolen. Exceptions to the general inquiry requirements are intended to make inquiry unnecessary in most instances. In order to avoid undue disruption of the normal course of commercial transactions, inquiry is required only in those circumstances most likely to involve missing, lost, counterfeit, or stolen securities. Cer-

tain additional exemptions are applicable during the pilot program. Inquiries that are not required may nevertheless be made at any time.

When an inquiry reveals that securities have been reported as missing, lost, counterfeit, or stolen, the Exchange Act and rules thereunder require only that the inquiring institution be provided with the name of the institution reporting the loss. The inquiring institution is expected to follow current business practices in dealing further with securities known to be lost or stolen.[139]

Fingerprinting of Securities Professionals

In March 1976, the Commission adopted Exchange Act Rule 17f–2[140] to implement the Congressional intention that persons be fingerprinted if they are engaged in the sale of securities, having access to securities, monies, or original books and records relating thereto, or supervising persons engaged in such activities, and that persons not so engaged be exempt.[141]

The rule became effective on July 1, 1976, for persons entering the securities industry after that date. Persons already employed by or associated with entities subject to the rule on that date originally were exempted until January 1, 1977, although the Commission later extended that deadline until January 1, 1978, upon the condition that 25 percent of those persons required to be fingerprinted under the Rule were in fact fingerprinted during each calendar quarter of 1977.[142]

The Rule requires a reporting organization to file a statement describing those classes of persons meeting the conditions for exemption and setting forth the security measures which the organization employs to ensure that only fingerprinted persons handle or process securities, monies, or original books and records relating thereto. In addition, fingerprint record retention requirements have been incorporated in Rule 17f–2(d), as well as in companion amendments to Exchange Act Rules 17a–3 and 17a–4, the Commission's recordkeeping and preservation requirements.

In order to avoid unnecessary regulatory duplication, Rule 17f–2(b) provides that persons whose fingerprints are submitted to the Attorney General for identification and appropriate processing pursuant to any other Federal, state or agency law, rule, or regulation may satisfy the fingerprinting requirements by compliance with those other requirements.

To facilitate the transmittal of fingerprint records, the Rule provides an exemption for persons whose fingerprints are submitted to the Attorney General through a self-regulatory organization pursuant to a plan filed by the self-regulatory organization and approved by the Commission. During the last fiscal year, the Commission approved fingerprinting processing plans submitted by six national securities exchanges—the Amex, BSE, MSE, NYSE, PSE, and Phlx—and the NASD. The Amex, BSE, and NYSE plans also provide for processing of fingerprint cards of transfer agents of exchange-listed issues. The NASD plan provides for transmittal of fingerprint records for transfer agents of securities traded over-the-counter and for members of the CBOE.

Commission Rates

Section 23(b)(4)(H) of the 1975 Amendments requires the Commission to include in its annual report to the Congress for each fiscal year beginning in 1975 and ending in 1980, a description of the effect of the absence of any schedule or fixed rates of commissions, allowances, discounts, or

other fees to be charged by members for effecting transactions on a national securities exchange on the maintenance of fair and orderly markets, and on the development of a national market system for securities. Five reports covering the first 20 months of commission price competition through December 31, 1976, were separately forwarded to Congress pursuant to Section 6(e)(3) of the Amendments, the last report on May 26, 1977.

Analysis of commission rates if now integrated into the Commission's ongoing monitoring of the financial condition of the industry. For the industry as a whole, securities commissions represented 45.8 percent of total revenue in 1976 and 42.9 percent during the first three quarters of 1977

From May 1, 1975, the beginning of negotiated commissions, to the end of September 1977, individual investors' commission rates have declined 12.3 percent. Institutional customers, reflecting their larger average order size and greater bargaining power, have negotiated discounts averaging 47.7 percent. Individuals paid an average of 26.3 cents per share on their September 1977 orders, which averaged 340 shares in size. Institutional orders averaged 1,575 shares in size and commissions averaged 13.6 cents per share for these customers.

Broker-dealers were affected by the elimination of fixed minimum commission rates more or less to the extent they serve institutional investors. Some firms which did a large portion of their total business with institutions have merged with more diversified firms. Several new discount broker-dealers have entered the industry to offer investors a reduced level of services at reduced commission rates. Those adjustments are continuing.

The elimination of fixed rates has not seriously affected the financial results of regional and over-the-counter firms. Market liquidity and the volatility of securities prices also do not appear to have been affected by the switch to competitively determined commissions.

Proposed Minimum Qualifications Rule

Section 15(b)(7) of the Exchange Act, as amended by the 1975 Amendments, provides that every registered broker and dealer and every person associated with them must meet minimum standards of training,experience and competence, and such other qualifications as the Commission finds necessary or appropriate in the public interest or for the protection of investors. Previously, only SECO broker-dealers[143] were subject to such minimum standards set by the Commission.

On June 27, 1977, the Commission published for comment proposed Exchange Act Rule 15b7–1, which would establish minimum qualification requirements for all registered brokers, dealers and associated persons.[144] The proposed rule would revise the presently applicable qualification standards by establishing various categories of principal and representative and by providing qualification standards for each category. Subject to certain conditions, however, an exemption from the proposed rule would be available for any broker-dealer complying with a comparable approved qualification rule of the NASD or a national securities exchange.

Section 31(b) Review

Section 31(b) of the 1975 Amendments permits the Commission, at any time within one year of the effective date of any amendment made by the 1975 Amendments to the Exchange Act, to notify any national securities exchange or national securities association if its organization or rules do not comply with the Exchange Act, as

amended. The Commission is authorized, on and after 180 days following receipt of such notification, to suspend the registration of any such exchange or association, or to impose limitations on its activities, functions, or operations if the Commission finds, after notice and opportunity for hearing, that its rules or organization still fail to conform to the Exchange Act. Any such suspension or limitation continues in effect until the Commission, by order, declares that such exchange or association is in compliance with the requirements of the Exchange Act.

Late in 1976, the Commission completed a review of those exchanges rules not addressed in the first set of notices provided to the exchanges in early 1976.[145] This review required a substantial effort by the Commission and its staff and covered all phases of the exchanges' and the NASD's regulatory programs as set forth in their rules. On December 1, 1976, the Commission provided notice to each exchange and to the NASD[146] that generally described the types of exchange and NASD rules, and identified specific rules,[147] that appeared to be inconsistent with specified parts of the Exchange Act.

The December notice isolated over 1,000 rules of the exchanges and the NASD, out of a total of several thousand, covering a broad range of regulatory matters. In its notice, the Commission discussed generally the relationship between several of those rules and the specific standards of the Exchange Act. For example, a number of exchange rules prohibit specialists from dealing directly with institutions, and may thus sanction unfair discrimination between dealers or customers without any corresponding justification in terms of the purposes of the Act. Other questioned rules relating to trading practices appear to accord undue preference, in the execution of orders, to large orders and may unfairly discriminate among customers.

In addition, the Commission expanded its inquiry with respect to rules governing membership and association with member organizations. The Commission, for example, raised questions with respect to (1) restrictions on access to communications systems operated by the exchanges and on access to the NASDAQ system, which is owned and managed by the NASD; (2) the extent to which the composition of governing boards and committees of the exchanges and the NASD complied with the statutory standard of fair representation; and (3) the absence of procedural safeguards in connection with certain exchange and NASD proceedings.

In the December notice, the Commission also questioned exchange rules which did not appear to foster cooperation and coordination with persons engaged in regulating, clearing, settling and facilitating transactions in securities and which may impose unwarranted burdens on competition. The rules of several exchanges, for example, tie contracts governing the clearance and settlement of securities transactions to the rules of clearing agencies affiliated with those organizations, even though members of such organizations might prefer to select other clearing agencies. In addition, the Commission cited rules affecting the processing of securities transactions which appeared to contravene certain provisions of the Exchange Act, including a provision designed to foster competition among brokers and dealers, clearing agencies and transfer agents. These rules may have impeded the development of efficient methods of clearance and settlement by discouraging technological innovation.

The Commission requested and generally has received preliminary presentations by each exchange and the NASD with respect to the rules questioned in the December notice.[148] In those presentations, the exchanges and the NASD addressed the extent to which amendments to their rules have been, or will be, filed pursuant to Section 19(b) and Rule 19b–4 thereunder. The exchanges and the NASD also indicated that certain questioned rules are, in their opinion, consistent with the Exchange Act or require further study. Following those presentations, the Commission's staff held discussions with the exchanges and the NASD in order to explain in further detail the bases on which rules were questioned under Section 31(b). The exchanges and the NASD have responded, in a few instances, with proposed rule changes under Rule 19b–4.

On September 27, 1977, the Commission, in accordance with Section 31(b), gave further notice and opportunity for hearing to the exchanges and the NASD regarding the transaction completion rules cited in the December notice.[149] Pursuant to that notice, the exchanges and the NASD were requested to submit, within forty-five days from the date of the notice, proposed changes to the transaction completion rules or written data, views and arguments explaining why those rules are in compliance with the Exchange Act.

DISCLOSURE RELATED MATTERS

Advisory Committee on Corporate Disclosure

The Advisory Committee on Corporate Disclosure met for a total of 16 days during its nine meetings between July 1976 and September 1977. It conducted comprehensive questionnaire and interview studies of the primary participants in the corporate disclosure system including: publicly held companies, financial analysts, portfolio managers, registered representatives, information disseminators and individual investors.

Briefly stated, the Committee arrived at the following conclusions about the operation of the corporate disclosure system as relates to investors:

Companies, as the principal source of firm-oriented information, are at the center of the corporate disclosure system. Their willingness (as opposed to their obligation) to provide information is a function of management's perception of the utility of the disclosure to the company and the user, the hard and soft dollar costs associated with the disclosure and the feasibility of communicating the information.

Analysts combine the information provided by companies with industry and macroeconomic data. They provide an interpretation of the information and frequently conclude with a buy-sell recommendation directed to specific portfolio objectives. The interest of analysts and disseminators in particular companies is influenced by the company's market capitalization or the potential for unusual return on investment.

Portfolio managers in large structured organizations select industries which will benefit from an assumed economic scenario and utilize analysts' recommendations for individual company selection appropriate to the characteristics of specific portfolios.

Information disseminators condense, summarize and disseminate available information and thereby assist analysts and investors in obtaining investment decision-making information in forms suitable to their respective needs and abilities to use it.

Individual investors use various methods in making investment decisions, ranging from fundamental analysis

and replication of the activities of portfolio managers, to total reliance on the advice of registered representatives.

The Commission administers a mandatory disclosure system intended to assure that reliable firm-oriented information is available to the public. It does not purport to administer a system designed to produce all information used in investment decision-making. Further, information filed with the Commission has often been widely disseminated before filing.

The Committee considered the significant studies concerning the functioning of securities markets, theories concerning capital asset pricing and portfolio organization and belief in some quarters that market forces may adequately provide sufficient reliable firm-oriented information, and concluded, with some dissent, that:

(1) The "efficient market hypothesis"—which asserts that the current price of a security reflects all publicly available information—even if valid, does not negate the necessity of a mandatory disclosure system. This theory is concerned with how the market reacts to disclosed information and is silent as to the optimum amount of information required or whether that optimum should be achieved on a mandatory or voluntary basis;

(2) Market forces alone are insufficient to cause all material information to be disclosed;

(3) Commission-filed documents often confirm information available from other sources. The Commission's filing requirements, while often not a source of new information to investors, assure that information disclosed by publicly held companies through many means is reliable and is broadly accessible to the public.

Although not all members agreed unreservedly, the Committee concluded that the disclosure system established by the Congress in the Secruities Act of 1933 and the Securities Exchange Act of 1934, as implemented and developed by the Commission, is sound and does not need radical reform or renovation. The Committee did forward recommendations for significant changes in the Commission's procedures, rules, emphases, and approaches to disclosure problems. The Committee agreed upon recommendations in a dozen major areas. Included among the recommendations are: (1) that the Commission implement a voluntary program for the disclosure of earnings forecasts and other kinds of forward-looking information; (2) that it develop on an industry by industry basis a standardized product line classification for presentation of both dollar and, where appropriate, unit sales of each product line (within a segment) whose total sales comprised a certain percentage of consolidated sales in the previous fiscal year; (3) that it require increased disclosure regarding candidates for and operation of boards of directors in proxy soliciting material and information statements; and (4) that it schedule hearings to examine the possibility and desirability of alleviating the reporting burden on small companies.

These and all other recommendations are fully discussed in the Advisory Committee's Final Report, available November 1977.

Securities Regulation and the Capital-Raising Ability of Smaller Businesses

In early 1977 the Commission began to examine how securities regulation affects the capital-raising ability of smaller businesses. Under an agreement with the Department of Commerce's National Bureau of Standards Experimental Technology Incentive Pro-

gram (ETIP), the Commission's Directorate of Economic and Policy Research is studying the effect of present and proposed policies on small issuers, broker-dealers and other economic agents in the venture capital industry.

The first phase of this effort analyzes the principal rules, regulations and procedures that influence the flow of capital to new or recently established technology-based ventures. This will include investigation of Securities and Exchange Commission Regulation A and Rules 144, 145, 146,147 and 240 in an effort to determine the costs and benefits of these provisions. The second phase refines and tests the data and models developed through the analyses in phase one so that an approach to monitoring the effects of SEC regulation in venture capital markets can be established. It is anticipated that this experimental project will require two years to complete.

Management Disclosure and Corporate Governance

The Commission has initiated or completed a number of actions dealing with management disclosure and corporate governance. Generally, these issues involve shareholder communications and corporate governance; disclosure of management background information necessary to evaluate the ability and integrity of management; shareholder proposals; and disclosure of management remuneration and perquisites. Certain broad policy aspects of these questions are being considered at public regional hearings conducted by the Commission; however, other actions, discussed below, have also been taken.

Corporate Governance Hearings

On April 28, 1977, the Commission requested written statements preparatory to holding public hearings on the subjects of shareholder communications, shareholder participation in the corporate electoral process and corporate governance.[150] Such statements and hearings are for the purpose of giving the Commission the benefit of the views of interested members of the public in order to assist the Commission in a broad re-examination of its proxy rules. On August 29, 1977, after a review of approximately 140 written statements received, the Commission published the specific issues to be considered at the hearings, which were scheduled to commence on September 29, 1977 in Washington, D.C.[151]

The Commission noted that numerous recent examples of an apparent breakdown in corporate accountability have led informed commentators to question the efficacy of existing methods of corporate governance. The Commission indicated that, while the proxy solicitation process and the Commission's rules governing that process are a central focus of its inquiry, it hoped to receive information concerning means unrelated to the proxy solicitation mechanism to stimulate increased shareholder interest and participation in corporate governance and to improve corporate accountability.

In view of the importance of the issues to be considered and the Commission's desire to make participation easier for potential witnesses, particularly individual shareholders, the Commission has taken the unusual step of scheduling hearings in Los Angeles, California; New York, New York; and Chicago, Illinois, in addition to Washington, D.C. The hearings are being conducted for the Commission by the Division of Corporation Finance. Witnesses scheduled to testify at the hearings include members of Congress, corporations, business associations,

bar associations, attorneys, public interest groups, individual and institutional investors, religious organizations, academics and others.

Issues to be considered in these proceedings include whether the Commission should require additional disclosures in proxy materials relating to socially significant information, including evironmental and equal employment matters, and whether the Commission should amend its rules relating to shareholder proposals. The Commission will also consider the advisability of affording shareholders access to managment's proxy materials for the purpose of nominating persons to serve on the Board of Directors and the advisability of expanding disclosures in the proxy statement relating to the qualifications of director nominees. At the conclusion of these proceedings, the Commission will determine whether to propose amendments to the proxy rules and other applicable rules and whether to recommend legislation to Congress, such as a bill establishing Federal minimum standards for corporate conduct.

Management Disclosure

On November 2, 1976, the Commission proposed for comment various amendments to registration forms under the Securities Act and to registration and reporting forms and the proxy schedule under the Exchange Act.[152] The proposed amendments are intended to provide more meaningful disclosure to investors regarding the backgrounds of the management of publicly held companies and to provide increased uniformity among various disclosure forms.

The proposed amendments would require disclosure about the identity and background of corporate officials and events which the Commission believes are material to an investor's evaluation of the ability and integrity of directors or executive officers. In addition to the information presently required in proxy material, annual reports and various registration forms concerning the identity and background of directors, the proposed amendments would, if adopted, also require disclosure of all directorships held by each director of the issuer in companies which are required to file reports under the Exchange Act or are registered under the Investment Company Act and disclosure of all memberships held by each director on any committees of the issuer's board of directors. The proposals would also amend the items in various forms relating to material events in the background of directors and executive officers to require disclosure of (1) injunctions prohibiting such persons from engaging in any type of business practice; (2) injunctions and consent decrees prohibiting future violations of Federal or state securities laws; and (3) certain civil actions involving violations of such laws.

To provide for more comprehensive information concerning remuneration received by certain officers and directors, the proposals would expand certain disclosure items by requiring presentation of all direct remuneration paid by the registrant and its affiliates. The existing requirements call for remuneration paid only by the issuer and its subsidiaries.

Concomitant with these proposals, amendments were proposed which would conform the disclosure requirements in the applicable forms under the Securities Act and the Exchange Act. The differences among the various registration and reporting forms in the items requiring disclosure of pending legal proceedings would be eliminated. In addition, amendments are proposed to the proxy schedule

which would reconcile the proxy statements and the annual report disclosure relating to corporate officials and other persons. These latter amendments are thought to be necessary because proxy and information statements, along with annual reports to shareholders, are among the most widely read disclosure documents. Since these documents are intended to communicate information to shareholders which may be useful to their exercise of a voice in corporate affairs, the Commission believes that material information on the background of directors and executive officers is particularly relevant and should be set forth in proxy statements and information statements which relate to election of directors.

In this release, the Commission also invited comments on a few areas involving the adequacy of information about persons responsible for corporate management. The Commission announced that it had received recommendations concerning additional disclosure in this area, especially as to remuneration of corporate officers and directors and as to certain transactions of management. As a result, comments were invited on whether additional disclosure should be required about the numerous emerging forms of indirect compensation or "perquisites" now given to management personnel, the various forms of executive compensation plans, and certain transactions of management involving the issuer and its subsidiaries, such as disclosure of loans extended by issuers or any of their subsidiaries which are primarily engaged in the business of lending money.

The comment period for these proposals ended on January 31, 1977.[153] The proposed amendments are being re-evaluated in light of the comments received.

14a–8 Amendments

On November 22, 1976 the Commission substantially amended Rule 14a–8 of the proxy rules, which sets forth the requirements applicable to proposals submitted by security holders for inclusion in the proxy soliciting materials of issuers.[154] The amendments were designed, among other things, to limit certain shareholder abuses that have occurred in the past, broaden the topics that can be covered by shareholder proposals, and formalize certain grounds for omitting proposals that were implied but not specifically stated in the former rule. Included among the revisions were amendments that: (1) limit proponents of shareholder proposals to a maximum of two proposals of not more than 300 words each to an issuer; (2) advance the timeliness requirements applicable to both proponents and managements by 20 days each; and (3) codify a number of past interpretations of the rule by the Commission's staff, including those which have stated that beneficial owners of securities as well as record owners may submit proposals, and that a proposal which may be improper under the applicable state law when framed as a mandate may be proper when framed as a recommendation or request.

Perquisites

On August 18, 1977,[155] the Commission announced its interpretation of the existing disclosure provisions of the securities acts relating to the disclosure of management remuneration. This release was issued for several reasons. During the four or five months preceding the publication of the release, the staff of the Commission received numerous inquiries relating to whether or not various personal benefits received by management from corporations should be in-

cluded within the aggregate remuneration reported in registration statements, reports and proxy and information statements filed by corporations under the securities laws. Some of these questions may have been prompted by the publicity given to recent enforcement cases brought by the Commission which revealed the failure of such corporations to include within the reported remuneration the value of various personal benefits received by members of management. Others may have raised questions because the Commission had asked for comments earlier[156] on whether additional disclosure about perquisites should be required in registration statements and reports.

The Commission emphasized in this release that registrants are required to report in documents filed under the securities laws the amount of remuneration received by officers and directors from the company from all sources, including salary, fees, bonuses and certain personal benefits, sometimes referred to as "perquisites." This does not mean, however, that the Commission believes that all benefits received by management are personal benefits which must be reported. Certain incidental benefits which are ordinary and necessary to the conduct of company business and incidental payments made by the company for items which are directly related to the performance of management's functions at the company plant or offices may not be reportable forms of remuneration. The Commission noted, however, that all payments made by the company for personal benefits received by management which are not directly related to job performance are forms of remueration which should be included within the reported remuneration.

The interpretative release was issued in order to provide some guidance to registrants in this area. The Commission announced, however, that it was aware that some questions may be unanswered by the release. It noted that the staff is available to assist with questions involving the appropriate disclosure of management remuneration and that it will continue to review its interpretation in light of any specific problems or comments brought to the attention of the staff by registrants and interested persons.

Beneficial Ownership

On February 24, 1977 the Commission adopted amendments to existing rules and Schedule 13D and new rules and a Form 13D–5 relating to disclosure by certain beneficial owners of voting securities pursuant to Section 13(d) of the Exchange Act.[157] At the same time, the Commission amended certain of its forms and schedules under the Securities Act and the Exchange Act to require issuers to disclose information regarding certain beneficial owners of their securities.[158]

These amendments and rules were primarily based on the proposals which were published for comment on August 25, 1975.[159] Among other things, they (1) provide a definition of the term "beneficial ownership" for the purposes of Section 13(d) of the Exchange Act; (2) make the disclosure in Schedule 13D acquisition statements more meaningful to investors and the reporting of that information less burdensome to beneficial owners; (3) provide a short form acquisition notice to be used by certain institutional investors and certain employee benefit plans acquiring securities in the ordinary course of their business and not for purposes of control; and (4) provide an exemption from the filing requirements of Section 13(d)(1) for certain underwriters engaging in a registered, firm commitment underwriting.

The amendments to the various registration, reporting and proxy forms require disclosure in such forms, to the extent known by the filing company, of beneficial owners of more than five percent of any class of voting securities and the aggregate amount and percentage beneficially owned by all directors and officers of each class of voting securities of the issuer and, depending on the form, its parent and/or subsidiaries.

All of the rules and forms adopted or amended on February 24, 1977 were originally scheduled to become effective on August 31, 1977. Because of the substantial practical and interpretative questions raised by institutional investors regarding compliance with the new rules as well as objections by institutions as to the exclusion of certain persons from the use of Form 13D–5, the Commission postponed their effective date until April 30, 1978.[160] In addition, the Commission requested public comment with respect to the objections raised by institutional investors in order to assure that its actions were responsive to the public interest.[161] The original comment period on the institutional investor objections was to expire on September 30, 1977; however, upon request, the Commission extended the period to October 31, 1977.[162]

Concurrently with the adoption of rules and amendments on February 24, 1977 the Commission proposed additional amendments thereto concerning areas which had not been specifically subject to public comment in connection with the prior proposals.[163] These proposed amendments would, among other things, (1) deem a person to be the beneficial owner of a security if he has the right to acquire beneficial ownership either within a specified period of time, pursuant to the automatic termination of a trust, discretionary account of similar arrangement, or at any time, if otherwise acquired; (2) make the short form acquisition notice available to certain foreign entities; and (3) require additional information in Schedule 13D acquisition statements concerning the involvement of reporting persons in civil securities violations and the plans of reporting persons relating to extraordinary corporate transactions involving the issuer or its subsidiaries. The Commission intends to coordinate the announcement of its action on these proposals with any action which may be necessary as a result of the objections raised by institutional investors to the rules which are now scheduled to take effect on April 30, 1978.

Tender Offers

On July 21, 1977 the Commission adopted Schedule 14D–1,[164] Tender Offer Statement, which sets forth the disclosure requirements for persons making certain tender offers. Concurrently, existing Rule 14d–1 was amended to implement the filing of the new Schedule and to specify the disclosure items contained therein which are required to be included or summarized in the information published, sent or given to security holders in connection with such tender offers. These actions, which became effective on August 31, 1977, are intended to augment the present statutory requirements by providing necessary disclosure to investors to enable them to make informed decisions in connection with a tender offer.

Schedule 14D–1 contains several new items which are not contained in Schedule 13D (which is now used solely for acquisition statements) and several significant modifications of items which are in Schedule 13D.

These include new Item 3 which requires disclosure of business transactions between the bidder and the subject company during a specified three year period as well as information relating to contacts and negotiations between those parties concerning the tender offer and other specified transactions. Item 4 requires additional disclosure regarding a bidder's source of funds and the bidder's plan to repay any loan used in connection with the tender offer. Item 9 requires disclosure of certain financial information of the bidder if the bidder is other than a natural person and the bidder's financial condition is material to a decision by a security holder of the subject company whether to tender, sell or hold securities being sought in the tender offer.

The adoption of the Schedule is part of the Commission's plan to replace its emergency rules under the Williams Act with a comprehensive regulatory framework with respect to tender offers. The other tender offer proposals which were published for comment with the Schedule in August, 1976[165] have not been withdrawn and certain of these proposals are being revised in response to the comment letters received from the public. Upon the completion of the revisions to these other tender offer proposals, the Commission presently anticipates further rulemaking action.

Guide 61 • Banks

On August 31, 1976, the Commission authorized the publication of Guides 61 and 3, "Statistical Disclosure by Bank Holding Companies" of the Guides for the Preparation and Filing of Registration Statements under the Securities Act and of the Guides for the Preparation and Filing of Reports and Proxy and Registration Statements under the Exchange Act, respectively.[166] These Guides are intended to provide registrants with a convenient reference to the statistical disclosures sought by the staff of the Division of Corporation Finance in registration statements and other disclosure documents filed by bank holding companies.

As the operations of bank holding companies have diversified, it has become increasingly difficult for investors to identify the sources of income of such companies. And, since various sources of income can have a wide range of risk characteristics, investors may have difficulty assessing the future earnings potential of a bank holding company without detailed information concerning the company's sources of income and exposure to risks.

In the preparation of the Guides, the staff has been mindful of the investor's need to assess uncertainties, the need for disclosure with respect to changes in risk characteristics, and specifically the need for substantial and specific disclosure of changes in risk characteristics of loan portfolios. Accordingly, the Guides call for more meaningful disclosure about loan portfolios and related items in filings by bank holding companies. In addition, many of the disclosures suggested by the Guides are intended to provide information to facilitate analysis and comparison of sources of income and exposure to risks. This information also will assist investors to evaluate the potential impact of future economic events upon a registrant's business and earnings and to assess the ability of a bank holding company to move into or out of situations with favorable or unfavorable risk/return characteristics.

The Commission intends to monitor the experience of registrants and users of the information provided pursuant to the Guides to determine, by June 30, 1978, whether the disclosures

sought by the Guides are necessary and appropriate in the public interest and for the protection of investors. In implementing this monitoring program, the staff will survey and interview potential users of the information including investors, analysts and academicians in order to assess the benefits derived from disclosures provided pursuant to the Guides. The staff also will survey registrants in order to determine what additional burdens and expenses, if any, are incurred in complying with the Guides.

Proposed Form S–16 - Primary Offerings

On December 20, 1976, the Commission announced that consideration was being given to amending Form S–16 to make it available for certain primary offerings.[167] Form S–16 is a registration form which is comparatively simpler and shorter than other available registration forms. Generally, the form is now available for the registration of certain securities of issuers subject to and in compliance with the reporting requirements of the Exchange Act for a period of 36 calendar months and having a net income of at least $250,000 during three of their most recent four years, provided (1) the securities are being offered for the account of persons other than the issuer and securities of the same class are already listed and registered on a national exchange or are quoted on the automated quotation system of a national securities association or (2) the securities are to be offered by the issuer upon conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer. The Commission invited comment on several factors which were intended to limit the type of issuers which would be permitted to use the short form for primary offerings, the kinds of securities which could be registered on the form, and the need for and possible content of additional disclosure items relating to the direct offering.

Upon consideration of the comments and the recommendation of the Advisory Committee on Corporate Disclosure relating to the integration of the Securities Act and the Exchange Act through the availability of the Form S–16 to certain registrants generally classified as Level 1 registrants, the Commission determined on November 1, 1977, to publish for comment specific amendments to the Form S–16 which would expand the availability of the form to certain primary offerings.[168] As proposed, the form would be expanded[169] to permit the registration of[170] (1) securities being offered to the public for cash by certain issuers about which information is widely disseminated among the investing public; and (2) securities being offered by issuers eligible to use the form to existing shareholders through either rights offerings or dividend or interest reinvestment plans. Criteria are proposed which are intended to assure that the protective mechanism of the full registration process is unnecessary because of the availability to the offerees of adequate information about the issuer and the suitability of the terms of the offering for the abbreviated disclosure required by the Form S–16.

Comments were requested on the following criteria for the eligibility of the form for the registration of securities offered in primary offerings: the issue has one or more classes of voting securities held by non-affiliates and has an aggregate market value of $50 million or more and/or 25,000 security holders and/or there is a certain volume of trading in the issuer's securities; the offering is pursuant to a firm

commitment underwriting; and any offering of debt securities is pursuant to a trust indenture subject to and qualified under the Trust Indenture Act of 1939. Certain foreign private issuers would be permitted under these amendments to register securities offered pursuant to rights offerings; and closed end management investment companies would be permitted to register on the Form S–16 securities being offered under Dividend on Interest Reinvestment Plans.

Inasmuch as a prospectus prepared pursuant to Form S–16 is only required to contain very limited information concerning the identity of the issuer or the selling security holders and the plan of distribution, the proposed amendments to the form include proposals to require additional disclosure in the Form S–16 about the use of the proceeds of the offering; the terms of the securities unless the securities are of the same class which is registered under Section 12 of the Exchange Act; and certain other information. Further, issuers using the form for primary offerings would be required by other proposed amendments to undertake to provide without charge to all offerees upon their request copies of any and all of the documents incorporated by reference except that the issuer may charge reasonable costs for exhibits to such documents.

In addition, the proposals include amendments which would: (1) incorporate the long-standing staff practice of allowing the form to be used for resales of securities by underwriters who acquire securities of an issuer in connection with the issuer's call for or redemption of convertible securities; (2) amend the instructions as to required exhibits to include any underwriting agreements or arrangements in connection with the subject offering; (3) require the presentation in the prospectus of information about material recent events which were not disclosed previously in periodic reports filed pursuant to the Exchange Act; and (4) clarify the existing requirement that the consent of experts who are named in any of the documents incorporated by reference or whose reports are used in connection with such documents must be filed with the registration statement or by amendment if the expert is named in material incorporated in the future.

The Commission believes that these amendments, if adopted, will reduce the cost to and simplify the procedures for issuers making primary offerings of their securities. It is believed that investor protection should be served adequately by the criteria proposed for the eligibility of issuers. Nonetheless, the Commission's paramount responsibility is investor protection and safeguarding the public interest in connection with sales and purchases of securities. Therefore, the proposals are being considered on an experimental basis; and, if the amendments are adopted, the broadened usage of the form will be monitored closely to determine the consistence of this usage with the disclosure goals of the Securities Act.

Segments

The Commission published for comment proposed amendments to certain disclosure forms, schedules and rules relating to industry and homogeneous geographic segment reporting.[171] This action is intended, in part, to avoid duplication of financial information as a result of the issuance in December, 1976 by the Financial Accounting Standards Board (FASB) of the Statement of Financial Accounting Standards No. 14, "Financial Reporting

for Segments of a Business Enterprise" (SFAS No. 14). These proposals will also partially implement certain recommendations made by the Advisory Committee on Corporate Disclosure.[172] The Commission also proposed the development of a new, integrated disclosure form, Form S–K. Form S–K should improve and simplify significantly the disclosure process by eliminating immaterial differences among the disclosure requirements in various registration and reporting forms.

SFAS No. 14 requires corporations to disclose revenue, profitability and identifiable assets information by industry and homogeneous geographical segments. Other related disclosures as to the industry segments are also required.

The Commission's principal forms for registration under the Securities Act (Forms S–1, S–7) and for reporting (Form 10–K) and registering (Form 10) under the Exchange Act require the presentation of line of business and foreign operations information which parallels in part the information required by SFAS No. 14. Therefore, amendments were proposed to avoid any duplication and to integrate the two disclosure provisions. The proposed amendments would revise the present reporting requirements to refer to industry segments in lieu of lines of business and to require disclosure of the amounts of identifiable assets, revenue from intersegment sales or transfers, and related matters in addition to the revenue and profitability information now required as to lines of business. Registrants would be required to present this information together with reconciliations of the amounts of revenue, operating profit and identifiable assets to the related amounts in the consolidated financial statements of registrants. In addition, the proposals would require the presentation of revenue, profitability and identifiable assets information as to foreign and domestic operations together with the appropriate reconciliations to related consolidated amounts and disclosure of the amount of export sales.

The Commission forms presently require disclosure of financial information relating to lines of business for a period of five years and accordingly the proposed amendments would require the presentation of financial information relating to industry segments for five years. SFAS No. 14, however, is only applicable to "complete" financial statements and the Commission forms require the inclusion of "complete" financial statements for at most 2 fiscal years. The Commission has invited comment therefore, on whether the proposed industry segment reporting requirement should apply only retroactively.

Five year financial information as to foreign and domestic operations, including the amount of export sales, would also be required by the proposed amendments for the purpose of year to year comparison. This information, however, would be required only for fiscal years beginning after December 15, 1976.

The proposed amendments include provisions intended to assist registrants in identifying industry segments. These provisions are substantially similar to portions of SFAS No. 14. The proposed amendments differ from SFAS No. 14 in two ways: financial information relating to a dominant industry segment would be required by the proposed amendments if the segment is or was experiencing a decline in sales or market share and/or profitability during either of registrant's most recent two fiscal years; in addition, information relating

to the pricing and recipients of intersegment and intra-enterprise sales or transfers would be required.

Amendments were also proposed which would require the presentation of the segment financial information in annual reports to shareholders and in certain proxy and information statements.

Finally, amendments were proposed which would implement the recommendation of the Advisory Committee that the Commission take action to integrate the textual disclosure required in Commission forms with the segmented financial statement disclosures required by SFAS No. 14. These amendments would require registrants to focus upon the industry segments in the description of business called for by Forms S–1, 10 and 10–K. The Commission also invited comments on the Advisory Committee's recommendation that segmented financial statement disclosure be required in interim reports on Form 10–Q.

Projections

On April 23, 1976, the Commission published for comment proposed Guides 62 and 4, "Disclosure of Projections of Future Economic Performance,"of the Guides for the Preparation and Filing of Registration Statements under the Securities Act of 1933 and of the Guides for the Preparation and Filing of Reports and Proxy and Registration Statements under the Securities Exchange Act of 1934, respectively.[173]

The proposed Guides set forth the views of the Commission's Division of Corporation Finance on the disclosure of projections in Commission filings. In particular, the Guides address three important considerations related to the preparation and disclosure of projections: (1) that management have a reasonable basis for its projections; (2) that the projections be presented in an appropriate format; and (3) that the accompanying disclosures facilitate investor understanding of the basis for and limitations of projections.

In announcing the proposed Guides, the Commission indicated that it is not encouraging the making or filing of projections because of the diversity of views on their importance and reliability but noted that the reliability issue, together with the question of whether a "safe harbor" rule for projections is needed, may be among those matters appropriately considered by the Commission's Advisory Committee on Corporate Disclosure.

After termination of the comment period, no further rulemaking action was taken on the proposed Guides pending the Advisory Committee's recommendations in this area. At its meeting on February 7 and 8, 1977, the Advisory Committee tentatively agreed to recommend that the Commission actively and generally encourage the publication of management projections of sales and earnings. The Committee proposed that the Commission issue a statement encouraging public companies to disclose projections in filings with the Commission subject only to the conditions that the projections be prepared on a reasonable basis, be disclosed in good faith, and be accompanied by an appropriate cautionary statement.

In order to make the issuance of forecasts attractive to managements, the Committee determined that managements should be accorded wide latitude in determining the manner and nature of the forecast. Accordingly, the Committee agreed to recommend that the Commission encourage, but not require, registrants to publish major assumptions underlying pro-

jections, comparisons of previous projections with actual results and management analysis of the variances. The items of information to be forecasted, the time period to be covered by the forecast, and the decision to discontinue forecasting would also be discretionary with management. Third party review would be permitted but not required. The Committee did agree that the Commission should require previously issued projections still current at the time a registration statement is filed to be included in the registration statement with appropriate updating if necessary.

The Division will consider proposed Guides 62 and 4 in light of the Advisory Committee's recommendations upon issuance of the Advisory Committee's final report.

Industry Guides - Rails

On April 28, 1977 the Commission solicited public comment to assist it in the development of guidelines to be followed by Class I Railroads in the preparation of Securities Act and Exchange Act disclosure documents.[174] The Commission selected Class I Railroads for guidelines formulation, in part, because of the impact of the Railroad Revitalization and Regulatory Reform Act of 1976.[175] This action was also in futherance of a recommendation of the Advisory Committee on Corporate Disclosure that the Commission adopt disclosure guides applicable to particular industries which are designed to encourage uniform textual and financial statement disclosure of material items that are unique to particular industries.

Among other areas, commentators were requested to consider guidelines with respect to: (1) line of business reporting, (2) the status of physical plant and equipment, (3) the average return on invested capital, (4) competitive conditions and position, and (5) disclosure of deferred maintenance.

The Commission also recognized that deferred maintenance is a phenomenon facing a substantial portion of the railroad industry. Accordingly, the Commission requested comment on the development of a uniform definition of deferred maintenance, uniform methodology for its quantification and the appropriate standards of disclosure for such amount under the Federal securities laws.

Because of the substantial differences of opinion on the appropriateness of betterment versus depreciation accounting for purposes of financial reporting by railroads, the Commission also invited comment as to whether betterment accounting should continue to be an acceptable accounting principle for railroads for reporting their financial position in filings with the Commission and in reports to shareholders.

The original comment period on these issues was to expire on June 17, 1977; however, upon request, the Commission extended the period to September 16, 1977.[176] The staff of the Division of Corporation Finance and of the Office of the Chief Accountant are currently conducting a review and analysis of the letters of comment as well as other materials developed internally.

Industry Guides - Electric and Gas Utilities

On May 10, 1977, the Commission announced its intention to develop guidelines for the disclosure to be included in registration statements and reports filed by electric and gas utility companies under the Federal securities regulations.[177] The decision to develop industry guidelines for this industry represents another step in the Commission's undertaking to imple-

ment the recommendation made by the Advisory Committee on Corporate Disclosure[178] that the Commission develop on a limited experimental basis disclosure guides for specific industries in order to encourage uniform textual and financial statement disclosure of material items which are unique to a particular industry.

The guidelines would not constitute Commission rules nor would they bear the Commission's official approval, rather, they would represent policies and practices followed by the Division in administering the disclosure requirements of the Federal securities laws. Generally, their format will be similar to that of the disclosure guidelines for the bank holding company industry.

The electric and gas utility industry was selected as one of the industries for guideline development because of the high demand of the industry for capital, the unavailability to this heavily regulated industry of current pricing adjustments for carrying through to customers increased expenses, and their ever-increasing needs for energy.

Users and preparers of information relating to electric and gas utility companies were invited to comment. The release mentions certain matters which may be appropriate for disclosure development and invites comments on these matters.

The comment period on the proposals expired on September 15, 1977.[179]

Repeal of Form 12–K, etc.

Pursuant to Section 13(b) of the Exchange Act, the Commission is granted authority to, among other things, prescribe the appropriate accounting methods to be used by registrants filing reports with the Commission. Section 308(b) of the Railroad Revitalization and Regulatory Reform Act,[180] as enacted on February 5, 1976, significantly amended and expanded this authority. As amended, Section 13(b) no longer specifically requires that the Commission allow ICC regulated carriers to file reports submitted to the ICC in lieu of the information specified by other Commission forms. In addition, Section 13(b) now provides that Commission rules applicable to registrants whose methods of accounting are prescribed by other laws or regulations may be inconsistent with the disclosure requirements of the other agencies to the extent that the Commission determines that the public interest or the protection of investors so requires.

On September 3, 1976 the Commission proposed to exercise its expanded authority under Section 13(b) and published for comment proposed amendments to Rules 13a–13, 14a–3, 14c–3 and 15d–13 and the revocation of Rule 13b–1 and Form 12–K.[181] These amendments were designed to require that those registrants regulated by the ICC, FPC, and CAB which currently file copies of annual and quarterly reports submitted to their respective agencies in lieu of Commission Forms 10–K and 10–Q instead file reports in compliance with Forms 10–K and 10–Q and the regulations governing such reports.

After review of the comment letters received and further consultation with interested government agencies, the Commission on April 28, 1977 adopted the September proposals substantially as proposed with the result that registrants reporting to the ICC, FPC, FCC and CAB must now file on Commission Forms 10–K and 10–Q for periods ending on or after October 1, 1977.[182]

During this proceeding it was also suggested by a number of railroad commentators that lessor and switching

company railroads should be the subject of a broad exemption from the financial statements requirements of Forms 10–K and 10–Q[183] In connection with its adoption of the September proposals, the Commission announced that it was considering the formulation of rules and requested public comment regarding the appropriateness of providing such an exemption.[184]

Based on its review of the public comment received, especially the fact that relatively few issuers would be within the scope of any exemptive rule of the type considered by the Commission, the Commission determined and announced on October 5, 1977,[185] that it was no longer considering the proposal of a general exemptive rule and that such matters would be most appropriately considered in the context of applications for exemption filed under Section 12(h) of the Exchange Act.[186]

INVESTMENT COMPANIES

The Division of Investment Management is responsible for the administration of the regulatory provisions of the Investment Company and the Investment Advisers Acts of 1940, and performs certain functions relating to disclosure requirements applicable to investment companies and certain similar types of issuers. For possibly the first time since the enactment of the Investment Company Act, the Division is undertaking a comprehensive review of each of the provisions of this statute and of related legislation. The study will seek to identify instances of overregulation, remedy legislative gaps and examine certain entities now excluded from coverage to determine the appropriateness of comparable regulation.

Bank Study

Section 11A(e) of the Exchange Act, added by the Securities Acts Amendments of 1975, authorizes and directs the Commission to study the extent to which banks maintain accounts on behalf of public customers for buying and selling securities registered under Section 12 of the Exchange Act and whether the exclusion of banks from the Exchange Act definitions of "broker" and "dealer" are consistent with the protection of investors and the other purposes of that Act. Section 11A(e) also directs the Commission to report the results of its study, together with such recommendations for legislation as the Commission deems advisable, to the Congress by December 31, 1976.

The major categories of bank securities services considered as part of the Bank Study are: (1) brokerage-type services, such as dividend reinvestment plans, employee stock purchase plans, automatic investment services and customer transactions service; and (2) certain aspects of bank investment management and advisory services, such as advice and assistance to corporate issuers in connection with private placements or mergers, acquisitions and divestitures. Since only limited public information concerning those services was available, the staff prepared a Bank Study Questionnaire and pre-tested it on a sample of potential bank respondents. Thereafter, the Bank Study Questionnaire was submitted to the General Accounting Office for approval pursuant to the Federal Reports Act. Following General Accounting Office approval, the Questionnaire was sent to a statistical sample of 261 banks and trust companies. Also, since much of the necessary factual information regarding these bank securities services was not susceptible to collection through a questionnaire, interviews were commenced with bank officials

and with representatives of securities firms offering comparable services.

In the course of the study, the Commission submitted to the Congress three Reports on Bank Securities Activities. The Initial Report presented detailed factual and statistical analyses of four bank-sponsored brokerage-type services which are similar to services offered by broker-dealers. The Second Report set forth the comparative regulatory framework relating to banks and broker-dealers in offering and operating each of the four services from the point of view of investor protection. The Final Report examined the corporate financing services and trust department securities trading activities of banks. The Final Report also included the Commission's conclusions and recommendations for legislation regarding all of these bank securities activities.

Although the Commission concluded that eliminating the exclusion of banks from the definitions of "broker" and "dealer"in some respects would result in duplicative and unduly burdensome regulation, the Commission established that some bank brokerage and investment management activities are not subject to an entirely adequate regulatory structure. Such documentation reinforced a number of concerns raised by earlier Congressional hearings on bank securities activities. In addition, the Commission's study identified regulatory disparities which, unless corrected, may result in undetected securities law violations resulting from bank securities activities.

The Commission, in its Final Report, submitted to the Congress specific recommendations, to enhance those basic investor safeguards currently unavailable to bank customers and to prevent regulatory disparities from recurring with the passage of time. Those recommendations have been incorporated into S.2131, which was introduced by Senator Williams on September 22, 1977.

Distribution Costs

A matter of chief concern to the Division of Investment Management has been the question of whether investment companies should be permitted to use their assets to pay for advertising, dealers' compensation and other expenses associated with the distribution of shares. In November of 1976 the Commission held public hearings to gain the benefit of the views of interested members of the public, including the industry, with respect to this matter.[187] The hearings were designed to assist the Commission in its consideration of the legal question of whether it is legal under any circumstances for a mutual fund to bear distribution expenses, directly or indirectly, and whether, and to what extent, the Commission presently has authority to permit, prohibit, or limit the use of mutual fund assets to finance various costs of distribution. Also, views were sought on the policy question of whether such use of fund assets would be in the public interest, assuming this is, or could be made, legal. At the close of the fiscal year, the Division was continuing to evaluate the information provided by the hearings.

Variable Life Insurance

In December 1975, the Commission announced a proposal to adopt Rule 6e–2 under the Investment Company Act, which would exempt separate accounts formed by life insurance companies to fund certain variable life insurance contracts from the registration requirements of the Act on the condition that such separate accounts comply with all but certain designated provisions of the Act. The due date

for comments was extended until March 31, 1976.

A variable life insurance contract differs from a traditional whole life insurance policy principally because the death benefit under the contract may or may not increase based upon the performance of a separate account of securities in which a portion of the fixed premiums has been invested. Moreover, the insured accepts the investment risks that the cash surrender value of his policy will be higher or lower than it would otherwise be under a traditional life insurance policy, since this value also reflects the performance of the separate account.

The proposal of Rule 6e–2 followed the granting of an application in October 1975 for an order of exemption from certain provisons of the Act filed by Equitable Variable Life Insurance Company (EVLICO), the Equitable Life Assurance Society of the United States, and EVLICO's separate account, which is registered under the Act as an open-end management investment company. On October 18, 1976 the Commission announced the adoption of Rule 6e–2 essentially as proposed.[188]

At the same time, in response to comments received on proposed Rule 6e–2, the Commission announced the adoption of Rule 6c–3, which provides exemptions for separate accounts which meet the requirements of Rule 6e–2, but which choose to register, under the same terms and conditions as non-registered separate accounts.

Brochure Rule

On July 21, 1977, the Commission published for comment proposed Rule 204–4 under the Investment Advisers Act[189], which would require registered investment advisers to furnish their clients and prospective clients with written disclosure statements containing certain specified information, and to maintain a copy of such written statement as part of their books and records. It was the Division's feeling that, in the absence of such a requirement, clients and prospective clients of registered investment advisers may not receive certain information which would assist them in evaluating and comparing advisory firms. At the same time the Commission announced proposed revisions in Form ADV, the registration form under the Investment Advisers Act, and a proposed new Form ADV–S which would serve as an annual update for all registered investment advisers.[190]

The proposals are designed to provide the Commission with more information than is presently available about a fast growing industry. The number of registered advisers has increased by almost 25 percent in the past year. Because the advisory industry is so large and diverse, the Division staff received many responses to its requests for comments on these proposals and the matter is under active consideration.

E. I. Du Pont de Nemours & Co. et al. v. Collins et al.

On June 23, 1976, the Court of Appeals for the Eighth Circuit, one Judge dissenting, set aside a Commission order which granted a joint application by E. I. Du Pont de Nemours and Company and Christiana Securities Company for an exemption from the Investment Company Act which would permit the proposed merger of the two companies. Application for a rehearing en banc was denied on February 27, 1976. The Supreme Court, however, granted the Commission's petition for certiorari.

On June 16, 1977 the Supreme Court held that the Commission reasonably exercised its discretion under

Section 17(b) of the Investment Company Act in approving the merger of a closed-end investment company, 98 percent of whose assets consisted of Du Pont Co. common stock, into an affiliated company, Du Pont. The court found that the record before the Commission reveals substantial evidence to support the findings of the Commission and the Commission's conclusions of law were based on a construction of the statute consistent with the legislative intent.[191]

ENFORCEMENT

Significant Cases Involving Securities Acts

SEC v. Advance Growth Capital Corporation et. al.[192]—The United States Court of Appeals for the Seventh Circuit affirmed a district court's refusal to vacate a permanent injunction that had been entered in a Commission enforcement action.

Appellants, the two individual defendants in the action, had been permanently enjoined, on April 9, 1973, from engaging in certain conduct which would constitute violations of the Investment Company Act. On a writ of mandamus, the Court of Appeals had directed the district judge to enter a permanent injunction that had been drafted by the Commission's staff.

Twenty-seven months later, the appellants moved to vacate the injunction under Rule 60(b)(5) of the Federal Rules of Civil Procedure, which authorizes a district court to grant relief from a final judgment, *inter alia*, when "it is no longer equitable that the judgment should have prospective application . . . ." In support of their motion, they asserted, *inter alia*, that they had (1) complied with provisions of the Investment Company Act; (2) suffered embarrassment as a result of being enjoined; and (3) been denied the right to participate in the management of Advance Growth Capital Corporation. The district court denied the motion on the ground that is lacked jurisdiction to modify or vacate the injunction without direction from the court of appeals.

Although the court of appeals found considerable authority to the effect that a motion in the same case for relief from a judgment entered pursuant to appellate mandate cannot be entertained by the trial court without appellate leave, it indicated that it would probably not go so far as to hold that appellate leave is necessary whenever relief is sought under Rule 60(b)(5).

The court of appeals affirmed the motion to vacate on the merits on the ground that any relief granted on the basis of the facts alleged in the motion would have been error since the defendants had made no showing that they were suffering a grievous wrong as the result of new circumstances that were not forseen at the time the injunction was entered.

SEC v. Arthur Lipper Corp. and Arthur Lipper, III.[193]—In this case the Court of Appeals for the Second Circuit affirmed the Commission's findings that Arthur Lipper III and Lipper Corporation had aided and abetted violations of the Federal securities laws by engaging in a fraudulent scheme whereby the investment adviser to a complex of mutual funds defrauded those funds and their shareholders of over $1,450,000. Mr. Lipper and Lipper Corp. facilitated this scheme by charging the funds excessive commissions for executing securities transactions in the United States over-the-counter markets and then funnelling 50 percent of those commissions to a subsidiary of the funds' investment adviser. In view of such conduct, the Commission had determined it to be in the public interest to revoke Lipper

Corporation's broker-dealer registration and to bar Mr. Lipper from future association with any broker or dealer. The court of appeals, however, viewed such sanctions as "too severe" and stated that, under the "special circumstances" of this case, selection of those sanctions constituted an abuse of discretion. As a consequence, it then "limited" the sanctions to suspension of Lipper Corporation's registration for 12 months and the barring of Mr. Lipper from association with any broker or dealer for the same period. The Commission filed a petition for a *writ of certiorari* on August 19, 1977.

SEC v. World Radio Mission[194]— On January 16, 1976, the Commission filed a complaint alleging that World Radio Mission (WRM), a religious organization, and Clinton D. White, president of WRM, were violating the antifraud provisions of the Federal securities laws by selling securities, in the form of notes and loan plans, to the public while misstating and omitting to state material facts. The district court subsequently denied a motion by the Commission for preliminary relief holding that in light of the First Amendment considerations involved, the Commission was not entitled to preliminary relief since it had failed to establish that irreparable harm to the public would result from the denial of the requested preliminary relief.

On appeal the Commission argued that the district court erred in requiring it to establish irreparable injury to the public, urging that while the Free Exercise Clause protects religious practices it does not immunize fraud.

In response to the defendants' arguments that the Commission had failed to establish an intent to deceive, the Commission argued that the holding in Ernst & Ernst v. Hochfelder,[195] that a private action for damages under Rule 10b–5 may not be based on simple negligence, was not applicable to this action for injunctive relief brought by the Commission and based on violations of Section 17(a) of the Securities Act, as well as Section 10(b) of the Exchange Act and Rule 10b–5 thereunder.

The Court of Appeals for the First Circuit agreed with the Commission, holding that: "From the standpoint of an SEC injunction against violations which the court finds are likely to persist, a defendants' state of mind is irrelevant."[196] The court also rejected the argument that defendants' sale of securities was protected by the First Amendment, noting that Congress had not exempted the securities of religious organizations from the anti-fraud provisions of the Federal securities laws.

SEC v. Petrofunds, Inc., et al.,[197]— In this case the district judge denied defendants' demand for a jury trial but, pursuant to 28 U.S.C. 1292(b), certified for immediate appeal the question of whether they were entitled to a jury trial in an action where the Commission sought injunctive and ancillary relief, including an accounting and disgorgement to investors of illicit profits.[198] Petrofunds and certain other defendants, with leave of the court of appeals, took an interlocutory appeal from that order., Subsequently, the court of appeals, after considering the Commission's motion, dismissed with prejudice the appeal for failure of appellants to prosecute it.[199]

In denying the defendants' demand for a jury trial, the district judge rejected defendants' argument that the Commission "stands in the shoes of private litigants with respect to its claims for ancillary relief," because the purpose of a Commission enforcement action is to safeguard the public interest by enjoining violations of

the Federal securities laws.[200] Accordingly, he held that the relief sought by the Commission "springs out of the policy of public enforcement of the provisions of the securities laws and exists as an exercise of the equity powers of the Federal court" and "cannot fairly be analogized to any form of relief available at common law."[201] He noted, however, that the case apparently raised for the first time the issue "whether defendants in an SEC enforcement action are entitled under the Seventh Amendment to a jury trial when part of the relief requested is an accounting for, and concomitant disgorgement of, illegal profits,"[202] and thus he certified the question for appeal.

Nassar and Company, Inc. v. SEC[203]—The United States Court of Appeals for the District of Columbia Circuit, in reviewing a Commission order,[204] vacated and remanded that order which had revoked the company's registration as a broker and dealer and barred George M. Nassar from association with any broker or dealer, while affirming a dismissal by the district court of the appellants' related action to have the Commission's order declared null and void.[205] The Commission's order was based on its determination that the evidence before it demonstrated "*** a high pressure sales effort that lasted for a long time, was unsupported by any semblance of an adequate foundation, and was characterized by grossly reckless price predictions."[206] After reviewing the Commission's findings, the court noted the absence of a discussion by the Commission concerning the appropriate mental state required for violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b–5 thereunder.[207] Accordingly, in deference to its opinion in *Collins Securities Corp. v. Securities and Exchange Commission*,[208] the court remanded the case to the Commission for reconsideration in the light of *Ernst & Ernst* v. *Hochfelder*.[209]

SEC v. American Commodity Exchange, et al.[210]—This action involved thirty-six individual and corporate defendants who were alleged to have engaged in a massive fraudulent scheme in connection with the offer and sale of purported commodity option contracts. The complaint alleged that certain individuals devised a scheme involving the passage of legislation by a state legislature which defined commodity option contracts as securities for purposes of state law, but which exempted from registration those commodity option contracts which were purchased or sold on the floor of a bona fide exchange or board of trade by a broker-dealer registered with the state securities commission. As a secondary step in the scheme, certain individuals undertook to create a commodities exchange which, with the assistance of the then state securities administrator, became the only such exchange in the state. No commodity option transactions ever took place on the floor of the exchange; in fact, the exchange and the clearing house merely served as vehicles for the individuals to collect unearned fees from brokerage houses which were required to join the exchange under threats of reprisals.

The Commission alleged that the purported commodity option contracts constituted "securities" within the scope of the Federal securities laws and that the defendants had violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b–5 thereunder in connection with the fraudulent offers and sales of such interests.

Of the thirty-six defendants, twenty consented to the entry of Final Judgments of Permanent Injunction with-

out admitting or denying the allegations of the complaint. Default judgments were entered against seven other defendants. The complaint was dismissed without prejudice against two other defendants who were not served. Final Judgments of Permanent Injunction by Summary Judgment were entered against the remaining seven defendants for violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b–5 thereunder. Only one defendant chose to appeal the entry of the injunction against him.

The court of appeals affirmed that district court judgment and held that violations of the antifraud provisions of the securities laws resulted from the scheme involving the creation of the purported exchange and clearing house and the collection of fees for which no legitimate function had been performed. It also stated that the district court correctly held that the purported commodity option contracts, in the circumstances of this case, were investment contracts and thus securities within the Federal securities laws. Further, in its opinion the court of appeals held that the passage of the Commodity Futures Trading Commission Act of 1974 did not strip this Commission of authority to institute this action after the effective date of that Act for conduct which occurred prior to the effective date of that Act. And with respect to the Commission's motion for summary judgment, the Tenth Circuit stated that it was proper for the Commission to submit investigative transcripts in support of its summary judgment motion, since such transcripts "are equivalent to affidavits in terms of the quality of the evidence involved."

Todd and Company, Inc. and Thomas K. Langbein v. *SEC*[211]—On June 27, 1977, the United States Court of Appeals for the Third Circuit, on a petition for review of a Commission order affirming disciplinary action taken by the NASD against a broker-dealer and its president, upheld the Commission's finding that the broker-dealer violated Rules 1, 4, and 18 of Article III of the NASD Rules of Fair Practice. The brokerage firm had created the appearance of a shortage of the stock it was underwriting by refusing to sell the amounts requested by certain of its customers in the initial distribution, and, thereafter, when substantially all the stock was under its control, the firm solicited its customers to buy and sell the stock at substantially increased prices. The court, however, found that procedural errors had been committed by the NASD, and accordingly vacated the Commission's order with instructions that the case be referred back to the NASD.

SEC v. Mor-Film Fare, Inc. et al.[212]—The Commission issued an order directing a private investigation into possible violations of the registration and antifraud provisions of the Federal securities laws by Mor-Film Fare, Inc. and others (appellants). It appeared, from the staff's informal inquiry, that the appellants were selling unregistered securities in the form of interests in limited partnerships and making false and misleading statements concerning, *inter alia*, the cost and value of properties acquired by the partnership, the nature and existence of assets of the partnership and the performance and operations of such properties or assets.

Pursuant to the Commission's order, subpoenas *duces tecum*, were issued to the appellants requiring them to produce relevant books and records of their respective business entities, but the appellants did not fully comply with the subpoenas. Accordingly, the Commission applied to the United

States District Court for the Central District of California for an order to show cause why the appellants should not be compelled to produce the materials requested under the subpoenas. The district court ordered the appellants to comply with the subpoenas and they appealed that order.

The appellants argued before the Court of Appeals for the Ninth Circuit, that the Commission's subpoenas were issued in connection with an unlawfully authorized purpose, sought materials irrelevant to the investigation, were broad and unreasonable, and that the officers of the business entities under investigation could assert their Fifth Amendment privilege against self-incrimination to avert the production of subpoenaed business entity documents.

The Ninth Circuit, in a memorandum opinion, affirmed the district court's order requiring obedience to the subpoenas.

A. J. White & Co. and Allen J. White v. SEC[213]—On June 15, 1977, the United States Court of Appeals for the First Circuit affirmed a Commission order revoking the registration as a broker-dealer of A. J. White & Co., and barring its president, Allen J. White, from association with any broker-dealer.[214] The Commission had found that the broker-dealer and its president had violated the antifraud, extension of credit, record-keeping, and prospectus-delivery provisions of the Federal securities laws in connection with a "best efforts, 65,000 shares or none" underwriting of common stock in Develco Corp. When the broker-dealer became aware that it would be unable to sell the requisite number of shares to investors in bona fide transactions, instead of refunding investors' money it resorted to unusual financing arrangements involving substantial bank loans in the names of one group of individuals being used to purchase stock for the accounts of another group of individuals. The court of appeals affirmed the Commission's finding that the prospectus should have been changed to reflect the changed method of distributing the stock, noting that "[i]f it was too late to disclose the change, the investors had a right to assume that the prospectus would be complied with, not changed."

Handler, et al. v. SEC, et al.[215]—In this case three former officers of Mattel, Inc., sought, among other things, a declaratory judgment voiding portions of a consent decree negotiated in an independent action, *Securities and Exchange Commission v. Mattel, Inc.*, Civ. Action No. 74–2958–FW (C.D. Calif.), which established, among other things, a Special Counsel and Special Auditor to conduct an investigation of Mattel as a result of the reporting violations and other corporate improprieties which had come to the Commission's attention. Plaintiffs instituted this action 15 months after the public dissemination of the reports of the special professionals and over 2 years after the entry of the consent decree. In addition to an order voiding the terms of the consent decree, the plaintiffs sought an injunction prohibiting the defendant's use in any manner of any information or materials compiled by the Special Counsel and Special Auditor.

In granting the Commission's motions, the court found, as the Commission had urged, that it had the power to enforce the consent decree, that there was no unlawful delegation of power from either the district court or the Commission, and that plaintiffs constitutional rights had been, or would be, appropriately protected.

Plaintiffs had challenged the terms of the negotiated consent decrees on the grounds that (1) the entry of the

consent decree judgment and approval of the Special Counsel and Special Auditor contravened the limits of the district court's judicial authority as defined by Article III of the United States Constitution; (2) the judgment represented an unlawful delegation of powers in several respects and was violative of the separation of powers clause of the Federal Constitution; and (3) the judgment unlawfully compromised several of the plaintiffs constitutional rights.

In moving to dismiss the action or, alternatively, for summary judgment, the Commission had argued that the entry of the consent decree judgment was clearly within the scope of the district court's broad equity powers; that plaintiffs misconceived the roles of the special professionals when they characterized them as agents of the Commission and that plaintiffs constitutional rights had been, and would be, appropriately protected.

SEC v. Parklane Hosiery Co.,[216] *Inc.*—In this case, the Court of Appeals for the Second Circuit affirmed the findings of violation made by the district court, but declined to reverse that court and enter a decree of permanent injunction. This action was instituted against Parklane Hosiery Co., Inc. and Herbert Somekh, Parklane's chief officer and major shareholder. The Commission had alleged, and the district court found, that Parklane had gone public by selling 300,000 shares of stock to the public at $9 per share. In 1974, because of heavy financial pressure relating to Somekh's personal finances, Somekh concocted a scheme to take Parklane private, at $2 per share. The Commission's complaint alleged, and the district court found, that the proxy statement seeking approval from Parklane's shareholders for the going-private merger was materially false and misleading, since it concealed from the public shareholders of Parklane the facts that: (1) the purpose of the going private transaction was to enable Somekh to discharge his personal debts from Parklane's treasury; (2) Parklane had engaged in negotiations suggesting that a leasehold held by the company might be saleable for an amount which would net Parklane $300,000; and (3) the independent appraisal of Parklane's shares reflected in the proxy statement had been conducted in the absence of relevant information (including items (1) and (2), above).

The defendants noticed an appeal from the district court's decision, arguing that the information was disclosed to the extent it was required to be, that the information not disclosed was not material to investors, and that any violations of the law were irrelevant, since Somekh owned or controlled 72 percent of Parklane's securities, and the shareholders were powerless to stop the merger in any event. The Commission thereupon cross-appealed from that portion of the district court's decision which denied the Commission's prayer for permanent injunctive relief.

In its decision, the court of appeals held that the district judge's conclusions were not clearly erroneous, and that there were material omissions from Parklane's proxy statement. In so holding, the court rejected the defendants reliance on the Supreme Court's decision in *Santa Fe Ind. v. Green,* U.S. (1977), emphasizing that *Santa Fe* was a private action for damages under Rule 10b–5 whereas this case was a Commission injunctive action for violations of the proxy, periodic reporting and antifraud provisions of the Federal securities laws.

Moreover, the court of appeals concluded that in *Parklane*, unlike the situation conceded to exist in *Santa*

Fe, had the shareholders of Parklane been aware of Somekh's reasons for the going-private transaction, they, or others, might well have been able to enjoin the merger under New York law as having been undertaken for no valid corporate purpose. Such a capacity to sue under state law, the court concluded, makes the omissions material, irrespective of Somekh's controlling influence over Parklane.

In re Weis Securities, Inc.[217]—In this case the district court held in enforcing subordinated loan agreements in a broker-dealer liquidation, that customers and creditors need not show actual reliance on subordination agreements, but that reliance on subordinated loans should be presumed as a matter of law. In that case, a number of subordinated lenders sought to rescind their subordination agreements and share in the distribution with customers or with general creditors of Weis on the ground that the subordinated lenders had been fraudulently induced to enter into such loan agreements. Under both Commission and New York Stock Exchange rules, Weis was permitted to treat subordinated loans as part of its capital for the purpose of meeting its net capital requirements.

The Commission argued in the district court and in its brief in the court of appeals,[218] that the Federal policy of customer protection embodied in the Federal securities laws relating to the financial responsibility of broker-dealers, including the net capital requirements, requires that subordinated lenders not be permitted to rescind subordination agreements, even if fraudulently procured, where rescission would adversely affect customer claims. The Commission also took the position that since the remedy of rescission is generally inapplicable in liquidations where, as in *Weis*, the funds or securities with which a creditor has been fraudulently induced to part cannot be traced or identified, to the extent that a subordinated lender has any claim, it could only be a tort claim for fraud. Accordingly, the Commission expressed the view that subordinated lenders could participate in the Weis estate, if at all, only with the claims of non-customer creditors after customer claims have been satisfied.

SEC v. Bausch & Lomb[219]—The United States Court of Appeals for the Second Circuit, determined not to reverse a district court's determination to deny the Commission's application for injunctive and other equitable relief. In the district court, the Commission had alleged that Bausch & Lomb, through its Chairman of the Board, had selectively disclosed material, inside information to a few securities analysts. But, the district court was "*** not convinced *** that absent an injunction there is a reasonable likelihood that defendants will violate the securities laws in the future,"[220] and therefore denied the Commission's prayer for equitable relief. The district court also opined that *scienter* is a necessary component in an action brought by the Commission under Section 10(b) of the Exchange Act and Rule 10b–5.[221] In affirming the judgment below, the court of appeals did not reach the *scienter* question, stating: "We need not now decide whether *Hochfelder*[222] mandates abandonment of our long-standing rule that proof of past negligence will suffice to sustain an SEC injunction action."[223] The court of appeals agreed with the district court that the Commission had not established the necessity for an injunction to prevent future violations and was "*** not inclined to substitute its judgment for that of the experienced trial judge who heard the witnesses and had the 'opportunity by observa-

tion better to prophesy future conduct than we can on this printed record'."[224]

Natural Resources Defense Council, et al. v. SEC[225]—This decision is the most recent development in a six-year effort by several public interest groups to compel the Commission to adopt rules requiring publicly-held companies to disclose non-material[226] information concerning their environmental and employment practices in documents filed with the Commission or distributed to shareholders. The plaintiffs had argued that the Commission was compelled to adopt the disclosure policy they favor by the National Environmental Policy Act of 1969, 42 U.S.C. 4321 *et seq*. The court rejected this contention, but remanded the matter to the Commission for further consideration because of certain "flaws" that it believed marred the Commission's decision-making process, including, *inter alia*, the failure to conduct "cost/benefit" studies, the failure to consider adopting the plaintiffs' suggestions only with respect to proxy disclosures, and the Commission's reliance, in part, on the activities of other governmental agencies. The Commission has taken an appeal to the United States Court of Appeals for the District of Columbia Circuit.

Collins Securities Corp. v. SEC[227]—In this case the Court of Appeals for the District of Columbia reversed and remanded a Commission order revoking the broker-dealer and investment adviser registrations of Collins Securities Corporation and barring Timothy Collins, its principal, from association with a broker or dealer (provided that after two years he could apply to become so associated in a position not directly or indirectly connected to market making activities). The Commission found that Collins Securities Corporation and Mr. Collins had violated numerous provisions of the Federal securities laws, including manipulation of the market for securities of Big Horn National Life Insurance Company.[228]

The court of appeals did not address either the respondents' substantive objections to the Commission's findings of violations of the Federal securities laws or the contentions they made regarding the propriety of the statutorily-authorized sanctions. Instead, after briefly describing the underlying factual setting, the court focused upon the standard of proof applicable in broker-dealer administrative proceeding involving allegations of violations of antifraud provisions of the Federal securities laws. In that connection, the court held that the Commission had erred in basing its decision on the "preponderance of the evidence" standard of proof because the court believed "clear and convincing evidence" is required in administrative proceedings involving charges of fraud, at least where the sanction is expulsion from the securities industry. It thus remanded the matter to the Commission for a reexamination of the entire evidentiary record. Further, in light of the Supreme Court's decision in *Ernst & Ernst v. Hochfelder*,[229] the court of appeals directed the Commission to consider the applicability of a *scienter* requirement to fraud charges in Commission administrative proceedings.

SEC v. Universal Major Industries Corporation, et al.[230]—In this case, the district court found that Arthur Homans, an attorney, through the issuance of opinion letters asserting the legality of the distribution of nearly 3.5 million shares of unregistered Universal Major Industries Corporation common stock to over 600 individuals, aided and abetted a violation of Section 5 of the Securities Act. The court held that "in some circumstances Homans knew, and in other circumstances had reason

to know, that his client was engaging in illegal distributions of its common stock and that his letters were being used to further those distributions."[231] Having found that the Commission had made a *prima facie* showing of violations of the Federal securities laws, and that there existed a reasonable likelihood of future violations by Mr. Homans, the district court granted the Commission's request for injunctive relief.

Mr. Homans appealed the district court decision to the United States Court of Appeals for the Second Circuit.[232] The Commission, in its answering brief, argued that (1) the offer and sale of Universal Major Industries common stock, under the circumstances described above, was not exempt from registration pursuant to Section 4(2) of the Securities Act; (2) the district court correctly concluded that Universal Major Industries common stock was sold as part of a public offering; (3) aiding and abetting liability could be imposed for Section 5 violations; (4) the *scienter* requirement enumerated in *Ernst & Ernst v. Hochfelder*[233] has no application in an action involving Section 5; and (5) the district court did not abuse its discretion in enjoining Mr. Homans from participating in further violations of the registration provisions of the Securities Act.

The Court of Appeals for the Second Circuit affirmed the district court,[234] finding that under the circumstances of this case, Homans had aided and abetted the public offering of unregistered securities. Moreover, the court rejected Homans' argument that the *Hochfelder* culpability standard was applicable in SEC injunctive actions and found that in proceedings instituted by the SEC seeking equitable relief, the cause of action may be predicated upon negligence alone and that proof of *scienter* is unnecessary.[235]

Sloan v. SEC[236]—In this case Samuel H. Sloan challenged the Commission's authority to issue a series of consecutive summary trading suspension orders, which had suspended trading in the common stock of Canadian Javelin Ltd. on the American Stock Exchange and in the over-the-counter market for consecutive ten-day periods from April 29, 1975 through May 2, 1976. These orders were entered pursuant to the authority conferred upon the Commission by former Sections 15(c)(5) and 19(a)(4) of the Exchange Act[237] and, after the Securities Acts Amendments of 1975 became effective, by new Section 12(k) of the Act,[238] which restated and consolidated the Commission's authority to issue summary trading suspension orders.

In the court of appeals, Mr. Sloan argued, among other things, that the Commission's authority to suspend trading is limited by the statute to "a period not exceeding ten days."[239] The Commission contended that the legislative history of the Securities Acts Amendments of 1964, which added Section 15(c)(5) to the Act, makes clear that Congress had accepted the Commission's practice of issuing consecutive suspension orders at the time that the Commission's summary suspension authority was extended to include securities traded in the over-the-counter market.

The court of appeals held that the Commission's practice of issuing consecutive summary trading suspension orders exceeded the authority conferred upon it by Section 12(k) of the Exchange Act (and former Sections 15 (c)(5) and 19(a)(4) of the Act). In addition, although the review proceeding was not a class action, the court directed the Commission to "discontinue" the practice of issuing consec-

utive ten-day trading suspensions "forthwith."

In May, 1977, the Solicitor General filed a petition for a writ of certiorari in the Supreme Court, on behalf of the Commission, which contends that the court of appeals erred in several respects, particularly in its reading of the legislative history and its determination that the suit had not become moot. The petition was granted on October 17, 1977.[240]

Commission Litigation

SEC v. National Student Marketing Corporation, et al.—Since the date of the last Report, the balance of the Commission's case arising out of its investigation relating to the affairs of National Student Marketing Corporation was either settled or tried. During this period, all but five of the remaining defendants consented to some form of court order. Each of the consenting individual defendants,[241] without admitting or denying the Commission's allegations, consented to the entry of a Judgment of Permanent Injunction against him with respect to certain violations of the Federal securities laws. They did so after the Commission had filed a detailed pretrial brief in December 1976 setting forth the factual allegations involved.

In addition, Marion J. Epley, III,[242] one of the defendants in the action and a partner of the law firm of White & Case, as part of his settlement, agreed in a letter to the Chairman not to practice before the Commission for a period of 180 days. The Injunction against Epley also prohibits him from issuing certain legal opinions under certain circumstances. Further, the Injunction requires Epley to comply with applicable procedures of White & Case regarding representation by the firm of corporations subject to the Federal securities laws.

The law firm of White & Case[243] which was also a defendant, as part of its settlement, agreed to a court Order which enables the court to retain jurisdiction to effect compliance with the terms and conditions of the settlement. The Stipulation of Settlement provides that White & Case "undertakes to adopt, effectuate and maintain procedures in connection with its representation of clients in matters involving the Federal securities laws." A copy of White & Case's procedures was attached to the Stipulation. Among the firm's procedures are provisions concerning the retention of certain new clients, review of certain registration statements by a second partner of the firm experienced in securities matters who is not otherwise involved in the transaction, and identification of certain circumstances involving the issuance of securities to the public where consultation with other partners within the firm is required. Both the Order and Stipulation indicate that the Commission has neither approved nor disapproved of the procedures.

One of the other individual defendants, John G. Davies, had a Default Judgment of Permanent Injunction entered against him by the court.

The trial of the Commission's action against the remaining defendants, Cameron Brown, the law firm of Lord, Bissell & Brook, and its two partners, Max E. Meyer and Louis F. Schauer, began on May 16, 1977. Closing arguments were held in early August 1977. At this time, the Commission is awaiting the decision of the court.

As previously reported, Anthony M. Natelli, the audit partner of Peat, Marwick, Mitchell & Co. responsible for the National Student Marketing account, was criminally convicted of violating the Federal securities laws. In late 1976, following his failure to set

aside that conviction, both by direct and collateral attack, Natelli served a prison term for his conviction.

With respect to the Peat, Marwick, Mitchell & Co. audit supervisor, Joseph Scansaroli, whose conviction, as previously reported, was reversed by the Court of Appeals for the Southern District of New York with a new trial ordered, a settlement was ultimately arrived at[244] which provided that he would not be retried. However, he agreed to the entry of a Permanent Injunction and permanent bar from practice before the Commission under Rule 2 (e) of the Commission's Rules of Practice. This disposition of the case as to Scansaroli was agreed to with the concurrence of the Department of Justice.

SEC v. Royal Industries Inc.—On November 16, 1976, the Commission filed a complaint seeking injunctive relief against Royal Industries Inc. (Royal), a Delaware corporation with its principal executive offices at Pasadena, California.[245] The Commission's complaint alleged that Royal had violated the filing requirements of the tender offer provisions of the Exchange Act in filing with the Commission incomplete and inaccurate statements on Schedule 14D urging rejection of a tender offer for its securities by Monogram Industries Inc. (Monogram).

The complaint further alleged that Royal's Schedules 14D failed to disclose that a principal purpose of Royal's proposed acquisition of SAR Industries Inc. (SAR) was to interpose a potential antitrust obstacle to Monogram's proposed tender offer.

The complaint further alleged that Royal's Schedules 14D filed with the Commission contained statements that Royal's board of directors urged rejection of a proposed tender offer by Monogram, but failed to disclose provisions in Royal's deferred compensation plans for certain employees which provided for acceleration of approximately $9 million of benefits to approximately 100 employees, in the event a 25 percent interest in Royal was acquired in a transaction in which a majority of Royal's board of directors did not concur. The complaint further alleged that Royal failed to disclose that two directors who voted to recommend against Monogram's proposed tender offer were participants in such plans and would receive approximately $1,325,000 in benefits upon acceleration of payments under the plans.

The complaint also alleged that Royal's Schedules 14D contained incomplete and inaccurate statements concerning commissions to be paid to brokers soliciting shares tendered, the obligations of Monogram to accept part or all of the shares tendered, and a financial statement comparison of Royal and Monogram.

The court entered a Judgment of Permanent Injunction against Royal restraining and enjoining Royal from violations of the filing requirements of the tender offer provisions of the Exchange Act. Royal consented to the entry of the Judgment without admitting or denying the allegations of the complaint.

In addition to the entry of the Judgment against Royal, the court ordered certain ancillary relief, including the following:

(1) An undertaking by Royal to adopt, implement and maintain procedures reasonably designed to prevent the recurrence of the activities alleged in the Commission's complaint, or similar activities, and designed to assure compliance with the filing requirements of the tender offer provisions of the securities laws; and

(2) An undertaking by Royal to amend its Schedules 14D filed with the Commission and to correct its statements

to shareholders to assure that such filings and statements are complete and accurate and otherwise comply with the securities laws.

SEC v. American Commonwealth Financial Corp., et al.—On May 12, 1977, the Commission filed a complaint seeking injunctive relief against American Commonwealth Financial Corporation (ACFC), an insurance holding company located in Dallas, Texas, of which Great Commonwealth Life Insurance Co. (GCL) of Dallas, Texas and National American Life Insurance Company (NALICO) of Baton Rouge, Louisiana, were or had been subsidiaries; Centram Industrial Limited (Centram), a Louisiana corporation; First Republic Life Insurance Company (FRLIC), a Louisiana corporation; Corporate Hotel Partnership (Partnership), a Louisiana limited partnership; Mountain, Inc. (Mountain), a Louisiana corporation; Valley, Inc. (Valley), a Louisiana corporation; Rodolfo Jesus Aguilar (Aguilar), a general partner in Partnership and owner of 30 percent of the stock of Mountain, and, directly and indirectly, all of the stock of Centram; Jules Burton LeBlanc, III (Jules LeBlanc), general partner in Partnership, owner of 70 percent of the stock of Mountain and 100 percent of the stock of Valley, and engaged in partnership with Aguilar in real estate development; Paul James LeBlanc (P. J. LeBlanc), director and chairman of the board of ACFC from April 1975 to December 1976; and Roger Jean LeBlanc (R. LeBlanc), president, director and chief executive officer of ACFC from approximately April 1975 through the filing of the complaint, controlling shareholder of ACFC since February 1975, owner of 99.5 percent of the stock of FRLIC, and brother of Jules LeBlanc.[246]

All of the defendants except P.J. LeBlanc consented to the entry of Final Judgments of Permanent Injunction, without admitting or denying the Commission's allegations.

The Commission's complaint alleged that the defendants engaged in a fraudulent course of conduct whereby they used the assets of ACFC and other public companies for their personal gain and benefit and to service debt owed to third parties by various of the defendants.

According to the complaint, prior to February 1975, defendants Jules LeBlanc, Aguilar and to a lesser extent R. LeBlanc had borrowed substantial sums from the Chase Manhattan Mortgage and Realty Trust (CMART), totalling over $25 million by the end of 1974, in connection with real estate development in Baton Rouge, Louisiana. All of the CMART loans were personally guaranteed by R. LeBlanc or Jules LeBlanc and were in default by the end of 1974.

The complaint further alleged that R. LeBlanc, aided and abetted by Jules LeBlanc, P. J. LeBlanc and others, acquired shares of common stock of ACFC so as to control that corporation in order to use its assets for their personal gain and to service the CMART debt.

According to the complaint, in February 1975 R. LeBlanc purchased approximately 28 percent of the common stock of ACFC, representing control of the corporation. In June and July 1975, according to the complaint, R. LeBlanc caused ACFC to sell to him 505,050 shares of the company's common stock at a value of $2 million in consideration for $1 million and real property purportedly worth more than $1,350,000. The complaint alleges that in connection with this additional acquisition of ACFC common stock, R. LeBlanc failed to disclose that the real property involved in the transaction had been acquired by Jules LeBlanc and other members of R. Le-

Blanc's family only three years prior at a price less than $400,000, and that the $1 million in cash for the acquisition of the shares was borrowed from a bank by pledging the ACFC shares which R. LeBlanc acquired in February 1975.

The complaint charged that in order to borrow approximately $3.5 million to repay certain indebtedness, R. LeBlanc pledged about 44 percent of the outstanding stock of ACFC, and, without the knowledge or prior approval of the ACFC Board of Directors, entered into a loan agreement which materially restricted ACFC's ability to conduct certain business, issue stock, increase capital or grant dividends.

The complaint further alleged that in September 1975 R. LeBlanc caused ACFC to purchase from Louis J. Roussel, Jr. (Roussel) and others approximately 56.5 percent of the outstanding shares of common stock of NALICO. ACFC gave to Roussel notes secured by a mortgage on the same property previously transferred to ACFC by R. LeBlanc to secure his own purchase of 505,050 shares of ACFC stock. After Roussel complained that this property was substantially overvalued, R. LeBlanc caused NALICO to purchase the notes from Roussel.

The complaint charged that in late November 1975, R. LeBlanc and Jules LeBlanc, with the assistance of Aguilar, engaged in a series of transactions to utilize the credit of ACFC to assist the Baton Rouge "Corporate Square" shopping and building complex, owned by Jules LeBlanc and Aguilar, in obtaining an extension of the CMART loans on which it and they were in default.

The complaint charged that R. LeBlanc caused FRLIC to engage in certain transactions with publicly-held insurance companies whereby FRLIC contracted to assume certain liabilities of those companies and in exchange acquired assets, including marketable securities, which he thereafter caused FRLIC to liquidate for cash. With this cash, R. LeBlanc caused FRLIC to purchase the notes or stock of various private companies owned and controlled by R. LeBlanc, Jules LeBlanc, or their associates, to disburse large sums of money to such persons, and to guarantee loans to such persons. The complaint alleged that the insurance companies contracting with FRLIC had been relying on FRLIC's ability to discharge its assumed liabilities but that the above transactions had resulted in a material impairment of FRLIC's capital and raised questions about its financial condition.

The complaint further alleged that in 1976 FRLIC, directly and through subsidiaries, acquired 34 percent of the shares of American Public Life Insurance Co. (APLIC), a Mississippi insurance company, and options to purchase a controlling block of shares of United Founders Life Insurance Co. (UFLIC), an Oklahoma insurance company, and in connection therewith, filed false and misleading Schedule 13D information statements with the Commission.

The complaint alleged that there was a close relationship between Louisiana Governor Edwin Edwards and Jules LeBlanc. The complaint further alleged that, at the request of Jules LeBlanc, Governor Edwards contacted the Insurance Commissioner of Louisiana concerning possible regulatory and enforcement action to be taken with respect to FRLIC, after which the Insurance Department deferred such action.

The court entered Judgments of Permanent Injunction on June 30, 1977 against R. LeBlanc, Jules LeBlanc, Aguilar, ACFC, FRLIC, Partner-

ship, Mountain, Valley and Centram, based on consents, enjoining them from violations of the antifraud provisions of the Federal securities laws. In addition, the Court enjoined R. LeBlanc, ACFC and FRLIC from violations of the reporting provisions and R. LeBlanc and FRLIC from violations of the proxy solicitation provisions of the Federal securities laws.

In addition, certain ancillary relief was ordered by the Court, including the following:

1. The Court gave R. LeBlanc nine months within which to dispose of his ACFC stock. In the event that R. LeBlanc failed to do so his stock would be placed in an independent voting trust, the trustee of which would be approved by the Commission;

2. R. LeBlanc was required to resign as an officer of ACFC;

3. ACFC was required to retain a person to act as a monitor over the business affairs of ACFC and to approve all ACFC transactions over $5,000. When ACFC failed to comply with this provision of its Final Judgment, the court, upon petition by the Commission, appointed a monitor on September 7, 1977;

4. FRLIC was required to retain an independent certified public accountant to perform an audit of FRLIC, including affiliated transactions, in the event that the state of Louisiana did not perform a full scale audit of FRLIC within a specified time period; and

5. FRLIC and LeBlanc were restrained from voting for or nominating more than a minority of the Board of Directors of APLIC and UFLIC in order that the Boards of these two companies would remain composed of a majority of persons unaffiliated with R. LeBlanc. APLIC consented to be bound by these provisions of the FRLIC and LeBlanc Final Judgments.

SEC v. National Pacific Corporation et al.—On September 24, 1976, the Commission filed a complaint for Injunctive, Receivership and Other Relief against National Pacific Corporation (NPC), National American Life Insurance Co. (NALICO), a publicly-held company, Great Pacific Corporation (GPC), Family Provider Life Insurance Company (Family), Pacific Southwest Insurance Agency, Inc. (PSIA), Joseph Hauser (Hauser), Melvin Wyman (Wyman), John Boden (Boden), and George Herrera (Herrera), chárging violations of the antifraud provisions and certain reporting provisions of the Federal securities laws.[247]

The complaint charged that, between June 1976 and the filing of the action, NALICO, NPC (controlled by defendants Hauser, Wyman, and Boden) and the other defendants made or caused to be made false filings with the Commission and other governmental agencies and misappropriated valuable assets of NALICO.

The Commission alleged that between January and June of 1976, prior to acquiring control of NALICO, the defendants wrongfully appropriated approximately $1 million from insurance premiums paid directly or indirectly to Family by various union health and welfare funds. After the acquisition of control of NALICO, the defendants caused NALICO to purchase from NPC convertible surplus notes of another company, Farmers National Life Insurance Co. (Farmers), which, according to financial statements filed by Farmers, did not have enough surplus to meet the terms of the convertible surplus notes put into NALICO by the defendants.

The complaint further alleged that the defendants caused NALICO to enter into a reinsurance agreement with Family, whereby assets and liabilities of Family were assumed by NALICO. Those assets included $2.2

million in notes which had been cancelled by Hauser in March of 1976 and, consequently, were worthless. The Commission in its complaint further alleged that the documents relating to the above transactions, which were entered into in late June, were backdated to make it appear as if they had been entered into prior to the acquisition of control of NALICO by NPC.

The complaint alleged that financial statements filed by the defendants on behalf of NALICO with various state insurance regulatory agencies as of June 30, 1976 were false and misleading by failing to disclose the above matters. In addition, documents relating to the acquisition of control of NALICO filed with the Louisiana Insurance Department and the Commission (an Information Statement on Schedule 13D) were false and misleading by failing to disclose the same matters.

Following July 15, 1976, according to the complaint, the defendants misappropriated from NALICO approximately $1.5 million, including approximately $100,000 used to pay off debts of the defendants incurred prior to their acquiring control of NALICO and $1.1 million paid to a newly-formed Swiss company.

In addition to seeking injunctive relief, the Commission, in its complaint and in a Motion for Preliminary Injunction filed simultaneously therewith, sought the appointment of a receiver for NALICO, a Louisiana-based, publicly-held insurance company, 58 percent of the common stock of which had been owned by NPC since June 15, 1976.

Upon the Commission's application for a Temporary Restraining Order, U.S. District Judge Gerhard Gesell, on September 24, 1976, issued such an order freezing the assets of all the defendants (except the normal and reasonable living expenses of the individual defendants). On September 29, 1976, upon the Commission's application for a preliminary injunction, U.S. District Judge Charles Richey issued another Temporary Restraining Order and appointed Herbert E. Milstein, Esq., Agent of the Court with authority over the assets of NALICO.

On October 14, 1976, U.S. District Judge William Bryant entered a Final Judgment of Permanent Injunction with respect to defendant Boden, by consent.

On December 2, 1976, Judge Charles Richey entered two Orders and a Stipulation effecting final settlement of this action by consent.[248] The Orders signed by Judge Richey were as follows:

(1) A Final Judgment of Permanent Injunction as to defendant NALICO, whereby NALICO was enjoined from violations of the antifraud provisions of the Federal securities laws, and whereby the court's agent, Herbert E. Milstein, was appointed as Receiver over NALICO, to control and manage the business affairs of NALICO and to prosecute any claims by or on behalf of NALICO.

(2) A Final Judgment of Permanent Injunction as to defendants Hauser, Wyman, Herrera, NPC, GPC, Family and PSIA, whereby all were enjoined from violations of the antifraud provisions; Hauser, Wyman, and NPC were enjoined from violations of the reporting provisions; and defendants Hauser, Wyman, Herrera, GPC, FPLIC, NPC and PSIA, and certain related entities were ordered to file with the court affidavits as to their assets and liabilities, and to cooperate with the Receiver or his successor.

In addition, the following terms, among others, were ordered:

(a) Hauser, for a period of 10 years,

and Wyman, for a period of 5 years were prohibited from serving as directors, officers, or control persons of any publicly-held company, without the prior written approval of the Commission;

(b) Hauser and NPC were ordered to return to NALICO within 10 days the $1.1 million remitted in the name of NALICO to the Swiss company in August of 1976; and

(c) The Receiver was authorized to seek disgorgement from any of the defendants.

In addition to the entry of the Orders, Judge Richey on December 2, 1976 also approved the terms of a Stipulation by and between NALICO, Mr. Milstein and Mr. Sherman A. Bernard, Commissioner of Insurance of the State of Louisiana. Pursuant to this Stipulation, which was also approved by the Commission, the parties to the Stipulation acknowledged the respective interests in NALICO of the Commission and the Insurance Commissioner, who had been appointed Rehabilitator of NALICO by a Louisiana State Court, and consented to the designation of the Agent as Receiver, with full powers of an equity receiver, over NALICO. The parties to the Stipulation further agreed that, among other things, any disputes between the Receiver and the Insurance Commissioner would be submitted to the United States District Court for the District of Columbia for its resolution of such disputes.

With respect to the $1.1 million that the court ordered Hauser to return by December 12, 1976, only $832,000 was initially returned. The Commission and the NALICO Receiver moved to hold Hauser in civil contempt of court for not returning the remaining funds. In addition, the Commission and the Receiver asked the court to hold Hauser in contempt for having used a NALICO credit card to incur $4,530.49 in expenses after the entry of the September 29, 1976 freeze order. The court, on July 7, 1977, adjudicated Hauser in contempt of the December 2, 1976 Final Judgment and the September 29, 1976 freeze order, and ordered Hauser to return the sums of $4,530.49 and $142,000 (the portion of the remainder of the $1.1 million that Judge Richey held Hauser in contempt for not returning) within 30 days.

At a hearing held September 28, 1977 in the U.S. District Court, Judge Richey, after hearing testimony of Hauser, held Hauser in further contempt of his July 7, 1977 Order, ordered that he be incarcerated until he paid to the NALICO Receiver $146, 530.49 and fined Hauser $10,000.

After being incarcerated in the jail in the District of Columbia for approximately one week, Hauser was discharged from confinement when he paid the Receiver $156,530.49.

SEC v. Falstaff Brewing Corporation, et al.,—On May 25, 1977, the Commission filed a complaint seeking permanent injunctive relief against Falstaff Brewing Corporation (Falstaff), a corporation with principal offices in San Francisco, California which engages in the manufacture and distribution of beer and other malt beverages; Paul Kalmanovitz (Kalmanovitz), the current chairman of the board of directors and controlling shareholder of Falstaff; Ferdinand Gutting (Gutting), former president and chairman of the board of Falstaff; and James S. McClellan (McClellan), a former member of the board of directors of Falstaff and counsel to Falstaff.[249] The complaint sought, in addition, preliminary relief against Falstaff, including an injunction against violations of certain provisions of the securities laws pending trial on the merits, and order pro-

hibiting Falstaff from convening its annual shareholders' meeting scheduled for June 7, 1977 and prohibiting Falstaff from soliciting or voting proxies by means of its 1977 proxy statement. McClellan and Gutting consented to the entry of Judgments of Permanent Injunction at the time the complaint was filed.

The complaint charged Falstaff, Kalmanovitz, McClellan and Gutting with violations of the antifraud, proxy and reporting provisions of the Federal securities laws in connection with a 1975 transaction whereby Kalmanovitz acquired 52 percent of the outstanding voting rights of Falstaff. It was alleged, among other things, that Falstaff's 1975 proxy soliciting material failed to disclose that Kalmanovitz would obtain such control; that one-half of his voting rights were obtained in consideration for an extension of credit by one of Falstaff's suppliers; and that certain provisions in the agreement between Falstaff and Kalmanovitz concerning the prepayment of Falstaff's long term debt would violate agreements with Falstaff's lenders which required *pro rata* payment among all such lenders. Falstaff was additionally charged with violations of the periodic reporting provisions of the securities laws in connection with its filings with the Commission from 1974 to 1977. The Commission also alleged that Falstaff's 1977 proxy soliciting material was materially false and misleading with respect to a proposed change in the dividend rights of Falstaff's Class A preferred stock, of which Kalmanovitz owned 100 percent.

On August 1, 1977, after a hearing on the Commission's motion for preliminary relief, Judge Howard F. Corcoran, U.S. District Judge for the District of Columbia, entered a Judgment of Preliminary Injunction and Other Relief against Falstaff enjoining Falstaff from future violations of the antifraud, reporting and proxy provisions of the Federal securities laws. In addition, the court preliminarily enjoined Falstaff from convening its annual shareholders meeting and prohibited the solicitation and voting of proxies by Falstaff in connection therewith. Judge Corcoran, in a lengthy opinion, stated that "The Commission has made a strong *prima facie* showing that there is a reasonable likelihood of future violations of the Federal securities laws on the part of defendant Falstaff...."

Since the entry of the preliminary injunction, Falstaff has filed an appeal which is currently pending before the Court of Appeals for the District of Columbia. Falstaff also made a motion to the district court for clarification and modification of the order of preliminary injunction, which was denied, and a motion to stay the preliminary injunction pending appeal, which was also denied. Discovery is presently progressing in the litigation in preparation for a trial on the merits.

SEC v. Sharon Steel Corp., et al.— The Commission, on September 21, 1977, filed a civil injunctive action in the United States District Court for the District of Columbia, and obtained a permanent injunction, by consent, against Sharon Steel Corporation (Sharon), Victor Posner (Posner), NVF Company (NVF), Steven Posner (S. Posner), Gail Posner Cohen (Cohen), Walter Gregg (Gregg), Bernard Krakower (Krakower), and DWG Corporation (DWG) as to certain violations of the antifraud, reporting, and proxy solicitation provisions of the Federal securities laws.[250] The Commission also obtained an Order mandating certain ancillary relief. The court also permanently enjoined Fingol Bloom (Bloom) from violations of the reporting and antifraud provisions of the Federal securi-

ties laws. In addition, Pennsylvania Engineering Corp. (PECOR) was permanently enjoined from violations of the proxy solicitation provisions of the Federal securities laws. Two other public companies, Southeastern Public Service Co. (SEPSCO) and Wilson Brothers (Wilson), subsidiaries of DWG, while not named as defendants, consented to a court Order to comply with the ancillary relief ordered as to the defendant corporations. All defendants were officers or directors of companies controlled by Posner.

The complaint alleged that, from 1970 to the present, Posner, S. Posner and Cohen, collectively the Posners, caused several public companies controlled by Posner (Sharon, NVF, DWG, PECOR, SEPSCO, and Wilson) to pay for a wide variety of non-business personal expenses for the Posners, costing such companies over $1,700,000. The complaint also alleged that Sharon and its parent, NVF, filed false financial statements in 1974 and 1975.

The court ordered Posner, and his children, S. Posner and Cohen, to pay $600,000 to the various public corporations in repayment for certain of their personal expenses. The Judgment recited that the court proceedings should not be deemed to prevent any of the public companies which paid for the personal expenses of the Posners from making any claim against them.

The complaint alleged that the non-business personal expenses paid for on behalf of the Posners by the Posner-controlled companies included expenses for travel in a corporate jet, groceries, liquor, a vacation, entertainment, rent for certain of Posner's personal living quarters, restaurant expenses, use of a corporate yacht, medical bills, limousines and drivers, and domestic servants.

The complaint also alleged that Posner had caused the above-mentioned companies, which rent space in a Miami Beach hotel he controls, to expend over $100,000 in rentals over that charged to nonaffiliated residents. The complaint further alleged that Posner caused SEPSCO, DWG and other Posner-controlled public companies to expend over $1 million to refurbish the top two floors of the hotel, over $300,000 of which was used to refurbish a personal residential apartment for Posner.

The complaint further alleged that the companies controlled by Posner paid for the Posners' personal expenses described in the complaint without making any independent examination to determine if such charges were proper or legitimate corporate expenses. The complaint further alleged that from at least 1973 to the present, DWG, which directly paid for the majority of such personal expenses of the Posners, did not maintain any records which reflected the business purpose of the bulk of such expenditures.

The complaint further alleged that the annual reports, proxy statements and registration statements of the companies controlled by Posner failed to disclose, in violation of the antifraud provisions of the Federal securities laws, the nature and extent of such expenditures made on behalf of the Posners. The Complaint further alleged that Sharon, NVF, NVF's treasurer, Bloom, NVF's Vice Chairman, Gregg, and NVF's chief operating officer, McCracken, violated the antifraud provisions of the Federal securities laws when Sharon improperly valued and misrecorded major inventory items, misrecorded certain transactions as sales, shifted income and expenses from one year to another, and improperly transferred steel products among inventory accounts, which

falsified their financial statements for 1974 and 1975. The financial statements of Sharon and NVF for 1974 and 1975 were restated in 1977 with respect to these matters.

The complaint further alleged that in 1975, Sharon, which reported $25, 600,000 in pre-tax earnings overstated these earnings by approximately $13, 900,000. The complaint further alleged that Sharon increased its reported 1975 pre-tax earnings by $4, 929,000 by improperly revalueing virtually its entire inventory of iron ore through the treatment of a certain type of iron ore pellet called TPV as a "new item" in inventory, when such treatment was inconsistent with Sharon's past practice and, under generally accepted accounting principles, did not qualify for treatment as a new item.

The court enjoined Sharon, NVF, Posner, S. Posner, Cohen, DWG, and PECOR from using or causing the use of any asset of any public company related to the Posners for the personal benefit of the Posners unless such use has been properly authorized by such company's board of directors.

In addition, Sharon, NVF, DWG, and PECOR were ordered by the court and, as part of the settlement of the action, SEPSCO and Wilson have also agreed, to appoint two new independent directors satisfactory to the Commission, and to each set up a three member Audit Committee with the two new independent directors comprising two of the three members. Such Audit Committees are directed, among other things, to adopt financial controls designed to prevent occurrence of matters alleged in the complaint, to supervise implementation of such controls, to examine the matters alleged in the Commission's complaint, to recommend appropriate action, and to file such recommendations with the Commission. The companies were further directed to act on all such recommendations and file a report with an explanantion of the action taken and the reasons any such recommendation was not adopted. Such companies were also ordered to submit their proxy statements and their annual reports to independent counsel familiar with the Federal securities laws for review. As part of the settlement, Krakower stipulated that he will not practice before the Commission for any company other than a company related to Posner for one year. During such time the Commission has agreed not to bring proceedings against him pursuant to Rule 2(e) of the Commission's Rules of Practice based solely on the matters in the complaint, or the entry of the Final Judgment.

The court also enjoined Sharon, NVF, DWG, PECOR, Posner, S. Posner, Cohen and their agents from making false entries on the books of public companies controlled by Posners.

SEC v. Louis J. Roussel, Jr., et al.—On August 19, 1976, the Commission filed a complaint in the United States District Court for the Eastern District of Louisiana against Louis J. Roussel, Jr. (Roussel), National American Life Insurance Company (NALICO), ICB Corporation (ICB), American Benefit Life Insurance Company (American Benefit) and certain other entities and individuals.[251]

The Commission's complaint alleged that during the first half of 1975, Roussel conducted a successful takeover of Farm & Ranch Financial, Inc. (F&R), a Kansas insurance holding company. It was further alleged that the takeover was accomplished through a series of purchases by Roussel and persons and entities controlled, affiliated or associated with him, including certain of the defendants, in such a way as to circumvent the reporting and tender offer provisions of the

Federal securities laws and the Kansas Insurance Holding Company Act. The complaint indicated that private purchases of F&R stock were made during the effective period of NALICO's tender offer by Roussel, who arranged to have F&R stock, being accumulated on his behalf by principals and employees of certain defendants, placed with various persons and entities. The complaint alleged that no filing was made which revealed this purchasing activity or the shares accumulated in support of Roussel.

The complaint alleged violations of the Federal securities laws in connection with various transactions and events which took place at the ICB Corp., a one-bank holding company in New Orleans, during the period from 1970 through 1974. It was alleged that under the direction of certain of the defendants, loans were made to ICB employees, in connection with several unregistered ICB stock offerings to employees, which violated Federal bank credit regulations. Loans were also made to an employee pension plan which were also used to purchase ICB stock. The Commission charged that purchases of ICB stock in the open market by the employee stock purchase and pension plans had the effect, at various times, of dominating the market for ICB stock and that this domination was not publicly disclosed.

The complaint further alleged that ICB came under the control of Roussel in late October of 1974, and at that time employee stock purchase plans were terminated and the stock was purchased by Roussel at the request and with the aid of the then chairman and president of ICB. The Commission alleged employees lost portions of their investment as a result of their participation in an unregistered stock purchase plan which existed before Roussel's purchase. The Commission alleged that the employees were not informed of various material facts concerning the purchase plan, involving the right of registrants to recover their entire investment.

Certain of the defendants consented to the entry of Final Judgments of Permanent Injunction restraining and enjoining violations of certain provisions of the Federal securities laws without admitting or denying the allegations in the complaint.

As part of the extensive ancillary relief obtained in this case, Special Counsels were appointed to conduct investigations, independent directors were appointed to the board of directors of F&R and restitution was made to shareholders who tendered F&R securities in transactions which violated the tender offer provisions of the securities laws.

SEC v. Milgo Electronic Corporation, et al.—The Commission filed a complaint, in the United States District Court for the District of Columbia, seeking injunctive relief against Milgo Electronic Corporation (Milgo), a Florida corporation with its principal executive offices in Miami, Florida, and Racal Electronics Limited (Racal), a United Kingdom corporation with its principal executive offices in Bracknell, England.[252]

The Commission's complaint alleged that Milgo, in an effort to thwart an exchange offer for its common stock, made untrue statements of material facts and omitted to state material facts concerning, among other things, the purposes of a proposed sale of Milgo stock to Racal, the terms of Milgo's agreement with Racal and certain other facts.

The complaint further alleged that Racal had actual knowledge of a false and misleading press release of Milgo and participated in the events surrounding its issuance.

The Commission's complaint further alleged that Milgo violated the tender offer filing requirements of the Federal securities laws in failing to file with the Commission, Milgo management's statements concerning the exchange offer and Milgo's proposed sale of stock to Racal.

On February 3, 1977, the court entered a Judgment of Permanent Injunction against Milgo, enjoining Milgo from violations of certain of the tender offer, antifraud and reporting provisions of the Exchange Act and ordering certain other relief. Milgo consented to the entry of the Judgment without admitting or denying the allegations of the complaint.

In addition to the entry of the Judgment, the court ordered certain ancillary relief, including the following:

(1) An Undertaking by Milgo to amend its Schedules 14D filed with the Commission to reflect the institution of the Commission's action, the substance of the allegations in the complaint and the relief entered by the court;

(2) An Undertaking by Milgo to file Schedules 13D with the Commission with respect to any acquisition by Milgo of five percent or more of any equity security registered with the Commission pursuant to Section 12 of the Exchange Act; and

(3) An Undertaking to file with the Commission Schedules 14D with respect to any solicitation or recommendation by Milgo to Milgo shareholders to accept or reject a tender offer or request or invitation for tenders.

On May 13, 1977,[253] the court entered a Judgment of Permanent Injunction against Racal enjoining Racal from:

(1) Failing to timely file reports on Schedules 13D and 14D;

(2) Acquiring additional Milgo shares without prior approval of Milgo's shareholders and without disclosing all material facts;

(3) Making any solicitation or recommendation to Milgo's shareholders without complying with the Federal securities laws;

(4) Participating with an issuer whose stock is subject to a takeover bid in issuing any press release that is not in compliance with the Federal securities laws; and

(5) Purchasing or agreeing to purchase stock from any takeover target in violation of the tender offer and antifraud provisions of the Federal securities laws.

SEC v. Ormand Industries Inc., et al. —The Commission filed a complaint in the United States District Court for the District of Columbia against Ormand Industries, Inc. (Ormand), a corporation with principal offices in California which has engaged in outdoor advertising and other lines of business, and Jarrell D. Ormand (J.D. Ormand), formerly Chairman of the board of Ormand.[254]

The Commission's complaint alleged that J.D. Ormand and certain other officers, directors and employees of Ormand diverted substantial amounts of corporate funds and other corporate assets for their personal use. Among other things, the Commission's complaint charged that J.D. Ormand received cash advances which were unaccounted for in an amount exceeding $250,000 which were neither repaid by J.D. Ormand nor utilized for business purposes related to the company. Further, the Commission's complaint alleged that J.D. Ormand caused Ormand to provide personal benefits to J.D. Ormand. Such benefits, the Commission alleged, included payments for improvements on J.D. Ormand's residence, entertainment and other personal expenses for J.D. Ormand and members of his family.

The Commission's complaint alleged, in addition, that certain commercial transactions were not recorded on the books and records of Ormand and that false and misleading entries were made on the books and records of Ormand. With respect to the foregoing and other matters, the Commission alleged that Ormand filed false and misleading annual and periodic reports and proxy statements.

The court restrained and enjoined Ormand from further violations of the antifraud, reporting and proxy provisions of the Federal securities laws, and restrained and enjoined J.D. Ormand from further violations of the proxy provisions and ordered him to make complete and accurate filings with the Commission and statements to the public. In addition, the court ordered certain ancillary relief, including the following: the expansion of Ormand's board of directors to include three additional independent directors; the establishment and maintenance of an audit committee of the board of directors, composed of three members, including at least two of the newly-appointed directors; and the appointment of a special counsel to the audit committee to conduct an investigation and recommend corrective measures.

As additional ancillary relief, Ormand was ordered to undertake to implement and maintain internal control procedures designed to avoid the unauthorized or undisclosed use of corporate assets or other things of value for the benefit of officers, directors or employees of Ormand, its subsidiaries or affiliates.

The Delphi Capital Corporation Cases–Following a 2½ year investigation by members of the Commission staff and the Organized Crime Strike Force in Philadelphia, five related criminal cases were instituted in the Eastern District of Pennsylvania against 30 defendants. The cases were an outgrowth of the staff's earlier investigation that led to the revocation of the broker-dealer registration of Delphi Capital Corporation of Philadelphia in 1974. The following five cases were brought pursuant to this investigation.

U.S. v. Yiddy Bloom, et al.[255]—In this case, the grand jury returned a thirty-one count indictment against Yiddy Bloom of Miami Beach, Florida, a real estate investor and hotel owner; his son Jerrold Bloom of Coral Gables, Florida, a former securities salesman in Miami Beach, Florida; Jack Silbiger of Shawnee Mission, Kansas; Abraham Salaman of Philadelphia, Pennsylvania, former president of Delphi Capital Corporation; Ira Ingerman of Narberth, Pennsylvania, president of Magic Marker Corporation, and former chairman of the board of Delphi Capital Corporation; Burton Dubbin of Miami Beach, Florida, secretary-treasurer and a controlling person of Casa Bella Imports, Inc.; Albert London of Lincroft, New Jersey, former floor broker on the National Stock Exchange; Bernard Cronin of Magnolia, Massachusetts, former securities salesman in Washington, D.C.; Robert Street of Brooklyn, New York, former securities salesman in Washington, D.C.; Robert Knoth of North Palm Beach, Florida, former securities salesman in North Palm Beach, Florida; Michael Rekoon of Cranford, New Jersey, a former securities trader in New York City; Joseph Patrick of Glenside, Pennsylvania; a former trader and securities salesman in Philadelphia, Pennsylvania; Myron Freeman (also known as Mickey Freeman) of Annapolis, Maryland; and Joseph DeLoge of St. Petersburg, Florida, former securities trader in Montgomery, Alabama. The above-named defendants were charged with securities fraud, mail fraud and conspiracy to

violate the Federal securities laws and mail fraud schemes.

Named as unindicted co-conspirators were nine other persons including former National Stock Exchange personnel, former securities salesmen, former stock brokerage firm personnel, a former editor of an investment advisory publication, and a corporate president.

The indictment alleges that the defendants and co-conspirators conspired in 1971 and 1972 to manipulate the common stock of Magic Marker Corporation, a security then traded on the National Stock Exchange and over-the-counter.

The indictment also alleges a manipulation in 1972 by certain of the defendants of the common stock of Casa Bella Imports, Inc., a publicly owned company, the common stock of which was traded over-the-counter.

U.S. v. Charles Birkholz, et al.—In a related information filed by the United States Attorney, the Magic Marker specialist on the National Stock Exchange and 6 other persons, all of whom had been named as unindicted co-conspirators in the *Yiddy Bloom* case, above, were charged with various violations in connection with the manipulation of Magic Marker Corporation common stock, including conspiracy to violate the securities and mail fraud statutes, securities fraud, unlawful extension of credit, and Federal income tax violations.

Others named in the information were Harvey Klebanoff (also known as Harvey Kaye), a former executive vice president of Delphi Capital Corporation; Charles Birkholz, a Kansas florist; Stanley Levin, a floor broker on the National Stock Exchange; John Tees, a margin clerk at Delphi Capital Corporation; and Lawrence Richter and Jay Teitelbaum, both registered representatives.

U.S. v. Harvey Birdman, et al.[256]—In the third case, the grand jury returned a twenty-five count indictment against Harvey Birdman of Elkins Park, Pennsylvania, President of Uni-Shield International Corporation; Bernard Cronin of Magnolia, Massachusetts, a former securities salesman in Washington, D.C.; Alan Hunter of Wyndmoor, Pennsylvania, a former securities salesman in Philadelphia; William Richman of Philadelphia, Pennsylvania, a former financial consultant; Arthur Salaman of Wyncote, Pennsylvania; and Robert Street of Brooklyn, New York, a former securities salesman in Arlington, Virginia.

The indictment charged all of the above named defendants with conspiracy to violate Federal securities and mail fraud statutes. Birdman, Cronin, Hunter, Salaman and Street were also charged with violating and aiding and abetting the violation of antifraud provisions of the Federal securities laws and mail fraud statutes. Birdman was also charged with violating the ownership reporting requirements of the Federal securities laws. Also named as unindicted co-conspirators were two former securities salesmen. In the indictment it was alleged that Birdman and the other defendants and co-conspirators conspired in 1972 and 1973 to manipulate the price of the common stock of Uni-Shield International Corporation. At the time, the corporation had registered securities with the Commission and its common stock was listed on the National Stock Exchange.

U.S. v. Richard Kirschbaum, et al.[257]—In the fourth case stemming from the joint investigation, the grand jury returned a three count indictment charging Richard Kirschbaum of Oyster Bay, New York, and Stanley H. Molosky of Cherry Hill, New Jersey, a former securities salesman at Delphi Capital Corporation, with violations of

the securities fraud, mail fraud, and conspiracy statutes.

The indictment alleges that in 1972, Kirschbaum and unindicted co-conspirators, Joel Kline and Eric Baer, arranged for the purchase of U.S. Vinyl Corporation common stock from Max Zerkin and Associates, Inc., in return for a cash payment to them for each Vinyl share bought and that Molosky, pursuant to this scheme, purchased approximately 8,500 shares of U.S. Vinyl stock for his customers from Max Zerkin and Associates, Inc. Molosky and Kirschbaum are alleged to have shared in the resultant cash payments made by Kline.

The indictment also alleges that Molosky did not disclose the receipt of these cash payments to his customers.

U.S. v. Alan Hunter[258]—The final case resulted in a two count indictment charging Alan Hunter of Wyndmoor, Pennsylvania, with Federal income tax violations relating to his former employment as a securities salesman at Delphi Capital Corporation.

U.S. v. Theodore H. Kaufman, et al.—In April 1977 part of the Commission's referral of its investigative files to the Department of Justice in the Giant Stores Corporation matter, a fourteen count indictment was returned naming Theodore H. Kaufman, Jack S. Shapiro, Benjamin A. Lieberman and Gerald Silverstein, former officers of Giant, a bankrupt Massachusetts corporation.[259] The indictment alleged a conspiracy by the four defendants and other employees of Giant during 1971, 1972 and 1973 to issue false financial statements regarding Giant's income and balance sheets.

According to the main thrust of the indictment, the defendants sought to coverup a $2.5 million loss for the fiscal year ending January 29, 1972 by concealing liabilities and placing false assets on Giant's books.

The indictment also alleged that various falsified financials were included in filings with the Commission; one such filing was a registration statement in 1972 registering 300,000 shares of common stock which was sold to the public. In addition, the defendants transmitted the financial statements to various banks in Boston and thereby obtained loans totalling $13 million.

U.S. v. David Stirling, Jr., et al.— As part of the Commission's referral of its investigative files to the Department of Justice in the Stirling Homex Corp. matter, an eleven count indictment was returned on July 27, 1976 by the U.S. Attorney's Office in the Southern District of New York charging four of the former principal officers of Stirling Homex Corp., David Stirling, Jr., William G. Stirling, Harold M. Yanowitch and Edwin J. Schulz, and an attorney-employee for the company, Rubel L. Phillips, respectively with fraud in connection with the 1970 and 1971 public distribution and sale of nearly $40 million of Stirling Homex common and preferred stock.

The indictment charged that the defendants used several fraudulent devices to inflate Stirling Homex's earnings in SEC registration statements and annual and interim reports and related documents. The indictment charges that in 1969 and 1971, the defendants boosted reported sales and profits by including substantial sales of land to shell corporations which lacked any real ability to pay, and by making the sales at prices which were artificially inflated. The indictment also charges that, in 1971, a fraudulent sale of modules to a shell corporation was included in sales and profits on the basis of a forged

$15 million governmental financing commitment.

On January 29, 1977, a Federal jury convicted the five defendants. On March 11, 1977, a U.S. District Judge imposed a 1 year prison sentence and $10,000 fine on David Stirling Jr. Harold Yanowitch received a sentence of one year and a fine of $2,000. William Stirling received a sentence of six months and fine of $10,000. Rubel Phillips was sentenced to ten months in prison and a fine of $5,000. Finally, Edwin Schulz was fined $2,500 and given a suspended sentence.

Farmers' Cooperatives—In 1975 and 1976, various promoters throughout the South and Midwest offered and sold interests in a number of "cooperatives," organized under state farm cooperative laws. The promoters generally claimed that the "cooperatives" were exempt from registration under the Federal securities laws, pursuant to the private offering exemption. Generally, these cooperatives stress that they eliminate the need for consumers to deal with retail store "middlemen"; in their stead, the cooperatives offer physical locations at which farmers can collectively seek to sell their produce to the public. While no direct connection has been found yet, it appears that all the cooperatives have similar corporate structures and fund raising techniques, stressing the savings resulting from elimination of the "middleman". Nationwide, losses to investors have been estimated to be $3.8 million. The Chicago Regional Office on May 13, 1977, filed a civil injunctive action against Progressive Farmers Association, a Missouri based organization and the largest of the various cooperatives.[260] Additionally, a case involving the Producers and Consumers Cooperative Exchange has resulted in a criminal indictment against two defendants, one of whom has entered a plea of guilty.[261] This case appears to be the only criminal case brought to date with Federal assistance against promoters of these "cooperatives".

City of Philadelphia v. SEC—In May 1976, the Staff of the Philadelphia Branch Office commenced an informal inquiry into the sale of municipal securities issued by the City of Philadelphia. Upon receiving a request for information from the staff, the City not only refused to cooperate with the inquiry but also commenced an action against the Commission, seeking to enjoin the Commission, the individual Commissioners and members of the Commission's staff from any further conduct of the inquiry. The action also sought a declaration of the invalidity of the Federal securities laws insofar as they vest any jurisdiction in the Commission either to investigate the City of Philadelphia or to commence a civil action against that City should it be shown that the City engaged in fraud in the distribution of its securities. The Commission authorized the Office of the General Counsel to move to dismiss the action and the court granted the Commission's motion.[262]

Essentially, the court distinguished between an informal inquiry and a formal order of investigation, holding that, since no formal order has issued, the issues the City had raised in that regard were not ripe for review. Nevertheless, the court found that the City had standing to challenge the staff's preliminary inquiry and that, in that respect, the case was not moot.

The court's opinion rejected both of the City's challenges to the constitutionality of the Commission's informal inquiry. The City had argued, first, that limitations inherent in the Commerce Clause and the Tenth Amendment prohibit Congress from authoriz-

ing a Commission investigation of the City "because it impermissibly infringes upon the sovereignty of the Commonwealth of Pennsylvania, of which the City is a political subdivision." The City also argued a violation of the Fifth Amendment, asserting that the Federal securities laws provisions authorizing the Commission to investigate possible violations of the Federal securities laws by any "person" violate due process because they are impermissibly vague.

With respect to the Tenth Amendment challenge, the court adopted the Commission's interpretation of *National League of Cities v. Usery*,[263] by holding that Commerce Clause legislation may be invalidated under the Tenth Amendment if, and only if, that legislation "orders the states to act in 'areas of traditional governmental functions,' and, by virtue of this order, substitutes Federal for state choices in a manner which significantly limits the 'States' freedom to structure integral operations' in such areas". Although the court accepted as true, for purposes of the Commission's motion, that the Commission's preliminary investigation has a significant effect on the financing and distribution of municipal services, the court found that the "threshhold requirement that the Federal action *command* the City is lacking" since the City had not been compelled to do anything.

Moreover, the court expressly rejected the City's argument that the Commission's inquiry was impermissible, because it had a significant de facto effect upon states or their political subdivisions. The court noted that "such de facto effect is a necessary attribute of a Federal system."

In addition, the court, in a footnote reference, seemed to express passing approval of the Commission's argument that the *National League of Cities* case need not necessarily preclude congressional legislation that is found to intrude into the states' decision making in areas of traditional governmental functions, if it can be shown that the Federal interest is demonstrably greater and state compliance with imposed Federal standards would be essential. While the court reserved judgment on the constitutionality of a formal investigation, it did "recognize that the considerations relevant to the constitutionality of the 'preliminary' investigation may well be similar to those which are pertinent to the constitutionality of a 'formal' investigation".

With respect to the plaintiffs' argument that the statutes and regulations authorizing the "preliminary" investigation are void for vagueness, the court firmly sustained the sufficiency of the statutory provisions by noting that the securities laws and regulations "sufficiently specify the obligations imposed upon the City."

The City has appealed this decision to the United States Supreme Court.

City of New York v. SEC[264]—On July 26, 1976, the City of New York filed an action for declaratory and injunctive relief against the Commission and the Commissioners in their official capacity in the United States District Court for the Southern District of New York challenging the statutory basis and constitutionality of a pending formal Commission investigation into transactions in the City's securities. The complaint alleged that the investigation constituted unlawful "regulation" of the City and sought a declaratory judgment and an injunctive relief. Prosecution of the action was deferred by agreement and subsequently, in December, 1976, the suit was dismissed without prejudice by stipulation.

Bertoli v. Hills, et al.[265]—On April

5, 1976, Richard Bertoli, a respondent in an administrative proceeding initiated by the Commission, *In the Matter of Executive Securities, Inc., et. al.*[266], commenced an action for damages and injunctive relief in the United States District Court for the Southern District of New York, naming as defendants, Chairman Roderick M. Hills, Reynolds Securities, Inc., and Henry Gottlieb and alleging, among other things, extortion, subordination of perjury, cover-up and an invasion of plaintiff's personal privacy by members of the Commission's staff. On May 17, 1976, the court dismissed this action as to defendants Reynolds and Gottlieb. On July 30, 1976, the Commission and Chairman Hills filed a motion to dismiss, or in the alternative, for summary judgment. In support of its motion, the Commission argued that Chairman Hills was immune from private damage liability for the discretionary acts performed by him and Federal employees under his control in the exercise of their official responsibilities, and that the Commission, as an agency of the United States government, cannot be sued in its own name in the absence of its consent, which it did not give in this case.

The Honorable Charles L. Brieant dismissed the action as to the Commission and Chairman Hills, holding the Commission "immune from this sort of litigation, calculated to and having the effect of chilling it in the fearless exercise of its delegated quasi-judicial functions" and holding that, as to Chairman Hills, "to function effectively, he must be granted immunity from private suits for damages."

Sidney Buchman and Joseph Buchman v. SEC[267] — On April 20, 1977, the United States Court of Appeals for the Second Circuit, on a petition for review of a Commission order modifying disciplinary action taken by the NASD against principals of a broker-dealer, vacated the Commission's order. The brokerage firm had entered into a contract to purchase securities from another firm. Before the settlement date, the Commission suspended trading in the stock and continued to issue consecutive ten-day orders suspending trading in the stock for seven months. After the suspension terminated, the brokerage firm refused to accept delivery of the stock. The NASD, and the Commission, determined that the breach of contract constituted conduct inconsistent with "just and equitable principles of trade" in contravention of Article III, Section 1 of the NASD Rules of Fair Practice. The court, however, determined that there was no violation because the refusal to complete the contract was "colorably justified by the confusion as to the true state of the market and as to the applicable law." The court held that "[a] breach of contract is unethical conduct in violation of NASD rules, only if it is in bad faith, just as conduct violates Rule 10b–5 only if there is *scienter*: intent to deceive, manipulate or defraud."

Carter v. DeGrazia, et al. — In this case, the plaintiff alleged, *inter alia*, that a member of the Commission's staff had participated, together with a former employee of a Carter-affiliated company, and a law firm that had previously represented Mr. Carter, in a conspiracy to violate Mr. Carter's civil and constitutional rights in connection with the Commission-authorized investigation of Mr. Carter and certain companies that were affiliated with him.[268] In that connection, the complaint alleged (1) that there was no basis in fact for the Commissions' investigation; and (2) that its purpose was to force him out of business and to permit the former employee to take over that

business. He sought $25 million in damages.

After denying motions to dismiss, or in the alternative, for summary judgment, that were filed on behalf of the Commission staff member, the district court, on April 11, 1977, commenced the trial, which lasted three days. At that juncture, Mr. Carter admitted, during a bench conference, *inter alia*, that he had no specific evidence that the defendants conspired to put him out of business and that he had "no way of proving that allegation." The court thereupon vacated its prior orders denying the defendants' motions to dismiss and dismissed the complaint.

Mr. Carter subsequently sought review of the dismissal of the complaint in the court of appeals, but his appeal was dismissed as frivolous on September 20, 1977.[269]

SEC v. Advance Growth Capital Corporation et. al.[270] — In this case the United States Court of Appeals for the Seventh Circuit affirmed a district court's refusal to vacate a permanent injunction that had been entered in a Commission enforcement action.

Appellants, the two individual defendants in the action, had been permanently enjoined, on April 9, 1973, from engaging in certain conduct which would constitute violations of the Investment Company Act. On a writ of mandamus, the court of appeals had directed the district judge to enter a permanent injunction that had been drafted by the Commission's staff.

Twenty-seven months later, the appellants moved to vacate the injunction under Rule 60(b)(5) of the Federal Rules of Civil Procedure, which authorizes a district court to grant relief from a final judgment, *inter alia*, when "it is no longer equitable that the judgment should have prospective application . . . ." In support of their motion, they asserted, *inter alia*, that they had (a) complied with provisions of the Investment Company Act; (b) suffered embarrassment as a result of being enjoined; and (c) been denied the right to participate in the management of Advance Growth Capital Corporation. The district court denied the motion, on the ground that it lacked jurisdiction to modify or vacate the injunction without direction from the court of appeals.

Although the court of appeals found considerable authority to the effect that a motion in the same case for relief from a judgment entered pursuant to appellate mandate cannot be entertained by the trial court without appellate leave, it indicated that it would probably not go so far as to hold that appellate leave is necessary whenever relief is sought under Rule 60(b)(5).

The court of appeals affirmed the motion to vacate on the merits on the ground that any relief granted on the basis of the facts alleged in the motion would have been error, since the defendants had made no showing that they were suffering a grievous wrong as the result of new circumstances that were not forseen at the time the injunction was entered.

Sloan v. SEC[271] — In this case Samuel H. Sloan sought review of a Commission order,[272] dated April 28, 1975, that had revoked the broker-dealer registration of Samuel H. Sloan & Co. and barred him from association with any broker or dealer. The Commission's order was based upon findings that Mr. Sloan had willfully violated: (a) the recordkeeping provisions contained in Section 17(a) of the Exchange Act and Rule 17a–3 promulgated thereunder[273]; (b) the net capital requirements contained in Section 15(c)(3) of the Act and Rule 15c3–1 thereunder[274]; and (c) the requirements that broker-dealers report their

financial condition for the past calendar year,[275] their income and expenses for the past calendar year,[276] and any net capital deficiency within 24 hours after it occurs.[277]

The court of appeals affirmed the Commission's order, noting that, in addition to the Commission's findings of violative conduct, Mr. Sloan had been enjoined by the United States District Court for the Southern District of New York on two occasions from violating various provisions of the Federal securities laws.[278] The court held that "Each of these injunctions was in itself a sufficient ground to support the revocation of Sloan's broker-dealer license under §15(b)(5)(c) of the 1934 Act" and that his challenges with respect to the constitutionality of the Exchange Act were frivolous.[279]

Mr. Sloan subsequently filed a petition for a writ of certiorari in the Supreme Court, seeking review of the court of appeals' decision. His petition was denied on October 3, 1977.[280]

Whiteside & Co. v. SEC[281] — In this case the court of appeals upheld a Commission order affirming sanctions imposed by the NASD upon Whiteside and Company, a broker-dealer registered with the Commission and its two partners Clarence K. Whiteside and William H. Whiteside. This case involved Rule 15c3–3, 17 CFR 240.15c3-3, under Section 15(b) of the Exchange Act, 15 U.S.C. 78*o*(c). This Rule requires every broker or dealer to establish a "Special Reserve Bank Account for the Exclusive Benefit of Customers." The purpose of this account is to ensure that each broker or dealer retains adequate funds to cover its indebtedness to its customers. Under the rule, smaller brokers or dealers, such as the Whitesides, must make monthly computations pursuant to a specified formula and maintain a balance in the account of at least 105 percent of the net credit balance as calculated pursuant to the formulas. Any required deposit must be made no later than one hour after the opening of banking business on the second business day following the last business day of the month. If a required deposit is not made, the rule requires that immediate telegraphic notice be given to the Commission, SIPC, and the regulatory authority which examines the broker or dealer as to financial responsibility.

The court of appeals found that substantial evidence supported the Commission's finding that the Whitesides had failed to make necessary deposits and to give the required notice.

With respect to the sanction imposed, the court stated that "in light of the fundamental nature of the reserve account system to the safeguarding of customers funds," it could not find the Commission's affirmance of the NASD's sanctions to be arbitrary or an abuse of its discretion.

E. I. du Pont de Nemours & Co. v. Collins; SEC v. Collins.[282]—On June 23, 1976, the Court of Appeals for the Eighth Circuit, in a 2–1 decision, set aside an order of the Commission entered pursuant to Section 17(b) of the Investment Company Act granting a joint application by E. I. du Pont de Nemours & Co. and Christiana Securities Company which would permit the proposed merger of the two companies. The court of appeals held that the Commission had erred, as a matter of law, in determining that Christiana stock should be valued on the basis of the market value of its principal asset—du Pont common stock—rather than on a basis reflecting the much lower market value of the Christiana outstanding stock. It also held that because the benefits to Christiana

were far greater than to du Pont, the terms of the proposed merger were unfair—that they were not within the range of an arm's length bargain as, it held, is required under the Act.[283]

The Supreme Court reversed the judgment of the court of appeals and held that the Commission reasonably exercised the broad discretion granted to it by Congress, which, recognizing that an arm's length bargain is seldom a realistic possibility in transactions between an affiliate and an investment company, had substituted the Commission's informed judgment to determine the fairness of such transactions. The Court found that the Commission properly relied on the principle it has long and consistently applied—that the key factor in valuing the assets of a closed end investment company should be the market price of its portfolio securities.

Staff Report on Transactions in Securities of the City of New York

On August 26, 1977, the Commission transmitted to Congress its Staff Report on Transactions in Securities of the City of New York (the Report). The Report was 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 in response to requests from Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs; Congressman William S. Moorehead, 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.

The Report was based on an investigation conducted by the Commission's New York Regional Office. That investigation 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 New York City officials, underwriters, rating agencies and bond counsel with respect to the then 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 New York City short-term debt securities were sold to the public.

The Report consists of seven chapters which examine the chronology of events related to the City's financial condition, the City's accounting practices and financial reporting, the role of the City and its officials and the role played, in connection with the offering and issuance of these securities, by the underwriters, bond counsel and the rating agencies.

The inquiry concluded that officials of New York City, with knowledge of the City's true financial condition, misled public investors in the offer and sale of its securities. The Report further found that the underwriters failed to fulfill their responsibilities to the investing public and inadequately disclosed materially adverse information regarding the budgetary and financial problems of the City.

According to the Report, the rating 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 properly their ratings of the City's

securities based on data which they knew in a manner consistent with standards upon which prior rating had been based. As to bond counsel, who issued opinions on the validity of the issuance of New York City securities, the Report concluded that they, when on notice of circumstances which called into question matters basic to their opinions, should have conducted additional investigation. The Report also concluded that bond counsel, who continued with their engagement having knowledge of information material to investors, should have, under those circumstances, taken reasonable steps to satisfy themselves that such material facts were disclosed to the public.

As stated in the Report, the Federal securities laws administered by the Commission have as their principal purpose the protection of public investors. Accordingly, the staff inquired as to whether, in the offer, sale and distribution of New York City's debt securities, under the circumstances, there was provided the measure of disclosure mandated under the Federal securities laws in the interest of the investing public. The Report stated, "We conclude that it was not."

The Report is a distillation, analysis and evaluation of the evidence which had been obtained as of the date it was issued. The investigation, which is a continuing one, is not an adjudicatory proceeding; nor does the investigation or the Report constitute a determination of the rights or liabilities of any person.

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

NOTES TO PART 1

[1]The Commission's report covers the periods from July 1, 1976 to September 30, 1976 (the transition quarter) and from October 1, 1976 to September 30, 1977 (fiscal year 1977). Unless otherwise indicated, references to the past fiscal year include the transition quarter.

[2]Act of June 4, 1975, Pub. L. No. 94-29, 89 Stat. 97.

[3]SEC, *Report of the Securities and Exchange Commission on Rules of National Securities Exchanges Which Limit or Condition the Ability of Members to Effect Transactions Otherwise Than on Such Exchanges* (September 2, 1975).

[4]Securities Exchange Act Release No. 11628 (September 2, 1975), 7 SEC Docket 762.

[5]*Id.* 7 SEC Docket 763.

[6]Securities Exchange Act Release No. 11942 (December 19, 1975), 8 SEC Docket 756.

[7]Although exchange members have been permitted to effect over-the-counter transactions in listed securities on an agency basis, Rule 19c-1 permitted each exchange to continue until January 2, 1977, to require its members to satisfy public limit orders on that exchange at prices equal to or superior to the over-the-counter transaction price as a condition to effecting any such transactions.

[8]Securities Exchange Act Release No. 11942 (December 19, 1975), 8 SEC Docket 766.

[9]*Id.*

[10]*Id.*

[11]*Id.* 8 SEC Docket 768-69.

[12]Letter to the Commission from the NMAB Concerning In-House Agency Cross Transactions in Listed Securities by Exchange Members, dated September 24, 1976.

[13]*Id.*

[14]*Id.* at 9.

[15]Letter to the Commission from the NMAB Concerning Off-Board Trading by Members of National Securities Exchanges, dated February 25, 1977.

[16]*Id.* at 2-3.

[17]Letter to the Commission from the NMAB Concerning Off-Board Trading by Members of National Securities Exchanges, dated May 19, 1977.

[18]*Id.*

[19]*Id.* at 3.

[20]*Id.*

[21]Securities Exchange Act Release No. 13662 (June 26, 1977), 12 SEC Docket 947.

[22]SEC, *Statement on the Future Structure of the Securities Markets* (February 2, 1972), 37 FR 5286 (1972).

[23]SEC, *Policy Statement on the Structure of a Central Market System* (March 29, 1973).

[24]Securities Exchange Act Release No. 9529 (March 8, 1972).

[25]Securities Exchange Act Release No. 10969 (August 14, 1974), 5 SEC Docket 735.

[26]Securities Exchange Act Release No. 11288 (March 11, 1975), 6 SEC Docket 425.

[27]Securities Exchange Act Release No. 11406 (May 7, 1975), 6 SEC Docket 859.

[28]Securities Exchange Act Release No. 12670 (July 29, 1976), 10 SEC Docket 108.

[29]Securities Exchange Act Release No. 13626 (June 14, 1977), 12 SEC Docket 835.

[30]Securities Exchange Act Release No. 12159 (March 2, 1976), 9 SEC Docket 76. *See also* December 1975 Release, 8 SEC Docket 773–76, and *infra* at p. 10 for a discussion of certain market linkage facilities proposed as alternatives to a composite book.

[31]Letter to the Commission from the NMAB concerning Establishment of a Composite Limit Order Book, dated January 28, 1977.

[32]*See* June 1977 Release for a discussion of market fragmentation. 12 SEC Docket 958–64.

[33]42nd Annual Report at 7–8; 41st Annual Report at 11; 40th Annual Report at 7; and 39th Annual Report at 9.

[34]Securities Exchange Act Release No. 12885 (October 12, 1976), 10 SEC Docket 697.

[35]*See* discussion, *supra* at p. 9.

[36]For a more detailed treatment of this request, *see* discussion, *infra* at p. 19.

[37]*See* Intermarket Execution System Discussion Paper, prepared by the National Market Association for the NMAB dated April 1977, and testimony of NYSE given during the August Hearings on August 2, 1977. (Official Transcript of Proceedings Before the Securities and Exchange Commission in the Matter of Off-Board Trading Rules, pp. 5–21) (both of which are available in File No. 4–180.)

[38]Letter to the Commission from Kenneth Rosenblum, Senior Vice President and Counsel of the MSE, dated September 9, 1977 (File No. 4–180).

[39]*See* discussion, *infra* at p. 19.

[40]Letter to the Commission from Michael Tobin, President of the MSE, dated March 22, 1977.

[41]Letter to the NMAB from Lee A. Pickard, Director, Division of Market Regulation, dated May 18, 1977.

[42]Letters to the MSE, the Amex, the NYSE and SIAC from the Commission, each dated October 4, 1977.

[43]NMAB, *Report to the Congress: The Possible Need for Modifications of the Scheme of Self-Regulation in the Securities Industry so as to Adapt it to a National Market System,* December 31, 1976.

[44]*See* discussion, *supra* at p. 5.

[45]Securities Exchange Act Release No. 13091 (December 21, 1976), 11 SEC Docket 1229.

[46]Securities Exchange Act Release No. 13092 (December 21, 1976), 11 SEC Docket 1248. Rule 10b–21 and the amendments to Rule 17a–3 were first proposed in Securities Exchange Act Release No. 10636 (February 11, 1974), 3 SEC Docket 540, and were reproposed in Securities Exchange Act Release No. 11328 (April 2, 1975), 6 SEC Docket 552.

[47]*See* 42nd Annual Report at 17–18; 41st Annual Report at 15–17; 40th Annual Report at 8–9; and 39th Annual Report at 10–11.

[48]*See* Securities Exchange Act Release No. 13230 (February 1, 1977), 11 SEC Docket 1630; and Securities Exchange Act Release No. 13674 (June 23, 1977), 12 SEC Docket 1014. After the end of the fiscal year, the Commission instituted proceedings to determine whether these proposals and those of other self-regulatory organizations designed either to expand existing programs for the trading of options or initiate new programs (the "Expansion Proposals") should be disapproved. *See* discussion of the Options Moratorium, *infra* at p. 14, and Securities Exchange Act Release No. 14057 (October 17, 1977), 13 SEC Docket 375.

[49]A standardized call option contract essentially gives the purchaser (its "holder") the right, until the contract expires, to purchase for a specified price (the "strike" or "exercise" price) a fixed number of shares of a given security (ordinarily 100 shares) (the "underlying security") from the seller (or "writer") of the call. Conversely, the purchaser of a standardized put option contract acquires the right to sell, before the option expires, a fixed number of shares of the underlying security (ordinarily 100 shares) to the writer of the put, at a specified price (the "strike" or "exercise" price) by the put option contract.

[50]*See* Securities Exchange Act Release No. 13592 (June 2, 1977), 12 SEC Docket 692; Securities Exchange Act Release No. 13587 (June 2, 1977), 12 SEC Docket 690; Securities Exchange Act Release No. 13588 (June 2, 1977), 12 SEC Docket 690; Securities Exchange Act Release No. 13591 (June 2, 1977), 12 SEC Docket 692; and Securities Exchange Act Release No. 13589 (June 2, 1977), 12 SEC Docket 691.

[51]As used here, the term "option class" means all option contracts of the same type, *i.e.*, put or call, covering the same underlying security.

[52]42nd Annual Report at 17.

[53]*Id.*

[54]*Id.*

[55]Securities Exchange Act Release No. 13045 (December 8, 1976), 11 SEC Docket 1120.

[56]*Id.*

[57]Securities Exchange Act Release No. 13051 (December 9, 1976), 11 SEC Docket 1124; Securities Exchange Act Release No.

13050 (December 9, 1976), 11 SEC Docket 1123; Securities Exchange Act Release No. 13080 (December 16, 1976), 11 SEC Docket 1220; and Securities Exchange Act Release No. 13058 (December 10, 1976), 11 SEC Docket 1173.

[58]By contrast, both the Amex and the Phlx, with some modifications, utilize unitary specialist systems in their options programs.

[59]The achievement of a centralized clearing system for listed options, the establishment of a common system for reporting and disseminating last sale information and the standardization of the terms of listed options, have facilitated such dual trading. Securities Exchange Act Release No. 10981 (August 22, 1974), 5 SEC Docket 224.

[60]At the end of the fiscal year, the Commission had pending before it a proposal by the PSE to permit dual trading with different expiration dates. Securities Exchange Act Release No. 12250 (March 23, 1976), 9 SEC Docket 259. Subsequent to the end of the fiscal year, the Commission instituted proceedings to determine whether this proposal and those of other self-regulatory organizations designed either to expand existing programs for the trading of options or to initiate new programs (the "Expansion Proposals") should be disapproved. *See* discussion of the Options Moratorium, *infra* at p. 14, and Securities Exchange Act Release No. 14057 (October 17, 1977), 13 SEC Docket 375.

[61]Such trading activity included "prearranged trading" and "wash sales" which involved option trades between exchange members which were entered into with the understanding that such trades were to be closed (reversed) within a short period of time at the same, or nearly the same, price. A related problem is "fictitious trading," which involves the reporting of transactions which do not actually occur.

[62]Securities Exchange Act Release No. 13433 (April 5, 1977), 11 SEC Docket 2194.

[63]*Id.*

[64]For a discussion of these inspections, see pp. 131-136, *infra*.

[65]These conferences were held at the Commission on March 7–8, 1977, March 31 to April 1, 1977, and on September 28–29, 1977.

[66]Securities Exchange Act Release No. 12334 (April 12, 1976), 9 SEC Docket 407; Securities Exchange Act Release No. 13160 (January 13, 1977), 11 SEC Docket 1447; Securities Exchange Act Release No. 13431 (April 5, 1977), 11 SEC Docket 2193; Securities Exchange Act Release No. 13071 (December 14, 1976), 11 SEC Docket 1179; and Securities Exchange Act Release No. 13161 (January 13, 1977), 11 SEC Docket 1448.

[67]Securities Exchange Act Release No. 13095 (December 22, 1976), 11 SEC Docket 1268; Securities Exchange Act Release No. 12703 (August 12, 1976), 10 SEC Docket 221; Securities Exchange Act Release No. 13406 (March 25, 1977), 11 SEC Docket 2150; Securities Exchange Act Release No. 12379 (April 27, 1976), 9 SEC Docket 493; and Securities Exchange Act Release No. 12539 (June 11, 1976), 9 SEC Docket 877.

[68]Securities Exchange Act Release No. 14056 (October 17, 1977), 13 SEC Docket 366.

[69]Securities Exchange Act Release No. 13760 (July 18, 1977), 12 SEC Docket 1275.

[70]*Id.*

[71]Securities Exchange Act Release No. 14056 (October 17, 1977), 13 SEC Docket 766.

[72]*Id.*

[73]Securities Exchange Act Release No. 14057 (October 17, 1977), 13 SEC Docket 375.

[74]*Id.*

[75]The impetus for the PSE's application for unlisted trading privileges was PRI's request that its securities be delisted from the PSE, where they had been listed since 1972. On June 22, 1977, the Commission ordered PRI stock removed from listing and registration on the PSE, effective upon the Commission's disposition of the PSE's application for unlisted trading, but in no event later than 120 days from June 22, 1977. Securities Exchange Act Release No. 13657 (June 22, 1977), 12 SEC Docket 930. In that order the Commission exempted, for the same time period, the NASD and all brokers and dealers from the requirements of Securities Exchange Act Rule 17a–15, which relates to last sale reports of OTC transactions in certain listed securities.

[76]Securities Exchange Act Release No. 13658 (June 22, 1977), 12 SEC Docket 933.

[77]Since June 22, 1977, PRI has been traded both on the PSE and in the OTC market. Such trading has been possible because the effective date of the delisting was deferred by the Commission pending resolution of PSE's application for unlisted trading privileges in that security and because the PSE had exempted from its off-board trading restrictions listed securities for which the issuer had applied for delisting and for which the PSE had applied for unlisted trading privileges. The latter action by the PSE enabled its members to act as dealers in PRI common stock in the OTC market if they desired.

[78]42nd Annual Report at 11.

[79]Securities Exchange Act Release No. 12055 (January 27, 1976), 8 SEC Docket 1155.

[80]Securities Exchange Act Release No. 13388 (March 18, 1977), 11 SEC Docket 2049.

[81]At the Joint Oversight Hearings conducted in July 1977 by the Subcommittee on Oversight and Investigations and the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce, the Commission was requested to furnish to the Subcommittee whatever legislative recommendations it wished to make. The Commission responded that it would not be in a position to make legislative recommendations until it had completed its rulemaking proceeding under Section 11(a). *See* letter to the Honorable John E. Moss and the Honorable Bob Eckhardt from Harold M. Williams, Chairman, Securities and Exchange Commission, dated August 19, 1977.

[82]Securities Exchange Act Release No. 12483 (May 26, 1976), 9 SEC Docket 731.

[83]The NASD is the only registered securities association.

[84]Securities Exchange Act Release No. 12994 (November 18, 1976), 10 SEC Docket 998.

[85]In this regard, Rule 19g2-1 defines "control" as the power to direct or cause the direction of the management or politics of a member company, and establishes certain rebuttable presumptions with respect to the control of a member.

[86]Securities Exchange Act Release No. 12395 (October 28, 1976), 10 SEC Docket 807.

[87]15 U.S.C. 78iii(c) (1970).

[88]42nd Annual Report at 22-23.

[89]*Id.* at 23. Securities Exchange Act Release No. 12802 (September 16, 1976), 10 SEC Docket 484. The term "NASDAQ" also refers to the automated quotation system developed by the NASD and now operated by its subsidiary, NASDAQ, Inc.

[90]Securities Exchange Act Release No. 13551 (May 19, 1977), 12 SEC Docket 434.

[91]Bradford's exemption was conditioned on requirements similar to those which the Commission previously imposed upon other processors exempted from registration. 42nd Annual Report at 23.

[92]*See* discussion *supra*, at p. 11.

[93]The provision of automated order routing systems by various exchanges was discussed in the 42nd Annual Report at 9-10.

[94]*See* note 41 *supra*.

[95]Securities Exchange Act Release No. 13726 (July 8, 1977), 12 SEC Docket 1107.

[96]Section 3(a)(23) of the Exchange Act defines the term "clearing agency" to include clearing corporations and depositories. Generally clearing corporations clear and settle transactions between participating brokers and dealers *(i.e.*, process trade data received from participating brokers and dealers and determine the amounts of securities and money that should be exchanged among them). Depositories hold securities certificates and effect delivery between participants by book entry.

[97]42nd Annual Report at 19.

[98]Securities Exchange Act Release No. 12795 (September 1, 1976), 10 SEC Docket 352.

[99]Securities Exchange Act Release No. 13584 (June 1, 1977), 12 SEC Docket 671. At the same time, the Commission issued an order extending until September 1, 1977, the existing registrations of The Depository Trust Company; Bradford Securities Processing Services, Inc.; Stock Clearing Corporation of Philadelphia; Boston Stock Exchange Clearing Corporation; Midwest Securities Trust Company; The Options Clearing Corporation; Midwest Clearing Corporation; Pacific Securities Depository Trust Company; Pacific Clearing Corporation; and TAD Depository Corporation. The Commission also announced the extension until September 1, 1977, of the time for concluding the registration proceedings. Three of the clearing agencies granted registration on December 1, 1975, had been combined to form the National Securities Clearing Corporation (NSCC) and their registrations were withdrawn in January 1977. See discussion, *infra* at p. 22.

Subsequently, the Commission extended until March 1, 1978, the interim registration of the above clearing agencies (other than NSCC whose interim registration had not expired) and extended until that date the time for concluding the proceedings. Securities Exchange Act Release No. 13911 (August 31, 1977), 12 SEC Docket 1640.

[100]Securities Exchange Act Release No. 12274 (March 29, 1976), 9 SEC Docket 305; Securities Exchange Act Release No. 12428 (May 11, 1976), 9 SEC Docket 622; and Securities Exchange Act Release No. 12825 (September 20, 1976), 10 SEC 527.

[101]Securities Exchange Act Release No. 12829 (September 24, 1976), 10 SEC Docket 593. Subsequently, proceedings were instituted with respect to NESDTC to determine whether to make permanent the interim registration granted to it. Securities Exchange Act Release No. 13664 (June 23, 1977), 12 SEC Docket 986.

[102]42nd Annual Report at 19.

[103]Securities Exchange Act Release No. 12954 (November 3, 1976), 10 SEC Docket 851.

[104]Securities Exchange Act Release No. 13163 (January 13, 1977), 11 SEC Docket 1448.

[105]*Bradford National Clearing Corporation v. Securities and Exchange Commission*, No. 77-1199 (C.A.D.C.).

[106]42nd Annual Report at 19.

[107]42nd Annual Report at 20.

[108]Securities Exchange Act Release No. 13293 (February 24, 1977), 11 SEC Docket 1818.

[109]Securities Exchange Act Release No. 13636 (June 16, 1977), 12 SEC Docket 853.

[110]That is, the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. *See* Section 3(a)(34) of the Securities Exchange Act.

[111]Securities Exchange Act Release No. 13914 (September 8, 1977), 13 SEC Docket 17.

[112]Securities Exchange Act Release No. 12874 (October 7, 1976), 10 SEC Docket 693.

[113]The "open throat" area is space in the center of a certificate reserved for imprinting the record owner's name and address and other information.

[114]556 F.2d 555 (2d Cir. 1977).

[115]5 U.S.C. 552.

[116]*See* 42nd Annual Report at 20–21 for a description of the Commission's preliminary report on the Street Name Study and the initial steps taken by the Commission during the second phase of the Street Name Study.

[117]Securities Exchange Act Release No. 13719 (July 5, 1977), 12 SEC Docket 1111.

[118]Pub. L. No. 95–213 (December 19, 1977).

[119]*See infra* at p. 157, for a discussion of SIPC.

[120]In 1975, companion bills H.R.8064 and S.1231, 94th Cong., 1st Sess., were introducted in both houses of Congress. *See* 42nd Annual Report at 98–99.

[121][1976–1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 95,627 (1976).

[122]NASD Manual (CCH) para. 2174 (April 21, 1977). Article III, Section 24, of the NASD's Rules of Fair Practice provides that selling concessions, discounts, or other allowances shall be allowed only as consideration for services rendered in a distribution and only to broker-dealers actually engaged in the securities business.

[123]Securities Exchange Act Release No. 13364 (March 9, 1977), 11 SEC Docket 1945.

[124]*Id.*, n. 9.

[125]Securities Exchange Act Release No 13185 (January 19, 1977), 11 SEC Docket 1514.

[126]In a letter dated May 11, 1976, from Chairman Hills to NYSE Chairman Batten, the NYSE was urged to consider that suggestion.

[127]Securities Exchange Act Release No. 12806 (September 16, 1976), 10 SEC Docket 465.

[128]Securities Exchange Act Release No. 13508 (May 5, 1977), 12 SEC Docket 299.

[129]Securities Exchange Act Release No. 13661 (June 23, 1977), 12 SEC Docket 940.

[130]Section 17(f)(1) applies to every national securities exchange, member thereof, registered securities association, broker, dealer, municipal securities dealer, registered transfer agent, registered clearing agency and participant therein, member of Federal Reserve System and bank whose deposits are insured by the Federal Deposit Insurance Corporation. Although other financial institutions, such as insurance companies and foreign banks, are not included in the system, such institutions may write to the Commission to request to be included. Such applications will be considered on a case-by-case basis.

[131]Securities Exchange Act Release No. 13053 (December 28, 1976), 11 SEC Docket 1161.

[132]Securities Exchange Act Release No. 13280 (February 18, 1977), 11 SEC Docket 1804.

[133]Securities Exchange Act Release No. 13281 (February 18, 1977), 11 SEC Docket 1807.

[134]Securities Exchange Act Release No. 13831 (August 4, 1977), 12 SEC Docket 1465.

[135]Securities Exchange Act Release No. 13053 (December 28, 1976), 11 SEC Docket 1161.

[136]In Securities Exchange Act Release No. 13538 (May 24, 1977), 12 SEC Docket 339, AutEx, Inc., was named as the designee. SIC was created as a wholly owned subsidiary of the ITEL AutEx, Inc. after ITEL Corporation acquired AutEx, Inc.

[137]Reports and inquiries concerning United States Government or Agency securities are to be made to any Federal Reserve Bank or Branch.

[138]17 CFR 249.1200.

[139]The Lost and Stolen Securities Program is not intended to be a substitute for other steps being undertaken to improve securities processing, prevent losses and reduce the risk of theft. The Commission continues to endorse the immobilization and elimination of certificates through greater use of depositories and book entry systems.

[140]Securities Exchange Act Release No. 12214 (March 16, 1976), 9 SEC Docket 203. Securities Exchange Act Section 17(f)(2) provides that every partner, director, officer, and employee of every member of a national securities exchange, broker, dealer, registered transfer agent and registered clearing agency shall be fingerprinted and shall submit, or cause to be submitted, such fingerprints to the Attorney General of the United States for identification and appropriate processing. The Commission is given authority to exempt certain classes of persons from these requirements in a

manner consistent with the public interest and the protection of investors.

[141]For instance, in the case of a registered transfer agent, the rule requires the fingerprinting of only those persons engaged in or having access to "transfer agent activities."

[142]Securities Exchange Act Release No. 13105 (January 11, 1977), 11 SEC Docket 1311.

[143]The term "SECO broker-dealers" refers to those broker-dealers which are not members of the NASD.

[144]Securities Exchange Act Release No. 13679 (June 27, 1977), 12 SEC Docket 1017.

[145]Securities Exchange Act Release No. 12157 (March 2, 1976), 9 SEC Docket 45. The first set of notices under Section 31(b) generally concerned the issue of exchange membership and access to the exchanges. It is discussed in the 42nd Annual Report at 25.

[146]Securities Exchange Act Release No. 13027 (December 1, 1976), 11 SEC Docket 1066.

[147]Because both the Cincinnati and Spokane Stock Exchanges had indicated a desire to overhaul their respective sets of rules, the Commission found it preferable to send notices to these exchanges with respect to their entire rulebooks instead of citing specific rules.

[148]The Cincinnati Stock Exchange and Spokane Stock Exchange have responded pursuant to Section 19(b) of the Securities Exchange Act with proposed revisions of their rulebooks. *See* Securities and Exchange Commission File No. SR–CSE–77–1; and Securities and Exchange Commission File No. SR–SSE–77–1.

[149]Securities Exchange Act Release No. 14002 (September 27, 1977), 13 SEC Docket 238. Further notice was not given with respect to the other rules cited in the December 1, 1976, notice. The Commission expects that, before any further action on those rules is taken pursuant to Section 31(b), the rule will be the subject of an interim statement intended to facilitate additional consideration of the issues they present.

[150]Securities Exchange Act Release No. 13482 (April 28, 1977), 12 SEC Docket 239.

[151]Securities Exchange Act Release No. 13901 (August 29, 1977), 12 SEC Docket 1630.

[152]Securities Act Release No. 5758 (November 2, 1976), 10 SEC Docket 834.

[153]The original deadline for submission of comments of December 15, 1976 was extended to January 31, 1977 in Securities Act Release No. 5783 (December 15, 1976), 11 SEC Docket 1164.

[154]Securities Exchange Act Release No. 12999 (November 22, 1976), 10 SEC Docket 1006.

[155]Securities Act Release No. 5856 (August 18, 1977), 12 SEC Docket 1520.

[156]Securities Act Release No. 5758 (November 2, 1976), 10 SEC Docket 834.

[157]Securities Act Release No. 5808 (February 24, 1977), 11 SEC Docket 1779.

[158]*Id.*, 11 SEC Docket 1978–1803.

[159]Securities Act Release No. 5609 (August 25, 1975), 7 SEC Docket 696.

[160]Securities Act Release No. 5851 (August 10, 1977), 12 SEC Docket 1461.

[161]Securities Act Release No. 5859 (August 29, 1977), 12 SEC Docket 1598.

[162]Securities Act Release No. 5872 (September 29, 1977), 13 SEC Docket 227.

[163]Securities Exchange Act Release No. 13292 (February 24, 1977), 11 SEC Docket 1814.

[164]Securities Exchange Act Release No. 13787 (July 21, 1977), 12 SEC Docket 1256.

[165]Securities Exchange Act Release No. 12676 (August 2, 1976), 10 SEC Docket 143.

[166]Securities Act Release No. 5735 (August 31, 1976), 10 SEC Docket 313.

[167]Securities Act Release No. 5792 (December 20, 1976), 11 SEC Docket 1214.

[168]Securities Act Release No. 5879 (November 2, 1977), 13 SEC Docket 509.

[169]The form would still be available for the registration of securities to be offered by security holders and by the issuer upon the conversion of outstanding convertible securities and exercise of outstanding options.

[170]The use of the form will continue to be conditioned upon the issuer meeting the rules for the use of the Form S–7.

[171]Securities Act Release No. 5826 (May 10, 1977), 12 SEC Docket 340.

[172]See minutes of the Meetings of the Advisory Committee on February 8, 1977.

[173]Securities Act Release No. 5699 (April 23, 1976), 9 SEC Docket 472.

[174]Securities Act Release No. 5824 (April 28, 1977), 12 SEC Docket 78.

[175]45 U.S.C. 801 (February 5, 1976).

[176]Securities Act Release No. 5840 (July 1, 1977), 12 SEC Docket 1097.

[177]Securities Act Release No. 5827 (May 19, 1977), 12 SEC Docket 426.

[178]See Minutes of the Meeting of the Advisory Committee on Corporate Disclosure on October 22, 1976.

[179]The original deadline of August 1, 1977 for commenting on the concept release was extended to September 15, 1977 in Securities Act Release No. 5850 (August 9, 1977), 12 SEC Docket 1460.

[180]45 U.S.C. 801 (February 5, 1976).

[181]Securities Exchange Act Release No. 12769 (September 3, 1976), 10 SEC Docket 407.

[182]Securities Exchange Act Release

No. 13477 (April 28, 1977), 12 SEC Docket 228.

[183]Lessor railroads are substantially or wholly owned subsidiaries of operating railroads whose facilities or trackbeds are operated under lease pursuant to which the parent railroad is lessee. The income of the lessor subsidiary is determined pursuant to the lease arrangement based on the interest and a fixed dividend on the outstanding securities of the lessor. Switching and terminal companies are owned and operating railroads which share the expense of operation on a user basis.

[184]Securities Exchange Act Release No. 13478 (April 28, 1977), 12 SEC Docket 232.

[185]Securities Exchange Act Release No. 14032 (October 5, 1977), 13 SEC Docket 303.

[186]Under Section 12(h), the Commission, upon application and after notice and opportunity for hearing, may exempt in whole or in part any issuer from the provisions of Sections 12(g), 13, 14 or 15(d), if the Commission finds, by reason of the number of public investors, amount of trading interest in the securities, the nature and the extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors.

[187]Investment Company Act Release No. 9470 (Ocotober 4, 1976), 10 SEC Docket 680.

[188]Investment Company Act Release No. 9482 (October 18, 1976), 10 SEC Docket 751.

[189]*Id*.

[190]Investment Advisers Act Release No. 602 (July 21, 1977), 12 SEC Docket 1337.

[191]No. 75–1870 (June 16, 1977).

[192]539 F.2d 649 (C.A. 7, 1976).

[193]547 F.2d 171 (C.A. 2, 1976).

[194]Litigation Release No. 7248, (January 23, 1976), 8 SEC Docket 1176.

[195]425 U.S. 185 (1976).

[196]544 F.2d 535 (C.A. 1, 1976).

[197]S.D.N.Y., No. 76 Civ. 2368. In its complaint, the Commission alleged violations of registration, reporting and antifraud provisions of the Federal securities laws in connection with the sale of interests in oil and gas drilling programs to public investors.

[198]*SEC v. Petrofunds, Inc.*, 420 F. Supp. 958, 960 n. 9 (S.D.N.Y., 1976) (Weinfeld, Jr.).

[199]C.A. 2, No. 76-6184 (entered on April 12, 1977). Litigation Release No. 7908 (May 5, 1977), 12 SEC Docket 339.

[200]*SEC v. Petrofunds, Inc., supra*, 420 F. Supp. at 960.

[201]*Id*.

[202]*Id*. at 959.

[203]No. 76–1278 and No. 1536 (C.A.D.C., October 3, 1977), [Current Binder] CCH Fed. Sec. L. Rep. para 96,185.

[204]*Richard C. Spangler, Inc., Nassar and Co., Inc. and Albert Teller and Co., Inc.*, Securities Exchange Act Release No. 12104 (February 12, 1976), 8 SEC Docket 1257.

[205]CCH Fed. Sec. L. Rep., para. 96,185 at p. 92,341.

[206]Securities Exchange Act Release No. 12104 (February 12, 1976), 8 SEC Docket at 1268.

[207]CCH Fed. Sec. L. Rep., para 96,185 at p. 92,342.

[208]No. 75–2200 (C.A.D.C., 1977), [Current Binder] CCH Fed. Sec. L. Rep., para. 96,122.

[209]425 U.S. 185 (1976).

[210]546 F.2d 1361 (C.A. 10, 1976).

[211]557 F.2d 1008 (C.A. 3, 1977).

[212]Nos. 76-3543 and 76-3764, (C.A. 9, 1977).

[213]556 F.2d 619.

[214]The Commission order imposing these sanctions provided that, after one year, Mr. White could apply for leave to become associated with a broker-dealer in a non-proprietary capacity. Securities Exchange Act Release No. 12614 (July 9, 1976), 10 SEC Docket 7.

[215]430 F.Supp. 71 (C.D. Cal., 1977).

[216]558 F. 2d 1083 (C.A. 2, 1977).

[217]425 F. Supp. 212 (S.D.N.Y., 1977), *appeal pending*, C.A. 2, No. 77–6034.

[218]Oral argument of the case occurred shortly after the close of the fiscal year.

[219]No. 76-6189 (C.A. 2, September 30, 1977), [Current Binder] CCH Fed. Sec. L. Rep., para. 96,186.

[220]420 F. Supp. 1226 1244 (S.D.N.Y. 1976) (citations omitted).

[221]*Id*. at 1241.

[222]*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

[223]CCH Fed. Sec. L. Rep., para. 96,186 at p. 92,350 (citations omitted).

[224]CCH Fed. Sec. L. Rep., para. 96,186 at p. 92,353 (citation omitted).

[225]432 F. Supp. 1190 (D.D.C., 1977), *appeal pending*, C.A.D.C., No. 1761.

[226]The Commission's existing rules already require disclosure of all *material* information. *See* e.g., 17 CFR 230.408, 240.12b–20, and 240.14a–9.

[227]562 F. 2d 820 (C.A. D.C., 1977).

[228]With respect to the Big Horn activities, the Commission found that Collins Securities Corporation and Mr. Collins had wilfully violated Securities Act Section 17(a), 15 U.S.C. 77q(a), and Securities Exchange Act Section 10(b), 15 U.S.C. 78j(b), as well as Rules 10b–5 and 10b–6 thereunder, 17 CFR 240.10b–5 and 240.10b–6.

In addition, the Commission also found that Collins Securities Corporation and Mr. Collins had wilfully violated or willfully

aided and abetted violations of margin, reporting and recordkeeping requirements of the Federal securities laws.

[229]425 U.S. 185 (1976).

[230][1975-1976 Transfer Binder] CCH Fed. Sec. L. Rep., para. 95,229 (S.D. N. Y., July 14, 1975).

[231]*Id.* at p. 98,207.

[232]No. 75–6111 (C.A. 2, 1976).

[233]425 U.S. 185 (1975).

[234]546 F. 2d 1044 (C.A. 2, 1976), certiorari denied sub nom., *Homans v. SEC* [Current] Fed. Sec. L. Rep. (CCH) 78,014.

[235]*Id.* at 1047.

[236]547 F. 2d 152 (C.A. 2, 1976), *petition for a writ of certiorari granted* Sup. Ct. No. 76-1607 (October 17, 1977).

[237]15 U.S.C. 78*o*(c)(5) and 15 U.S.C. 78s(a)(4).

[238]15 U.S.C. 78*l*(k).

[239]*Id.*

[240]Sup. Ct. No. 76–1607.

[241]Litigation Release Nos. 8077 and 8078 (August 22, 1977), 12 SEC Docket 1590.

[242]Litigation Release No. 7902 (May 2, 1977), 12 SEC Docket 336.

[243]Litigation Release No. 7902 (May 2, 1977), 12 SEC Docket 336.

[244]Securities Act Release No. 5800 (January 21, 1977), 11 SEC Docket 1548.

[245]Litigation Release No. 7651 (November 16, 1976), 10 SEC Docket 981.

[246]Litigation Release No. 7920 (May 12, 1977), 12 SEC Docket 421.

[247]Litigation Release No. 7581 (September 24, 1976), 10 SEC Docket 626.

[248]Litigation Release No. 7682 (December 3, 1977), 11 SEC Docket 1155.

[249]Litigation Release No. 7943 (May 27, 1977), 12 SEC Docket 743.

[250]Litigation Release No. 8119 (September 21, 1977), 13 SEC Docket 178.

[251]Litigation Release No. 7529 (August 19, 1976), 10 SEC Docket 263.

[252]Litigation Release No. 7921 (February 3, 1977), 11 SEC Docket 1110.

[253]Litigation Release No. 7921 (May 13, 1977), 12 SEC Docket 452.

[254]Litigation Release No. 7910 (May 9, 1977), 12 SEC Docket 415.

[255]Litigation Release No. 8103 (September 7, 1977), 13 SEC Docket 52.

[256]Litigation Release No. 8104 (September 7, 1977), 13 SEC Docket 52.

[257]Litigation Release No. 8082 (August 24, 1977), 12 SEC Docket 1593.

[258]Litigation Release No. 8105 (September 7, 1977), 13 SEC Docket 52.

[259]Litigation Release No. 7882 (April 20, 1977), 12 SEC Docket 72.

[260]Litigation Release No. 7932 (May 23, 1977), 12 SEC Docket 503.

[261]Litigation Release No. 7940 (May 25, 1977), 12 SEC Docket 506.

[262]City of Philadelphia v. SEC, 434 F. Supp. 281 (1977).

[263]426 U.S. 833 (1976).

[264]S.D.N.Y. No. 76–Civ. 3707.

[265]76 Civ. 1331 (CL 13).

[266]Admin. Proc. File No. 3–4694.

[267]553 F.2d 816 (C.A. 2, 1977).

[268]Civil Action No. 74–2263–S (D. Mass.) The Commission had entered orders for public proceedings, on the basis of the information acquired during the investigation: (1) to determine whether two Carter-affiliated companies had willfully violated the registration (Section 5 of the Securities Act, 15 U.S.C. 77e) and antifraud provisions of the Federal securities laws (Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b–5, 17 CFR 240.10b–5) promulgated under the latter Act) and whether Mr. Carter had willfully aided and abetted such violations (*In the Matter of Brokers Diversified Inc.*, Administrative Proceeding File No. 3–4421 (January 15, 1974)); and (2) to determine whether a proposed stock offering of another Carter-affiliated company would violate registration and antifraud provisions of the Federal securities laws (*In the Matter of Brokers Diversified Services Corp.*, Administrative Proceeding File No. 3–4436 (Feb. 12, 1974)). The Commission consolidated the proceedings and thereafter, on August 1, 1974, following the filing of Mr. Carter's complaint, entered a default order based on basis of his failure to appear at a scheduled administrative hearing. The Commission's order found that Mr. Carter had aided and abetted violations of registration and antifraud provisions of the Federal securities laws in connection with the offer and sale of common stock of two affiliated companies between June 1972 and January 1974.The order also barred Mr. Carter from being associated with any broker-dealer. *In the Matter of Brokers Diversified, Inc., et al.*, Securities Exchange Act Release No. 10938 (August 1, 1974).

[269]Docket No. 77-1228 (C.A. 1), *petition for a writ of certiorari denied*, Sup. Ct. No. 77–5501.

[270]539 F.2d 649 (C.A. 7, 1976).

[271]547 F.2d 152 (C.A. 2, 1976), *petition for a writ of certiorari denied* Sup. Ct. No. 76–1547 (October 3, 1977).

[272]Securities Exchange Act Release No. 11376 (April 28, 1975), 6 SEC Docket 772.

[273]15 U.S.C. 78q(a) and 17 CFR 240.17a-3 respectively.

[274]15 U.S.C. 78*o*(c)(3) and 17 CFR 240.15c3-1 respectively.

[275]Rule 17a-5, 17 CFR 240.17a-5.

[276]Rule 17a-10, 17 CFR 240.17a-10.

[277]Rule 17a-11, 17 CFR 240.17a-11.

[278]*Sloan v. SEC, supra*, 547 F.2d at 155.

[279]*Id.*

[280]Sup. Ct. No. 76–1547.

[281]557 F.2d 1118 (C.A. 5, 1977).

[282]97 S. Ct. 2229 (1977).

[283]The Commission's application for *en banc* rehearing was denied.

Part 2
The Disclosure System

Part 2
The Disclosure System

A basic purpose of the Federal securities laws is to provide disclosure of material, financial, and other information on companies seeking to raise capital through the public offering of their securities, as well as companies whose securities are already publicly held. This aims at enabling investors to evaluate the securities of these companies on an informed and realistic basis.

The Securities Act of 1933 generally requires that before securities may be offered to the public a registration statement must be filed with the Commission disclosing prescribed categories of information. Before the sale of securities can begin, the registration statement must become "effective." In the sales, investors must be furnished a prospectus containing the most significant information in the registration statement.

The Securities Exchange Act of 1934 deals in large part with securities already outstanding and requires the registration of securities listed on a national securities exchange, as well as over-the-counter securities in which there is a substantial public interest. Issuers of registered securities must file annual and other periodic reports designed to provide a public file of current material information. The Exchange Act also requires disclosure of material information to holders of registered securities in solicitations of proxies for the election of directors or approval of corporate action at a stockholder's meeting, or in attempts to acquire control of a company through a tender offer or other planned stock acquisition. It provides that insiders of companies whose equity securities are registered must report their holdings and transactions in all equity securities of their companies.

PUBLIC OFFERING: THE 1933 SECURITIES ACT

The basic concept underlying the Securities Act's registration requirements is full disclosure. The Commission has no authority to pass on the merits of the securities to be offered or on the fairness of the terms of distribution. If adequate and accurate disclosure is made, it cannot deny registration. The Act makes it unlawful to represent to investors that the Commission has approved or otherwise passed on the merits of registered securities.

Information Provided

While the Securites Act specifies the information to be included in registration statements, the Commission has the authority to prescribe appropriate forms and to vary the particular

items of information required to be disclosed. To facilitate the registration of securities by different types of issuers, the Commission has adopted special registration forms which vary in their disclosure requirements so as to provide maximum disclosure of the essential facts pertinent in a given type of offering while at the same time minimizing the burden and expense of compliance with the law. In recent years, it has adopted certain short forms, notably Forms S-7 and S-16, which do not require disclosure of matters already covered in reports and proxy material filed or distributed under provisions of the Securities Exchange Act. Another short form for registration under the Securities Act is Form S-8 for the registration of securities to be offered to employees of the issuer and its subsidiaries. Recent Commission actions to amend the three forms referred to above are discussed below.

Reviewing Process

Registration statements filed with the Commission are examined by its Division of Corporation Finance for compliance with the standards of adequate and accurate disclosure. Various degrees of review procedures are employed by the Division.[1] While most deficiencies are corrected through an informal letter of comment procedure, where the Commission finds that material representations in a registration statement are misleading, inaccurate, or incomplete, it may, after notice and opportunity for hearing, issue a "stop-order" suspending the effectiveness of the statement.

Time for Registration

The Commission's staff tries to complete examination of registration statements as quickly as possible. The Securities Act provides that a registration statement shall become effective on the 20th day after it is filed (or on the 20th day after the filing of any amendment). Most registration statements require one or more amendments and do not become effective until some time after the statutory 20-day period. The period between the filing and effective date is intended to give investors an opportunity to become familiar with the proposed offering through the dissemination of the preliminary form of prospectus. The Commission can accelerate the effective date to shorten the 20-day waiting period—taking into account, among other things, the adequacy of the information on the issuer already available to the public and the ease with which facts about the offering can be understood.

During the 3 months ended September 30, 1976, 637 registration statements became effective. Of these, 72 were amendments filed by investment companies pursuant to Section 24(e) of the Investment Company Act of 1940, which provides for the registration of additional securities through amendment to an effective registration statement rather than the filing of a new registration statement. For the remaining 565 statements, the median number of calendar days between the date of the original filing and the effective date was 28.

During the 1977 fiscal year, 2,921 registration statements became effective, including 402 which were amendments filed by investment companies. The median number of calendar days between the date of the original filing and the effective date for non-investment company filings was 16.

Recent Actions Concerning the Registration Process

The Commission continuously monitors its disclosure forms and the rules

concerning the procedures for registration statements and exemptions under the Securities Act to assure that the provisions are current and adequate, and to assure that they do not involve undue burdens on registrants. Actions of this general nature occurring during the period covered by this report are discussed under the following headings.

Form S-8

On November 22, 1976 the Commission adopted amendments to Form S–8[2] substantially as previously proposed[3] but with several significant modifications. In considering the over 160 letters of comment, the Commission, in addition to responding with significant changes to further simplify the disclosure requirements together with the wider availability of the new form, made major changes to: (1) delete the regulatory conditions governing the availability of the form; (2) modify the limitations on the use of the form for reoffers and resales; and (3) delete the requirement for an opinion of counsel concerning compliance with the Employee Retirement Income Security Act of 1974.

As proposed, Form S–8 would not have allowed reoffers to be made by affiliates or underwriters through the use of the Form S–8 prospectus. No person can use the new Form S–8 prospectus for reoffers or resales. The new form continues with the prohibition in the use of a Form S–8 prospectus for reoffers and resales by "affiliates" but goes on to allow any affiliates to make registered reoffers of certain amounts of securities acquired pursuant to a registration statement on Form S–8 through the use of a Form S–16 or S–1 prospectus as indicated under general Instruction E of the Form S–8. The Form S–16 or S–1 prospectus can be filed as part of the registration statement on Form S–8 and need not be the subject of a new, separate registration statement or any new filing fee. Persons deemed to be "underwriters" may utilize the reoffer and resale procedure specified for affiliates in general Instruction E or comply with the provisions of Rule 144. Persons not deemed to be "affiliates" or "underwriters" of the issuer make reoffers or resales under the exemption afforded by Section 4(1) of the Securities Act, presupposing that these persons satisfy the requirements for the exemption. These procedures are designed to provide adequate notice to the public and to the Commission with respect to the registered reoffer of securities.

The new form became effective for all registration statements and post-effective amendments filed on Form S–8 after December 31, 1976.

Amendments to Forms S–7 and S–16 and Rescission of Form S–9.

On December 20, 1976, the Commission adopted amendments to Forms S–7 and S–16 and rescinded Form S–9 under the Securities Act.[4] These amendments were adopted substantially as proposed[5] and generally expand the availability of the S–7 and S–16 short form registration statements to additional issuers which are subject to the reporting requirements of the Exchange Act.

Issuers using Forms S–7 and S–16 are permitted to omit from the Form S–7 prospectus, or to incorporate by reference in the Form S–16 prospectus, certain information already provided to security holders or available to investors in reports filed under the Exchange Act. Thus, the amendments reflect recent improvements in the nature and extent of information required to be included in reports and

proxy and information statements under that Act, and the increased availability of such information to the investing public.

Among the principal changes in the availability of the Forms S–7 and S–16 are their expansion to issuers with a class of debt securities listed on a national securities exchange or a class of securities subject to Section 15(d) of the Exchange Act; the elimination of the requirement that a majority of the registrant's board of directors must have served during the prior three years; the reduction in the net income test from the present requirement of $500,000 for each of the prior five years to $250,000 for three of the last four years, including the most recent year; the deletion of any requirement that the issuer must have had income adequate to cover dividends paid for the prior five years; and the reduction of the present ten year test to a new thirty-six month standard within which the registrant must not have had any defaults in the payment of any dividend or sinking fund installment on preferred stock, or installment on indebtedness. Also, Form S–7 was made available for the registration of securities in any type of offering, such as exchange offers, not solely in cash offerings as was previously required. At present, Form S–16 may be used only for certain types of offerings, most commonly those by persons other than the issuer.[6]

In addition, certain of the disclosure items of Form S–7 were amended to require additional information if the securities are to be offered in exchange for the assets or securities of any other person. Such information relates to the management of the issuer and to the person whose assets or securities are the subject of the offer. Also, if there has been a recent change in control of the issuer, Forms S–7 and S–16 were amended to require that certain additional disclosure concerning such change in control and the management of the issuer be made in the prospectus if not previously reported pursuant to the Securities Act or the Exchange Act.

Form S–9 previously was a short registration form for use by issuers in registering certain debt securities under the Securities Act if they met certain minimum earnings coverage ratios in their debt securities. Since the form had not been widely used recently and since the amended Form S–7 is now available to virtually all issuers which could previously have used Form S–9, the Commission rescinded Form S–9.

Registration Form for Business Combination Transactions

On September 27, 1976, the Commission published for comment proposed Form S–14A,[7] an optional short form for registration under the Securities Act of securities of certain issuers to be issued in reclassifications and business combination transactions of the character described in Securities Act Rule 145(a), and proposed amendments to related rules.[8] The proposed form provided for a short prospectus (which could be in the form of a proxy or information statement), consisting principally of information concerning the transaction in which the registered securities would be issued. More detailed information concerning the transaction and the parties to the transaction would be filed with the Commission as a new Part II of the registration statement and incorporated by reference in the prospectus. The registrant would be required to provide Part II at its own expense, upon request. These proposals were intended to result in cost savings

to registrants and to provide disclosure to investors in a simpler, more understandable form.

During the comment period, which expired January 10, 1977, 22 comments were received. Although the comments indicated overwhelming support for the Commission's goals of simplifying disclosure for investors and reducing the burdens on registrants, a large number of commentators felt that the differential disclosure approach embodied in the proposed form did not achieve these goals.

In February, 1977, the Commission announced that, in light of the comments received on proposed Form S–14A, it did not intend to adopt the form at that time.[9] Instead, the Commission invited comment on the advisability of developing a new registration form for the same purpose. The new form, as contemplated, would consist of a single, abbreviated prospectus (and proxy or information statement) which would incorporate by reference reports filed under the Exchange Act and/or the issuer's annual report to shareholders. The staff of the Division of Corporation Finance will consider both the comments received on this matter and the recommendations of the Advisory Committee on Corporate Disclosure.

Rule 146

The so-called "private offering" exemption from registration under the Securities Act, Section 4(2), provides that offers and sales by an issuer not involving any public offering will be exempt from registration. The section has long been a source of uncertainty for issuers wanting to sell their securities in private placements. In April 1974, the Commission adopted Rule 146 under the Securities Act, "Transactions by an Issuer Deemed Not to Involve Any Public Offering," which is designed to protect investors while at the same time providing more objective standards to curtail uncertainty as to the meaning of Section 4(2) to the extent feasible.[10]

In general, the rule provides that transactions by an issuer meeting all the conditions of the rule do not involve "any public offering." Major conditions to be met are essentially that (1) there must be no general advertising or solicitation in connection with the offering; (2) offers can be made only to persons the issuer reasonably believes have the requisite knowledge and experience in financial and business matters, or can bear the economic risk; (3) sales can be made only to persons the issuer reasonably believes have the requisite knowledge and experience, or who can bear the economic risk and have an advisor (meeting certain standards) who can provide the requisite knowledge and experience; (4) all offerees either must have access to or must be furnished with the type of information that registration would disclose; (5) there can be no more than 35 purchasers of securities in the offering; and (6) reasonable care must be taken to prevent resale of the securities in violation of the registration provisions of the Securities Act.

Rule 146 does not provide the exclusive means for offering and selling securities in reliance on Section 4(2). Issuers may continue to rely on the Section 4(2) exemption by complying with relevant administrative and judicial criteria at the time of a transaction. The staff of the Commission will issue interpretive letters to assist persons in complying with the rule, but will issue no-action letters relating to Section 4(2) only in the most compelling circumstances.

In December 1976, the Commission requested from the public empirical

information regarding the operation of Rule 146 and whether it should be revised, retained or rescinded.[11] Moreover, specific recommendations for amendments to the rule were sought. The request was prompted by criticism that the rule has hindered the investment of venture capital and has facilitated the fraudulent offering of certain types of securities. Subsequently, the Commission proposed an amendment to the rule which would require the filing of a notice when the rule is used.[12]

The majority of the comments favored retention of the rule; it is expected that several amendments to the rule will be proposed in order to increase its availability to issuers and improve its efficiency.

Proposed Rule 148 and Amendments to Form 8-K

On September 16, 1977 the Commission proposed the adoption of Rule 148 under the Securities Act, which would establish objective standards for the resale of certain types of securities relating to bankruptcy proceedings.[13] The purpose of the proposed rule is to provide some degree of certainty as to when a person could sell such securities without the need for registering them under the Act. In a related matter, the Commission also proposed the adoption of certain amendments to Form 8–K under the Exchange Act for the purpose of assuring that current information about a debtor and the bankruptcy proceedings in which it has participated will be available to the public shortly after such proceedings have been completed.

Status of Securities Acquired Pursuant to an ESOP

On October 8, 1976 the Commission announced that the Division of Corporation Finance issued a letter[14] reversing the position stated in Securities Act Release No. 5223, January 1, 1972 and Securities Act Release No. 5243, April 12, 1972, regarding the status of securities acquired pursuant to an Employee Stock Ownership Plan (ESOP). Under prior practice, the Commission took the position that securities acquired pursuant to stock bonus or similar plans were included within the Rule 144 definition of "restricted securities." Accordingly, the Division of Corporation Finance, in issuing interpretive and "no-action" letters, consistently took the position that common stock acquired by a trustee of an ESOP, from the issuer, for allocation, distribution and subsequent sale by employees of the issuer would be "restricted securities" for purposes of Rule 144.

The Commission reconsidered this position and, in light of the possible burdens of non-affiliate employee compliance with the provisions of Rule 144 compared with the limited benefits of compliance, if any, along with the facts set forth in the letter, concluded that it was not in the public interest or in the interest of the protection of investors to take the position that ESOP shares in the hands of non-affiliate employees are "restricted" where the plan does not function as a conduit for distribution to the public. As indicated in Release No. 5750, the volume of shares contributed to the plan vis-a-vis the company's outstanding shares as well as the length of time the plan holds the shares prior to distribution to participants are important factors in reaching a conclusion on this issue. Therefore, where (1) the corporation is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, (2) the corporation's common stock is actively traded on an exchange or in the over-the-counter

market, and (3) the number of shares issuable pursuant to the plan is small in relation to the number of shares presently issued and outstanding, the Commission has authorized the Division to take the view that shares issued and to be issued as bonuses do not constitute "restricted securities" within the meaning of Rule 144. Affiliates would be required to use Rule 144 for resales absent registration of their shares.

Undertaking to Provide Financial Information Added to Guide 60

On September 27, 1976 the Commission approved the addition of Section 21(c), "Undertaking to Provide Financial Information" to Guide 60, "Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships".[15] Section 21(c) requests that registrants undertake to furnish to investors the financial statements required by Form 10–K for one full year of operations after the effective date of a registration statement relating to a real estate limited partnership. The purpose of this undertaking is to try to assure that investors receive financial information for at least the first year of actual operations. In many instances, the issuers obligation to file reports under the Exchange Act terminates before the proceeds of the offering are fully invested so that the investor never receives financial information of the type required by Form 10–K relating to partnership operations.

Guide 42

On June 13, 1977[16] the Commission announced that it is considering clarification or amendment of Guide 42, "Reports or Memoranda Concerning the Registrant," one of the Guides for the Preparation and Filing of Registration Statements under the Securities Act of 1933. This guide requires that certain reports or memoranda be furnished to the staff as supplemental information in connection with submission of a registration statement in order that the staff have access to materials necessary and helpful for its review of registration statements and that the staff be able to discern whether any conditioning of the market has taken place prior to the proposed offering. The Commission's consideration of the guide is focusing on whether its requirements are unnecessarily broad and whether there is a consensus of understanding on the part of the securities industry and its counsel as to the guide's requirements, purposes and operation.

Delegation of Authority

The Commission delegated to the Director of the Division of Corporation Finance its authority to issue releases announcing that the Secretary of the Treasury, pursuant to authority contained in Section 3(a) (12) of the Exchange Act, has designated certain securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as "exempted securities" under the Act. This delegation of authority will result in more timely notice to the public of the designation of a new exempted security by eliminating any delay caused by seeking Commission approval for release of the information.[17]

Amendments to Rules 424 and 429

In order to expedite the processing of prospectuses and to reduce the filing burden on issuers, the Commission adopted certain minor amendments to Rules 424 and 429 under the Securities Act.[18] The amendments reduce the number of copies of prospectuses required to be filed and require that certain data be set forth on the front pages of such documents.

Rescission of Rule 458

The Commission rescinded Rule 458 on July 5, 1977.[19] This rule required corporations to submit with an initial filing of a registration statement a brief summary of that statement for the Commission's use. The summary, which was used to prepare notices of filing of registration statements included in the SEC News Digest, is no longer being required because the Commission believes that this will reduce paperwork and ease the burdens on corporations which are preparing registration statements and that the Commission staff can write a shorter version of News Digest notices themselves.

The notices in the Digest continue to give the following information: (1) the file number; (2) the form on which the registration statement is filed; (3) the name, address and phone number of the issuer of the security; (4) the title and the number or face amount of the securities being offered; (5) the name of the managing underwriters, if any; and (6) whether the offering is a rights offering. The editors of the Digest are now considering whether additional information should be set forth in the notices.

Office of Engineering

During the fiscal year the Division reorganized the functions previously performed by the Office of Oil and Gas and the Office of Engineering by consolidating all of the Division's engineers and geologists in one office, which was designated the Office of Engineering.

This office is responsible for reviewing from a technical standpoint the disclosure in all filings involving oil and gas, mining, aerospace, and other engineering and geological matters. Sixty-five registration statements were examined during fiscal 1977 for oil and gas drilling programs, totaling $808,851,466. In the transition quarter of July through September 1976, 11 oil and gas drilling programs totaling $117,505,000 were examined.

Additional information regarding certain offerings of fractional undivided interests in oil and gas rights is contained under Regulation B in this part.

SMALL ISSUE EXEMPTION

The Commission is authorized under Section 3(b) of the Securities Act to exempt securities from registration if it finds that registration for these securities is not necessary to the public interest because of the small offering amount or limited character of the public offering. The law imposes a maximum limitation of $500,000 upon the size of the issues which may be exempted by the Commission.

The Commission has adopted the following exemptive rules and regulations:

Regulation A:	General exemption for U.S. and Canadian issues up to $500,000.
Regulation B:	Exemption for fractional undivided interests in oil or gas rights up to $250,000.
Regulation E:	Exemption for securities of a small business investment company up to $500,000.
Regulation F:	Exemption for assessments on assessable stock and for assessable stock offered or sold to realize the amount of assessment up to $300,000.

Rules 234-237 and 240: Exemptions of first lien notes, securities of cooperative housing corporations, shares offered in connection with certain transactions, certain securities owned for five years and certain limited offers and sales of small dollar amounts of securities by closely-held issuers.

Regulation A

Regulation A permits a company to obtain needed capital not in excess of $500,000 (including underwriting commissions) in any one year from a public offering of its securities without registration, provided specified conditions are met. Among other things, a notification and offering circular supplying basic information about the company and the securities offered must be filed with the Commission and the offering circular must be used in the offering. In addition, Regulation A permits selling shareholders not in a control relationship with the issuer to offer in the aggregate up to $300,000 of securities which would not be included in computing the issuer's $500,000 ceiling.

During the transitional quarter, 54 notifications were filed under Regulation A, covering proposed offerings of $20,433,368. A total of 78 reports of sales were filed reporting aggregate sales of $7,699,859. Such reports must be filed every six months while an offering is in progress and upon its termination.

During the 1977 fiscal year, 218 notifications were filed under Regulation A, covering proposed offerings of $78,209,915 as compared with 240 notifications covering proposed offerings of $83,528,448 in the prior year. A total of 356 reports of sales were filed reporting aggregate sales of $37,920,060. As stated above such reports must be filed every six months while an offering is in progress and upon its termination. Sales reported during 1976 had totaled $41 million. Various features of Regulation A offerings over the past three years and the transitional quarter are presented in the Part 9 of the report.

In the transitional quarter the Commission temporarily suspended 2 exemptions where it had reason to believe there had been noncompliance with the conditions of the regulation or with disclosure standards, or where the exemption was not available for the securities. Added to 6 cases pending at the beginning of this quarter, this resulted in a total of 8 cases for disposition. Of these the temporary suspension order became permanent in 2 cases: one by lapse of time and one by acceptance of an offer of settlement. Six cases were pending at the end of the quarter.

In fiscal 1977 the Commission temporarily suspended 2 exemptions where it had reason to believe there had been noncompliance with the conditions of the regulation or with disclosure standards, or where the exemption was not available for the securities. Added to 6 cases pending at the beginning of the fiscal year, this resulted in a total of 8 cases for disposition. Of these the temporary suspension order became permanent in 6 cases: in 3 by lapse of time, in 2 cases after hearings, and in one by acceptance of an offer of settlement. Two cases were pending at the end of the fiscal year.

On September 29, 1977 the Commission announced the adoption of

Rule 264 and an amendment to its rule governing delegation of authority to Regional Administrators[20] effective October 31, 1977, establishing a procedure whereby the Commission may, in its discretion, determine that a notification on Form 1–A filed pursuant to the Regulation A exemption from the registration requirements of the Securities Act of 1933, as amended, has been abandoned. The Commission may then remove such filings from consideration as pending matters.

Regulation B

Regulation B provides an exemption from registration under the Securities Act for public offerings of fractional undivided interests in oil and gas rights where the initial amount to be raised does not exceed $250,000, provided certain conditions are met. An offering sheet disclosing certain basic and material information of such offering must be furnished to prospective purchasers at least 48 hours in advance of sale of these securities.

Form S–10 is available for the registration of fractional undivided interests in oil and gas rights where the initial amount to be raised exceeds $250,000 or where the exemption is unavailable for any other reason.

During the 1977 fiscal year, 96 offering sheets and 95 amendments thereto were filed pursuant to Regulation B and examined by the Office of Engineering of the Division of Corporation Finance. Sales reported during the year aggregated $7.3 million. In the transition quarter from July through September 1976, 39 offering sheets and 58 amendments were filed, and aggregate sales of $889,551 were reported. During the 1976 fiscal year 365 offering sheets and 462 amendments were filed and examined by the Office of Engineering. Aggregate sales reported during fiscal 1976 were $22.5 million.

In fiscal 1977, the Commission temporarily suspended the Regulation B exemption for one offeror and permanently suspended the exemption for 29 offerors where it had evidence that the offerors had failed to comply with certain requirements. In addition, the exemption was temporarily suspended for one offeror during the transition quarter.

Regulation F

Regulation F provides exemptions from registration for two types of transactions concerning assessable stock. First, an assessment levied upon an existing security holder may be exempted under the regulation, provided the assessable stock is issued by a corporation incorporated under the laws of and having its principal business operations in any State, Territory or the District of Columbia. Regulation F provides an exemption also when assessable stock of any such corporation is sold publicly to realize the amount of an assessment levied thereon, or when such stock is publicly reoffered by an underwriter or dealer. The exemption is available for amounts not exceeding $300,000 per year. The Regulation requires the filing of a notification and other materials describing the offering.

During the transitional quarter, 5 notifications were filed under Regulation F, covering assessments of stock of $174,289. During the 1977 fiscal year, 12 notifications were filed under Regulation F, covering assessments of stock of $444,815, as compared with 15 notifications covering assessments of $356,318 in 1976.

CONTINUING DISCLOSURE: THE SECURITIES EXCHANGE ACT

The Exchange Act contains significant disclosure provisions designed to

provide a fund of current material information on companies in whose securities there is a substantial public interest. The Act also seeks to assure that security holders who are solicited to exercise their voting rights, or to sell their securities in response to a tender offer, are furnished pertinent information.

Over-the-Counter Registration

Section 12(g) of the Exchange Act requires a company with total assets exceeding $1 million and a class of equity securities held of record by 500 or more persons to register those securities with the Commission unless one of the exemptions set forth in that section is available or the Commission issues an exemptive order under Section 12(h). Upon registration, the reporting and other disclosure requirements and the insider trading provisions of the Act apply to these companies to the same extent as to those with securities registered on exchanges.

During the 3 months ended September 30, 1976, 54 registration statements were filed under Section 12(g). Of these, 16 were filed by issuers already subject to the reporting requirements, either because they had another security registered on an exchange or they had registered securities under the Securities Act. During the fiscal year, 231 registration statements were filed under Section 12(g). Of these, 137 were filed by issuers already subject to the reporting requirements, either because they had another security registered on an exchange or they had registered securities under the Securities Act. Included in these figures are companies which succeeded to the businesses of reporting companies and thereby became subject to the reporting requirements.

Registration on Exchanges

Generally speaking, a security cannot be traded on a national securities exchange until it is registered under Section 12(b) of the Exchange Act. If it meets the listing requirements of the particular exchange, an issuer may register a class of securities on the exchange by filing with the Commission and the exchange an application which discloses pertinent information concerning the issuer and its affairs. During the 3 months ended September 30, 1976, a total of 36 issuers listed and registered securities on a national securities exchange for the first time, and a total of 121 registration applications were filed. The registrations of all securities of 9 issuers were terminated. During the fiscal year 1977, a total of 89 issuers listed and registered securities on a national securities exchange for the first time, and a total of 367 registration applications were filed. The registrations of all securities of 113 issuers were terminated. Detailed statistics regarding securities traded on exchanges may be found in Part 9 of the report.

Exemptions

Section 12(h) of the Act authorizes the Commission to grant a complete or partial exemption from the registration provisions of Section 12(g) or from other disclosure and insider trading provisions of the Act where it is not contrary to the public interest or the protection of investors.

There were 27 exemption applications pending on July 1, 1976, and 15 applications were filed between that date and September 30, 1976. Of these 42 applications, 5 were withdrawn, 2 were granted, and 35 applications were pending at the end of the period. For the 1977 fiscal year 35 applications were pending at the beginning of the year, and 56 applica-

tions were filed during the year. Of these 91 applications, 26 were withdrawn, 34 were granted, and 2 denied. Twenty-nine applications were pending at the end of the fiscal year.

Exemptions — Foreign Private Issuers Under Section 12(g)

Foreign private issuers with total assets in excess of $1 million and a class of equity securities held of record by 500 or more persons, of which 300 or more reside in the United States, are subject to the registration, reporting, proxy and insider trading provisions of the Exchange Act of 1934. Notwithstanding, Rule 12g3–2(b) provides an exemption from registration under Section 12(g) of the Act for a foreign issuer which submits material specified in the Rule to the Commission on a current basis. Such required material includes that information about which investors ought reasonably to be informed with respect to the issuer and its subsidiaries and which the issuer (1) has made public pursuant to the law of the country of its domicile or in which it is incorporated or organized, (2) has filed with a stock exchange on which its securities are traded and which was made public by such exchange and/or (3) has distributed to its security holders.

When it adopted Rule 12g3–2 and other rules relating to foreign securities,[21] the Commission indicated that from time to time it would issue lists of those foreign issuers which have obtained exemptions from the registration provisions of Section 12(g) of the Act by providing the information specified in Rule 12g3–2(b). The purpose of the publication of such lists is to call to the attention of brokers, dealers and investors that some form of relatively current information concerning those foreign issuers on the list is available in the public files of the Commission and also that current information concerning other foreign issuers not on the list may not be available in the United States. The latest list was published on August 31, 1977,[22] and includes those foreign private issuers which as of July 31, 1977, appear to be current in furnishing the information under Rule 12g3–2(b). There is a total of 141 foreign private issuers on the list.

Periodic Reports

Section 13 of the Exchange Act requires issuers of securities registered pursuant to Sections 12(b) and 12(g) to file periodic reports keeping current the information contained in the registration application or statement. Similar reports are required pursuant to Section 15(d) of certain issuers which have filed registration statements under the Securities Act which have become effective.

During the 3 months ended September 30, 1976, 13,057 reports — annual, quarterly and current — were filed. In 1977, 45,139 reports — annual, quarterly and current — were filed.

Amendments to Certain Periodic Reports and Related Rules

On January 13, 1977, the Commission adopted amendments to Forms 8–K, 10–Q and 10–K, which are used for current, quarterly and annual reports filed pursuant to section 13 or 15(d) of the Exchange Act and to the disclosure schedule for proxies and information statements.[23]

Although many of the persons who commented on the amendments, which were proposed by the Commission on July 19, 1976,[24] argued that the Form 8–K should be eliminated

and its items transferred to the Form 10–Q, the Commission determined to retain the current report on Form 8–K to assure disclosure of certain matters about which investors might not otherwise receive adequate and reasonably current information. Accordingly, the Form 8–K has been retained to serve as the report for the disclosure of changes in control of the registration, acquisition and disposition of significant amounts of assets, the appointment of a receiver of the registrant in a bankruptcy or similar proceeding[25] and changes in a registrant's certifying accountant. Registrants may also use the form to report certain material events.

In order to assure that the current reports are more timely filed, the amendments require registrants to file reports on Form 8–K within fifteen days after the occurrence of the event reported. Registrants are permitted, however, to request an extension of time in which to file the audited financial statements required in reports of an acquisition of assets; and events which are reported voluntarily by registrants may be described in reports filed within ten days after the end of the month during which such an event occurs.

The remainder of the Form 8–K items have been transferred to the Form 10–Q or eliminated altogether because of sufficient existing requirements in other forms.[26] As a result, generally there was an approximately 62 percent decrease in the number of items of information required to be included in reports on Form 8–K.

The amendments to Form 10–Q provide for a two part report. Part II contains the items which were transferred to the Form 10–Q from the Form 8–K. In addition, two new items permit registrants to disclose other material events on the Form 10–Q and require registrants to state whether any reports on Form 8–K were filed during the quarter. The latter amendment provides users of the reporting system with a convenient reference to determine whether a registrant has filed any reports on Form 8–K. The Form 10–K was also amended to require disclosure about the information encompassed by the items which were transferred to the Form 10–Q that have occurred during the fourth quarter of a registrant's fiscal year.

Substantive amendments of some of the disclosure items were adopted also. The change in control item in the Form 8–K was amended to require additional information including the consideration used by the person(s) which acquired control and descriptions of any arrangements or understandings among the members of both the former and new control group and their associates with respect to election of directors or other matters. In addition, the item requiring disclosure about certain acquisitions and dispositions of assets was amended to require registrants to disclose the source of the funds used for the acquisition. The legal proceedings item and the item relating to disclosure of increases and decreases in outstanding securities in the Form 10–Q were amended to require registrants to describe the disposition of previously reported legal proceedings and to report certain increases and decreases in outstanding indebtedness.

These proposals were adopted because the Commission believed that they would provide for more comprehensive quarterly and annual reports, more timely reporting of events of current importance to investors, reduction of those reports filed on Form 8–K, and substantial savings to registrants and the Commission.

Withdrawal of Proposed Amendments to Forms 10-K and 10-Q

On December 2, 1976 the Commission formally withdrew its proposal to amend Forms 10-K and 10-Q[27] to provide a space on the cover page of each form which a registrant could use to indicate its intent to file a registration statement on Forms S-7, S-9 or S-16.[28] The Commission, however, did adopt a modified version of the proposal in the form of amendments to the General Instructions to Forms S-7, S-16, 10-K and 10-Q. The amendments are in the form of an instruction to each of those forms requesting that the registrant provide the staff with optional notice, by letter, of its intention to file a registration statement on Form S-7 or Form S-16.[29]

Foreign Private Issuer Registration and Annual Report Forms

On December 10, 1976, the Commission announced that it was soliciting the views of the public concerning means of improving the disclosure presently required by Forms 20 and 20-K under the Act.[30] Forms 20 and 20-K are the registration and annual report forms, respectively, authorized for use by certain foreign private issuers under the Act. The Commission indicated that it was considering the possibility of publishing for further comment specific proposals to make Forms 20 and 20-K substantially similar in content to filings on the counterpart Forms 10 and 10-K authorized for use by domestic and certain other North American issuers.

The Commission indicated that its present consideration was prompted in part by the significant differences in the disclosure requirements between those in Forms 20 and 20-K as compared to those in Forms 10 and 10-K. Continual efforts by the Commission to improve disclosures to investors have resulted in material amendments to Forms 10 and 10-K in the past several years. Forms 20 and 20-K, on the other hand, have not been amended since 1967. Additional Commission considerations included the theory that amendments of this nature might not only make the information concerning foreign issuers more meaningful, but also improve the domestic market for foreign securities and thereby facilitate the free flow of capital among nations. It was also suggested that such amendments might reduce, to an extent, any competitive disadvantages reporting domestic issuers possibly suffer in relation to reporting foreign issuers.

In its announcement, the Commission indicated that it was soliciting public views concerning the appropriate approach to be used with respect to disclosures by those foreign issuers which have used or contemplate using the United States capital markets. Of particular interest were public views concerning the desirability, feasibility, and the potential impact on the domestic markets for foreign securities if increased disclosure requirements were made applicable to foreign private issuers.

The comment period for public views on the concept amendment proposals expired March 31, 1977. A total of 54 substantive comment letters were received as a result of the solicitation. The staff of the Division of Corporation Finance completed its review and analysis of the letters of comment and submitted its recommendations to the Commission. At the close of the fiscal year, the Commission was considering the Division's recommendation.

Annual Reports to Security Holders

Based in part on the Industrial Issuers Advisory Report[31] the Commission proposed amendments to its proxy rules in 1974 in order to improve the disclosure in, and dissemination of, annual reports to security holders and to improve the dissemination of annual reports filed with the Commission on Form 10–K.[32]

On October 31, 1974, the Commission amended Rules 14a–3 and 14c–3 under the Exchange Act of 1934[33] to require that annual reports to security holders contain at least the following information: certified financial statements for the last two fiscal years; a summary of operations for the last five fiscal years and management's analysis of the summary with special attention to significant changes occurring during the most recent three years; a brief description of the company's business which, in the opinion of management, indicates the general nature and scope of the company's business; a line of business breakdown of total revenues and of income (or loss) before income taxes and extraordinary items for the last five fiscal years; the name and principal occupation or employment of each director and executive officer of the company; and the market price ranges and dividends paid for each quarterly period during the last two fiscal years with respect to each class of equity securities entitled to vote at the company's annual meeting.

In addition, the new rules require that annual reports to security holders, or the proxy statement, must contain an undertaking that the company will provide, without charge, to any security holder as of the record date, upon written request, a copy of the company's Form 10–K annual report, except for the exhibits thereto, as filed with the Commission. Companies must also undertake to make copies of the exhibits to their Form 10–K available, but companies may impose a fee limited to their reasonable expenses for providing such copies. Finally, these companies will be required: to contact known record holders, such as brokers, banks and their nominees, who may be reasonably expected to hold securities on behalf of beneficial owners; to inquire of them as to the number of sets of material needed for distribution to beneficial owners for whom they hold securities; to furnish the material to them; and to pay the reasonable expenses of the record holders for distributing the material to the beneficial owners.

In furtherance of its responsibility to promote the dissemination of complete information about issuers subject to its jurisdiction, the Commission authorized the publication of a guideline exhibiting policies and practices of its Division of Corporation Finance which permits the integration of the information required by Form 10–K into a company's annual report to shareholders.[34] It is believed that utilization of this procedure will effect a beneficial result for shareholders and issuers alike because the substance of publicly disseminated reports to shareholders should be upgraded and issuers will be able to file one report with the Commission in lieu of two.

Proxy Solicitations

Where proxies are solicited from holders of securities registered under Section 12 or from security holders of registered public-utility holding companies, subsidiaries of holding companies, or registered investment companies, the Commission's proxy regulation requires that disclosure be made of all material facts concerning

the matters on which the security holders were asked to vote and that they be afforded an opportunity to vote "yes" or "no" on any matter other than the election of directors. Where management is soliciting proxies, a security holder desiring to communicate with the other security holders may require management to furnish him with a list of all security holders or to mail his communication for him. A security holder may also, subject to certain limitations, require the management to include in proxy material an appropriate proposal which he wants to submit to a vote of security holders, or he may make an independent proxy solicitation.

Copies of proposed proxy material must be filed with the Commission in preliminary form prior to the date of the proposed solicitation. Where preliminary material fails to meet the prescribed disclosure standards, the management or other group responsible for its preparation is notified informally and given an opportunity to correct the deficiencies in the preparation of the definitive proxy material to be furnished to security holders.

Issuers of securities registered under Section 12 must transmit an information statement comparable to proxy material to security holders from whom proxies are not solicited with respect to a stockholders' meeting.

During the 3 months ended September 30, 1976, 970 proxy statements in definitive form were filed, 938 by management and 2 by nonmanagement groups or individual stockholders. In addition, 30 information statements were filed. The proxy and information statements related to 962 companies and pertained to 898 meetings for the election of directors, 75 special meetings not involving the election of directors, and 12 assents and authorizations.

Aside from the election of directors, the votes of security holders were solicited with respect to a variety of matters, including mergers, consolidations, acquisitions, sales of assets and dissolution of companies (52); authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (90); employee pension and retirement plans (3); bonus or profit-sharing plans and deferred compensation arrangements (40); stock option plans (91); approval of selection by management of independent auditors (472); and miscellaneous amendments to charters and by-laws, and other matters (254).

During the 3 months, 46 proposals submitted by 17 stockholders for action at stockholders' meetings were included in the proxy statements of 27 companies. Typical of such proposals submitted to a vote of security holders were resolutions on amendments to charters or by-laws to provide for cumulative voting for the election of directors, preemptive rights, limitations on the grant of stock options to and their exercise by key employees and management groups and the sending of a post meeting report to all stockholders.

A total of 12 proposals submitted by 8 stockholders were omitted from the proxy statements of 8 companies in accordance with the provisions of the rule governing such proposals. The most common grounds for omission were that the proposals were not proper subjects for stockholders' action under the applicable state law and that the proposals related to the issuer's ordinary business operations.

For the 3 months, 4 companies were involved in proxy contests for the election of directors which bring special requirements into play. In these

contests, 42 persons, including both management and nonmanagement, filed detailed statements required of participants under the applicable rule. Control of the board of directors was involved in 4 instances. Four were pending as of September 30, 1976.

During the 1977 fiscal year, 5,832 proxy statements in definitive form were filed, 5,669 by management and 14 by nonmanagement groups or individual stockholders. In addition, 149 information statements were filed. The proxy and information statements related to 6,278 companies and pertained to 6,235 meetings for the election of directors, 271 special meetings not involving the election of directors, and 39 assents and authorizations.

Aside from the election of directors, the votes of security holders were solicited with respect to a variety of matters, including mergers, consolidations, acquisitions, sales of assets and dissolution of companies (225); authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (541); employee pension and retirement plans (24); bonus or profit-sharing plans and deferred compensation arrangements (327); stock options plans (386); approval of selection by management of independent auditors (3,403) and miscellaneous amendments to charters and by-laws, and other matters (1,547).

During the 1977 fiscal year, 492 proposals submitted by 163 stockholders for action at stockholders' meetings were included in the proxy statements of 268 companies. Typical of such proposals submitted to a vote of security holders were resolutions on amendments to charters or by-laws to provide for cumulative voting for the election of directors, preemptive rights, limitations on the grant of stock options to and their exercise by key employees and management groups and the sending of a post meeting report to all stockholders. In addition, a significant number of proposals relating to social issues were included in management proxy materials. Those proposals related to such subjects as the Arab boycott of Israel, corporate operations in South Africa, corporate political activities and questionable corporate payments abroad, and equal employment opportunities.

A total of 239 proposals submitted by 116 stockholders were omitted from the proxy statements of 122 companies in accordance with the provisions of the rule governing such proposals. The most common grounds for omission were that the proposals were not submitted on time, were not significantly related to the issuer's business, and were related to the issuer's ordinary business operations.

In fiscal 1977, 37 companies were involved in proxy contests for the election of directors which bring special requirements into play. In these contests, 594 persons, including both management and nonmanagement, filed detailed statements required of participants under the applicable rule. Control of the board of directors was involved in 26 instances. In 8 of these, management retained control. Of the remainder, 3 were settled by negotiation, 5 were won by nonmanagement persons, and 10 were pending at year end. In the other 11 cases, representation on the board of directors was involved. Management retained all places on the board in 6 contests; opposition candidates won places on the board in 5 cases.

Takeover Bids, Large Acquisitions

Sections 13(d) and (e), and 14(d), (e) and (f) of the Exchange Act, enacted in 1968 and amended in 1970, provide for full disclosure in cash tender offers and other stock acquisitions in-

volving changes in ownership or control. These provisions were designed to close gaps in the full disclosure provisions of the securities laws and to safeguard the interest of persons who tender their securities in response to a tender offer.

During the transitional quarter, 231 Schedule 13D reports were filed by persons or groups which had made acquisitions resulting in their ownership of more than five percent of a class of securities. Twenty-seven Schedule 13D reports were filed by persons or groups making tender offers (including 3 tender offers filed with the Commission by foreign nationals), which, if successful, would result in more than five percent ownership. In addition, 13 Schedule 14D reports were filed on solicitations or recommendations in a tender offer by a person other than the maker of the offer. One statement was filed for the replacement of a majority of the board of directors otherwise than by a stockholder vote.

During the 1977 fiscal year, 1,098 Schedule 13D reports were filed by persons or groups which had made acquisitions resulting in their ownership of more than five percent of a class of securities. One hundred thirty four reports were filed (on either Schedule 13D or on the new Schedule 14D–1 which went into effect August 31, 1977) by persons or groups making tender offers (including 18 tender offers filed with the Commission by foreign nationals), which, if successful, would result in more than five percent ownership. In addition, 79 Schedule 14D reports were filed on solicitations or recommendations in a tender by a person other than the maker of the offer. Eight statements were filed for the replacement of a majority of the board of directors otherwise than by stockholder vote. One statement was filed under a rule on corporate reacquisitions of securities while an issuer is the target of a cash tender offer.

Rule 14d–2 under the Exchange Act exempts certain communications involved in a tender offer from the provisions of Regulation 14D. Among such communications are those from an issuer to its security holders which do no more than identify the tender offer, state that management is studying the proposal and request the security holders to defer making a decision on the tender offer until they receive management's recommendation. Such recommendations must be made no later than 10 days before expiration of the tender offer, unless the Commission authorizes a shorter period.

Insider Reporting

Section 16 of the Exchange Act and corresponding provisions in the Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940 are designed to provide other stockholders and investors generally with information on insider securities transactions and holdings and to prevent unfair use of confidential information by insiders to profit from short-term trading in a company's securities.

Section 16(a) of the Exchange Act requires every person who beneficially owns, directly or indirectly, more than 10 percent of any class of equity security which is registered under Section 12, or who is a director or an officer of the issuer of any such security, to file statements with the Commission disclosing the amount of all equity securities of the issuer of which he is the beneficial owner and changes in such ownership. Copies of such statements must be filed with exchanges on which the securities are listed. Similar provisions applicable to insiders of registered public-utility holding companies and registered closed-end in-

vestment companies are contained in the Holding Company and Investment Company Acts.

In connection with insider securities transactions under Section 16 of the Exchange Act, the Commission adopted various amendments to Rules 16b–3 and 16a–6(c) under the Act for the purpose of including certain transactions in stock appreciation rights within the exemptions provided by those rules.[35] The amendments exempt from the reporting requirements of Section 16(a) and the short swing profit recovery provisions of Section 16(b) cash settlements of stock appreciation rights by insiders, provided certain conditions are met. Included among these conditions are requirements relative to the issuer, the rights, and the administration of the plan under which the rights are granted. In addition, the amendments clarify the conditions for the availability of the exemption provided by Rule 16b–3 and make clear the circumstances under which amendments to existing plans must be submitted to an issuer's security holders for approval.

During the 3 months ended September 30, 1976, 21,676 ownership reports were filed. These included 2,607 initial statements of ownership on Form 3, 18,111 statements of changes in ownership on Form 4, and 958 amendments to previously filed reports.

In fiscal 1977, 94,444 ownership reports were filed. These included 10,041 initial statements of ownership on Form 3, 80,001 statements of changes in ownership on Form 4, and 4,402 amendments to previously filed reports.

All ownership reports are made available for public inspection when filed at the Commission's office in Washington and at the exchanges where copies are filed. In addition, the information contained in reports filed with the Commission is summarized and published in the monthly "Official Summary of Security Transactions and Holdings," which is distributed by the Government Printing Office to about 2,197 subscribers.

ACCOUNTING AND AUDITING STANDARDS

The Federal securities laws reflect a recognition by Congress that dependable financial statements of a company are indispensable to informed investment decisions regarding its securities. A major objective of the Commission has been to improve accounting, disclosure, and auditing standards related to financial statements and to assure that high standards of professional independence and conduct are maintained by the public accountants who examine them. The primary responsibility for implementing these objectives rests with the Office of the Chief Accountant of the Commission.

Under the Commission's broad rulemaking power, it has adopted a basic accounting regulation (Regulation S-X) which, together with interpretations and guidelines on accounting and reporting procedures published as Accounting Series Releases, governs the form and content of financial statements filed with the Commission. The Commission has also formulated more specific rules on accounting and auditing of broker-dealers. The accounting rules and releases of the Commission, and its decisions in particular cases, have contributed to clarification of the accounting principles and practices and auditing standards, developed by the accounting profession, generally followed in the preparation of financial statements.

The accounting and financial reporting rules and regulations prescribe

accounting principles to be followed only in certain limited areas. One of the principal ways the Commission protects investors from inadequate or improper financial reporting is to require a report of an independent public accountant, based on an examination of financial statements performed in accordance with generally accepted auditing standards, which expresses an opinion on the financial statements covered by the report and the accounting principles and practices reflected therein. The requirement that the opinion be rendered by an independent public accountant, which was initially established under the Securities Act, is designed to secure the benefits of the detached objectivity and skill of a knowledgeable professional person not connected with management.

The Commission's accounting staff selectively reviews financial statements filed with the Commission for compliance with existing standards and to assure that accounting and auditing standards do not remain static in the face of changes and new developments in financial and economic conditions. New methods of doing business, new types of business, economic changes affecting business generally or industries specifically, the combining of old businesses, the use of new types of securities, and other innovations create accounting problems which require a constant reappraisal of reporting requirements.

Relations With the Accounting Profession

In order to keep abreast of changing conditions, and in recognition of the need for a continuous exchange of views and information between the Commission's accounting staff and outside accountants regarding appropriate accounting and auditing policies, procedures and practices, the staff maintains continuing contact with individual accountants and various professional organizations. The latter include the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB), the principal professional organizations concerned with the development and improvement of accounting and auditing standards and practices. The Chief Accountant also meets regularly with his counterparts in other regulatory agencies to improve coordination on policies and actions among the agencies.

Because of its many foreign registrants and the vast and increasing foreign operations of American companies, the Commission has an interest in the improvement of accounting and auditing principles and procedures on an international basis. To promote such improvement, the Chief Accountant corresponds with foreign accountants, interviews many who visit the country, and, on occasion, participates in foreign and international accounting conferences.

Professional efforts are being made to improve and harmonize accounting standards among countries through various international accounting conferences and committees. One committee, comprised of representatives from approximately thirty-five countries, was established to promulgate international accounting standards. This committee has adopted five standards, has proposed a number of other standards and is developing additional proposals. The Commission will continue to cooperate closely with these committees and groups which have as their long-term objective the development of a coordinated worldwide accounting profession with uniform standards.

The Audit Function

Oversight — Events over the past few years, including major fraud cases brought by the Commission involving false and misleading financial statements, have led to a major reexamination of the role of the accounting profession and the means of achieving and maintaining audits which consistently reflect standards of high quality. The AICPA is the private organization of the profession to which the Commission has historically looked for establishing auditing standards for the profession.

In early 1977 the Commission on Auditors' Responsibilities (Cohen Commission), which had been established by the AICPA in 1974 to study the role and responsibilities of independent auditors, issued its "Report of Tentative Conclusions and Recommendations." This comprehensive report included approximately forty tentative recommendations related to the role of the independent auditor which include: the decisions an auditor must make when he forms an opinion on financial information; reporting on uncertainties; the auditor's responsibility for detecting fraud; the auditor's role in corporate accountability; the boundaries of the auditor's role and its extension; the effectiveness of the auditor's role and its extension; the effectiveness of the auditor's communication with users and the public; the effectiveness of the education, training and development of auditors; the problems associated with the auditor's independence; the process of establishing auditing standards; and the effectiveness of the profession's self-regulation and regulation from outside the profession.

During this year, Congress also took a more active role in examining the accounting profession. The Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce of the House of Representatives, in its October 1976 report, entitled "Federal Regulation and Regulatory Reform", included recommendations concerning the Commission's role in setting accounting and auditing standards, the establishment of adequate systems of internal control, the structure and responsibilities of independent audit committees of corporate boards of directors, and disciplinary actions against accountants.

In January 1977 a staff study entitled "The Accounting Establishment" was issued by the Subcommittee on Reports, Accounting and Management of the Committee on Government Operations of the Senate, and in April, May and June of 1977 this Subcommittee held hearings on accounting and auditing practices and procedures. A major subject under consideration at those hearings was the kind and type of increased regulation needed for the accounting profession and whether Federal legislation is necessary to ensure such regulation.

In September 1977, the AICPA announced the establishment of a new "Division of CPA Firms", an organization designed to carry out reforms which members of the accounting profession have represented that the profession is capable of accomplishing on its own. A Public Oversight Board composed of five individuals of high stature from outside the profession is to oversee the activities of the Division. The Commission has undertaken to report to Congress prior to July 1 of each year on the progress of the Commission and of the profession in responding to the concerns which have been raised about the profession.

Auditor Independence—Financial statements reported on by independent

auditors are, under the Federal securities laws, the keystone to providing investors with reliable financial information. The independence of an auditor is crucial to his effectiveness. Over the past year, the Commission took a number of steps to strengthen auditor independence. In July 1976, the Commission revised Rule 3–16(s) of Regulation S–X to require disclosure in a note to the financial statements of the existence and nature of a previously reported disagreement between a company and its former accountants in those cases in which the successor accountant found acceptable an accounting method which the former accountant found unacceptable.[36] Previously, the Commission had adopted rules which required companies to disclose, in Form 8–K, disagreements between the company and a terminated auditor. The requirements are aimed at strengthening auditor independence by discouraging companies from changing auditors merely to obtain approval of an alternative accounting treatment.

In September 1977, the Commission proposed for public comment amendments to disclosure rules and forms to require disclosure of (1) the reasons for any change of a registrant's independent accountants; and (2) whether the decision was approved by the registrant's Board of Directors or its audit committee.[37] In its release the Commission noted that these proposals accorded with the increased significance of the role of the independent accountant and should aid investors in better understanding and evaluating the registrant's relationship with its independent accountants. The inclusion of audit committees in the proposed rule is indicative of the importance of these committees in the view of the Commission.

As a further aid in strengthening the independence of auditors, the Commission proposed that proxy statements which include selection or ratification of the independent auditors contain information on (1) the nature of services other than examination of financial statements provided during the last fiscal year by the independent auditors and the related fees; (2) whether the board of directors or audit committee approved all services; and (3) the company's revenues derived from the independent auditors.[38]

These proposed amendments are one way in which the Commission has encouraged the formation of audit committees comprised of independent members of the Board of Directors. The Commission strongly favors such committees, which can serve as links between independent accountants and shareholders for the discussion of matters pertinent to the examination of the financial statements. In furtherance of these objectives, the Commission believes that one of the principal responsibilities of an independent audit committee should be that of recommending the engagement or discharge of the company's independent accountants to the shareholders or the full Board of Directors.

In recognition of the disagreement and concern over whether and what types of services offered by accountants result in a lessening of the independence or the appearance of independence of auditors, the Commission solicited information and comment on the nature of services auditors provide their audit clients.[39]

The Accounting Function

FASB—The FASB is an independent private body which establishes standards of financial accounting and presentation for the guidance of issuers of financial statements and public accountants who examine such

statements. The FASB provides leadership to the profession in establishing and improving accounting principles and standards, and the Commission expects that the FASB's conclusions will promote the interests of investors. Unless the Commission has expressed a view to the contrary, it considers the statements of the FASB to be substantial authoritative support for an accounting practice or procedure.

The Financial Accounting Foundation, an organization sponsored by a number of leading organizations which represent various aspects of the accounting, securities, banking, academic, financial and other professions, appoints the seven members of the FASB and the members of the advisory council to the FASB. In the past year, the Structure Committee of the Financial Accounting Foundation, after reviewing the operations of the FASB, published a report containing a number of recommendations to increase the effectiveness of the FASB, many of which have been implemented.

As of September 30, 1977, the FASB had issued 16 Statements of Financial Accounting Standards and 18 Interpretations relating to accounting opinions or standards. In addition, it had under active consideration a heavy agenda of technical projects which included: conceptual framework for accounting and reporting; financial accounting and reporting in the extractive industries; criteria for determining materiality; interim financial reporting; business combinations and purchased intangibles; accounting for interest costs; accounting and reporting for employee benefit plans; and classification of preferred stock. It had held public hearings on many of the projects and had issued exposure drafts of certain proposed statements.

The FASB has appointed a permanent screening committee to assist it in identifying emerging practice problems, evaluating their magnitude and urgency, and assessing priorities for their resolution. The Chief Accountant and the FASB maintain liaison procedures for consultation on projects of either the Board or the SEC which are of mutual interest.

When the FASB issues improved standards of accounting and financial reporting, the Commission revises its rules and regulations to co-ordinate with the improved standards. In August 1977, the Commission amended Rule 3–16 of Regulation S–X to conform its lease accounting and disclosure requirements to those standards adopted by the FASB in its Statement No. 13, "Accounting for Leases" to require that financial statements filed with the Commission for fiscal years ending after December 24, 1978 reflect such requirements and to require certain lease disclosures of rate-regulated enterprises.[40]

In May 1977, the Commission published for comment proposals for revisions of certain disclosure forms and rules relating to industry and homogeneous geographic segment reporting. These proposals were intended to coordinate the Commission's line-of-business information with FASB Statement No. 14, "Financial Reporting for Segments of a Business Enterprise" and to avoid unnecessary duplication resulting from compliance with this statement. In certain instances the proposals would require additional information, such as intersegment sales and transfers, beyond the requirements of the FASB. The proposals would require registrants to provide detailed descriptions of industry segments in which they engage in business, as well as five year financial information relating to industry segments and foreign and domestic operations. In connection with these pro-

posals, the Commission also sought comment on proposed Form S–K, a new integrated disclosure form.[41]

Oil and Gas Accounting—The Energy Policy and Conservation Act of 1975 (EPCA) authorized the Commission to take such steps as may be necessary to assure the development and observance of accounting to be followed by companies engaged in the production of crude oil or natural gas. In carrying out these responsibilities, the Commission is required to consult with the Department of Energy, the General Accounting Office and the Federal Energy Regulatory Commission. The Commission is authorized to rely on accounting practices developed by the FASB if the Commission is assured that such practices would be observed to the same extent as if the Commission had prescribed such practices by rule.

In June 1977, the Commission solicited public comment on matters relating to the reporting of financial and operating data on oil and gas operations pursuant to the EPCA and to the disclosure of such data in filings with the Commission pursuant to the Federal securities laws.[42] In July 1977, the FASB issued an exposure draft of a proposed "Statement on Financial Accounting and Reporting by Oil and Gas Producing Companies." In the exposure draft the FASB proposed that oil and gas production companies should follow a form of the successful efforts method of accounting and that, among other things, companies should disclose information on quantities of oil and gas reserves and certain related data in their financial statements.

In August and October 1977, the Commission proposed rules for public comment pursuant to the EPCA and the Federal securities laws.[43] These proposed rules were substantially the same as those contained in the FASB exposure draft except that they required certain data in addition to those proposed in the FASB's statements.

Replacement Cost Disclosure—In December, 1976, the Commission amended Rule 3–17 of Regulation S–X, the rule which requires disclosure of certain replacement cost data, to state that liability for disclosures of replacement cost data may be imposed only in instances in which it can be shown that the disclosures were prepared without a reasonable basis or were disclosed in other than good faith. The Commission took this action in recognition of the imprecise nature of replacement cost information and in order to encourage the development and disclosure of such information.[44]

In August 1977 the Commission, noting that significant effort has been expended by registrants, public accounting firms and industry groups to provide meaningful replacement cost disclosures, requested public comment on experience with problems which have arisen in implementing Rule 3–17. The Commission also indicated its plans to engage in a general evaluation of experiences with the replacement cost rule during 1978.[45]

Establishment of Accounting Principles—In July 1976, the public accounting firm of Arthur Andersen & Co. (Andersen) brought suit against the Commission in the United States District Court for the Northern District of Illinois to enjoin the Commission from enforcing compliance with (1) Instructions H(f) of Form 10–Q which requires that independent accountants express their judgment regarding the preferability of an accounting principle adopted when accounting principles are changed at the discretion of a registrant; and (2) the statement of policy embodied in Accounting Series Release No. 150 in which the

Commission stated that it would consider accounting principles, standards and practices promulgated by the FASB as having substantial authoritative support and those contrary to such FASB promulgations as having no support.

Andersen's motion for a restraining order, *pendente lite*, was denied on August 13, 1976, and its motion for a preliminary injunction was denied on September 3, 1976. On October 4, 1976, the Commission filed a motion for summary judgment, or, alternatively, to dismiss the action on the basis that (1) Accounting Series Release No. 150 is not a substantive rule but is merely a statement of Commission policy, and as such does not constitute any delegation of Commission authority to any person and was properly issued; (2) Instruction H(f) is a proper exercise of the Commission's broad authority to adopt accounting rules; and (3) Andersen lacks standing to pursue the issues raised. This motion remains pending.

Disciplinary Matters

During the period July 1, 1976 to September 30, 1977, the Commission issued twenty-two orders imposing disciplinary sanctions on public accountants pursuant to the Commission's Rules of Practice. Professional accountants were also the subject of a number of enforcement proceedings alleging misconduct in connection with audit examinations or the preparation of financial statements. (See Part 4 for a discussion of significant accounting proceedings).

Staff Accounting Bulletins

The Division of Corporation Finance and the Office of Chief Accountant issued eight Staff Accounting Bulletins during the year. The statements in these bulletins are not rules or interpretations of the Commission, nor do they bear the Commission's official approval; they represent interpretations and practices followed by the staff in reviewing financial statements and administering the requirements of the federal securities laws. These bulletins included interpretations regarding disclosure of replacement cost, interim financial reporting, disclosure of holdings of New York City securities, allowance for funds used during construction, and data relating to FASB Statement No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies."

EXEMPTIONS FOR INTERNATIONAL BANKS

Section 15 of the Bretton Woods Agreement Act, as amended, exempts from registration securities issued, or guaranteed as to both principal and interest, by the International Bank for Reconstruction and Development. The Bank is required to file with the Commission such annual and other reports on securities as the Commission determines to be appropriate. The Commission has adopted rules requiring the Bank to file quarterly reports and copies of annual reports of the Bank to its Board of Governors. The Bank is also required to file advance reports of any distribution in the United States of its primary obligations. The Commission, acting in consultation with the National Advisory Council on International Monetary and Financial Problems, is authorized to suspend the exemption for securities issued or guaranteed by the Bank. Except where otherwise indicated, all amounts that follow are expressed in U.S. dollar equivalents as of June 30, 1977.

Net income for the year was $209 million, compared with $220 million the previous year. Of the $209 million net income earned in the fiscal year ended June 30, 1977, the Executive

Directors of the Bank in July 1977 approved the allocation of $109 million to the General Reserve and recommended to the Board of Governors of the Bank that the balance of $100 million be transferred by way of grant to the International Development Association.

Repayments of principal on loans received by the Bank during the year amounted to $709 million, and a further $64 million was repaid to purchasers of portions of loans. Total principal repayments by borrowers through June 30, 1977, aggregated $8.0 billion, including $5.7 billion repaid to the Bank and $2.3 billion repaid to purchasers of borrowers' obligations sold by the Bank.

Outstanding borrowings of the Bank were $18.5 billion at June 30, 1977. During the year, the Bank borrowed $650 million through the issuance of 2-year U.S. dollar bonds to central banks and other governmental agencies in some 80 countries; $1,850 million in the United States; DM 3,400 million (U.S. $1,394.1 million) in the Federal Republic of Germany; 2.0 billion yen ($7.0 million) in Japan; SwF 1,250 million (U.S. $502.5 million) in Switzerland; SwF 75 million (U.S. $29.5 million) and $150 million in Saudi Arabia; $100 million in Yugoslavia; and $37.5 million from the Interest Subsidy Fund, which is administered by the Bank. The Fund, which obtained its resources from voluntary contributions from member governments, was established to subsidize the interest payments to the Bank on loans made to poorer developing countries.

These borrowings, in part, refunded maturing issues amounting to the equivalent of $916 million. After retirement of $78 million equivalent of obligations through sinking fund and purchase fund operations, the Bank's outstanding borrowings showed a net increase of $3,831 million from the previous year after adding $566 million representing adjustment of borrowings as a result of currency depreciations and appreciations in terms of U.S. dollars of the value of the non-dollar currencies in which the debt was denominated.

The Inter-American Development Bank Act, which authorizes the United States to participate in the Inter-American Development Bank, provides an exemption for certain securities which may be issued or guaranteed by the Bank similar to that provided for securities of the International Bank for Reconstruction and Development. Acting pursuant to this authority, the Commission adopted Regulation IA, which requires the Bank to file with the Commission substantially the same type of information, documents and reports as are required from the International Bank for Reconstruction and Development. The following data reflect information submitted by the Bank to the Commission.

On September 30, 1976, the outstanding funded debt of the Ordinary Capital resources of the Bank was the equivalent of $1.927 billion, reflecting a net increase during the transition quarter of the equivalent of $111 million. During such quarter, the funded debt increased through a public offering in the United States of $100 million and private placements in Trinidad and Tobago for $15 million and in Germany for the equivalent of $19.6 million. In addition, there were drawings totalling $5.9 million under arrangements with Japan and the United Kingdom. The funded debt decreased by approximately $14.5 million due to downward adjustment of the U.S. dollar equivalent of borrowings denominated in non-regional currencies. The funded debt also decreased through the retirement

of approximately $15.3 million from sinking fund purchases and scheduled debt retirement.

On September 30, 1977, the outstanding funded debt of the Ordinary Capital resources of the Bank was the equivalent of $2.246 billion, reflecting a net increase in the past year of the equivalent of $319 million. During the year the funded debt increased through a public offering in the United States of $100 million; public offerings in Austria and Germany for the equivalent of $16.3 million and $39.2 million, respectively; the Bank's first public offerings in Japan and Trinidad and Tobago for the equivalent of $56.2 million and $10.4 million, respectively; a public offering and a private placement in Switzerland totalling the equivalent of $93.9 million; as well as a private placement in Italy for $15 million. In addition, there were drawings totalling $277 million under arrangements with Finland, Japan and the United Kingdom. Additionally, $73.9 million of two-year bonds were sold to Latin American and Caribbean Central Banks or Governmental Agencies, essentially representing a roll-over of a maturing borrowing of $54.1 million and an increase in short-term funded debt of $19.8 million. The funded debt increased by approximately $43 million due to upward adjustment of the U.S. dollar equivalent of borrowings denominated in non-regional currencies. The funded debt decreased through the retirement of approximately $78.2 million from sinking fund purchases and scheduled debt retirement.

The Asian Development Bank Act, adopted in March 1966, authorized United States participation in the Asian Development Bank and provides an exemption for certain securities which may be issued or guaranteed by the Bank, similar to the exemptions accorded the International Bank for Reconstruction and Development and the Inter-American Development Bank. Acting pursuant to this authority, the Commission has adopted Regulation AD which requires the Bank to file with the Commission, documents and reports as are required from those banks. The Bank has 42 members with subscriptions totaling $6.95 billion.

From July 1, 1976 through September 30, 1976, the Bank's net borrowings totaled the equivalent of $108 million. Through fiscal 1977, the Bank's net borrowings totaled the equivalent of $1,151 million. From July 1, 1976 through September 30, 1976, the Bank issued obligations of the equivalent of $32.6 million in Switzerland and for fiscal 1977, the Bank issued obligations of the equivalent of $42 million in Germany. From July 1, 1976 through September 30, 1976, borrowing in the United States was $75 million at 8.625 percent; and for fiscal 1977, borrowing in the United States was $70 million at 6.5 percent (2 year).

As of September 30, 1977, 14 countries have contributed or pledged a total of $486.1 million to the original source mobilization of the Bank's concessionary loans fund. A total of $57.4 million from Ordinary Capital resources has been set aside by the Board of Governors for concessionary loan purposes. Congress appropriated a $25 million contribution during fiscal 1977, bringing U.S. contributions to $150 million. As of the same date, pledges from donor countries for replenishment of the Bank's concessional loan funds amounted to an additional $580.96 million. The total to be contributed could amount to $809.16 million.

TRUST INDENTURE ACT OF 1939

This Act requires that bonds, debentures, notes and similar debt securities offered for public sale, except as specifically exempted, be issued under an indenture which meets the requirements of the Act and has been duly qualified with the Commission.

The provisions of the Act are closely integrated with the requirements of the Securities Act. Registration pursuant to the Securities Act of securities to be issued under a trust indenture subject to the Trust Indenture Act is not permitted to become effective unless the indenture conforms to the requirements of the latter Act, designed to safeguard the rights and interests of the purchasers. Moreover, specified information about the trustee and the indenture must be included in the registration statement.

The Act was passed after studies by the Commission had revealed the frequency with which trust indentures failed to provide minimum protections for security holders and absolved so-called trustees from minimum obligations in the discharge of the trusts. It requires, among other things, that the indenture trustee be a corporation with a minimum combined capital and surplus and be free of conflicting interests which might interfere with the faithful exercise of its duties on behalf of the purchasers of the securities, and it imposes high standards of conduct and responsibility on the trustee.

During the three months ended September 30, 1976, 83 trust indentures relating to securities in the aggregate amount of $4 billion were filed. During fiscal year 1977, 358 trust indentures relating to securities in the aggregate amount of $24.63 billion were filed.

INFORMATION FOR PUBLIC INSPECTION: FREEDOM OF INFORMATION ACT

On November 21, 1974, Congress passed over President Ford's veto amendments to the Freedom of Information Act.[46] which significantly changed the procedures governing the handling of requests made pursuant to the Freedom of Information Act (5 U.S.C. 552) as well as the scope of certain of the exemptions from Act's provisions. These amendments became effective February 19, 1975. The Commission amended its rules under the Freedom of Information Act (17 CFR 200.80)[47] to reflect the amended provisions of the Freedom of Information Act; these rules specify the categories of available materials and those categories of records that are generally considered nonpublic. These rules establish the procedure to be followed in requesting records or copies and provide for a method of administrative appeal from the denial of access to any record. They also provide for the imposition of duplicating fees and search fees when more than one-half man-hour of work is performed by the Commission's staff to locate and make records available. In addition to the records described, the Commission makes available for inspection and copying all requests for no-action and interpretive letters received after December 31, 1970, and responses thereto (17 CFR 200.80). Also made available since November 1, 1972 are materials filed under Proxy Rule 14a–8(d), which deals with proposals offered by shareholders for inclusion in management proxy-soliciting materials, and related materials prepared by the staff (17 CFR 200.82).

Following the effective date of the amendments to the Freedom of In-

formation Act, the Commission instituted the practice of issuing a public release, in a series designated Freedom of Information Act Releases, in most administrative appeals decided under the Act. The Commission hopes that this series of releases will serve to inform the public as to its disclosure policies under the Freedom of Information Act and of the manner in which it has interpreted and applied the Act to the many types of records maintained by the Commission.

Exemption 3 of the Freedom of Information Act was amended by the Congress when it enacted the "Government in the Sunshine" Act[48] in order to conform FOIA Exemption 3 to the analogous exemption contained in the Sunshine Act. Previously, the FOIA exemption had applied to any matter "specifically exempted from disclosure by statute."[49] The purpose of the amendment, the Conference Report on the Sunshine Act states, is to overrule the decision of the Supreme Court in *Administrator, FAA v. Robertson,*[50] in which the Court approved withholding under a statute which gave an agency discretion to withhold matters where it determined that disclosure was not "in the public interest."[51] As a result, statutes which contain only a "public interest" standard no longer serve as statutory authorization under these exemptive provisions. This amendment did not substantially affect the Commission, however, since Section 24 of the Exchange Act, as amended by the 1975 Securities Acts Amendments (which applies to all records in the Commission's possession, however obtained), already had the effect of limiting Commission discretion to withhold records "in the public interest."

Most of the administrative appeals decided by the Commission are concerned with investigatory records. The seventh exemption of the Act, as amended, provides that the Freedom of Information Act "does not apply" to such records to the extent that their production would "interfere with enforcement proceedings," "deprive a person of a right to a fair trial or an impartial adjudication," "constitute an unwarranted invasion of personal privacy," or cause other types of harm specifically enumerated in the exemption. The Commission, in the administrative appeals it has decided, has determined that investigatory records will generally be withheld on the ground that production will "interfere with enforcement proceedings" only if judicial or administrative proceedings brought by the Commission or other law enforcement authorities are in progress or there is a concrete prospect that law enforcement proceedings will be instituted.[52] Evidentiary materials contained in investigatory files closed after the completion of public law enforcement proceedings will generally be available to any person requesting access to them.[53] In those cases where investigations are closed by the Commission without the institution of public enforcement action, the Commission has recognized that considerations of personal privacy often require that such records not be disclosed to members of the public,[54] except where a demonstration of particularized need for access to the records sufficient to outweigh considerations of personal privacy has been made.[55]

Registration statements, applications, declarations, and annual and periodic reports filed with the Commission each year, as well as many other public documents, are available for public inspection and copying at the Commission's public reference room in its principal offices in

Washington, D.C. and, in part, at its regional and branch offices.

The Commission has special public reference facilities in the New York, Chicago and Los Angeles Regional Offices and some facilities for public use in other regional and branch offices. Each regional office has available for public examination copies of prospectuses used in recent offerings of securities registered under the Securities Act; registration statements and recent annual reports filed under the Exchange Act by companies having their principal office in the region; recent annual reports and quarterly reports filed under the Investment Company Act by management investment companies having their principal office in the region; broker-dealer and investment adviser applications originating in the region; letters of notification under Regulation A filed in the region, and indices of Commission decisions.

During the Transitional Quarter and the 1977 fiscal year, over 25,000 persons examined material on file in Washington (4,812 from July 1, 1976, through September 30, 1976, and 20,899 from October 1, 1976, through September 30, 1977); several thousand others examined files in New York, Chicago, Los Angeles, and other regional offices. More than 69,000 searches were made for information requested by individuals (12,260 from July 1, 1976, through September 30, 1976, and 57,213 from October 1, 1976, through September 30, 1977); and approximately 19,000 letters were received for information and/or documents (3,423 from July 1, 1976, through September 30, 1976, and 15,376 from October 1976, through September 30, 1977).

The public may make arrangements through the Public Reference Section of the Commission in Washington, D.C. to purchase copies of material in the Commission's public files. The copies are produced by a commercial copying company which supplies them to the public at prices established under a contract with the Commission. Current prices begin at 10 cents per page for pages not exceeding 8½" × 14" in size, with a $3.50 minimum charge. Under the same contract, the company also makes microfiche and microfilm copies of Commission public documents available on a subscription or individual order basis to persons or firms who have or can obtain viewing facilities. In microfiche services, up to 60 images of document pages are contained on 4" × 6" pieces of film, referred to as "fiche."

Annual microfiche subscriptions are offered in a variety of packages covering all public reports filed on Forms 10–K, 10–Q, 8–K, N–1Q and N–1R under the Securities Exchange Act or the Investment Company Act; annual reports to stockholders; proxy statements; new issue registration statements; and final prospectuses for new issues. The packages offered include various categories of these reports, including those of companies listed on the New York Stock Exchange, the American Stock Exchange, regional stock exchanges, or traded over-the-counter. Reports are also available by standard industry classifications. Arrangements also may be made to subscribe to reports of companies of one's own selection. Over one hundred million pages (microimagery frames) are being distributed annually. The subscription services may be extended to further groups of filings in the future if demand warrants. The copying company will also supply copies in microfiche or microfilm form of other public records of the Commission desired by a member of the public.

Microfiche readers and reader-print-

ers have been installed in the public reference areas in Washington, D.C. and the New York, Chicago, and Los Angeles regional offices, and sets of microfiche are available for inspection there. Visitors to the public reference room in Washington, D.C. may also make immediate reproduction of material on photostatic-type copying machines. The cost to the public of copies made by use of all customer-operated equipment is 10 cents per page. The charge for an attestation with the Commission seal is $2. Detailed information concerning copying services available and prices for the various types of services and copies may be obtained from the Public Reference Section of the Commission.

FREEDOM OF INFORMATION ACT LITIGATION

In *Harnett, et al. v. SEC, et al.*,[56] Joel Harnett, a candidate in New York City's mayoral election campaign, sought the disclosure of draft portions of a staff report of investigation into certain transactions in the securities of the City of New York.[57] Even though the plaintiffs had not made a formal FOIA request for the draft portions of the report and, accordingly, the Commission was never afforded an opportunity to consider the matter, the United States District Court ordered the Commission to submit the report to it for *in camera* inspection.[58] Since the records were clearly exempt from compelled disclosure pursuant to Exemptions 5 and 7 of the FOIA, and since production for *in camera* inspection would have disrupted unnecessarily the Commission's ongoing investigation, the Commission secured a stay of the District Court's order pending review by the Court of Appeals or, alternatively, consideration of the Commission's petition for a writ of mandamus. The action was subsequently rendered moot, however, when the staff's completed report was issued on August 26, 1977,[59] although the demands of both the plaintiffs and the Commission for costs, including reasonable attorneys' fees, have yet to be resolved by the district court.

In *Continental Stock Transfer and Trust Co. v. SEC*,[60] a stock transfer agent registered with the Commission sought review of a Commission order pursuant to Rule 24b–2 under the Exchange Act,[61] denying Continental's request for confidential treatment of the list of the names of the issuers of securities for which it acted as a transfer agent. Continental claimed that the information in question, which was required to be submitted pursuant to Form TA–1, was exempt from disclosure as "confidential commercial information" under Exemption 4 of the Freedom of Information Act. The Commission, in denying the request for confidential treatment, cited the facts that (1) the information in question was already publicly available, although some research was necessary to compile it, and (2) other transfer agents in positions similar to that of Continental had filed comparable information with the Commission without making any claim of competitive disadvantages.

On March 21, 1977, the Court of Appeals for the Second Circuit affirmed the Commission's order. In its opinion, the court adopted for the Second Circuit the test formulated by the District of Columbia Circuit for determining what information is within the scope of Exemption 4.[62] Applying that test, the court ruled that disclosure of the information in question was neither likely to impair the government's ability to obtain similar information in the future or to cause substantial harm to Continental's competitive position. In this latter regard, the court noted that it

found persuasive the fact that almost all of the information disclosed by Continental was already available to the public through various reference works.

Canadian Pacific Ltd. v. SEC[63] also involved a petition for review of a Commission order entered pursuant to Rule 24b–2 under the Exchange Act. The information in issue in that case was data regarding the remuneration which Canadian Pacific Limited, a diversified Canadian corporation, paid to its three highest paid officers. The information was required to be filed with the Commission pursuant to the Commission's rules relating to proxy solicitations and, unless granted confidential treatment by the Commission, was required to be disseminated by Canadian Pacific to its shareholders.

The Commission, in response to the request of the corporation, did grant confidential treatment for the remuneration information pertaining to the three years in issue in this case, 1974 through 1976. Upon consideration of a request for access to this information under the Freedom of Information Act, however, the Commission determined that the FOIA required the Commission to honor the request and, accordingly, entered an order suspending the three prior orders granting confidential treatment, which had been entered by the staff pursuant to delegated authority.

In petitioning the court of appeals for review of the Commission's order, the company claimed that the information was exempt pursuant to Exemptions 4 and 6 of the Freedom of Information Act, relating to confidential commercial information and to information the disclosure of which would result in a clearly unwarranted invasion of personal privacy. In addition, the company raised certain procedural objections to the Commission's order. After the issues had been fully briefed in the court of appeals, the company, on February 28, 1978, elected to dismiss the pending petition for review, and the information was disclosed to the party requesting access to it.

NOTES TO PART 2

[1]Securities Act Release No. 5231 (February 3, 1972).

[2]Securities Act Release No. 5767 (November 22, 1976), 10 SEC Docket 983. Corrected in Securities Act Release No. 5767A (December 17, 1976), 11 SEC Docket 1200.

[3]Securities Act Release No. 5723 (July 2, 1976), 9 SEC Docket 1014.

[4]Securities Act Release No. 5791 and Securities Exchange Act Release No. 13083 (December 20, 1976), 11 SEC Docket 1205.

[5]The amendments were proposed in Securities Act Release No. 5728 (July 26, 1976), 10 SEC Docket 92.

[6]The Commission announced that it is considering amendments to Form S–16 to allow its use in certain primary offerings. *See* Securities Act Release No. 5792 (December 20, 1976), 11 SEC Docket 1214.

[7]Securities Act Release No. 5744 (September 27, 1976), 10 SEC Docket 574.

[8]A proposed amendment to Securities Act Rule 429 (a) would make the rule unavailable if the issuer's latest registration statement was filed on Form S–14A. Proposed amendments to Rules 14a–3, 14a–6, 14a–11, 14a–12, 14c–2 and 14c–5 under the Exchange Act provided that material filed in a Form S–14A registration statement would satisfy the informational and filing requirements of the proxy or information rules under Section 14 of the Exchange Act.

[9]Securities Act Release No. 5806 (February 16, 1977), 11 SEC Docket 1716.

[10]Securities Act Release No. 5487 (April 23, 1974), 4 SEC Docket 154.

[11]Securities Act Release No. 5779 (December 6, 1976), 11 SEC Docket 1116.

[12]Securities Act Release No. 5822 (April 18, 1977), 12 SEC Docket 4.

[13]Securities Act Release No. 5865 (September 16, 1977), 13 SEC Docket 107.

[14]Securities Act Release No. 5750 (October 8, 1976), 10 SEC Docket 691.

[15]Securities Act Release No. 5745 (September 27, 1976), 10 SEC Docket 586.

[16]Securities Act Release No. 5834 (June 13, 1977), 12 SEC Docket 814.

[17]Securities Exchange Act Release No. 13190 (January 19, 1977), 11 SEC Docket 1525.

[18]Securities Act Release No. 5811 (February 28, 1977), 11 SEC Docket 1864.

[19]Securities Act Release No. 5842 (July 5, 1977), 12 SEC Docket 1099.

[20]Securities Act Release No. 5871 (September 29, 1977), 13 SEC Docket 226.

[21]Securities Exchange Release No. 8066 (April 28, 1967).

[22]Securities Exchange Act Release No. 13913 (August 31, 1977), 12 SEC Docket 1642.

[23]Securities Exchange Act Release No. 13156 (January 13, 1977), 11 SEC Docket 1425.

[24]Securities Exchange Act Release No. 12619 (July 19, 1976), 10 SEC Docket 15.

[25]This is a new requirement in the Form 8–K which was adopted because the Commission believes that the availability of this information in the Commission's files will be useful to investors.

[26]The following items of information were transferred to the Form 10–Q: Legal Proceedings, Changes in Securities, Changes in Security for Registered Securities, Defaults upon Senior Securities, Increase and Decrease in Outstanding Securities, and Submission of Matters to a Vote of Security Holders. Two other items of information were eliminated altogether: Options to Purchase Securities and Extraordinary Item Charges and Credits.

[27]See Securities Act Release No. 5715 (June 2, 1976), 9 SEC Docket 760, for the text of the withdrawn proposal.

[28]Securities Act Release No. 5776 (December 2, 1976), 11 SEC Docket 1051.

[29]Securities Act Release No. 5777 (December 2, 1976), 11 SEC Docket 1051.

[30]Securities Exchange Act Release No. 13056 (December 10, 1976), 11 SEC Docket 1172.

[31]See 39th Annual Report, pp. 16–17.

[32]Securities Exchange Act Release No. 10591 (January 10, 1974), 3 SEC Docket 359. See 40th Annual Report, pp. 15–16.

[33]Securities Exchange Act Release No. 11079 (October 31, 1974), 5 SEC Docket 356.

[34]Securities Exchange Act Release No. 13639 (June 17, 1977), 12 SEC Docket 918.

[35]Securities Exchange Act Release No. 13097 (December 22, 1976), 11 SEC Docket 1269; Securities Exchange Act Release No. 13385 (March 17, 1977), 11 SEC Docket 2008; Securities Exchange Act Release No. 13659 (June 22, 1977), 12 SEC Docket 935.

[36]Accounting Series Release No. 194 (July 18, 1976), 10 SEC Docket 100.

[37]Securities Act Release No. 5868 (September 26, 1977), 13 SEC Docket 218.

[38]Securities Act Release No. 5869 (September 26, 1977), 13 SEC Docket 221.

[39]*Ibid.*

[40]Accounting Series Release No. 225 (August 31, 1977), 12 SEC Docket 1612.

[41]Securities Act Release No. 5826 (May 10, 1977), 12 SEC Docket 340.

[42]Securities Act Release No. 5837 (June 20, 1977), 12 SEC Docket 900.

[43]Securities Act Release Nos. 5861 (August 31, 1977), 12 SEC Docket 1617, 5877 (October 26, 1977), 13 SEC Docket 416, 5878 (October 26, 1977), 13 SEC Docket 434.

[44]Accounting Series Release No. 203 (December 9, 1976), 11 SEC Docket 1162.

[45]Securities Act Release No. 5848 (August 5, 1977), 12 SEC Docket 1458.

[46]Pub. L. No. 93–502.

[47]Securities Act Release No. 5571 (February 21, 1975), 6 SEC Docket 286.

[48]P.L. 94–409. The "Government in the Sunshine" Act is codified at 5 U.S.C. 552b.

[49]5 U.S.C. 552 (b) (3).

[50]442 U.S. 255 (1975).

[51]H. R. Rep. No. 94–1441, 94th Congress., 2d Sess. 25 (1976).

[52]See, *e.g., In the Matter of Request of I. Walton Bader*, FOIA Release No. 1 (April 3, 1975), 6 SEC Docket 541; *In the Matter of Request of Jeffrey B. Albert*, FOIA Release No. 10 (June 11, 1975), 7 SEC Docket 138.

[53]Securities Act Release No. 5571 (February 21, 1975), 6 SEC Docket 288. *In the Matter of Request of John A. Jenkins*, FOIA Release No. 11 (June 11, 1975), 7 SEC Docket 139.

[54]*In the Matter of Request of John A. Jenkins*, FOIA Release No. 11 (June 11, 1975), 7 SEC Docket 139.

[55]*In the Matter of Request of Jung Ja Malandris*, FOIA Release No. 8 (May 29, 1975), 7 SEC Docket 58.

[56]S.D.N.Y., No. 77 Civ. 3110 (VLB); C.A. 2, No. 77–6124.

[57]The report was prepared and issued pursuant to Section 21(a) of the Securities Exchange Act, 15 U.S.C. 78u(a).

[58]5 U.S.C. 522(a) (4) (B).

[59]Securities and Exchange Commission, *Staff Report on Transactions in Securities of the City of New York*, Subcommittee on Economic Stabilization, House Committee on Banking, Finance and Urban Affairs, 95th Cong., 1st Sess. (Comm. Print, 1977).

[60]C.A. 2, No. 77–4034; CCH Fed. Sec. L. Rep. para. 96,172 (March 21, 1977).

[61]17 CFR 240.24b–2.

[62]*See, e.g., Charles River Park "A", Inc. v. Department of Housing and Urban Development*, 519 F.2d 935 (C.A.D.C., 1975).

[63]C.A.D.C., No. 77–1587.

Part 3
Regulation of Securities Markets

Part 3
Regulation of Securities Markets

In addition to the disclosure provisions discussed in the preceding chapter, the Securities Exchange Act of 1934 (Exchange Act), as amended by the Securities Acts Amendments of 1975 (the 1975 Amendments),[1] assigns to the Commission broad regulatory responsibilities over the securities markets, the self-regulatory organizations within the securities industry and persons conducting a business in securities. Among other regulatory responsibilities, the Exchange Act directs the Commission to facilitate the establishment of a national market system for securities and a national system for the clearance and settlement of securities transactions. The Exchange Act requires registration of securities exchanges and certain clearing agencies, permits registration of associations of brokers or dealers, established the Municipal Securities Rulemaking Board (MSRB), as a self-regulatory organization, to formulate rules for the municipal securities industry, and provides for Commission supervision of the self-regulatory responsibilities of national securities exchanges, registered clearing agencies, registered securities associations and the MSRB. The Exchange Act also requires the registration of securities brokers and dealers, certain municipal securities professionals, securities information processors, and transfer agents. Finally, the Exchange Act contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets. Important recent developments concerning regulation of the securities markets are discussed in Part 1 of this Annual Report.

REGULATIONS OF EXCHANGES

Registration

The Exchange Act generally requires a securities exchange to register with the Commission as a national securities exchange unless the Commission, acting pursuant to Section 5 of the Exchange Act, exempts it from registration because of the limited volume of its transactions. As of September 30, 1977, the following ten securities exchanges were registered with the Commission: American Stock Exchange, Inc.; Boston Stock Exchange, Incorporated; Chicago Board Options Exchange, Incorporated; Cincinnati Stock Exchange; Intermountain Stock Exchange; Midwest Stock Exchange, Incorporated; New York Stock Exchange, Inc.; Pacific Stock Exchange, Incorporated; Philadelphia Stock

Exchange, Inc.; Spokane Stock Exchange.

On October 12, 1976, the Commission, pursuant to Section 19(a)(3) of the Exchange Act, issued an order withdrawing the registration of the Detroit Stock Exchange as a national securities exchange. That exchange had ceased operations at the close of business on June 30, 1976, in accordance with a plan of liquidation adopted by its governing committee on May 12, 1976, and approved by a majority of its membership on June 7, 1976.[2]

On October 13, 1977, the Honolulu Stock Exchange (HSE), the only securities exchange currently exempted from registration,[3] informed the Commission that it would cease operations as of December 30, 1977. At the end of the fiscal year, that exchange had begun taking the steps necessary to terminate its business operations in an orderly fashion and to seek termination of its exemption from registration as a national securities exchange.

Delisting

Pursuant to Section 12(d) of the Exchange Act, a security may be withdrawn from listing and registration with a national securities exchange upon the exchange's application to the Commission, or upon the application of its issuer, in accordance with the rules of the exchange and upon such terms as the Commission may impose for the protection of investors. In evaluating delisting applications, the Commission generally does not substitute its judgment for that of an exchange, and, where there has been full compliance with the rules of an exchange with respect to delisting, the Commission will grant a delisting application. The Commission's authority in such cases is limited to the imposition of terms deemed necessary for the protection of investors.[4]

The standards for delisting vary among the exchanges, but generally delisting actions are based on one or more of the following factors: (1) the number of publicly held shares or shareholders is insufficient (often as a result of acquisition or merger) to support a broad-based trading market; (2) the market value of the outstanding shares or the trading volume is inadequate; (3) the company no longer satisfies the exchange's listing criteria with respect to earnings or financial condition; or (4) required reports have not been filed with the exchange.

During the fiscal year, the Commission granted exchange applications for the delisting of 86 stock issues, 20 bond issues, and 5 warrants. Applications were granted to the individual exchanges as follows: American Stock Exchange (Amex), 35 stocks, 7 bonds and 5 warrants; Pacific Stock Exchange (PSE), 30 stocks and 1 bond; Philadelphia Stock Exchange (Phlx), 14 stocks and 1 bond; New York Stock Exchange (NYSE), 18 stocks and 12 bonds; Boston Stock Exchange (BSE), 1 stock; Midwest Stock Exchange (MSE), 6 stocks.[5]

The Commission also granted the application of 16 issuers to withdraw their securities from listing and registration on the Amex; 2 from the NYSE; 6 from the BSE; 1 from the Intermountain Stock Exchange; and 1 from the HSE.

Unlisted Trading Privileges

Prior to the 1975 Amendments, Section 12(f) of the Exchange Act provided that a national securities exchange might, upon application to and approval by the Commission, extend unlisted trading privileges to

any security listed and registered on another national securities exchange. The 1975 Amendments broadened that provision to encompass securities not listed on any other exchange; other textual changes reflected Congressional concern over the impact of unlisted trading on the development of a national market system and clarified that such applications may not be granted if the effect would be to restrict competition.[6]

On March 25, 1977, the PSE submitted an application for unlisted trading privileges in the common stock of Pacific Resources, Inc. The PSE application was the first application for unlisted trading privileges in a security not listed on another exchange filed pursuant to Section 12(f)(1)(C) for consideration by the Commission.[7]

At the end of fiscal year 1976,[8] the Commission had under review an Initial Decision[9] granting an application of the BSE for unlisted trading privileges in the common stock of Ludlow Corporation, which was already listed and registered on the NYSE.[10] On March 11, 1977, the Commission affirmed the decision of the Administrative Law Judge granting unlisted trading privileges.[11] The Commission held that the standards of Section 12(f) of the Exchange Act and Rule 12f-1 thereunder were met because considerable local interest existed in the security on the BSE, which provided an appropriate medium for trading the security. In addition, the Commission concluded that competitive factors existed which could lead to the execution of transactions on the BSE instead of the primary market, and there had not been any showing that the primary market would cease to be fair and orderly if unlisted trading privileges were extended to the BSE. The Commission stated that the "fair and orderly markets" standard, which was added to Section 12(f) by the 1975 Amendments, reflected congressional focus on the development of a national market system. On May 6, 1977, Ludlow filed a petition, which is currently pending, requesting the United States Court of Appeals for the District of Columbia Circuit to review and to set aside the Commission order granting the BSE application for unlisted trading privileges in Ludlow common stock.[12]

Exchange Disciplinary Actions

Section 19(d) of the Exchange Act requires exchanges to report for Commission review any final disciplinary sanction imposed by an exchange that (1) denies membership or participation to any applicant, (2) prohibits or limits access to services offered by an exchange or member thereof, or (3) imposes final disciplinary sanctions on any person associated with a member or bars any person from becoming associated with a member.

During the fiscal year, three exchanges reported to the Commission a total of 279 separate disciplinary actions. The sanctions imposed by the exchanges as a result of those actions included (1) the imposition of fines ranging from $350 to $75,000 in 177 cases, (2) the admonishment of 42 individuals, (3) the suspension from membership in the exchanges (for periods ranging from three weeks to three years) of three member organizations and 52 individuals, (4) the censure of four member firms and 75 individuals, (5) the barring from association with a member of 50 individuals and (6) the expulsion from membership of 28 individuals and two member firms.

EXCHANGE RULES

Section 19(b) of the Exchange Act,

as amended by the 1975 Amendments, requires self-regulatory organizations to file with the Commission any proposed rule or change in an existing rule accompanied by a concise statement of the basis and purpose.[13] Promptly after filing, the Commission is required to publish notice of the proposed rule change and to give interested parties an opportunity to submit their views on it. Proposed rule changes may not take effect unless approved by the Commission (with the exception of certain types of rule changes, such as interpretations of existing rules, which are permitted to take effect without Commission review, subject to the Commission's powers under Section 19(b)(3)(C) to abrogate such rule changes).

As previously reported,[14] the Commission has adopted Exchange Act Rule 19b–4 and related Forms 19b–4A and 19b–4B, which provide procedures by which self-regulatory organizations may file proposed rule changes for the Commission's approval or give notice of those rule changes which may take effect without Commission approval. The rule also provides the self-regulatory organizations criteria by which they may determine which of their policies, practices and interpretations are deemed to be rules for the purpose of the filing requirement. Furthermore, it specifies the procedures to be followed by the Commission in passing upon proposed rule changes.

During the fiscal year, the Commission received 248 submissions from exchanges involving a variety of rules and stated policies. The following were among the more significant rule changes considered by the Commission:

1. On June 15, 1976, the NYSE submitted a package of three rule proposals to remove major restrictions on floor trading activity, including a reduction in the minimum capital requirements applicable to registered floor traders. In connection with these proposals, the staff of the Division of Market Regulation conducted an inspection of the NYSE's capacity to conduct adequate regulation and surveillance of floor trading activities. On January 17, 1977, as a result of its inspection and analysis of the NYSE proposals, the Commission approved a reduction of the minimum capital requirement for registered floor traders from $250,000 to $25,000 and requested the NYSE to analyze further the remaining proposals in light of the Commission's comments thereon.

2. The Commission approved rule changes filed, respectively, by the Amex and the NYSE to rescind their so-called "New York City Rules," pursuant to which each exchange had prohibited trading on its floor of any security which was admitted to trading on any other exchange located in New York City. As a result of the Commission's approval of the these proposals, the common stock of Varo, Inc., became the first Amex-NYSE dual listing in more than fifty years. In addition, stock of six other companies is now dually traded on the Amex and the NYSE.

3. The Commission approved an NYSE rule change proposal to rescind certain restrictions with respect to "off-floor" trading by its members—that is, trades executed on the floor of the NYSE as a result of a member's order originating from off the floor. The restrictions generally prohibited an NYSE member who acquired stock by means of an off-floor order on a "plus" or "zero plus" tick, at or above the previous day's closing price, from selling that stock within twenty-four hours, except at a loss. These restrictions had been adopted in 1969 in

response to a Commission study which indicated that manipulation in a stock's price may result from concentrated and dominant trading by off-floor traders. The NYSE stated that the proposal was in response to improvements in communications facilities since the rule was adopted, and it agreed to implement a surveillance program to monitor its members' off-floor trading activities. The Commission's staff informed the NYSE that it would oversee the NYSE monitoring plan to ensure that the NYSE could effectively determine whether there had been a recurrence of the conduct which the rule was designed to prevent.

4. The Commission approved an NYSE rule proposal rescinding membership restrictions upon foreign broker-dealers and broker-dealers controlled by foreign parent organizations.

5. The Commission also approved rule changes filed by the NYSE requiring its listed companies to establish independent audit committees comprised solely of directors independent of management.[15]

6. The Commission disapproved a proposed Amex rule change which would have established alternate listing criteria for domestic corporations. In disapproving that proposed rule, the Commission noted that it would have expanded the universe of issuers whose stocks would be eligible for listing on the Amex and explained that, in light of Amex rules restricting off-board principal transactions in listed stocks, the Commission could not conclude that the Amex rule proposal was consistent with the requirements of the Exchange Act. At the end of the fiscal year, the Commission had under consideration an Amex request that the Commission reconsider its disapproval of this proposed rule change in conjunction with its consideration of a related Amex proposal concerning Amex foreign listing standards.

7. The Commission approved a proposed rule change filed by the Chicago Board Options Exchange, Incorporated (CBOE), enabling the CBOE to develop procedures for appointing its "board brokers" on the basis of a competitive bidding process.[16] The specific procedures were to be set forth in a subsequent filing by the CBOE and had not been received as the end of the fiscal year.

8. The Commission approved a rule change filed by the NYSE which eliminated the "three man" unit rule for specialist firms, rescinded a prohibition against the maintenance of joint limit orders by non-affiliated specialists in their specialist stocks, and lowered certain capital requirements for specialist firms.

9. The Commission approved an Amex rule proposal rescinding a prohibition against the entry of quotations of listed stocks by Amex members in over-the-counter quotation sheets and NASDAQ.

EXCHANGE INSPECTIONS

NYSE Advertising Inspection

On October 15, 1976, the NYSE filed proposed rule changes which would rescind its pre-clearance requirements for member advertising. The NYSE's pre-clearance of member advertising was viewed as a primary means of ensuring compliance with the NYSE's rules governing the content of member advertising.[17] In order to obtain information as to NYSE surveillance of member advertising under the existing rules and to evaluate the feasibility of proposed alternative procedures, members of the Commission's staff inspected (on December 9 and 10, 1976) the NYSE's Advertising and Sales Literature Review Section and, as a follow-up, inspected

(on January 10, 1977) the NYSE's Enforcement Department with respect to its enforcement of NYSE advertising standards.

On the basis of the information obtained during these inspections, and information submitted by the NYSE in support of its proposed rule change, the Commission was satisfied that rescission of the pre-clearance requirements for member advertising, and substitution of a post-use sampling review, probably would not lead to any substantial lessening of compliance with the NYSE advertising standards. Accordingly, the Commission approved the NYSE proposal.[18] In doing so, however, the Commission directed the staff to transmit a letter to the NYSE as to certain findings made during the course of the staff's inspections. In its letter, the staff communicated its concern that certain shortcomings in NYSE advertising review procedures be corrected to assure that the quality of member advertising not be allowed to deteriorate. The staff suggested that:

(1) An apparent lack of sufficient knowledge of the NYSE's substantive advertising standards should be corrected by the use of educational circulars and conferences between the NYSE staff and NYSE members;

(2) In order to ensure compliance with the NYSE's advertising standards, post-use sampling reviews may need to be conducted on a more frequent basis than once annually;

(3) Disciplinary actions should be pursued more vigorously by the NYSE staff as a means of enforcing the NYSE's advertising rules, particularly where repeat offenders are involved and warnings had been issued; and

(4) The NYSE should make greater efforts to avoid delay in investigating potential disciplinary cases.

NYSE Specialist Surveillance Inspection

From February 16–18, 1977, the Commission's staff conducted an inspection of the NYSE to review its programs for the regulation and surveillance of specialists and its recently revised procedures for the allocation of newly listed stocks. This was accomplished through interviews with NYSE staff personnel and examination of files pertaining to the interpretive and investigative activities of those individuals. Further, in the area of stock allocations, the Commission's staff examined procedures and standards for evaluating specialist performance and effecting stock allocations. In particular, the staff focused on the use of the Specialist Performance Evaluation Questionnaire (SPEQ), and grades derived therefrom, by the NYSE's Allocation Committee in effecting the assignment of newly-listed stocks.

By letter dated June 29, 1977, the findings of the Commission staff were communicated to the NYSE. The principal areas addressed in that letter were: (1) specialists' execution of percentage orders[19] and regulation thereof; (2) provision of an adequate audit trail to deter, among other things, the printing of fictitious trades (*i.e.*, reported transactions which appear on Network A of the Consolidated Tape but which are never cleared or settled); and (3) the relationship of stock allocation procedures to the potential for greater competition among specialists on the NYSE floor.

With respect to the first area, the NYSE undertook an educational program (partially in response to earlier Commission approval of an amended percentage order rule) to reinforce specialists' understanding as to the proper handling of percentage orders. In addition, the NYSE advised its

employees who conduct periodic inspections of specialists' trading records to effect certain procedures in order to monitor compliance in this area.

Concerning the question of an adequate audit trail, the NYSE has reported to the Commission's staff that it is continuing to explore alternative modifications in its transactional reporting system in order to incorporate certain features which the Commission deems essential for improved market surveillance. One such feature would be the ability to reconstruct, in a timely and accurate fashion, trading sequences in all NYSE-listed securities.

Finally, with regard to allocation procedures and standards, the Commission's staff observed that the NYSE's approach to this function presupposes the continued dominance of the unitary specialist system on the NYSE floor.[20] The NYSE recently submitted a proposed rule change which establishes minimum levels of acceptable specialist performance in terms of SPEQ grades. Failure to meet one or more of the minimum criteria for a specified period could result in the reallocation of one or more of the assigned stocks of the affected specialist. At the end of the fiscal year, the Commission had not completed its review of the procedures and standards which this proposal would establish.

Midwest Stock Exchange Inspection

On September 26–28, 1977, members of the Commission staff conducted an inspection of the MSE relating primarily to (1) the regulation and surveillance of stock specialists; (2) MSE procedures related to Regulation T extension requests by member firms; and (3) implementation of the MSE's program to allow members to function as registered market makers in stocks admitted to trading on the MSE.[21] In the course of this inspection, the Commission's staff conferred with several MSE employees and reviewed a variety of records pertaining to the operation of the MSE stock floor. In addition, the Commission's staff observed the transmission of orders to brokers on the MSE floor through the MSE's signet 80 and Quote 'n Trade systems as well as the execution and reporting of transactions on the floor.

In the area of specialist surveillance and regulation, members of the Commission's staff reviewed the MSE's procedures for ongoing surveillance of stock trading and implementation of a recently revised program for evaluating specialist performance. The latter is significant in that performance results will constitute the principal criteria for allocating newly listed stocks. The staff also examined the execution of odd-lot orders in NYSE-listed stocks which are admitted to trading on the MSE.

Another area upon which the inspection focused was the MSE's program in passing upon member requests for extensions of time within which customers must comply with Regulation T margin requirements. Concern in this area was heightened by the recent insolvency of an MSE member which had sought, and obtained, a number of Regulation T extensions in certain securities for which its customers subsequently refused to pay, contributing to the demise of the firm.[22]

The Commission's staff also observed the functioning of registered market makers on the MSE floor. The MSE's creation of this function was approved by the Commission in June 1977.[23] Members that register to act in this capacity serve as supplemental market makers in their respective assigned issues and thereby are able to accept market or limit orders in those issues. Where registered market makers accept orders in such issues,

their handling of those orders is generally governed by the same MSE rules which pertain to specialists acting under similar circumstances. The MSE believes that the registered market maker function will add greater depth and liquidity to the marketplace.

At the end of the fiscal year, the Commission's staff was continuing its review of the data and records obtained from the MSE. Upon completion of that review, a report discussing its findings will be transmitted to the MSE.

American Stock Exchange Options Program Inspection

On November 10–11, 1976, and on April 12–13, 1977, members of the Commission's staff conducted inspections of the Amex focusing primarily on (1) the adequacy of its member education programs in connection with its proposal to list put options for trading on its floor[24] and (2) the ability of the Amex's option surveillance systems to enable it adequately to enforce compliance with its rules and the Federal securities laws. Special attention was given to Amex procedures for monitoring member trading in securities underlying Amex-listed options, use by members of certain non-public information in effecting option transactions and member option transactions designed solely to produce benefits under option margin rules.[25] While the design of the Amex educational program appeared generally adequate to prepare members for the commencement of put trading on the exchange, the Commission's staff was concerned with the Amex's failure to make any substantial progress in developing surveillance procedures which would enable it to detect questionable member trading activity.

During that inspection, the Commission's staff was particularly concerned about the inability of the Amex to identify accurately those members executing particular option transactions,[26] and the staff suggested possible changes in Amex procedures which would correct this deficiency. By the April 1977 inspection, the Amex had instituted some new procedures designed to facilitate the collection of this information with respect to some option transactions, but as the fiscal year ended, substantial improvements still needed to be made.

Also, based in part on this inspection, it was determined that the Amex's surveillance programs were not adequate to determine whether its members or their customers were trading in concert with others in an attempt to evade rules of the exchanges on which options are traded (options exchanges) regarding maximum positions in an option class.[27] Subsequently, the Commission's staff found similar inadequacies in the surveillance programs of the other options exchanges. At the end of the fiscal year, the options exchanges had begun some efforts, working jointly with the Commission's staff, to develop ways of improving surveillance programs.[28]

Chicago Board Options Exchange Inspection

On April 4–5, 1977, the Commission's staff conducted an inspection of the CBOE which focused primarily upon the CBOE's procedures for enforcing member compliance with its rules concerning option selling practices and the trading of put options under the CBOE's proposed put option program. The inspection also included a review of the CBOE's system for monitoring the initial and continued

qualification of securities which underlie CBOE listed options.

Although the inspection team was concerned, in some cases, with delays in handling inquiries and complaints in the area of sales practices, the CBOE's complaint procedures in this area generally seemed satisfactory.[29] On the basis of that preliminary inquiry, the CBOE put option training program generally appeared adequate to apprise members of their responsibilities with regard to the trading of put options on the CBOE floor.[30]

In connection with its overall investigation and study of options trading,[31] the Commission contemplated the need for industry-wide standards for monitoring the performance of market makers on the floors of the options exchanges. In that regard, the Commission's inspection staff determined that the CBOE had made some limited progress toward defining and monitoring compliance with standards for the performance of market makers and other parties on the CBOE floor.[32]

Midwest Stock Exchange Options Program Inspection

On April 6, 1977, the Commission conducted its first inspection of the newly established pilot options program at the MSE.[33] The inspection focused upon the adequacy of the MSE's systems for the surveillance of options trading on its floor.

After reviewing the MSE's options market surveillance program, the Commission's inspection staff concluded that while it generally appeared to be adequate, at the then current trading volume, to monitor options trading by MSE members, it might well not be adequate to handle any substantial expansion in options trading on that exchange.[34] As the fiscal year ended, the MSE was responding to the Commission's suggestion that it improve its oversight capability by computerizing certain surveillance systems in anticipation of increased trading volume resulting from future expansions of the MSE's options pilot program.

The inspection indicated that the MSE was responding to suggestions by the Commission's staff that the MSE refine standards for evaluating market maker trading performance in order to justify the favorable margin treatment accorded to such options market participants.[35]

Following the commencement of its options pilot program, the MSE had upon occasion certified incorrectly that certain underlying securities for listed options met its requirements for initial and continued qualification,[36] and the Commission's staff had urged at that time that certain improvements be made by the MSE in its certification procedures. Based upon comments made by the MSE during the Commission's inspection, it appears that the MSE has now instituted certain new procedures to ascertain whether underlying securities meet its qualifications.

Pacific Stock Exchange Options Program Inspection

On April 7, 1977, the Commission's staff conducted an inspection of the PSE to determine whether its surveillance programs could accommodate an expanded options program.[37] The inspection also reviewed the adequacy of the PSE's educational programs for members and the operation of its disciplinary procedures for member violations of PSE rules.

Based upon the inspection, it appeared that the PSE's educational programs for put option trading,[38] and for the training of new floor members, generally were adequately designed to

inform members of their responsibilities under PSE rules, but that there were other deficiencies in the PSE's options program that require attention. Partially in response to suggestions of the Commission's staff during this inspection and another inspection conducted the preceding fiscal year,[39] the PSE modified and instituted a previously proposed system of fixed fines for relatively minor infractions of exchange rules. The object of the new system is to streamline the PSE's disciplinary process for minor infractions and to permit its enforcement staff to allocate more of its time and resources to other areas. The Commission's inspection team also noted a number of areas in which the PSE's surveillance systems, like those of other options exchanges, were demonstrably inadequate and had to be strengthened before existing options programs could be allowed to expand.[40]

Based, in part, on its staff's inspection of the options exchanges, the Commission subsequently determined that the surveillance and enforcement programs of each of the options exchanges appeared to be inadequate, and the staffs of the Commission and the options exchanges were working on solutions to the problem as the fiscal year ended.

SUPERVISION OF THE NASD

The Exchange Act provides that an association of brokers and dealers may be registered with the Commission as a national securities association if it meets the standards and requirements for the registration and operation of such associations contained in Section 15A of the Act. The Exchange Act contemplates that such associations will serve as a medium for self-regulation by over-the-counter brokers and dealers. In order to be eligible for registration, an association's rules must be designed to protect investors and the public interest, to promote just and equitable principles of trade and to meet other statutory requirements. Registered securities associations operate under the Commission's general supervisory authority, which includes the power to review disciplinary actions taken by an association, to approve or disapprove changes in the association's rules and to abrogate, add to and delete from such rules. The NASD is the only association registered with the Commission.

At the close of the fiscal year, 2,782 brokers and dealers were NASD members. This represented a net decrease of 113 members during the year, resulting from 207 admissions to and 320 terminations of membership. The number of members' branch offices increased by 226 to 6,194 as a result of the opening of 965 new offices and the closing of 739. During the fiscal year, the number of registered representatives and principals (which categories include all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which require registration) decreased by 2,103 to 192,396. This decrease reflects the net result of 15,635 initial registrations, 14,501 re-registrations and 32,239 terminations of registrations during the year.

In fiscal year 1977, the NASD administered 45,948 qualification examinations, of which 24,317 were for NASD qualification, 2,161 were for the Commission's SECO program[41] and the balance were for other agencies, including the major exchanges and various state securities regulators.

NASD Rules

Under Section 19(b) of the Exchange Act and Rule 19b–4 thereunder, the NASD is required to file with the Commission any proposed rule change,

accompanied by a concise general statement of its basis and purpose. The Commission is generally required to publish notice of the proposed rule change together with the terms of such change or a description of the subjects and issues involved and to give interested parties an opportunity to submit their views. Most proposed rule changes may not take effect unless approved by the Commission; however, certain rule changes, including those establishing or changing a due, fee, or other charge imposed by the NASD and those concerned solely with the administration of the NASD, need not be approved by the Commission before taking effect.

During the fiscal year, the NASD filed numerous rule changes with the Commission under Rule 19b–4. Among the major filings which the Commission approved were:

(1) Adoption of a new Section 33 to Article III of the NASD Rules of Fair Practice, which authorizes the Board of Governors of the NASD to adopt rules, regulations and procedures relating to transactions in options contracts, including options to be included in the NASDAQ System.[42] Under this new rule, the Board of Governors has the authority, among other things: (1) to develop a regulatory program consistent with existing standardized options trading plans and Commission rules and regulations governing options, and (2) to adopt rules governing trading in conventional over-the-counter option contracts as well as the activities of the NASD-only member firms doing business through option exchange members in exchange-listed options on an "access basis."[43]

(2) Amendments to Article XVII of the NASD By-Laws, Code of Arbitration Procedure and Uniform Practice Code, to reflect the transfer of the securities processing operations of the National Clearing Corporation (NCC), a wholly-owned subsidiary of the NASD, to the National Securities Clearing Corporation (NSCC).[44]

(3) Amendment to Section 1(a) of Schedule G under Article XVIII of the NASD By-Laws, to permit any member of the NASD to become a so-called "Designated Reporting Member" upon request, provided the member executes over-the-counter transactions in listed securities required to be reported on the Consolidated Tape and maintains transaction reporting capability through the NASDAQ Transaction Reporting System.[45]

NASD Inspections

During the past fiscal year, the Commission's staff conducted inspections of NASD district offices located in Atlanta, Boston, Chicago, Dallas, Denver, Kansas City, New Orleans, Seattle and Washington, D.C., and of the NASDAQ Qualifications Department in the NASD's Washington headquarters. These inspections were conducted as a part of the Commission's oversight responsibility to assure that the NASD is performing its self-regulatory functions adequately. They aid the Commission in determining whether there is a need for new rules, or for amendment or modification of existing Commission rules or NASD rules, policies or interpretations. They also are intended to further coordination of the Commission's and the NASD's regulatory and enforcement activities relating to the over-the-counter market.

The NASD district office inspections involved a review of (1) the composition and effectiveness of the District Business Conduct Committees, examination subcommittees, and nominating committees, (2) the functioning of the district staffs, especially their working relationships with the various commit-

tees composed of NASD-member firms, and (3) the district staffs' coordination and cooperation with the Commission's regional offices, the exchanges, and other interested regulatory bodies. Problems uncovered during these inspections related to (1) procedures for notifying the Commission's regional offices, either orally or in writing, of possible violations of Federal securities laws, (2) delays in the timely processing of disciplinary matters, (3) the thoroughness of certain investigations in response to customer complaints, and (4) adequacy of review of members' supervisory practices upon receipt of customer complaints or notices of termination of registered representatives' employment for cause. The staff also observed a need for (1) closer monitoring of district nominating committees to assure a fairer representation of their members on District Business Conduct Committees and (2) more complete member office examination reports and District Business Conduct Committee meeting minutes to include notation of all apparent violations and their disposition. All of these problems and observations were reviewed with representatives of the NASD's national office during the course of the fiscal year, and appropriate corrective action has been initiated or completed.

The purpose of the inspection of the NASD's NASDAQ Qualifications Department (Department) was to evaluate the effectiveness of the Department's enforcement of the NASDAQ qualification standards for an issuer's eligibility and continued inclusion in the NASDAQ system. The inspection revealed instances where the NASD had not (1) taken steps to remove promptly from the NASDAQ system securities of issuers which had not been filing required financial reports in a timely fashion and had not been maintaining the prescribed minimum $250,000 capital and surplus, (2) obtained current financial or other pertinent information with respect to foreign issuers included in the system in order to verify their compliance with applicable maintenance criteria, (3) routinely advised its market surveillance department of the names of delinquent issuers for which special monitoring efforts might be needed to detect any unusual trading problems relating to those issuers, or (4) scheduled hearings promptly in those instances where an issuer requested one after being notified that it was to be deleted from the NASDAQ system for not maintaining minimum qualification standards. The Commission's staff recommended to the NASD that, for the benefit of potential investors, the NASD should consider providing a means for identifying, on NASDAQ quotation display terminals, in newspapers and in various financial publications, issuers involved in Chapter X or XI bankruptcy proceedings. By the end of the fiscal year, the Department had initiated corrective procedures in most areas. The Commission's staff plans to conduct a follow-up review during the next fiscal year.

NASD Disciplinary Actions

The Commission receives from the NASD copies of its decisions in each case where disciplinary action is taken against a member or a person associated with a member. Generally, such actions are initiated on the basis of allegations that the respondents have violated specified provisions of the NASD Rules of Fair Practice. Where violations by a member firm are found, the NASD may impose such sanctions as expulsion, suspension, limitation of activities or operations, fine, censure, or other fitting sanction. If the violator is an individual, his regis-

tration with the NASD may be suspended, he may be barred from association with any member, or he may be fined, censured, or otherwise suitably sanctioned.

During the past fiscal year, the NASD reported to the Commission final disposition of 281 disciplinary complaints in which 156 members and 318 individuals were named as respondents. Complaints against 6 members and 26 individuals were dismissed for failure to establish the alleged violations. In its disciplinary actions, the NASD expelled 20 members from membership and suspended 5 members for periods ranging from one day to two years. The NASD imposed fines, ranging from $25 to $20,000, on members in 107 cases and censured members in 18 cases. In addition, the NASD barred 83 persons associated with member firms and suspended the registrations of 45 persons for periods ranging from one day to five years. Finally, the NASD imposed disciplinary sanctions on 164 other individuals in the form of censures or fines in amounts ranging from $100 to $20,000.

Review of NASD Disciplinary Actions

Section 19(d) of the Exchange Act requires a self-regulatory organization which imposes a disciplinary sanction on a member or a person associated with a member to file notice of such sanction with the Commission.[46] An action subject to the filing requirement may be reviewed by the Commission on its own motion or on the timely application of any person aggrieved by the action. The effectiveness of any sanction is not stayed pending appeal to the Commission unless the Commission so orders. If the Commission finds on review that the party against whom an action has been taken committed the acts found by the NASD, and that such acts violated the specified rules, the Commission must sustain the action unless it finds that the penalties imposed are excessive or oppressive. Such penalties may be reduced or set aside; the Commission may not, however, increase the penalties imposed by the NASD.

At the beginning of the fiscal year, 15 proceedings for review of NASD disciplinary actions were pending before the Commission, and during the year 13 additional cases were brought up for review. The Commission disposed of 13 of these appeals. In five cases, the Commission affirmed the NASD's action. The Commission set aside the NASD's action in one case, dismissed appeals in four cases because of the respondents' failure to file briefs, remanded two cases to the NASD, and permitted withdrawal of one appeal. At the close of the fiscal year, 15 appeals were pending.

Four significant opinions were issued during the fiscal year. In *Ben B. Reuben*,[47] the Commission affirmed the NASD's findings that the respondent violated the NASD Rules of Fair Practice by deliberately attempting to negotiate a check on behalf of a client when the respondent knew or should have known that the client was not entitled to the check. Respondent, a registered principal of an NASD member firm, caused the firm to issue a check to his client in payment for securities sold for the client's account. Several days later the firm put a stop payment order on the check and issued a duplicate check which was cashed by respondent and deposited in his personal account to be used for his client's benefit. Approximately one year later, after respondent had organized his own broker-dealer firm, the original check reappeared in his client's possession. The respondent, without consulting his own records or those of his previous firm, deposited

the check in his personal account, where it failed to clear. He explained that he suspected his client was not entitled to the check, but he nontheless deposited it with the idea that clearance of the check would indicate that his client was in fact entitled to it. Respondent contended that the NASD had erred in finding his conduct inconsistent with just and equitable principles of trade, that he was denied due process, and that the sanctions imposed by the NASD—censure, a 30 day suspension and a $2,500 fine—were too harsh in view of the economic hardship he would suffer, the absence of prior history of misconduct on his part, and the fact that no one was injured as a result of his actions. The Commission affirmed the NASD's finding that Respondent's actions did not meet the standards imposed by the NASD's Rules of Fair Practice and found Respondent's due process arguments without substance. The Commission also affirmed the sanctions imposed, stating that, because disciplinary proceedings conducted by the securities industry's self-regulatory bodies under the "high standards of commercial honor and just and equitable principles of trade" standards are ethical in character, the fact that a violation of those standards did not result in actual harm does little, if anything, to mitigate the severity of the offense.

In *Hibbard & O'Connor Securities, Inc., et al.*,[48] the Commission affirmed findings of the NASD with respect to respondent's "parking" of securities to circumvent net capital requirements, failure to register salesmen, improper payments to an employee of another member of the NASD, and failure to comply with certain recordkeeping, customer protection and delivery requirements. Other findings against the member and an officer were set aside, and proceedings were remanded to the NASD for a reassessment of sanctions. The Commission noted, however, that the officer's attempt to cover up misconduct and to frustrate the NASD's investigation of alleged violations with respect to which he had not been named a party could be a basis for instituting new NASD proceedings against him.

With respect to the officer, the NASD District Committee had imposed a $2,000 fine and a censure for his alleged role in certain net capital hypothecation violations. After a hearing before the NASD Board of Governors, the fine was raised to $10,000 and the officer was barred from association with any NASD member because the Board found that the officer had attempted to cover up misconduct concerning improper payments to another member's employee and to inhibit the NASD's investigation of the improper payments. On review the Commission set aside the NASD's findings of violations in which the officer allegedly participated; accordingly, no findings adverse to the officer could be predicated on them. Moreover, the Commission found that since the officer had never been charged with participation in the improper payments or with attempting to obstruct the NASD's investigation, the alleged obstruction could not serve as a basis for adverse findings against the officer. The Commission noted, however, that its reversal of the NASD's actions with respect to the officer did not preclude the institution of new NASD proceedings against him based upon his alleged efforts to cover up the improper payments and to frustrate the NASD's investigation.

In *Waldron & Co., Inc.*,[49] the Commission, in reviewing a disciplinary action by the NASD, rejected the member's claim that it was deprived of a

fair and impartial hearing, sustained the NASD's finding that the member and its president had sold securities at unfair prices and affirmed the sanctions imposed. The NASD found that the member and its president had executed, on a principal basis, a series of securities sales to members of the public at prices not reasonably related to the then current market prices, thereby violating the NASD's "mark-up" policy.[50] The member argued to the Commission that the proper base on which to compute the mark-up was not the firm's contemporaneous cost, but rather the primary market maker's asked price in the sheets published by the National Quotation Bureau, Inc. The Commission rejected this argument, noting that the member (as well as other broker-dealers) had purchased the security in question from the primary market maker at prices less than the asked price quoted in the "pink sheets." On that basis, the Commission found that the best evidence of the prevailing market price was the member's contemporaneous cost.

In *Fred K. Kerpen*,[51] the Commission affirmed action taken by the NASD against a member and its registered principal, where the principal failed to take timely steps to discover conversion of customers' funds by a registered representative of the member and to prevent future occurrences of such incidents. On appeal to the Commission, while not disputing the NASD's findings with respect to the misconduct of the registered representative, the member and principal expressed disagreement concerning the steps that should have been taken by the principal to discover and prevent the misconduct. The principal argued that he had failed to take action against the registered representative following an initial complaint involving forgery and conversion because the allegations, when made, appeared incredible in view of the representative's previous good reputation in the investment community. Nevertheless, following subsequent complaints from other customers, the principal continued to fail to examine the representative's accounts or to terminate his employment, apparently choosing to attempt to rehabilitate the representative. The NASD found, and the Commission affirmed, that the principal was negligent in failing to supervise, particularly following the subsequent complaints against the representative. It was further argued that the sanction imposed by the NASD against the principal—a ten-day suspension—was excessive, particularly since the principal devoted only part of his time to the firm, which no longer had any full-time employees. The Commission affirmed the sanction, noting that one of the purposes of the disciplinary action is to indicate to other members the seriousness with which the NASD regards failure to supervise employees.[52]

Review of NASD Membership Action

Under Section 15A(g)(2) of the Exchange Act, the NASD must notify the Commission of its intention to admit to membership a registered broker-dealer subject to a statutory disqualification, or to permit a statutorily disqualified person to become associated with a member, not less than 30 days before the member's admission or the person's association. At the time the notice is filed, the NASD may apply for an order stating that, notwithstanding the disqualification, the Commission will not proceed under those provisions of the Exchange Act empowering the Commission to exclude the firm or associated person. The Commission, in its discretion and subject to such terms and conditions as it deems

necessary, may issue an order permitting such membership or association if it finds such action appropriate in the public interest and for the protection of investors. At the beginning of the fiscal year, four applications of this nature were pending before the Commission. During the year, four applications were filed, four were approved and three were withdrawn, leaving one application pending at the end of the year.

SUPERVISION OF THE MUNICIPAL SECURITIES RULEMAKING BOARD

The Municipal Securities Rulemaking Board (the MSRB) was established under the 1975 Amendments as a self-regulatory organization whose principal purpose is to draft and submit for Commission approval[53] a comprehensive body of rules establishing standards for the municipal securities industry. During the fiscal year, the MSRB filed with the Commission over 40 proposed rule changes and amendments to proposed rule changes. The following were among the more significant rule changes approved by the Commission:

(1) The Commission approved a series of MSRB rules concerning professional qualifications of members of the municipal securities industry.[54] Basically, the rules provide for examination of prospective industry members and require each of those persons who have not previously been employed in the securities industry to serve a 90-day apprenticeship before transacting a municipal securities business with the public. In addition, the rules provide for the examination of supervisory personnel, including persons responsible for the financial affairs of securities firms engaged in the municipal securities business. The rules also require the collection of pertinent information concerning the background of all personnel engaged in underwriting, trading and sales of municipal securities.

(2) The Commission also approved a series of MSRB recordkeeping rules designed to assure that securities firms and banks maintain certain basic information concerning their activities as municipal market professionals, both for purposes of their own operations and to permit the conduct of compliance examinations by the regulatory agencies.

(3) The MSRB adopted, and the Commission approved, a customer confirmation rule which requires municipal securities dealers to provide their customers with pertinent information concerning their transactions in municipal securities including several items of information necessary to describe accurately the securities[55] purchased.

(4) The Commission also approved the MSRB's rule G-12 which establishes uniform industry practices relating to the processing, clearance and settlement of transactions in municipal securities. Rule G-12 is intended, among other things, to increase the efficiency and reduce disputes concerning the delivery of securities.[56] The provisions of rule G-12 are applicable only to transactions between municipal securities professionals and do not apply to municipal securities transactions with customers.

REVENUES, EXPENSES AND OPERATIONS OF SELF-REGULATORY ORGANIZATIONS

Section 23(b)(4)(B) of the Exchange Act requires that the Commission submit "a statement and analysis of the expenses and operations of each self-regulatory organization in connection with the performance of its responsibilities under this title." As set forth in Section 3(a)(26) of the Exchange Act, the term "self-regulatory organi-

zation" refers to any national securities exchange, registered securities association (*i.e.*, the NASD), registered clearing agency, and, for limited purposes, the MSRB.

Self-regulatory organizations, exclusive of registered clearing agencies and the MSRB, receive approximately 75 percent of their revenue from five sources: transaction charges, listing fees, communication fees, clearing fees and depository fees. The nature of these revenue sources makes the financial condition of self-regulatory organizations highly dependent upon price fluctuations and trading volume.

Total share volume of securities traded on all national securities exchanges and over-the-counter increased by 14.5 percent between calendar year 1975 and 1976, bringing 1976 share volume to 8.7 billion. As a result of this increased trading activity, combined self-regulatory organization revenues increased to $249 million, up $44 million from the 1975 total.

Changes in major revenue components between 1975 and 1976 were as follows:

- Revenues from transaction fees increased to $39 million from $33 million;
- Revenues from communication fees increased to $39 million from $26 million;
- Revenues from clearing fees increased to $41 million from $35 million;
- Revenues from tabulating services increased to $17 million from $14 million; and
- Revenues from all "other" sources increased to $43 million from $38 million.

The expenses of the self-regulatory organizations are concentrated in two areas, employee costs and communication and data processing costs. These costs accounted for 74 percent of the $233 million in self-regulatory expenditures for 1976.

In 1976, for the second consecutive year, the net income of self-regulatory organizations, exclusive of the registered clearing agencies and the MSRB, increased. The 1976 pre-tax income of self-regulatory oganizations equaled $17 million, a $3 million increase over 1975's earnings.

Financial Results of the NASD

Each year the Commission reviews the NASD's proposed fee and assessment schedule, its supporting financial statements for the current and past fiscal years, and proposed budget for the following fiscal year. The fee and assessment schedule must comply with Section 15A(b)(5) of the Exchange Act, which requires the NASD to allocate dues equitably among its members.

The NASD's statement of financial results for its fiscal year ended September 30, 1976 revealed that the NASD's equity increased to $11.1 million from $9.2 million in the prior year. This increase in the NASD's equity resulted principally from higher net operating earnings and to a lesser extent from profitable operations of NASDAQ, Inc.

Operating revenues of the NASD were $22.2 million, an increase of $9.2 million over the previous year's operating revenues. This increase resulted primarily in $8.0 million in new revenues from the newly acquired NASDAQ system. Other sources of income generally remained stable. Fees charged for administering qualifications examinations appears to have stabilized, at $2.4 million in 1976. Member assessments and branch office fees increased from $5.9 million in fiscal year 1975 to $6.5 million in 1976, a 10 percent increase.

During the 1976 fiscal year, operating expenses of the NASD increased to $20.5 million from $12.0 million in fiscal year 1975, thus, net operating income for fiscal 1976 was $1.8 million as opposed to $0.9 million in the prior year, a marked increase. In addition, in fiscal year 1976, the National Clearing Corporation had net income of $0.2 million which, when added to the NASD's net income, increased the NASD equity by $2.0 million, as compared with a net increase of $1.4 million in its 1975 fiscal year.

NASD Budget

The Commission reviews the NASD budget as part of its regulatory oversight responsibilities. During recent years, the Commission has been specifically interested in the NASD's budget as it relates to its program for examination of member broker-dealers, in order to assure that the NASD has a sufficient examiner staff to perform its enforcement and surveillance responsibilities. The NASD budget for fiscal year 1977 provides for total expenditures of $13.67 million in fiscal year 1977, an increase of $1.7 million. The increase is largely attributable to the increase in employee compensation which increased by $1.05 million to $10.35 million.

The NASD has projected its income for fiscal year 1978 at $15.42 million, based upon its current schedule of fees and assessments. The NASD fee structure remains unchanged for fiscal year 1978, but the annual assessment base has been modified. The fiscal year 1977 gross income assessment rate was 0.2 percent of a member's revenues from municipal securities transactions and 0.25 percent of a member's revenue from other over-the-counter securities transactions during calendar year 1975. The fiscal year 1978 rates would be 0.17 percent and 0.21 percent, respectively, of revenue derived from municipal securities and over-the-counter transactions during calendar year 1976.

American Stock Exchange, Midwest Stock Exchange, National Association of Securities Dealers, and New York Stock Exchange

In calendar year 1976, the markets governed by the four largest self-regulatory organizations (in terms of total revenue) — the Amex, the MSE, the NASD, and the NYSE — experienced rising share volume. On the NYSE, share volume rose from 5.1 billion in 1975 to 5.6 billion in 1976, an increase of 12 percent. For the same period, MSE share volume increased 7 percent, share volume from over-the-counter transactions by members of the NASD increased 21 percent, and AMEX share volume increased 18 percent. This rise in share volume resulted in increased revenues for those four self-regulatory organizations.

The Amex experienced the second largest share volume increase of the four self-regulatory organizations and, with the growth in options trading, the largest percentage increase in revenues. In 1976 total revenue increased 37 percent from 1975. Transaction fees accounted for much of the increase with a 62 percent gain from 1975 to 1976. This increase in revenues, coupled with a 33 percent increase in expenses, resulted in an increase of net income of 258 percent to $1.5 million.

The MSE posted a 21 percent increase in revenue between 1975 and 1976 with the largest gains occurring in depository and registration fees. Although the MSE's revenue increased 21 percent in 1976, expenses increased even more, by 23 percent, and as a result net income declined by 24 percent to $745,000.

The NYSE ranked third among the four largest self-regulatory organizations in percentage gain in total revenue between 1975 and 1976. Even with the rise in NYSE share volume, transaction fees decreased $314,000. Listing fees increased 37 percent from $23 million in 1975 to $31 million in 1976. Depository fees and floor usage revenue also increased $5 million. Much of the revenue improvement was carried through to pre-tax income, which increased $1.6 million from 1975 to 1976.

NASD revenues are not as sensitive to changes in volume as are those of the national securities exchanges. As a result, the NASD had the smallest percentage increase in total revenue of the four largest self-regulatory organizations between 1975 and 1976, approximately 12 percent. The NASD's expenses for the same period increased, however, by only ten percent; and, consequently, the NASD had a net income of $2 million in 1976, compared to a net income of $1.3 million in 1975.

Boston Stock Exchange, Chicago Board Options Exchange, Pacific Stock Exchange, and Philadelphia Stock Exchange

The next four largest self-regulatory organizations (in terms of gross revenue) also experienced rising revenues, expenses and volume. During 1976, share volume on the BSE increased by 3 percent; the CBOE experienced a 49 percent increase in contract volume; the PSE gained 38 percent in volume; and the Phlx gained 3 percent in share volume.

The CBOE's increase in volume generated a 120 percent rise in membership dues and a 63 percent increase in communication fees. Expenses for the CBOE, however, increased 51 percent during 1976. The items with largest gains were depreciation and amortization (141 percent increase) and communications, data processing and collection (121 percent increase). Earnings in 1976 were 4 percent higher than in 1975.

The BSE's rise in revenue came from two sources: increased transactions fees and the opening of the New England Securities Depository Trust Company in 1976. Share volume increased from 54 million in 1975 to 56 million in 1976. Expenses increased 30 percent from January to December, 1976. This resulted in a decline in net income to $150,000, a decrease of 58 percent from 1975.

The PSE also experienced increases in revenue due to greater volume. Nevertheless, the PSE had large increases in its expenses, particularly communications, data processing and collection and professional and legal services, which caused net income to fall again this year. Expenses exceeded revenues by $686,000 in 1976.

Phlx also registered gains in total revenue. Between 1975 and 1976 Phlx gained 21 percent in total revenue, primarily because of a 93 percent increase in transaction fees. Pretax income increased to $230,000 in 1976 representing a 174 percent increase over 1975.

Cincinnati Stock Exchange, Spokane Stock Exchange, and Intermountain Stock Exchange

Following the trend of the four largest self-regulatory organizations, the Cincinnati Stock Exchange (CSE) and the Spokane Stock Exchange (SSE) also experienced rising share volume in 1976.

In 1976 the CSE nearly tripled its portion of total share volume; this was the second year of continued increases in share volume. Total revenue, however, decreased 35 percent with

the largest changes occurring in transaction fees, membership dues, and floor usage revenue. Expenses increased 10 percent in 1976, causing pre-tax income to decline from $35 thousand in 1975 to a loss of $18 thousand in 1976.

The SSE, which receives income primarily from membership dues and listing fees, had offsetting increases in total revenue and total expenses for 1976.

Most of the Intermountain Stock Exchange (ISE) revenue is from miscellaneous sources. While revenue rose in 1976, expenses rose more, reducing pre-tax income for the year.

Expenses and Operations of Registered Clearing Agencies

Clearing agencies were required by the 1975 Amendments to register with the Commission by December 1, 1975. This is the first year that operating revenues and expenses for registered clearing agencies have been presented in the Commission's annual report separately from revenue and expense data for the exchanges or securities association with which many of the clearing agencies are affiliated.[57] Accordingly, a comparative analysis of this data cannot be made against prior years' operations. As reported in the statistics section of this report at Table 10, Self-Regulatory Organizations– Clearing Agencies,[58] total revenues for all clearing agencies were $93.1 million for their fiscal years ending in 1976 (except OCC, for which figures are included for a fiscal year ending June 30, 1977). Revenues from clearing services were $50.6 million; from depository services, $34.8 million; and from interest and other sources, $7.7 million.

Since the operating results of many clearing agencies historically have been presented as part of the consolidated operating reports of securities exchanges and the NASD, the statistics section of this report at Table 8, Consolidated Revenues and Expenses of Self-Regulatory Organizations, also presents revenues from clearing fees and depository fees for affiliated clearing agencies. These consolidated reports show that, for calendar year 1976, revenues from clearing fees increased by 16 percent over calendar year 1975 to $41.2 million and revenues from depository fees increased 30 percent over calendar year 1975 to $36.2 million.[59]

While 1976 trading volume increased only 13.6 percent over 1975 volume, clearing and depository fee revenues for clearing agency subsidiaries of self-regulatory organizations increased by much larger percentages. The increase in revenues may not entirely be accounted for by increases in fees charged; it appears, therefore, that there is an increasing use of clearing agencies by the securities industry, which will further reduce the physical movement of securities certificates.

Municipal Securities Rulemaking Board

The MSRB income of $420,994 during the transitional quarter from July 1, 1976 to September 30, 1976 and $1,338,115 during fiscal year 1977 (as reported in the Part 9 of this report at Table 11, Self-Regulatory Organization–Municipal Securities Rulemaking Board) was derived primarily from two fees established by rules adopted under the Securities Act. Municipal securities brokers and municipal securities dealers are assessed (1) an initial registration fee of one hundred dollars and (2) an underwriting assessment equal to a percentage of the face value of all municipal securities they purchase from an issuer as part of a new is-

sue which has a final stated maturity of not less than two years from the date of the securities.[60] The underwriting assessment accounted for 99 percent of MSRB income during the transitional quarter and 94 percent of MSRB income during fiscal year 1977. The balance of MSRB income was from other fees and interest income.

During the fiscal year, the MSRB had expenses which totaled $957,088. The major expense items were staff salary and benefits (43 percent); meetings and travel including Board members' allowance of $250 per day (27 percent); and mailing lists, rule manuals, postage and other printing (14 percent). During the transitional quarter, income exceeded expenses by $227,486; and, during fiscal year 1977, despite the reduction in the underwriting assessment, income exceeded expenses by $574,535. As of September 30, 1977, the MSRB had a surplus of $1,084,413.

BROKER-DEALER REGULATION

Persons Deemed Not to be Brokers

Section 15(a) of the Exchange Act generally requires, with certain exceptions, the registration of any broker or dealer which uses the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security. Section 3(a)(4) of the Exchange Act, in turn, provides that the term 'broker' means "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." The Commission's staff frequently has been requested to interpret the applicability of the broker-dealer registration requirement of the Exchange Act to those situations in which an issuer of securities elects not to employ a registered broker-dealer in the distribution of its securities, but instead utilizes the services of its officers, directors, or other employees to effect a distribution. Such a method of distribution is frequently employed by, among others, promoters of tax-sheltered interests such as real estate syndications or oil and gas drilling programs. In this regard, the Exchange Act generally has not been interpreted by the staff to require the registration of the issuer itself as a broker or dealer.[61] At the same time, however, persons acting on behalf of the issuer in distributing its securities may, depending on the circumstances, be brokers (or, more infrequently, dealers) within the meaning of the Exchange Act.

On January 21, 1977, the Commission published for comment proposed Exchange Act Rule 3a4–1,[62] which is designed to clarify the circumstances under which persons distributing securities on behalf of an issuer are deemed not to be "brokers" within the meaning of Section 3(a)(4). If adopted in the form proposed, Rule 3a4–1 would establish a "safe harbor" within which natural persons associated with an issuer would not be deemed to be brokers. Generally, an associated person of an issuer might avail himself of this "safe harbor" in one of three ways: (1) by confining his participation to certain kinds of transactions, such as offers and sales made through a registered broker-dealer or to certain institutions, (2) by being a *bona fide* employee meeting specified criteria set forth in the proposed rule with regard to frequency of involvement in selling securities, performance of other duties with the issuer and nature of compensation, or (3) by restricting his activities in connection with a distribution to ministerial or other essentially passive func-

tions. The "safe harbor" of proposed Rule 3a4-1 would not be available, however, to any person subject to a "statutory disqualification" within the meaning of Section 3(a)(39) of the Exchange Act.

Exemption from Registration for Certain Financial Institutions

On November 11, 1976, the Commission adopted Exchange Act Rule 15a-5 which provides an exemption from the Act's broker-dealer registration requirement for non-bank lenders participating in the guaranteed loan program of the Small Business Administration (SBA).[63] The securities activities of such lenders must be limited to making loans guaranteed by the SBA and selling the guaranteed portion of such loans. The rule, however, permits such a financial institution participating in the SBA loan program to sell the guaranteed portion of a note evidencing such indebtedness provided that the sale is made through or to a broker or dealer registered with the Commission or to a bank, a savings institution, an insurance company, or an account over which an investment adviser registered under the Investment Advisers Act of 1940 exercises investment discretion.

Rule 15a-5 is intended to facilitate participation by qualified lending institutions in the SBA's guaranteed loan program by exempting such institutions from regulatory requirements under the Exchange Act which, under the circumstances, are not necessary for the protection of investors. Under its loan program, the SBA has sought to encourage private financing of small business concerns by providing a guarantee of a portion of an approved loan to an eligible small business enterprise. In order to increase the supply of capital available to such businesses, the SBA also has encouraged the development of a secondary market in the guaranteed portion of such loans. Rule 15a-5 represents an effort by the Commission to reduce duplicative regulation which might frustrate the goals of the SBA's loan program.

Financial Responsibility Requirements

The 1975 Amendments required the Commission to establish, not later than September 1, 1975, minimum standards of financial responsibility for brokers and dealers. On June 26, 1975, fulfilling this congressional directive, the Commission amended Exchange Act Rule 15c3-1 to adopt a uniform net capital rule.[64] During the fiscal year, the Commission further amended the uniform net capital rule to refine its requirements based on the year's experience and to respond to specific regulatory concerns, particularly relating to the treatment of options positions.

On November 20, 1975, the Commission implemented a series of temporary amendments to Rule 15c3-1 to provide a transitional period for municipal securities brokers and municipal securities dealers newly subject to the financial responsibility standards of Section 15(c) of the Exchange Act.[65] Most significantly, the rule reduced, on an interim basis, the capital required by brokers and dealers effecting transactions solely in municipal securities in order to qualify for the alternative net capital requirement.[66] After carefully monitoring the effect of this temporary amendment for approximately a year and a half, the Commission determined that the $25,000 minimum capital requirement was appropriate and, on July 28, 1977, permanently adopted the temporary amendment.[67]

Under the net capital rule, effective January 1, 1977, brokers and dealers

were permitted to reduce substantially the "haircuts"[68] on short-term commercial paper rated in one of the three highest categories by at least two of the nationally recognized statistical rating organizations. On December 30, 1976, at the request of certain major dealers in commercial paper, the Commission solicited public comment on possible alternatives to requiring ratings by two rating services.[69] After reviewing the proposals submitted in response, the Commission, on June 16, 1977,[70] reaffirmed the two-rating requirement as a prerequisite for the reduced haircuts.

On May 23, 1977, the Commission adopted modifications to the uniform net capital rule and the customer protection rule in order to prohibit brokers and dealers from effecting substantial short sales of securities without sufficient capital to carry such transactions.[71] The amendment applies to brokers or dealers which maintain short security positions for extended periods of time in stock loan or broker-dealer accounts receivable and requires that they obtain sufficient collateral to secure such receivables fully or, in lieu of such collateral, reduce their net worth and establish reserves to the extent of such collateral deficiencies.

On September 2, 1977, the Commission further amended the net capital rule in order to adjust the treatment accorded positions in options.[72] These amendments (1) revised the provisions relating to the capital requirements for brokers and dealers which carry, clear, endorse, or guarantee (carrying firms) the accounts of options specialists or market makers, (2) established early warning notification requirements for such carrying firms, and (3) limited, on the basis of their net capital, the market maker positions such firms can carry. In order to assure that the capital position of a carrying firm reflects the risk attributable to the positions in each of its market maker accounts assessed on an account-by-account basis, the Commission amended the rule to require the consolidation of securities positions held in multiple market maker accounts carried by a firm. The early warning provisions require that a carrying firm promptly notify the Commission and the designated examining authority if at any time a market maker fails to make certain deposits or if the aggregate deductions attributable to all market maker accounts carried by the clearing firm exceed 1,000 percent of the carrying firm's net capital. In addition to the notification requirements, the amendments prohibit a carrying broker from allowing these deductions to exceed 1,000 percent of the carrying broker's net capital for a period exceeding five business days.

The Commission also amended the net capital rule in order to establish a financial responsibility standard for options specialists and market makers which transact a business solely with other brokers and dealers who, because of the nature of their business (*i.e.*, traders on the floor of an exchange[73] or clearing members of a clearing corporation[74]), are not exempt from the requirements of the net capital rule.

Recordkeeping and Preservation Requirements

Exchange Act Rules 17a–3 and 17a–4 require registered brokers and dealers to make, keep current, and preserve for specified periods certain books and records relating to their business. During the past fiscal year the Commission adopted four major amendments to these rules in order to adjust the requirements in accordance

with developments in the securities industry.

On February 24, 1977, the Commission approved the MSRB's recordkeeping and record-retention rules for municipal securities brokers and municipal dealers, rules G-8 and G-9.[75] Because the MSRB's rules establish standards substantially similar to those prescribed by Exchange Act Rules 17a-3 and 17a-4, the Commission amended its recordkeeping and preservation rules in order to permit municipal securities brokers and municipal securities dealers to elect to comply with either the generic requirements of the Commission's rules or the more specific requirements of MSRB rules G-8 and G-9.

The Commission also adopted paragraph (a) (14) of Rule 17a-3 and paragraph (e) (4) of Rule 17a-4 in order to incorporate recordkeeping and retention requirements relating to the Lost and Stolen Securities Program.[76] Under the amended rules, every member, broker or dealer must make, and retain in an easily accessible place for a period of three years reports concerning lost, missing, stolen, and counterfeit securities,[77] and all confirmations of inquiry or other information received from the Federal Reserve Banks or the Securities Information Center, Inc., the Commission's designee under the Lost and Stolen Securities Program.[78]

On April 22, 1977, the Commission amended Exchange Act Rule 17a-4 (b) (9) to require brokers or dealers subject to Rule 15c3-3 to maintain a current and detailed description of the procedures they utilize to comply with Rule 15c3-3.[79] This recordkeeping requirement is consistent with the revised FOCUS report which is discussed below.

Finally, on September 15, 1977, the Commission adopted a new paragraph (i) to Exchange Act Rule 17a-4.[80] This paragraph provides that any outside service bureau, depository, bank not operating pursuant to Exchange Act Rule 17a-3(b) (2), or other recordkeeping service which prepares or maintains a broker's or dealer's books and records must acknowledge that such books and records are the property of the broker-dealer and must represent, among other things, that such books and records are available for examination by the Commission and its designees. Such Commission designees include a trustee appointed pursuant to the Securities Investors Protection Act of 1970 (SIPC Act)[81] and the self-regulatory organization designated to inspect the broker or dealer for compliance with financial responsibility rules pursuant to the SIPC Act and Exchange Act Rule 17d-1.

FOCUS Reporting System

The Financial and Operational Combined Uniform Single (FOCUS) reporting system, Form X-17A-5, which became effective on January 1, 1976,[82] superseded the previously existing and often uncoordinated reporting systems used by the Commission, the self-regulatory organizations and the state securities agencies in their surveillance registration programs. The FOCUS report[83] is designed to present, clearly and concisely, data reflecting the financial status and operational condition of a firm. The report has generally eliminated the necessity for a broker-dealer to prepare and file multiple reports with more than one regulator.

During the fiscal year, the Commission adopted a number of amendments to the reporting program on the basis of a continuing reevaluation of the needs of the self-regulatory organi-

zations, the Commission and the 45 states which use the system.[84] In particular, Forms X-17A-10 and X-17A-20 were revoked, and that information previously submitted on these forms was incorporated into Form X-17A-5. The Commission also revised the reporting requirements on Form X-17A-5. A broker or dealer subject to amended Exchange Act Rule 15c3-3 must represent that its procedures for obtaining possession or control of customers' funds and securities have been tested and are functioning in a manner adequate to fulfill the requirements of Rule 15c3-3. In addition, a broker or dealer is required to report the number and market value of securities not in its possession or control as of the report date. In order to facilitate an independent assessment of the adequacy of a broker's or dealer's procedures, the Commission also proposed[85] that Form X-17A-5 include data on the number and market value of a customer's fully paid and excess margin securities for which the instructions required by Exchange Act Rule 15 c3-3 had not been issued as of the report date.

In addition, the Commission amended the reporting program to require an independent public accountant, as part of the annual audit, to review a broker-dealer's procedures for obtaining and maintaining possession or control of certain customer securities pursuant to Exchange Act Rule 15c3-3, and to give its opinion as to the adequacy of those procedures. On June 30, 1977, however, the Commission suspended this requirement until January 1, 1978, in order to evaluate whether Rule 15c3-3 constituted a sufficient standard of adequacy and to consider alternatives to that requirement.[86] At the close of the fiscal year, the Commission was in the process of analyzing the comments received.

Broker-Dealer Examinations

The Commission, as part of its review of compliance by brokers and dealers with the provisions of the Exchange Act, the rules under that Act, and the rules of the self-regulatory organizations of which such brokers and dealers are members, conducts an examination program for SECO brokers and dealers, self-regulatory organizations and members of self-regulatory organizations.

The Commission conducts two types of examinations of SECO brokers and dealers. The first, a routine examination, is conducted on an annual basis to determine the financial and operational condition of the firm. A second type of examination, the "cause" examination, is conducted whenever a financial or operational problem is discovered or suspected, and generally concentrates on that particular problem area rather than the overall condition of the firm. During the fiscal year, the Commission conducted 232 routine examinations and 91 cause examinations of SECO firms.

In addition, under Section 15(b)(2)(C) of the Exchange Act, as amended by the 1975 Amendments, the Commission, or a self-regulatory organization acting at the Commission's direction, is required to examine each newly registered broker or dealer within six months of its registration. Accordingly, the Commission conducts examinations of each SECO registrant under its Post Effective Conference Program. During the fiscal year, the Commission conducted 277 such examinations. In addition, the Commission has directed each self-regulatory organization to conduct a similar examination of any newly-registered broker or dealer for which it is the

designated examining authority under Exchange Act Rule 17d–1.

The Commission also reviews the programs and procedures implemented by self-regulatory organizations to fulfill their regulatory responsibilities under Sections 6, 15A, and 19(g)(1) of the Exchange Act.[87] One phase of this review, consisting of on-site inspections of a self-regulatory organization's examination and compliance programs and facilities, is the primary responsibility of the Commission's Division of Market Regulation. The second phase—the "oversight" examination—is the primary responsibility of the Commission's regional offices. This examination is designed to evaluate the adequacy and quality of the examinations performed by the self-regulatory organizations.

In the "oversight" examination, conducted promptly after the completion of a self-regulatory organization's examination, the Commission reviews the financial and operational condition of a member broker or dealer.[88] Generally, the specific findings of the examination are discussed with the self-regulatory organization shortly after the examination, and the working papers, reports and evaluations prepared by the self-regulatory organization as part of its examination of the broker or dealer are compared to the information gathered and the conclusions formed by the Commission's staff. During the transition quarter and the fiscal year, the Commission conducted 427 oversight examinations.

The Commission also conducts, as necessary, cause examinations of member firms. These examinations are nearly identical in purpose and scope to the Commission's cause examination of SECO brokers and dealers. During the fiscal year, the Commission conducted 467 cause examinations of member firms.

The Commission continues to update its Broker-Dealer Examination Manual and Checklist to reflect the current rules and regulations applicable to brokers and dealers.[89] In addition, the Commission prepares and distributes to all its regional offices educational materials on new regulatory developments and examination techniques to supplement the Broker-Dealer Examination Manual to inform the securities compliance examiners of such matters. The Commission's staff also prepares and transmits to the regional offices a monthly status report regarding new rule proposals and regulatory developments, the Commission's examination program and the surveillance and examination efforts of the self-regulatory organizations.

Early Warning and Surveillance

The Commission is responsible for the financial and operational soundness of all registered brokers and dealers. In this connection, pursuant to Section 5(a) of the SIPC Act, the Commission requires each self-regulatory organization to identify member firms which may be in or approaching financial difficulty or which, for other reasons, may require closer-than-normal surveillance. Each firm so identified is placed on an "early warning" list, which is transmitted on a bi-weekly basis to the appropriate Commission regional office. While on the early warning list, a firm is monitored by the Commission's regional office, acting in conjunction with the firm's self-regulatory examining authority.

In addition, Exchange Act Rule 17a–11 requires a broker or dealer to notify the Commission and the appropriate self-regulatory organization if the firm falls below certain standards of financial and operational soundness, measured in terms of capi-

tal sufficiency and adequacy of books and records. A firm not in compliance with the rule must take immediate remedial action and provide the Commission with financial and operational information on an accelerated basis.

The Commission, in a two-phased program, periodically reviews the early warning and surveillance tools of the self-regulatory organizations to ensure that they constitute sound, effective programs. In the first phase, the Commission's staff evaluates the self-regulatory organization's early warning and surveillance program, including its goals, procedures, budget and staffing. In that connection, the Commission maintains on-going communication with all self-regulatory organizations, particularly those which have not been inspected during the past fiscal year, to determine the status of their regulatory programs.

The second phase of the Commission's early warning and surveillance program, generally carried out by its regional offices, involves an on-site review of member firms to determine their understanding of and compliance with the applicable early warning standards and procedures. As a rule, a regional office combines its evaluation with a review of the firm's financial and operational soundness and of the self-regulatory organization's most recent examination of that firm.

The Commission's efforts, in conjunction with those of the self-regulatory organizations, to develop comprehensive and effective early warning and surveillance programs explain, in part, the steady decline in the number of securities firms which have been subject to liquidation in the past several years.[90] Seven liquidation proceedings under the SIPC Act were commenced during the fiscal year.

Training Program

The Commission administers comprehensive periodic training programs for securities compliance examiners, both those on the Commission's staff and those employed by the self-regulatory organizations.[91] These programs are designed to broaden the knowledge and the skills of the examiners and acquaint them with the latest modifications of examination procedures.

The Commission's training efforts essentially consist of four distinct programs:

(1) Periodic two-day training seminars conducted at each regional office and dealing with the Commission's oversight examinations. Such seminars review the results of oversight examinations, discuss any new and important developments or techniques emerging from these examinations, and provide an opportunity for the regional offices to discuss with self-regulatory organization staff members means to refine and to coordinate more closely their examination programs and techniques.

(2) Two-day seminars held twice each year in each regional office for the more experienced securities compliance examiners on the subject of examination techniques. Such seminars discuss significant new developments in the industry and particular examination techniques that may be used to deal with such developments.

(3) One four-day training seminar held at the Commission's headquarters. This seminar provides examiners from the Commission, the self-regulatory organizations and State securities commissions with information on basic examination techniques, as well as the various regulatory programs of the Commission pertaining to broker-dealer financial and operational compliance.

(4) Bi-weekly, one-hour training sessions in the regional offices for the Commission's examiners. These sessions focus on new developments, regulatory problems, rules and examination techniques.

In addition, the individuals charged with primary responsibility for each regional office's examination program meet every three months with the Commission's staff to discuss new training and examination techniques, areas where additional training is required, and the strengths and weaknesses of the Commission's current regulatory program. Such meetings ensure uniformity of regulation throughout the Commission's regional offices and contribute to the continuing refinement of the Commission's training and examination programs.

Regulatory Burdens on Brokers and Dealers

In recent years the Commission has become increasingly cognizant of the need to evaluate carefully the impact, on both competitive and regulatory levels, of the substantive requirements of its rules and regulations on brokers and dealers, especially the smaller firms. As a consequence, the Commission has undertaken a number of programs aimed at streamlining and simplifying requirements for the securities industry.

As noted above, on July 28, 1977, the Commission amended the net capital requirement, Exchange Act Rule 15c3–1,[92] to permit brokers and dealers transacting business solely in municipal securities, generally smaller brokers and dealers, to operate under the alternative net capital requirement while maintaining only the greater of $25,000 or four percent of aggregate debit items in the reserve formula rather than the $100,000 minimum required of other brokers and dealers.[93]

The Commission's program to allocate regulatory responsibilities under Rule 17d–2, in conjunction with the development of uniform registration (Form BD), agent application (Form U–4), and agent termination (Form U–5) forms,[94] has been a catalyst for reducing regulatory burdens among brokers and dealers. Under the Commission's program, a number of self-regulatory organizations have reached agreements to share key summary financial and operational information among themselves and with state administrators. These agreements help obviate the necessity for brokers and dealers to file multiple copies of information with numerous regulators and thus reduce the burden (and the cost) of regulation.

In implementing Lost and Stolen Securities Program, the Commission provided exemptions from the inquiry requirements of Rule 17f–1 where it is unlikely that missing, lost, counterfeit, or stolen securities would be involved.[95] In instances where inquiry is required, the Commission has approved, on a pilot basis, a system under which institutions may tailor their participation according to their business needs. It is expected, therefore, that smaller firms which do not anticipate making any required inquiries or can obtain lower charges through a correspondent may choose to become indirect inquirers.

Similarly, in adopting Rule 17f–2,[96] which implements the congressional directive that securities industry personnel be fingerprinted, the Commission attempted to reduce the burden of compliance on brokers and dealers while still offering maximum protection to the investing public. In order to ease implementation of the rule, which requires the fingerprinting of

all persons who are engaged in the sale of securities, who have access to securities or monies or original books and records relating thereto, or who supervise persons engaged in such activities, the Commission provided for the rule to become effective on a gradual basis.[97]

Finally, the Commission revised the alternative net capital requirement for any broker acting solely as a floor broker on a national securities exchange. As adopted in 1975, the net capital rule required floor brokers to maintain net capital of at least $25,000 predicated on the fact that the value of an exchange membership generally exceeded that amount. In recognition of the current market value of such memberships, on May 23, 1977, the Commission made this provision available where the membership value exceeded $15,000 or where the excess of $15,000 over the value of the membership was held in escrow by an independent agent.[98]

Regulation of SECO broker-dealers

Under Section 15(b) of the Exchange Act, the Commission is responsible for prescribing rules establishing qualifications standards for all brokers and dealers, including those who are not members of the NASD (nonmember or SECO brokers or dealers). This section also empowers the Commission to adopt rules governing the business conduct of SECO brokers and dealers, in order to provide regulation of such brokers and dealers comparable to that provided by the NASD for its members.

At the close of the fiscal year, the number of SECO brokers and dealers registered with the Commission and not entitled to an exemption from the Commission's SECO rules totaled 309, and the number of associated persons of such firms (i.e., partners, officers, directors, sole proprietors and employees not engaged in merely clerical or ministerial functions) totaled 23,236.

Exchange Act Rule 15b9–2 imposes an annual assessment to be paid by SECO brokers and dealers to defray the cost of their regulation by the Commission. On September 9, 1977, the Commission announced the adoption of the annual assessment form for SECO brokers and dealers for fiscal 1977 (Form SECO–4–77).[99] In adopting Form SECO–4–77, the Commission modified the assessment by reducing the gross income assessment from 0.375 percent to 0.2 percent for municipal securities transactions and 0.25 percent for OTC securities transactions.[100] The annual base SECO firm and personnel assessment ($250 and $5, respectively) remained unchanged.

CLEARANCE AND SETTLEMENT

Progress Toward a National System for the Clearance and Settlement of Securities Transactions

With the Commission's active encouragement, entities involved in securities processing improved during the fiscal year their ability to complete securities transactions in a prompt, accurate and economical manner. The continued development of interfaces among clearing corporations and depositories (which immobilize securities certificates and allow participants to complete transactions and move securities throughout the country by book entry) tended to reduce costs and accelerate the settlement process.

Recently adopted Exchange Act Rules 17Ad–1 through –7 are designed to protect investors and to facilitate the establishment of a national system for the clearance and settlement of securities transactions by

assuring that the transfer agent community performs its functions in a prompt, accurate and more predictable manner, and, by prohibiting those transfer agents which are unable to do so, from expanding their transfer agent activities.[101]

As a result of such improvements, as well as the increased participation in depositories by broker-dealers, banks and other institutions, the Commission believes that substantial progress is being made toward the development of an efficient national system for the clearance and settlement of securities transactions. The Commission expects that the continued development and refinement of clearing and depository services will attract more persons to become participants in these systems because of the substantial benefits which accrue from such participation. The increased number of participants will, in turn, contribute toward the effectiveness of the national system by enabling greater numbers of securities transactions to be cleared and settled through book-entry movement.

Rule Changes of Registered Clearing Agencies

Numerous changes in, or additions to, the rules, practices and operations of the twelve registered clearing agencies[102] were submitted to the Commission for its approval under the provisions of Section 19(b) of the Exchange Act and Rule 19b–4 thereunder. The following are among the most significant items on which the Commission acted favorably:

(1) The Options Clearing Corporation (OCC) amended its rules to permit each clearing member of OCC to effect settlements in respect of exercised option contracts through a clearing agency designated by the clearing member for that purpose. Previously, a clearing member of OCC was required to effect settlement of exercised option contracts through an account sponsored by OCC at one clearing agency. Now, a clearing member of OCC is permitted to exercise and settle options transactions through its regular clearing account maintained directly with a clearing agency of its choice. This allows the designated clearing agency to net the exercised option transactions against other securities transactions of the clearing member.[103]

(2) OCC also amended its rules to permit put option contracts and to provide for the clearance and settlement of put transactions and exercises.[104] Other changes in OCC's rules were adopted to permit option contracts to be exercised on the same date the option contracts were purchased[105] and to provide for the automatic exercise of certain "in-the-money" option contracts held in a clearing member's account on the expiration date of such option contracts.[106]

(3) Stock Clearing Corporation of Philadelphia (SCCP) adopted amendments permitting members to use its depository facility to hypothecate securities to a bank by means of a book entry pledge.[107]

(4) SCCP also implemented a continuous net settlement system as an alternative to trade-for-trade clearance.[108] That system was established in order to permit members with high volume to net transactions in specific issues, thereby reducing the cost of securities processing.

(5) The Depository Trust Company (DTC) and the Pacific Securities Depository Trust Company (PSDTC) each adopted rule changes providing for an interface between the two entities.[109] The depository-to-depository interface

permits book entry movements of securities between DTC and PSDTC.

(6) The National Securities Clearing Corporation (NSCC) adopted[110] amendments to the rules of its Stock Clearing Corporation (SCC) Division and its American Stock Exchange Clearing Corporation (ASECC) Division providing for the settlement of Amex transactions in listed debt securities through NSCC's SCC Division rather than through NSCC's ASECC Division. The amendments were designed to permit the inclusion of all Amex-listed debt securities transactions in the SCC Division's interfaces with Midwest Clearing Corporation (MCC), Pacific Clearing Corporation, and SCCP. NSCC also adopted[111] a rule change of the SCC Division of NSCC expanding the class of persons who may become Special Representatives to include any registered clearing agency and any member of the SCC Division of NSCC. This rule change permits a non-member of the SCC Division to have trades compared by NSCC but cleared and settled by regional clearing agencies and allows parties to compare a trade outside NSCC and then submit the trade to NSCC for clearance and settlement via the Special Representative. Bradford National Clearing Corporation and Bradford Securities Processing Services, Inc. (BSPS), filed a petition in the United States Court of Appeals for the District of Columbia Circuit seeking to reverse the approval of these rules.[112]

(7) MCC and Midwest Securities Trust Company (MSTC) adopted rule changes providing for a pledge loan program.[113] The program enables participants, via book entry, to pledge with banks, as collateral for loans, their securities held in the depository.

(8) MSTC and DTC each adopted rule changes to provide a book entry settlement capability for securities transactions between participants of the two depositories even though one or both participants might not be a participant in both depositories.[114]

(9) The New England Securities Depository Trust Company adopted a number of rule changes providing for the establishment of interfaces with DTC[115] and MSTC.[116]

(10) Pacific Securities Depository Trust Company adopted rules providing for the implementation of a Transfer Agent Custodian program.[117] As part of that program, PSDTC, through agreements with transfer agents, will maintain at the transfer agent shares it holds on deposit.

(11) TAD Depository Corporation (TAD) adopted a change in its rules to provide for the establishment of an interface with DTC.[118]

(12) TAD also amended its rules to establish a collateral loan service for its participants.[119]

(13) BSPS adopted several rule changes providing for the establishment of regional clearing centers through which its participants may submit securities transactions for settlement.[120]

SECURITIES INVESTOR PROTECTION CORPORATION

The SIPC Act established the Securities Investor Protection Corporation (SIPC) to provide certain protections to customers of member brokers and dealers who were unable to meet their financial obligations to their customers. SIPC is a non-profit membership corporation, and all registered brokers and dealers and all members of national securities exchanges are, with certain limited exceptions, members.[121] SIPC is funded primarily through assessments on its members, although it may borrow up to $1 billion from

the U.S. Treasury under certain conditions.

Liquidation Proceedings

During the period covered by fiscal year 1977, liquidation proceedings under the SIPC Act were initiated for seven SIPC members. While most of the cases involved claims by a relatively small number of customers, SIPC advanced over a million dollars to the trustee of Institutional Securities of Colorado, Inc., and over $900,000 to the trustee of A.H. Speer Co. Total claims will also be quite substantial in the liquidation of Swift, Henke & Co., Inc., and I.E.S. Management Group, Inc.

Litigation Related to SIPC

The membership in SIPC of a registered broker-dealer who marketed the shares of mutual funds and advised the funds as well as its clients was at issue in *Massachusetts Financial Services, Inc. v. SIPC*.[122] The broker-dealer asserted that, as a broker-dealer registered to engage exclusively in the marketing of shares of mutual funds, it was exempt from SIPC membership pursuant to the exception in Section 3(a) (2) of the SIPC Act[123] and was not liable for assessments. The firm also performed other functions, none of which required broker-dealer registration, that went beyond the statutory exceptions. SIPC argued that once the firm registered as a broker-dealer, it became a SIPC member by virtue of its other activities that are not among the specific exceptions and thus could be assessed for the non-exempt activities. The Court of Appeals for the First Circuit disagreed and affirmed the decision of the District Court that the broker-dealer was not a SIPC member because all of its activity as a broker-dealer was statutorily exempted.

In *SIPC v. Executive Securities Corporation*,[124] a broker-dealer and an educational institution had lent securities to the broker-dealer in exchange for full cash collateral. When the latter firm became insolvent, the lenders sought to recover losses by claiming customer status under the SIPC Act. The Court of Appeals for the Second Circuit, affirming the orders of the bankruptcy court and the District Court below, held that the broker-dealer and the institution maintained neither investment nor trading accounts with the debtor and, therefore, were not within the class of investors or traders entitled to protection as "customers" under the SIPC Act.

In *Stock Clearing Corporation v. Weis Securities*,[125] SCC, a subsidiary of the NYSE, sought to reclaim securities which it had delivered to the debtor in exchange for an uncertified check on the debtor's bank account which had been frozen upon initiation of the debtor's liquidation. SIPC instituted the proceeding a few hours after the securities were delivered. Shortly thereafter, SCC, having been informed that the account was frozen, accepted the check, which later was returned for insufficient funds to SCC. SCC argued that the securities had been delivered to the debtor on the condition that they would be paid for in cash and that the debtor's failure to fulfill the condition precluded the securities from passing into the debtor's estate. The Court of Appeals for the Second Circuit, affirming the lower court decision, held that since SCC had knowingly accepted an uncertified check on a frozen bank account it had effectively relied on the debtor's credit since there was reason to believe the check could not be converted into cash immediately. Accordingly, the

court held, SCC could not reclaim the securities.

By-Law Proposals Submitted by SIPC to the Commission

In July 1977, SIPC submitted a proposed by-law change to repeal Section 5 of Article 3 of the SIPC by-laws, which required the Board of Directors to meet at least once each quarter.[126] The proposal was approved by the Commission on August 31, 1977.

EXEMPTIONS

The Commission granted various exemptions from provisions of the Exchange Act during the fiscal year. On November 11, 1976, the Commission adopted Rule 15a-5, which provides an exemption from the Act's broker-dealer registration requirement for non-bank lenders participating in the guaranteed loan program of the Small Business Administration.[127]

Exchange Act Rule 10b–6 imposes certain prohibitions upon trading in securities by persons interested in a distribution of such securities. During the fiscal year, the Commission granted approximately 300 exemptions under paragraph (f) of Rule 10b–6 under circumstances indicating that the transactions did not appear to constitute manipulative or deceptive devices or contrivances within the meaning of the Exchange Act.

One application pursuant to Section 15B(a) (4) for exemption from the municipal securities dealer registration requirements and the rules and regulations applicable to municipal securities dealers was received by the Commission and granted as consistent with the public interest, the protection of investors, and the purposes of Section 15B.

Other applications for exemption from the provision of the Exchange Act are discussed elsewhere in this Annual Report, in connection with the individual provisions pertinent to those applications.

NOTES TO PART 3

[1]Act of June 4, 1975, Pub. L. No. 94-29, 89 Stat. 97.

[2]42nd Annual Report at 77–78.

[3]Section 5 of the Exchange Act requires exchanges to register with the Commission as national securities exchanges or to seek an exemption from such registration. Exemptions may be granted in cases where the volume of transactions effected on the exchange is limited.

[4]*See Ecological Science Corp.*, Securities Exchange Act Release No. 10217 (June 13, 1973), 1 SEC Docket 5, and cases cited therein. *See also Clary Corp.*, Securities Exchange Act Release No. 11751 (October 20, 1975), 8 SEC Docket 196; *BBI, Inc.*, Securities Exchange Act Release No. 11686 (September 26, 1975), 7 SEC Docket 978. There were not any contested delistings during fiscal year 1977.

[5]In addition, an application by the Amex to strike the stock of University Savings Association was granted by the Federal Home Loan Bank Board, pursuant to its authority under Section 12(i) of the Exchange Act.

[6]*See* S. Rep. No. 75, 94th Cong., 1st Sess. 106 (1975); H. Conf. Rep. No. 229, 94th Cong., 1st Sess. 95 (1975).

[7]*See* Part 1, *supra* at p. 15 for a discussion of PSE's application for unlisted trading privileges. On February 7, 1977, the Phlx submitted an application for unlisted trading in four securities not listed on any exchange: American Greetings Corporation, Combined Insurance Company of America, Kearney and Trecker Corporation and Pennzoil Off-Shore Gas Operators. That application, however, was subsequently withdrawn by the Phlx.

[8]42nd Annual Report at 78–79.

[9]BSE, Administrative Proceeding File No. 3-4646 (May 6, 1976).

[10]Application for Unlisted Trading Privileges in Common Stock of Ludlow Corp. by the BSE, File No. 7–4596 (filed April 23, 1974).

[11]Securities Exchange Act Release No. 13359 (March 11, 1977).

[12]Petition for Review, United States Court of Appeals for the District of Columbia Docket No. 77–1417, filed May 4, 1977.

[13]This requirement applies to the rules of exchanges as well as rules of the National Association of Securities Dealers, Inc. (NASD), clearing agencies and the MSRB.

[14]42nd Annual Report at 79.

[15]Part 1, *supra* at p. 27.

[16]On December 13, 1977, a group of board brokers on the CBOE filed a notice of appeal in the United States Court of Appeals for the Seventh Circuit challenging

the Commission's approval order (Carey et al v. SEC, No. 77–1704). The litigation was pending as of the end of the year.

[17]The proposed rule changes did not involve any changes in the substantive standards governing member advertising.

[18]Securities Exchange Act Release No. 13238 (February 2, 1977), 11 SEC Docket 1633.

[19]The Commission's concern over the handling of percentage orders arose from inspections that indicated that the NYSE did not have adequate procedures, including recordkeeping, to prevent specialists from handling percentage orders on a discretionary basis in violation of Section 11(b) of the Act.

[20]The staff noted that, since SPEQ grades are the primary allocation criteria, it would be difficult for a new specialist unit, although possessing adequate capital and qualified personnel, to compete with established units for the allocation of stocks which become listed on the NYSE.

[21]The scope of this inspection did not extend to the MSE options program.

[22]Litigation Release No. 7843 (March 23, 1977), 11 SEC Docket 2146.

[23]Securities Exchange Act Release No. 13651 (June 20, 1977), 12 SEC Docket 925.

[24]The Amex commenced put option trading under a strictly limited and carefully controlled pilot program on June 3, 1977. Securities Exchange Act Release No. 13592 (June 2, 1977), 12 SEC Docket 692.

[25]By executing a transaction at the close of business which moves the price of an option up or down, a member could alter his daily margin requirement for his positions in that option.

[26]This lack of an "audit trail" resulted because, under procedures then in effect, Amex personnel reported the terms of trades without requiring written indicia thereof from the parties to the trade.

[27]Each Options Exchange has established uniform maximum limits on the size of positions in a particular option class which may be held by a member or member's customer, acting either alone or in concert with others. *See, e.g.*, Amex Rule 904.

[28]*See* Part 1, *supra* at p. 14, concerning the imposition of a moratorium on the expansion of options programs.

[29]The Commission has, however, been concerned that the CBOE and other options exchanges have apparently not organized any comprehensive enforcement efforts to develop and pursue cases in this area. At the end of the fiscal year, this subject was being considered in connection with the Commission's review and investigation of the standardized options markets. See discussion, *supra* at p. 15.

[30]The CBOE commenced put option trading under a strictly limited and carefully controlled pilot program on June 3, 1977. Securities Exchange Act Release No. 13587 (June 2, 1977), 12 SEC Docket 690.

[31]As discussed in Part 1, *supra* at p. 15, the Commission has instituted an investigation and study of standardized options trading. Securities Exchange Act Release No. 14056 (October 7, 1977), 13 SEC Docket 366.

[32]For example, since the Commission's last inspection, the CBOE had developed a minimum attendance standard for market makers and had instituted a program whereby it now receives comments upon the performance of each market participant (including market makers, floor brokers and board brokers) from other CBOE floor members who have daily contact with them.

[33]As discussed at p. 13, *supra*, the MSE began listing standardized call options on December 10, 1976. Securities Exchange Act Release No. 13045 (December 8, 1976), 11 SEC Docket 1120.

[34]As the fiscal year ended, the Commission was, however, studying a number of problems related to surveillance of options markets which were not limited to any one exchange. *See* discussion in Part 1, *supra* at p. 15.

[35]Article XLVII, Rule 6, of the MSE rules provides that markets makers' option transactions on the MSE should constitute a course of business reasonably calculated to contribute to the maintenance of a fair and orderly market. In order to monitor and enforce compliance with this rule, the MSE was developing minimum attendance standards for market makers, guidelines concerning percentages of trades which they may execute in certain option classes, and procedures to obtain input from other floor participants concerning market maker performance.

[36]These requirements are set forth in Article XLI, Rules 3 and 4, of the MSE rules.

[37]At the time of the inspection, the Commission had pending before it a rule proposal by the PSE to expand from 30 to 50 the maximum number of stocks on which call options could be listed. The PSE subsequently filed another rule proposal to extend this maximum number to 80 classes. In connection with its investigation and study of standardized trading (discussed in Part 1, *supra* at p. 15), the Commission commenced disapproval proceedings with respect to these proposals. Securities Exchange Act Release No. 14057 (October 17, 1977), 13 SEC Docket 375.

[38]The PSE commenced put option trading under a strictly limited and carefully controlled pilot program on June 3, 1977. Securities Exchange Act Release No. 13589 (June 2, 1977), 12 SEC Docket 691.

[39]42nd Annual Report at 17–18.

[40]One such area involved the use by exchange members who are members of The Options Clearing Corporation (OCC) of the OCC Adjusted Trade Report. This report is used by clearing members to make changes in their accounts with OCC to permit correction of errors after the final clearing process is completed. However, because review of this report was not incorporated into the exchange surveillance programs, the Commission has become concerned that clearing members might employ this report to abuse the trade adjustment process. As the fiscal year ended, the Commission was evaluating this problem in connection with its investigation and study of standardized options markets. *See* discussion in Part 1, *supra* at p. 15.

[41]Those registered broker-dealers which are not NASD members are referred to as SECO broker-dealers (the term "SECO" being an acronym standing for SEC Only).

[42]Securities Exchange Act Release No. 13162 (January 13, 1977), 11 SEC Docket 1448.

[43]*See* the sections entitled "Regulation of the Options Markets" and "Options Morotorium" in Part 1, *supra* at p. 12–15, for a discussion of subsequent developments in this area.

[44]This proposed rule change became effective concurrent with the Commission's order granting registration to the NSCC and the NSCC's implementation of the terms, conditions and directives contained in that order. Securities Exchange Act Release No. 13163 (January 13, 1977), 7 SEC Docket 1448.

[45]Securities Exchange Act Release No. 13860 (August 15, 1977), 12 SEC Docket 1526.

[46]Securities Exchange Act Rules 19d–1, 19d–2, 19d–3 and 19h–1 set forth the form and content for such notices. *See* Part 1, *supra* at p. 21.

[47]Securities Exchange Act Release No. 12944 (November 2, 1976), 10 SEC Docket 847.

[48]Securities Exchange Act Release No. 13996 (September 27, 1977), 13 SEC Docket 231.

[49]Securities Exchange Act Release No. 12872 (October 6, 1976), 10 SEC Docket 663.

[50]NASD Mark-up Policy Interpretation, Article III, Section 4, NASD Manual (CCH) para. 2154 (April 21, 1977).

[51]Securities Exchange Act Release No. 12898 (October 15, 1976), 10 SEC Docket 722.

[52]*Petition for review denied, F. K. Kerpen & Co., v. SEC*, 559 F.2d 1203 (2d Cir. 1977).

[53]Under Section 19(b) of the Exchange Act and Rule 19b–4 thereunder, self-regulatory organizations are required to file with the Commission any proposed rule change and a concise general statement of the basis and purpose of such proposed rule change. The Commission must then publish notice of the proposed rule change together with either the terms of such change or a description of the subjects and issues involved and must give parties an opportunity to submit their views. Most proposed rule changes may not take effect unless approved by the Commission; however, certain rule changes, including those establishing or changing fees, dues or other charges, imposed by a self-regulatory organization or rules concerned soley with the administration of the self-regulatory organization, may become effective without Commission review, subject to the power of the Commission under Section 19(b)(3)(C) to abrogate such rule changes.

[54]Securities Exchange Act Release No. 12949 (November 3, 1976), 10 SEC Docket 850; Securities Exchange Act Release No. 13274 (February 16, 1977), 11 SEC Docket 1747; Securities Exchange Act Release No. 13905 (August 31, 1977), 12 SEC Docket 1636; Securities Exchange Act Release No. 14038 (October 7, 1977), 13 SEC Docket 307.

[55]Securities Exchange Act Release No. 13942 (September 9, 1977), 13 SEC Docket 60.

[56]Securities Exchange Act Release No. 13939 (September 8, 1977), 13 SEC Docket 26.

[57]42nd Annual Report at 98.

[58]Separate revenue and expense figures are included in Table 10 for American Stock Exchange Clearing Corporation (ASECC), National Clearing Corporation (NCC), Stock Clearing Corporation (SCC). In January 1977, the Commission granted registration to the NSCC an entity formed to combine the operations conducted by ASECC, NCC and SCC. On September 24, 1976, the Commission granted registration to the New England Securities Depository Trust Company (NESDTC). *See* p. 22, *supra*. The Commission expects to conclude the NSCC and NESDTC revenue and expense figures in its Annual Report for fiscal year 1978.

[59]The difference in the reported revenue figures for clearing and depository services and fees in Table 8 and 10, result from the following factors: (1) clearing agencies which are not affiliated with other self-regulatory organizations are not included in Table 8; (2) the periods covered in Table 8 are on a calendar year basis while the periods in Table 10 are on the clearing agencies fiscal year basis; and (3) the reporting entities may not use the same classifications in reporting revenue items.

[60]That fee amounted to 0.005 percent for all sales prior to November 1, 1976; 0.003 percent for all sales from November 1,

1976 through June 30, 1977; and 0.002 percent for all sales from July 1, 1977 through October 31, 1977. Effective November 1, 1977, the fee was reduced to 0.001 percent.

[61]As a general matter, the issuer would not be deemed to be in the business of effecting transactions in securities for the account of others as a broker, or buying and selling securities for its own account as a dealer. Section 3(a)(5) of the Exchange Act defines the term "dealer" to mean "any person engaged in the business of buying and selling securities for its own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business."

[62]Securities Exchange Act Release No. 13195 (January 21, 1977), 11 SEC Docket 1552.

[63]Securities Exchange Act Release No. 12967 (November 11, 1976), 10 SEC Docket 904.

[64]Securities Exchange Act Release No. 11497 (June 26, 1975), 7 SEC Docket 241.

[65]Securities Exchange Act Release No. 11854 (November 20, 1975), 8 SEC Docket 459. While many of these temporary amendments expired, the Commission extended until March 1, 1978, a number of amendments relating to certain receivables and undue concentrations in municipal securities. Securities Exchange Act Release No. 12482 (May 26, 1976), 9 SEC Docket 722; Securities Exchange Act Release No. 13113 (December 28, 1976), 11 SEC Docket 1322; Securities Exchange Act Release No. 13488 (April 29, 1977), 12 SEC Docket 285; and Securities Exchange Act Release No. 13806 (July 28, 1977), 12 SEC Docket 1381.

[66]As amended, Exchange Act Rule 15c3-1(f)(1)(a) permits brokers and dealers effecting transactions solely in municipal securities to operate under the alternative method while maintaining net capital at least equal to the greater of $25,000 (rather than $100,000 as required of other brokers and dealers) or 4 percent of aggregate debit items computed under a reserve formula, 17 CFR 240.15c3-3a (1976). Smaller municipal securities firms would have experienced substantial difficulty in maintaining the $100,000 of net capital otherwise required by Rule 15c3-1(f)(1)(a).

[67]Securities Exchange Act Release No. 13806 (July 28, 1977), 12 SEC Docket 1381.

[68]In determining the value of its assets for purposes of computing its net capital, a broker or dealer must reduce the value of securities held for its own account by prescribed amounts (commonly known as "haircuts"), which are calibrated on the basis of the volatility and marketability of the securities.

[69]Securities Exchange Act Release No. 13125 (December 20, 1976), 11 SEC Docket 1353.

[70]Securities Exchange Act Release No. 13635 (June 16, 1977), 12 SEC Docket 850.

[71]Securities Exchange Act Release No. 13565 (May 23, 1977), 12 SEC Docket 463.

[72]Securities Exchange Act Release No. 12766 (September 2, 1976), 10 SEC Docket 362.

[73]Securities Exchange Act Release No. 12766 (September 2, 1976), 10 SEC Docket 362.

[74]Securities Exchange Act Release No. 13623 (June 13, 1977), 12 SEC Docket 823.

[75]Securities Exchange Act Release No. 13296 (February 24, 1977), 11 SEC Docket 1833.

[76]Securities Exchange Act Release No. 13831 (August 5, 1977), 12 SEC Docket 1456.

[77]Securities Exchange Act Release No. 13280 (February 18, 1977), 11 SEC Docket 1804.

[78]*See* Part 1, *supra* at p. 29.

[79]Securities Exchange Act Release No. 13462 (April 22, 1977), 12 SEC Docket 156.

[80]Securities Exchange Act Release No. 13962 (September 15, 1977), 13 SEC Docket 71.

[81]15 U.S.C. 78aaa (1970).

[82]Securities Exchange Act Release No. 11935 (December 17, 1975), 8 SEC Docket 808. 42nd Annual Report at 12-14.

[83]The FOCUS reporting system serves multiple purposes, including surveillance of a broker's or dealer's financial and operational condition, annual review of its activity, transmission of relevant data to customers, and collection of economic and statistical information. It consists of the following parts: (1) a monthly filing by brokers and dealers which carry or clear customers' accounts (Part I); (2) quarterly filing by brokers and dealers which carry or clear customer accounts (Part II), and by brokers and dealers which introduce their accounts on a fully disclosed basis to another broker or dealer (Part IIA, an abbreviated version of Part II); and (3) an audited annual report (Part III). 42nd Annual Report at 12-14.

[84]Securities Exchange Act Release No. 13462 (April 22, 1977), 12 SEC Docket 156.

[85]Securities Exchange Act Release No. 13461 (April 22, 1977), 12 SEC Docket 86. Part II would otherwise require that this information be submitted on a quarterly basis.

[86]Securities Exchange Act Release No.

13713 (July 1, 1977), 12 SEC Docket 1108.

[87]Securities Exchange Act Release No. 12352 (April 20, 1976), 9 SEC Docket 450. 42nd Annual Report at 92.

[88]The examination includes, among other things, a physical inspection of the broker or dealer's books and records and supporting materials and a review of the firm's sales practices.

[89]It may be noted that the self-regulatory organizations have similarly developed and updated their examination manuals and checklists during the fiscal year.

[90]*See* 6 Securities Investor Protection Corp. Ann. Rep. (1976).

[91]In addition to inviting examiners employed by the self-regulatory organizations to certain of the Commission's training programs, the Commission also works with the self-regulatory organizations to improve their own training programs. The Commission periodically reviews the training efforts of the self-regulatory organizations which hold informal, bi-monthly training programs and more formal annual training sessions for their own examination staffs. In many instances, the Commission's examiners have been invited to attend or participate in such sessions.

[92]In general, Rule 15c3–1 prescribes a lower net capital requirement for firms which neither carry customers accounts nor hold customer funds and securities and for firms which conduct a limited securities business; these are generally smaller brokers and dealers. In addition, the net capital rule provides an "alternative net capital requirement," available at the election of qualified brokers and dealers, which adjusts net capital requirements.

[93]Securities Exchange Act Release No. 13806 (July 28, 1977), 12 SEC Docket 1381.

[94]42nd Annual Report at 96.

[95]Securities Exchange Act Release No. 13832 (August 25, 1977), 12 SEC Docket 1465.

[96]Securities Exchange Act Release No. 12214 (March 30, 1976), 9 SEC Docket 203.

[97]Securities Exchange Act Release No. 13105 (January 11, 1977), 11 SEC Docket 1311. As to persons entering the securities industry after July 1, 1976, the rule is effective immediately. Persons already employed by or associated with entities subject to the rule on that date were exempted until January 1, 1977. On December 23, 1976, the Commission adopted an amendment to Rule 17f–2 extending the January 1, 1977, deadline for fingerprinting the latter class of persons until January 1, 1978, on the condition that 25 percent of those persons required to be fingerprinted under the rule are in fact fingerprinted during each calendar quarter of 1977.

[98]Securities Exchange Act Release No. 13565 (May 23, 1977), 12 SEC Docket 463.

[99]Securities Exchange Act Release No. 13943 (September 9, 1977), 13 SEC Docket 63.

[100]The distinction between the levies on municipal and other OTC securities income has been made because the Commission is relieved of certain rulemaking functions as to SECO firms and associated persons by the MSRB. The MSRB has established fixed and variable fees to defray the costs of its regulatory activities in the municipal securities area which must be paid to that Board by firms engaging in that type of business.

[101]*See* discussion of the new transfer agent rules in Part 1, *supra* at

[102]As of September 30, 1977, the following twelve clearing agencies were registered with the Commission: Boston Stock Exchange Clearing Corporation; Bradford Securities Processing Services, Inc.; The Depository Trust Company; Midwest Clearing Corporation; Midwest Securities Trust Company; Options Clearing Corporation; National Securities Clearing Corporation; New England Securities Depository Trust Company; Stock Clearing Corporation of Philadelphia; Pacific Clearing Corporation; Pacific Securities Depository Trust Company; and TAD Depository Corporation.

[103]Securities Exchange Act Release No. 12857 (October 4, 1976), 10 SEC Docket 657.

[104]Securities Exchange Act Release No. 13428 (April 4, 1977), 11 SEC Docket 2191.

[105]Securities Exchange Act Release No. 13709 (June 30, 1977), 12 SEC Docket 1102.

[106]Securities Exchange Act Release No. 13155 (January 12, 1977), 11 SEC Docket 1424.

[107]Securities Exchange Act Release No. 12642 (July 19, 1976), 10 SEC Docket 1142.

[108]Securities Exchange Act Release No. 12749 (August 31, 1976), 10 SEC Docket 325.

[109]Securities Exchange Act Release No. 12788 (September 13, 1976), 10 SEC Docket 457; Securities Exchange Act Release No. 12789 (September 13, 1976), 10 SEC Docket 457.

[110]Securities Exchange Act Release No. 13456 (April 21, 1977), 12 SEC Docket 42.

[111]*Id.*

[112]*Bradford National Clearing Corporation v. SEC*, No. 77–1547 (C.A.D.C.).

[113]Securities Exchange Act Release No. 13378 (March 16, 1977), 11 SEC Docket 2005.

[114]Securities Exchange Act Release No. 13378 (March 16, 1977), 11 SEC Docket

2004; Securities Exchange Act Release No. 13934 (September 6, 1977), 13 SEC Docket 25.

[115]Securities Exchange Act Release No. 13467 (April 25, 1977), 12 SEC Docket 185; Securities Exchange Act Release No. 13530 (May 11, 1977), 12 SEC Docket 383; Securities Exchange Act Release No. 13800 (July 25, 1977), 12 SEC Docket 1377.

[116]Securities Exchange Act Release No. 13466 (April 25, 1977), 12 SEC Docket 184; Securities Exchange Act Release No. 13600 (June 6, 1977), 12 SEC Docket 768.

[117]Securities Exchange Act Release No. 13277 (February 17, 1977), 11 SEC Docket 1748.

[118]Securities Exchange Act Release No. 13714 (July 1, 1977), 12 SEC Docket 1109.

[119]Securities Exchange Act Release No. 12961 (November 8, 1976), 10 SEC Docket 902.

[120]Securities Exchange Act Release No. 12915 (October 21, 1976), 10 SEC Docket 782; Securities Exchange Act Release No. 13511 (May 6, 1977), 12 SEC Docket 362; Securities Exchange Act Release No. 13876 (August 19, 1977), 12 SEC Docket 1567.

[121]Excluded from membership are brokers and dealers whose business consists exclusively of (1) the distribution of shares of mutual funds, (2) the sale of variable annuities, (3) the business of insurance, or (4) the business of rendering investment advisory services to certain investment companies or insurance company separate accounts.

[122]545 F.2d 754 (1st Cir. 1976), *cert. denied*, 97 S. Ct. 1696 (1977).

[123]Section 3(a) (2) exempts from membership in SIPC persons "whose business as a broker or dealer consists exclusively of (i) the distribution of shares of registered open end investment companies or unit investment trusts...."

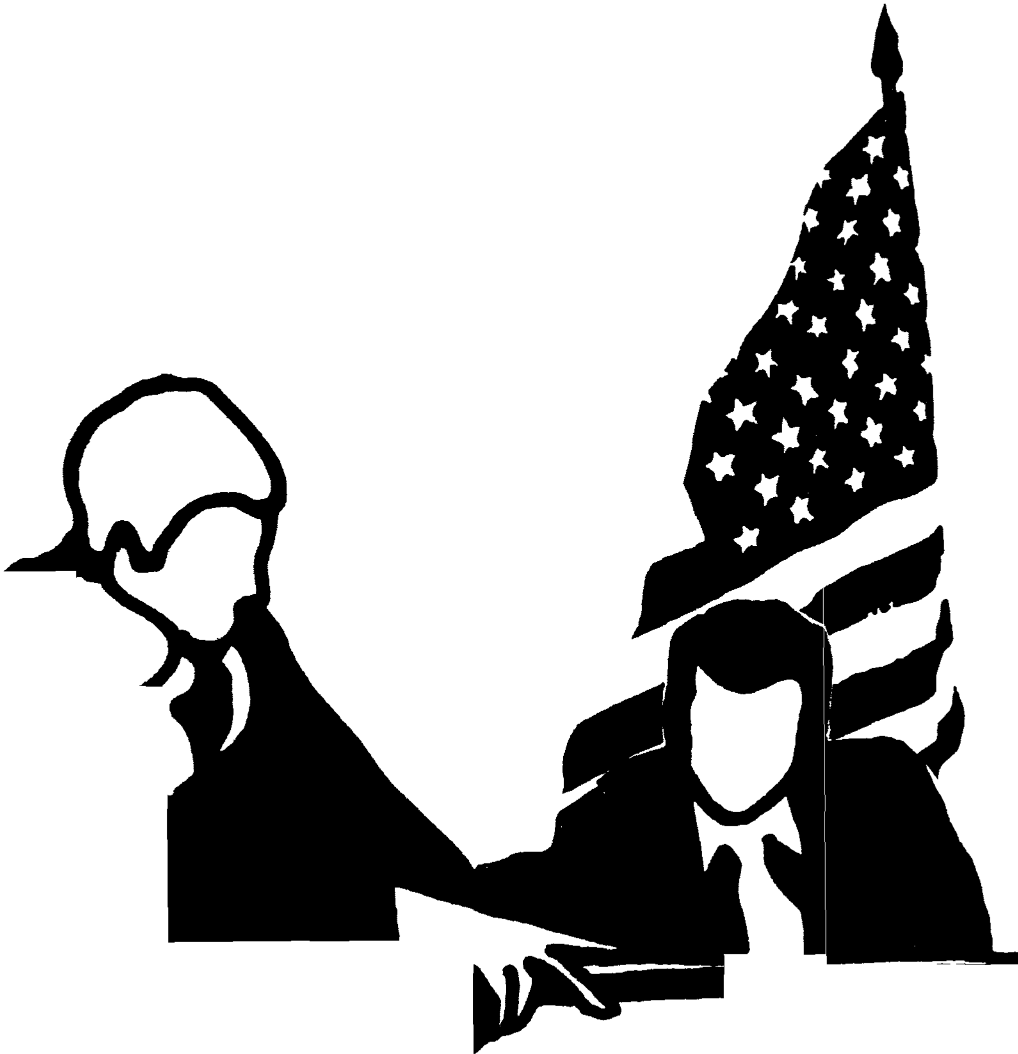
[124]556 F.2d 98 (2nd Cir. 1977).

[125]542 F.2d 840 (2d Cir. 1976).

[126]Section 3(d) of the SIPC Act provides that the Board of Directors meet at the call of the Chairman. In addition, Section 6 of Article 3 of the by-laws permits a special meeting to be called by the Vice Chairman or at the request of three directors.

[127]*See* discussion, *supra* at p. 148.

Part 4
Enforcement



Part 4
Enforcement

The Commission's enforcement activities, which are designed to combat securities fraud and other illegal conduct, continued at a high level during the past year. These activities encompass civil and criminal court actions, as well as administrative proceedings. Where violations of the securities laws are established, the sanctions which may result range from censure by the Commission to prison sentences imposed by a court.

The enforcement program is designed to achieve as broad a regulatory impact as possible within the framework of resources available to the Commission. In view of the capability of self-regulatory and state and local agencies to deal effectively with certain securities violations, the Commission seeks to promote effective coordination and cooperation between its own enforcement activities and those of other agencies.

DETECTION

Complaints

The Commission receives a large volume of communications from the public. These consist mainly of requests for information and complaints against broker-dealers and other members of the securities community as well as complaints concerning the market price of particular securities. During the past year, approximately 4,000 complaints against broker-dealers were received, analyzed and answered. Most of these complaints dealt with operational problems, such as the failure to deliver securities or funds promptly, or the alleged mishandling of accounts. In addition, there were about 9,100 complaints received concerning investment advisers, issuers, banks, transfer agents, mutual funds or similar matters.

The Commission seeks to assist persons in resolving complaints and to furnish requested information. Thousands of investor complaints are resolved through staff inquiries of the firms involved. While the Commission does not itself maintain an arbitration program to resolve disputes between brokerage firms and investors,[1] a complaint may lead to the institution of an investigation or an enforcement proceeding, or it may be referred to a self-regulatory or local enforcement agency.

Market Surveillance

The Commission's staff has devised procedures to identify possible violative activities in the securities markets through surveillance of listed securities. This program is coordinated with the market surveillance operations of the New York, American and

regional stock exchanges, as well as the various options exchanges.

In this regard, the Commission's market surveillance staff maintains a continuous watch of transactions on the stock and options exchanges and reviews reports of large block transactions to detect any unusual price and volume variations. It also monitors financial news tickers, financial publications and statistical services. In addition, the staff has supplemented its regular reviews by receiving daily and periodic market surveillance reports from the exchanges and the NASD which provide in-depth analysis of information developed by them. To augment its surveillance capabilities, the staff is using various data processing services so that irregular trading activity will be promptly detected and effectively investigated.

For those securities traded by means of the NASDAQ system, the Commission has also developed a surveillance program, which is coordinated with the NASD's market surveillance program, through a review of weekly and special stock watch reports.

For those over-the-counter securities not traded through NASDAQ, the Commission uses automated equipment to provide an efficient and comprehensive surveillance of stock quotations distributed by the National Quotation Bureau. This is programmed to identify, among other things, unlisted securities whose price movement or dealer interest varies beyond specified limits in a pre-established time period. When a security is so identified, the equipment prints out current and historic market information. Other programs supplement this data with information concerning sales of securities pursuant to Rule 144 under the Securities Act, ownership reports, and periodic company filings such as quarterly and annual reports. These data, combined with other available information, are analyzed for possible further inquiry and enforcement action.

The staff also oversees tender offers, exchange offers, proxy contests and other activities involving efforts to change control of public corporations. Such oversight includes review not only of trading markets in the securities involved, but also, of filings with the Commission of required schedules, prospectuses, proxy material and other information.

TRADING SUSPENSIONS

The Exchange Act authorizes the Commission summarily to suspend trading in a security traded either on a national securities exchange or in the over-the-counter market for a period of up to ten days if, in the Commission's opinion, such action is in the public interest.

During fiscal 1977, the Commission suspended trading in the securities of 111 companies, compared with 126 companies in fiscal 1976 and 113 companies in fiscal 1975. In most instances the trading suspension was ordered because of a delinquency in filing required reports with the Commission, substantial questions as to the adequacy, accuracy or availability of public information concerning the company's financial condition or business operations, or because of transactions in the company's securities suggesting possible manipulation or other violations.

Of the 111 companies whose securities were the subject of trading suspensions in fiscal 1977, 25 were related to the Penn Central Transportation Company (Penn Central). On December 13, 1976, the Commission suspended trading in the securities of Penn Central, Penn Central Company (Penn Central's parent) and

the securities of 23 of its leased lines companies and other affiliates at the request of the companies pending announcement by Penn Central of its proposed plan of reorganization.

On May 4, 1977, the Commission again suspended trading in the securities of Penn Central, Penn Central Company, and the securities of 28 other companies affected by the plan at the request of these companies' pending announcement by Penn Central of certain amendments to its proposed plan of reorganization.

ENFORCEMENT PROCEEDINGS

The Commission has available a wide range of possible enforcement remedies. It may, in appropriate cases, refer its files to the Department of Justice with a recommendation for criminal prosecution. The penalties upon conviction are specified in the various statutes and include imprisonment for substantial terms as well as fines.

The securities laws also authorize the Commission to file injunctive actions in the Federal district courts to enjoin continued or threatened violations of those laws and applicable Commission rules. In injunctive actions, the Commission frequently has sought to obtain other equitable relief under the general equity powers of the Federal district courts. The power of the Federal courts to grant such relief has been judicially recognized. The Commission often has requested the court to appoint a receiver for a business where investors were likely to be harmed by continuance of the existing management. It also has requested court orders which, among other things, restrict future activities of the defendants, require that rescission be offered to securities purchasers, or require disgorgement of the defendants' ill-gotten gains.

The Commission's primary function is to protect the public from fraudulent and other unlawful practices and not to obtain damages for injured individuals. Thus, a request that disgorgement be required is predicated on the need to deprive defendants of profits derived from their unlawful conduct and to protect the public by deterring such conduct by others.

If the terms of any injunctive decree are violated, criminal contempt proceedings may be filed as a result of which the violator may be fined or imprisoned.

The Federal securities acts also authorize the Commission to impose remedial administrative sanctions. Administrative enforcement proceedings involve alleged violations of the securities acts or regulations by firms or persons engaged in the securities business. Generally speaking, if the Commission finds that a respondent willfully violated a provision of or rule under the securities acts, failed reasonably to supervise another person who committed a violation, or has been convicted of or enjoined from certain types of misconduct, and that a sanction is in the public interest, it may revoke or suspend the registration of a broker-dealer or investment adviser, bar or suspend an individual from the securities business or from association with an investment company, or censure a firm or individual. Proceedings may also cover adequacy of disclosure in a registration statement or in reports filed with the Commission. Such a case may lead to an order suspending the effectiveness of a registration statement or directing compliance with reporting requirements. The Commission also has the power to suspend

trading summarily in a security when the public interest requires.

INVESTIGATIONS

Each of the acts administered by the Commission authorizes investigations to determine if violations have occurred. Most of these are conducted by the Commission's regional offices. Investigations are normally carried out on a confidential basis, consistent with effective law enforcement and the need to protect persons against whom unfounded charges might be made. Thus, the existence or results of a nonpublic investigation are generally not divulged unless they are made a matter of public record in proceedings brought before the Commission or in the courts. During the fiscal year 1976, a total of 400 investigations were opened, as against 413 in the preceding year.

ADMINISTRATIVE PROCEEDINGS

Summarized below are some of the administrative proceedings which were instituted or concluded in the fiscal period.

In the Matter of Plotkin, Yolles, Siegel & Turner[2]—The Commission instituted administrative proceedings under Rule 2(e) of its Rules of Practice against the Michigan law firm of Plotkin, Yolles, Siegel & Turner and three of its individual partners, Marcus Plotkin, Murray Yolles and Robert W. Siegel. On accepting offers of settlement from the respondents, the Commission censured the law firm and accepted the resignations of the three individual partners from appearance or practice before the Commission, provided that after eighteen months, they may apply to the Commission for reinstatement. In addition, the three partners were ordered to consult with competent securities counsel in connection with the preparation of any documents that may reasonably be expected to be delivered to public investors, until such time as these respondents demonstrate to the satisfaction of the Commission that they are familiar with the disclosure provisions of the securities laws.

On the basis of the Commission's order for private proceedings, to which the respondents consented without admitting or denying the allegations, the Commission found that respondents had been retained by an issuer of securities to advise prospective investors as to tax consequences of investing in oil and gas leases. The respondents did counsel and advise client-investors about these investments, and in some cases favorably recommended the investments and distributed documents concerning such investments to some of the clients. The respondents received payments from the issuers of such securities based, at least in part, on the fact of, or on the amount of, monies invested by clients of the law firm; which payments may not have been disclosed to some of the client-investors. In addition, the respondents failed to reveal to client-investors that two of the partners in the law firm owned common stock in one of the issuers of such securities. Under the circumstances, the Commission found that the respondents did not possess the requisite qualifications to represent others before the Commission.

In the Matter of Revere Management Company, Inc. et al. — On January 5, 1977, an order for public administrative proceedings was entered by the Commission for the purpose of hearing evidence on allegations of violations of the antifraud provisions of the Federal securities laws by Revere Management Co., Inc. (Management), a broker-dealer registered with the Commission and located in Philadelphia, Pennsylvania, William M. Hess (Hess) of

Philadelphia, Pennsylvania, president and director of Revere Fund, Inc. (Revere), an open-end, diversified investment company registered with the Commission pursuant to Section 8(a) of the Investment Company Act of 1940; American Fund Services, Ltd. (AFS), a broker-dealer located in Dusseldorf, Germany; and Albert Kuhn (Kuhn), a German national who was the principal operator of AFS.[3] Management has been the principal underwriter for Revere since its inception in 1959. Kuhn, as Revere's "exclusive representative," distributed shares of Revere throughout Germany from 1967 through 1969; from 1969 through 1974 Kuhn was Management's "general representative" in Germany.

In December 1975, Kuhn was found by a German court to have converted, from 1972 continuing into 1974, redemption checks from 37 Revere shareholders totalling approximately $239,000. In the Commission's order for proceeding, it was alleged that from June 1972 through December 1973, Management, Hess, Kuhn and AFS willfully violated and willfully aided and abetted violations of Section 10(b) (the antifraud provisions) of the Exchange Act of 1934 and Rule 10b-5 thereunder in redeeming and effecting transactions in the redeemable shares of Revere. In this regard, the order for proceedings alleged, among other things, that the respondents generally engaged in acts, practices, and a course of conduct that operated as a fraud and deceit upon shareholders in connection with (1) the redemption procedures employed by Revere, (2) the failure of the Revere shareholders to receive their redemption proceeds, and (3) the processing of improperly guaranteed redemption requests.

A public hearing on the alleged violations was held in Philadelphia, Pennsylvania, on April 12–15, 1977, and May 2–6, 1977, before Administrative Law Judge Ralph Hunter Tracy. Decision had not yet been entered at the end of the fiscal year.

In the Matter of Touche Ross & Company, et al. — On September 2, 1976, the Commission ordered the institution of a public administrative proceeding under Rule 2(e) of the Commission's Rules of Practice against Touche Ross & Co., and three auditors of the firm.[4]

The charges involved in the proceeding stem from Touche's examination of an Annual Report on the financial statements of Giant Stores Corp. (Giant) for the fiscal year ended January 29, 1972, and of Ampex Corporation (Ampex) for the fiscal year ended May 1, 1971.

The order alleged that Touche's April 18, 1972, report on the Giant financial statements and its June 21, 1971 report on the Ampex financial statements, were materially false and misleading as to its statements that Touche's examination was made in accordance with generally accepted auditing standards and accordingly, included such tests of the accounting records and such other auditing procedures as were considered necessary under the circumstances. In addition it was charged that Touche did not have a reasonable basis for opining, as it did, that the financial statements of Giant and Ampex as of January 29, 1972, and May 1, 1971, respectively, fairly presented (1) the consolidated positions of Giant and Ampex and their subsidiaries; (2) the results of their operations; or (3) the changes in their financial position, all in conformity with generally accepted accounting principles.

The Order further alleged that Giant materially overstated net income in its financial statements and that the re-

spondents, in performing the examination of Giant's financial statements, failed to follow generally accepted auditing standards, permitted the use of accounting principles which were not in accordance with generally accepted accounting principles and did not have a reasonable basis for the expression of an unqualified opinion on Giant's financial statements.

Touche filed suit in the United States District Court for the Southern District of New York to enjoin the Commission's proceedings against it. In December, 1976, the Commission filed a motion to dismiss. This motion is now pending before the court.[5]

In the Matter of Investors Diversified Services, Inc., et al. — On July 19, 1977, the Commission ordered two public administrative proceedings under the Securities Exchange Act of 1934, the Investment Advisers Act of 1940 and the Investment Company Act of 1940 against William H. Langfield (Langfield), Investors Diversified Services., Inc., (IDS), 26 broker-dealers and 22 individuals employed by the broker-dealers.[6]

As alleged in the proceedings, the case stemmed from Langfield's personal trading activities during the period between 1971 and 1973 while he was employed as an over-the-counter (OTC) securities trader for IDS, which served as investment adviser to several registered investment companies (the IDS Funds). Langfield, during 1971–1973, executed approximately $1.8 billion in purchases and sales of OTC securities for the IDS Funds. Langfield had discretion to choose which OTC market-makers would receive orders to purchase or sell securities on behalf of the IDS Funds. The Commission's orders alleged that during the period from August 1969 to April 1974, Langfield was placing orders with OTC market-makers on behalf of the IDS Funds and negotiating trades and placing orders for his personal account directly with many of the same market-makers with whom he placed IDS Fund orders.

Although Langfield traded directly with the market-makers' personnel, the Commission's orders alleged that he did not maintain an account with each market-maker but, instead, had his personal transactions confirmed to another broker-dealer where he did maintain an account which he used exclusively to clear the trades he made with the market-makers with whom he also placed IDS Fund orders. The records of the market-makers reflected that Langfield's orders had been placed by the broker-dealer with whom Langfield maintained his personal account, when in fact Langfield negotiated and effected those trades directly with the market-makers.

According to the Commission's orders, from October 1970 to about April 1974, Langfield executed approximately 1,850 trades in OTC stocks for his personal account, 83 percent of which involved purchases and sales of the same securities within two days time or less. Langfield, who received a salary of about $25,000 from IDS, netted, in addition to his salary, in excess of $300,000 as a result of his trading with the various OTC market-makers for his personal account.

The Orders also alleged that certain of the market-makers and several of their employees gave Langfield preferential price treatment when he executed trades with them for his personal account. The alleged preferential treatment consisted of, among other things, giving Langfield: (1) direct access to the market-makers' trading personnel for personal trades; (2) the use of price and volume quotations that would only be given in some instances to preferred institutional cus-

tomers; and (3) prices on OTC securities which were inconsistent with and more advantageous than the prevailing market prices as represented by the market-makers' bid and ask quotations or which were inconsistent with other purchases and sales executed by those market-makers at the same time or immediately before or after Langfield's trade.

The Commission found that thirteen of the broker-dealer respondents involved wilfully violated the bookkeeping provisions of the Exchange Act and, with the consent of those respondents, ordered those broker-dealers to adopt and maintain new procedures to prevent any recurrence of this type of conduct in the future.[7] The Commission also found that IDS failed reasonably to supervise Langfield and that James Murray (Langfield's immediate supervisor at IDS for whose account Langfield also traded) wilfully violated the antifraud provisions of the Securities Act, Exchange Act and Investment Advisers Act, the section of the Investment Company Act forbidding agents from accepting outside compensation, and failed reasonably to supervise Langfield.[8] The Commission, upon consent, censured IDS and Murray and suspended Murray from being associated with a broker-dealer, investment adviser, or investment company or affiliate thereof for 45 days and from being associated in any supervisory capacity therewith for one year.

The Commission further found that Langfield wilfully violated and aided and abetted violations of the antifraud provisions of the Securities Act, Exchange Act and Investment Adviser's Act and violated the section of the Investment Company Act making it unlawful for agents of an investment company to accept outside compensation. Langfield, with his consent, was barred from association with any broker or dealer, investment adviser, investment company or affiliate thereof.

The Commission also found that ten of the broker-dealers and eight of their employees wilfully violated and/or aided and abetted violations of the antifraud provisions of the Securities Act and Exchange Act and that ten of the broker-dealers and nine of their employees failed reasonably to supervise persons who committed such violations. The Commission, with the consent of the subject respondents, ordered these respondents to adopt procedures designed to prevent a recurrence of this type of conduct and imposed various other sanctions ranging from censures to suspensions for periods of time up to 20 business days. In lieu of imposition of the ordered suspensions, the various broker-dealers agreed to pay amounts ranging from $10,000 to $40,000 each to the appropriate IDS investment companies for whom Langfield effected transactions.

The proceedings are still pending as to two broker-dealers and four employees or officers of broker-dealers.

In the Matter of Frank S. Arko, et al.[9]—The Commission instituted public administrative proceedings against Frank S. Arko, a Bellevue, Washington investment adviser, and William M. Mitchell, a salesman employed by a registered broker-dealer in Seattle, Washington. Arko's business involves mailing, nationally and internationally, a report in which he recommends investments in coins and valuable metals, and in securities of companies involved in mining such metals. The proceedings are based on allegations by the Commission that Arko, in violation of the Exchange Act and Advisers Act antifraud provisions, engaged in a prac-

tice commonly known as "scalping" with respect to securities of QC Explorations, Ltd. and Lion Mines, Ltd., Canadian corporations whose stock is traded on Vancouver, B. C. Exchange, and Galaxy Oil Company, a Texas corporation whose stock is traded in the over-the-counter market.

Specifically, it is alleged that Arko advanced information to Mitchell on recommendations to be made in the report prior to its distribution to Arko's subscribers and that Mitchell traded for his own account in QC Explorations, Lion and Galaxy securities based on this advance knowledge. Mitchell is alleged to have aided and abetted Arko by taking positions in these securities in his firm's trading account prior to the distribution of Arko's recommendation, then selling shares from the trading account to Arko's personal account. On occasion, Arko and Mitchell split the sale from the trading account to their personal accounts, then sold at the market for a substantial profit. Arko and Mitchell were previously enjoined by the U. S. District Court for the Western District of Washington from further violations of the Exchange Act and Advisers Act antifraud provisions for the same conduct alleged in the administrative proceeding.[10]

In the Matter of S. D. Leidesdorf & Co. et al. — On February 16, 1977, the Commission issued an Opinion and Order under Rule 2(e) of the Commission's Rules of Practice which set forth the findings of an investigation and imposed sanctions against S. D. Leidesdorf & Co. (Leidesdorf) and a partner and audit manager of that firm.[11] Leidesdorf and the individual respondents submitted offers of settlement in which they consented to the issuance of the Opinion and Order without admitting or denying any of the statements or conclusions set forth therein.

The Commission's Opinion focused upon Leidesdorf's examination of financial statements issued by Tidal Marine International Corporation (Tidal) in 1971 and 1972. The Commission found that those financial statements were materially false and misleading and that Leidesdorf and the individual respondents had failed to conduct their examinations in accordance with generally accepted auditing standards.

The Commission ordered Leidesdorf to submit to an examination by an outside committee of the manner in which the firm conducts its audit practice with respect to publicly held companies. The Commission also suspended Leidesdorf from accepting new Commission audit clients for a period of two months and ordered the firm to comply with certain undertakings set forth in its offer of settlement.

In the Matter of Seidman & Seidman, et al. — In September 1976, the Commission issued an Opinion and Order pursuant to Rule 2(e) of the Commission's Rules of Practice that set forth findings of four Commission investigations and imposed sanctions against Seidman & Seidman and certain partners and employees in connection with its combination of practices in February 1972 with the Los Angeles Office of Wolfson, Weiner, Ratoff & Lapin.[12]

The Commission's Opinion focused on the auditing deficiencies in Seidman & Seidman's examinations of the financial statements of three former Wolfson/Weiner clients—Equity Funding Corporation of America, Omni-Rx Health Systems and SaCom and certain of the audits of financial statements of Cenco, Inc.

The Commission found that the audits of the financial statements of Equity, Omni-Rx, SaCom and Cenco involved serious deficiencies in Seid-

man & Seidman's audit performance, review, supervision and, except with respect to Cenco, its professional independence. The Commission noted that the financial statements of these issuers were not prepared in conformity with generally accepted accounting principles and the audits were not conducted in accordance with generally accepted auditing standards as was represented by Seidman & Seidman in its reports.

Pursuant to an offer of settlement submitted by Seidman & Seidman, the Commission ordered implementation of certain measures to provide assurance of the quality of the firm's practice before the Commission including a comprehensive examination by an independent committee of Seidman & Seidman's audit practice and a subsequent review to determine whether reasonable recommendations of the independent committee have been implemented. The review has been completed, and a committee report has been filed with the Commission. Temporary restrictions were also placed on mergers and combinations of practice and on the acquisition of new clients involving filings with the Commission.

In the Matter of Laventhol & Horwath, et al. — In September 1977, the Commission issued an Opinion and Order pursuant to Rule 2(e) of the Commission's Rules of Practice that set forth findings of three Commission investigations and imposed sanctions against Laventhol & Horwath, (Laventhol) and three former partners of that firm.[13] Laventhol and the individual respondents submitted offers of settlement in which they consented to the issuance of the Opinion and Order and certain other relief without admitting or denying the Commission's allegations.

The Commission's Opinion focused on the auditing deficiencies in connection with Laventhol's examination of certain financial statements of Western Properties Limited Partnership, Co-Build Companies Inc., and Cosmopolitan Investors Funding Co. The Commission concluded that Laventhol failed to conduct these audits in accordance with generally accepted auditing standards.

As part of the Order, Laventhol agreed to submit to an examination of the manner in which it conducted its accounting practices with respect to publicly-held companies. The examination is to be made by an independent committee, and a report submitted to the Commission and disseminated to the public as a result of this examination. Laventhol also agreed not to accept new Commission audit clients for a period of 60 days beginning September 1, 1977.

In the Matter of Government Employees Insurance Company, et al.—On October 27, 1976, the Commission instituted proceedings pursuant to Sections 15(c) (4) and 21(a) of the Exchange Act as well as Findings of Fact and an Order of the Commission with respect to Government Employees Insurance Company (GEICO), Norman Lawrence Gidden (Gidden), formerly the chairman of GEICO's board of directors and Ralph Clark Peck (Peck), formerly president of GEICO.[14]

The respondents submitted offers of settlement and statements pursuant to Section 21(a) of the Exchange Act in which they, without admitting or denying the findings, consented to the Findings and Order of the Commission.

The Commission found with respect to GEICO that during 1975 the company filed quarterly reports with the Commission on Form 10-Q which failed in material respects to disclose its deteriorating financial condition, changes in the accounting

treatment of deferred acquisition costs and loss reserves, the effect of such changes on earnings and the uncertainty of the operating results which it did report due to these changes. Had such changes in accounting treatment not been undertaken, GEICO would have reported pretax losses for the first nine months of 1975 of $823 million instead of $50.7 million of pretax losses actually reported. The Commission also found that Peck and Gidden in their respective capacities as officers of GEICO failed in material respects to comply with the reporting provisions of Section 15 of the Exchange Act. In addition, the Commission found that Gidden sold 15, 045 shares of GEICO common stock in November 1975 while in possession of material non-public information concerning the deteriorating financial condition of the company.

The Commission ordered GEICO to comply fully with the provisions of the Exchange Act and accepted undertakings from GEICO contained in the company's offer of settlement to: accept the resignations of Peck and Gidden, maintain certain newly instituted procedures with respect to establishment of loss reserves and select a qualified individual for the board of directors. The Commission accepted the undertakings of Gidden and Peck to: comply with the provisions of the Exchange Act, terminate their employment relationships with GEICO and refrain from accepting employment as officers or directors of any publicly held company for three years. In addition, the Commission accepted an undertaking from Gidden to establish a $35,000 fund for the compensation of any party who may be judged by a court to have been damaged by his sale of GEICO stock in November 1975.

In the Matter of Hinkle Northwest, Inc., et al. — The Commission instituted public administrative proceedings against Hinkle Northwest, Inc. (Hinkle), a registered broker-dealer and investment adviser located in Portland, Oregon, its principals, Ernest Hinkle, Kenneth LaMear, and Dennis Reiter, and three salesmen, Bernard Molinari, Fred Hogg, and Patrick McGinnis.[15] The Commission alleged violations of the recordkeeping, net capital, and antifraud provisions of the Exchange Act in connection with Hinkle's purchase of U.S. treasury securities financed by repurchase agreements. Also named as a respondent in the proceedings is John Wied, formerly vice-president and treasurer of Benjamin Franklin Federal Savings and Loan Association (the Association), a Federally chartered savings and loan association in Portland, Oregon. In 1975, Wied facilitated Hinkle's purchase of $25 million of U.S. Treasury notes from First Pennco Securities and of $100 million of U.S. Treasury bills from Blyth Eastman Dillon Capital Markets, Inc. Both Pennco and Blyth relied upon the credit and credibility of the Association in executing the transactions.

Wied was recently found guilty in the United States District Court for the District of Oregon, in a 15 count indictment which alleged misapplication of the Association's assets, personal benefit from transactions of the Association, and making of false entries in the books and records of the Association relating to the Pennco and Blyth transactions.[16] In activities unrelated to the treasury transactions, Hinkle is alleged to have transmitted documents improperly offering for sale the securities of R. L. Burns Corporation, Pacific Power & Light Co., and Super-Valu Stores, Inc., to members of the public at a time when registration statements had not yet become effec-

tive with respect to such securities. Further, in April 1976, while trading was suspended in securities of Presley Companies, it is alleged that Hinkle mailed an article and business card inducing transactions in Presley securities in violation of Section 12(k) of the Exchange Act.

CIVIL PROCEEDINGS

During the fiscal year, the Commission instituted a total of 166 injunctive actions. Many Commission proceedings resulted in wide-ranging ancillary relief and remedies which the Commission sought according to the needs of the particular case. Such relief reflects the Commission's intent to carry out to the fullest extent its mandate to protect the public from future violations of the securities laws. Some of the more noteworthy proceedings and significant developments in actions instituted in earlier years are reflected below.

SEC v. Century Mortgage Company, Ltd. — This is a civil action filed in the United States District Court for the District of Utah, in which the complaint, in substance, alleged that the defendants violated the registration and antifraud provisions of the Federal securities laws in the offer and sale of notes, investment contracts and evidence of indebtedness of Century Mortgage Company, Ltd. (Century Mortgage) and Gateway Valley Estates, Inc. (Gateway).[17]

The complaint further alleged that the defendants made untrue statements of material facts, including, among others, that money obtained from the sale of securities would be used to purchase real estate instruments of conveyance and debt securities at discounts; that Century Mortgage could earn enough profits in its business operations to enable it to pay to persons purchasing its two-year notes an effective rate of annual interest of 16.23 percent on notes of $2,500 face value or more, and effective annual interest rates from 10.8 percent to 12.8 percent on notes of lesser face value; that contracts receivable (i.e., real estate contracts and debt securities) held by Century Mortgage were "fully collectible"; and that the total market value of the contracts and properties purchased by Century Mortgage was nearly double their purchase cost.

The complaint further alleged that the defendants omitted to disclose, among other things, that they used and dissipated monies obtained by Century Mortgage from public investors for their own personal use; that proceeds of the public offering would be used to fund affiliated corporations and business ventures of promoters of the issuer; and that Century Mortgage's certified financial statements included in prospectuses did not present fairly the financial position of Century Mortgage.

A receiver was appointed by the Court and was ordered, among other things, to take possession and custody of all business assets of Century Mortgage and Gateway and a temporary restraining order was entered against the defendants. Thereafter, preliminary and permanent injunctions were entered against certain of the defendants. The hearing on the Motion for Preliminary Injunction as against some of the defendants has been consolidated with the trial on the merits and is scheduled for hearing in February 1978.

SEC v. Penn Central Co., et al. — In May 1974, the Commission instituted an action for injunctive and other relief against the Penn Central Co.[18] and others alleging violations of the antifraud provisions of the securities laws.

In December 1976 the District Court for the Eastern District of Pennsylvania denied certain motions made by several

defendants to dismiss the complaint and/or for summary judgment. With respect to one such defendant, however, the judge dismissed the Commission's complaint with respect to injunctive relief, based on a finding of the absence of any reasonable likelihood of future violations, but granted the Commission leave to amend its complaint with respect to the Commission's request for disgorgement. The court determined that the Commission's request for ancillary relief survived the denial of the request for injunctive relief.[19] A motion to reconsider the denial of the motions for summary judgment and/or dismissal is pending.

By orders entered on February 18 and March 14, 1977, the Court vacated a previous preliminary injunction freezing assets of certain Liechtenstein entities in the United States and provided for payment to the Trustees of the Penn Central Transportation Co. of $1,250,000 by those entities whose assets were subject to the preliminary injunction. Fiedel Goetz, the defendant who the Commission alleged controlled the Liechtenstein entities whose assets were frozen, died while residing in Switzerland in December 1976. The complaint alleged that Goetz had improperly received funds from a subsidiary of the Penn Central Transportation Co. prior to its bankruptcy in 1970.

In July 1977 the Court ordered reentry of a Stipulation and Order between the Commission and three defendants who were non-management directors of the Penn Central Transportation Co. prior to its bankruptcy in 1970. The three directors undertook not to become associated with the Penn Central Transportation Co., its parents, its affiliates or successors in the future and, upon becoming a director of a corporation subject to the Federal securities laws in the future, to set forth in writing the manner in which each would discharge his duties as director and to submit the document to the general counsel of the corporation. The Court also entered a Final Judgment of Permanent Injunction against David Bevan, the former chief financial officer of the Penn Central Transportation Co. Bevan consented to the injunction without admitting or denying the allegations of the complaint.[20]

SEC v. SCA Services, Inc., et al. — In August, 1977 the Commission filed a complaint for injunctive and other relief charging SCA Services, Inc. (SCA); Christopher P. Recklitis (Recklitis), SCA's former President, Treasurer and Director; Berton Steir (Steir), founder and former Chief Executive Officer and President of SCA; Carlton Hotel Corporation (Carlton), a privately held corporation owned primarily by Recklitis; and four other persons with violations of certain of the antifraud, reporting and proxy solicitation provisions of the federal securities laws.[21]

The complaint charged that from approximately January 1972 through July 1975, Recklitis, while an officer of SCA and aided and abetted by Steir and others, diverted nearly $4 million of SCA's assets to his personal and Carlton's use and benefit through cash advances to Recklitis and Carlton and vendors of Carlton, which advances were not in the ordinary course of SCA's business, and through three fraudulent land transactions whereby he used nominees to acquire properties located in Amesbury, Massachusetts and Utica, New York. Ricklitis then caused the properties to be resold to SCA at values inflated by approximately $2.5 million. Further, the complaint charged that Recklitis used the funds improperly obtained to pay Carlton debts and personal debts and expenses. The complaint further alleged that the receivable due SCA

from Carlton was misrepresented in SCA's financial statements and that material facts concerning the alleged activities were omitted from SCA's reports, proxy materials and registration statements and prospectuses.

The complaint further charged that loans, advances and guarantees were given to employees which were either not properly authorized by SCA's board of directors or were not in the ordinary course of business and, thus, contrary to SCA's public representations. In addition, the Commission alleged that SCA made an improper political contribution in Massachusetts and paid gratuities and bribes to obtain contracts and to obtain necessary permits to use property owned by SCA for landfill purposes.

The Commission also charged that a former vice president and director of SCA, who was not charged with the above activities, withdrew, without proper authorization, $65,000 from a wholly owned subsidiary of SCA, applied approximately $53,000 of such funds owed to pay an outstanding personal debt to SCA and retained the balance. Certain of SCA's reports, proxy materials and registration statements and prospectuses did not disclose such misuse of SCA's assets.

Simultaneously with the filing of the complaint, SCA consented, without admitting or denying the allegations, to the entry of a Judgment of Permanent Injunction enjoining it from violating the above-mentioned provisions of the federal securities laws and ordering certain other relief. Recklitis, Carlton and one other defendant also consented, without admitting or denying the allegations, to the entry of a Judgment of Permanent Injunction enjoining them from violating the federal securities laws. The remaining defendants are currently in litigation with the Commission.

SEC v Basic Food Industries, Inc., et al. — On September 15, 1977, the Commission filed a complaint for injunctive and other relief charging Basic Food Industries, Inc. (BFI); Allan H. Applestein (Applestein), BFI's former Chairman of the Board and Chief Executive Officer; Gilbert Pasquet (G. Pasquet), formerly a director of BFI; Alix Pasquet (A. Pasquet) and Haitian Equities, S.A. with violations of certain of the antifraud, reporting, proxy solicitation and stock ownership reporting provisions of the Federal securities laws.[22]

The complaint charged that, since about 1971, Applestein caused BFI to make cash advances and other payments aggregating in excess of $217,000 for his personal benefit. During this period, according to the complaint, Applestein utilized at least $182,000 of such funds for, among other things, personal and family travel, personal entertainment expenses, personal legal expenses, personal office-related expenses and personal telephone expenses. The Commission also charged Applestein with engaging in undisclosed transactions with G. Pasquet and A. Pasquet, who are Haitian nationals, and Haitian Equities, S.A., a Haitian company controlled at the time of the transactions by the Pasquets. The complaint alleged that the defendants concealed material aspects of the underlying transactions in materials filed with the Commission and disseminated to the public.

The Commission also alleged that Applestein, on or about February 4, 1975, assertedly sold his control block of 450,000 shares of BFI common stock to Haitian Equities, a company not yet formed, for $100,000, substantially below the market value of the stock. The complaint charged that Applestein and the Pasquets planned

to pledge all or part of the stock for a bank loan, the proceeds of which were to be used to compensate Applestein for the stock and to acquire several of Applestein's privately-held companies. According to the complaint, by November 1975, Applestein purportedly rescinded the "sale" of his stock. It is alleged that Applestein, G. Pasquet, A. Pasquet and Haitian Equities filed false and misleading reports on Schedule 13D with the Commission concerning both the purported sale and reacquisition inasmuch as these reports, among other things, failed to disclose the conditions of and circumstances surrounding the events, including the extent and nature of business transactions between Applestein and the Pasquets and Haitian Equities. This case is currently in litigation.

SEC v. Petrofunds Inc., et al. — As previously reported, on May 26, 1976, the Commission instituted an action in the U.S. District Court for the Southern District of New York for injunctive and other relief against defendants Petrofunds, Inc. (Petrofunds); McRae Oil Corporation (McRae Oil); McRae Consolidated Oil and Gas, Inc. (Consolidated); James A. McRae (J.A. McRae); David Kelly (Kelly); J. Frank Benson (Benson); Osias Biller (Biller); Louisiana Gas Purchasing Corporation (LGP); Louisiana Gas Intrastate, Inc. of Shreveport (LGI); Sunny South Oil and Gas, Inc. (SSOG); Houston National Bank; Bromley DeMeritt, Jr. (DeMeritt); Henry Becton; Sidney Raphael (Raphael); Edmund D'Elia (D'Elia); the law firm of Raphael. Searles, Vischi, Scher, Glover and D'Elia; Thomas Leger & Co. (Leger & Co.); Thomas Leger (Leger); Judge Edward Coulson (Coulson); Bennett J. Roberts, Jr. (Roberts); and Edward C. Dorroh (Dorroh).[23] In its complaint the Commission charged these defendants with failing to comply with certain of the antifraud and other provisions of the Securities Act and the Exchange Act. The Commission's motion for a preliminary injunction against the above-named defendants was denied by the Court in June 1976. On June 23, 1976 the Court approved a stipulation entered into by the Commission and Houston National Bank providing for the dismissal of the Commission's action against the bank without prejudice. Subsequent to such ruling, certain of the defendants entered a Demand for a Jury Trial. By an order dated October 13, 1976, the court granted the Commission's motion to strike the defendants' Demand for a Jury Trial.

In May 1977, the Court entered a Final Order terminating the Commission's action against the defendant Henry Becton and requiring him to "take all reasonable actions including all reasonable and appriate inquiry and investigation to assure himself that" he complies with Rule 10b–5 "in connection with any securities offering, by any company of which he is an officer or director or any partnership of which he is a general partner, or any issuer controlled by such company or partnership, of interests in any oil or gas drilling fund, program or venture, or in which the solicitation of investments is based in substantial part on the affording to investors of tax deductions, credits or losses arising from the proposed method of operation . . . '" Such Final Order was entered pursuant to an agreement by Stipulation between the Commission and Henry Becton by the provisions of which Becton neither admitted nor denied the allegations of the complaint.

Subsequent to the completion of discovery and the submission of proposed pre-trial orders by the Commis-

sion and the defendants, eighteen of the nineteen remaining defendants agreed by Stipulation to the entry of certain Final Orders without admitting or denying the allegations of the complaint. On June 28, 1977, the Court entered such Final Orders. The action as to the remaining defendant was terminated by the Commission on the basis of an exchange of letters between the Commission and that defendant.[24]

The Final Orders respecting fourteen of these defendants, Petrofunds, McRae Oil, Consolidated, J.A. McRae, Kelly, Benson, DeMeritt, Leger & Co., Leger, SSOG, Dorroh, LGP, LGI, and Biller prohibit them from engaging in conduct violative of the antifraud provisions of the Exchange Act.

In addition to the Final Order, Consolidated, which is the parent company of McRae Oil and Petrofunds, in its Stipulation, has undertaken to establish and maintain an Audit Committee, consisting of certain named individuals, to perform certain specified functions. The Final Order directs compliance with all of the terms of the Stipulation including this undertaking. The Audit Committee is to review, among other things, all proposed dealings between Consolidated, its subsidiaries or affiliates and oil and gas drilling funds controlled by any of them to assure they are fair; is to make recommendations to Consolidated's board of directors with respect to such dealings; and is authorized to consult outside auditors and would review at least twice a year all expenses charged to each of the drilling funds and make appropriate recommendations and reallocations. The Audit Committee also is to make recommendations regarding disclosure in offering documents employed in connection with the offering of interests in any new drilling fund.

The Final Order with respect to Biller includes a representation by Biller that he has not actively practiced before the Commission, does not intend to practice before the Commission, and will give the Commission thirty days notice in advance of his practicing before it. By letter, the Commission has agreed to refrain from instituting a proceeding against Biller under Rule 2(e) of its Rules of Practice based on the allegations in the complaint or the entry of the Final Order so long as he complies with the above stated representations.

In addition to the Final Order, Leger & Co. and Leger agreed to the Commission's issuing an Order and an Opinion pursuant to Rule 2(e) of its Rules of Practice pursuant to which Leger & Co. and Leger are to submit to a review, by an individual acceptable to the Commission and its Office of the Chief Accountant, of its current policies, practices, and procedures in accordance with the AICPA Technical Standards Review Program to determine any weaknesses therein and adopt and implement any reasonable recommendations of the reviewer made in his final report. The report of the reviewer which was expected to be completed within 90 days from the date of the Commission's Opinion and Order is to be submitted to the Office of the Chief Accountant. A follow-up review is to be conducted one year after the issuance of the above stated report to determine the extent to which Leger & Co. and Leger have adopted and implemented the recommendations made in such report. These defendants will not accept engagement by any new public clients until one month after the above described report is submitted to the Office of the Chief Accountant. (For further information, see Accounting Series Release No. 223).

In addition, the Court entered Final Orders against the law firm of Raphael, Searles, Vischi, Scher, Glover and D'Elia and two of its partners, Raphael and D'Elia. The Final Order entered with respect to Raphael requires him to take all reasonable and appropriate measures and actions including all reasonable and appropriate inquiry and investigation to assure himself that the following contain full and fair disclosure of all material facts: (a) any offering document filed with the Commission pursuant to the Securities Act on behalf of the issuer or sponsor of any oil and gas drilling fund, program or venture, or tax incentive investments, for which issuer or sponsor he is registration counsel; (b) any offering document filed with the Commission on behalf of any issuer of securities of which he is or shall become an officer, director or control person.

In addition, by a separate letter undertaking, Raphael agreed not to practice before the Commission for a period of sixty days immediately following the entry of the Final Order with respect to him and thereafter to submit for review by a partner of the law firm (who has seniority at least equal to his and did not work on such filing) any offering document prepared by Raphael in whole or part which is to be filed with the Commission. Such review is to be conducted for the purpose of ensuring that such filing complies with the provisions of the 1933 and 1934 Acts. By letter, the Commission agreed not to institute any proceeding under Rule 2(e) of its Rules of Practice against Raphael based upon the above-described Final Order or the allegations in the amended complaint so long as he abides by such commitments. The Commission's Division of Enforcement advised Raphael by letter that, in its view, breach of any of the above-stated undertakings would constitute an independent ground for the institution of a proceeding under Rule 2(e), but that such a proceeding would not involve the facts alleged in the Commission's complaint.

The Final Order with respect to D'Elia and Raphael, Searles, Vischi, Scher, Glover & D'Elia requires these defendants to take all reasonable actions to assure themselves that full and fair disclosure of all material facts is made in any registration statement or offering circular filed with the Commission for any issuer or sponsor of participation units in oil and gas drilling funds, programs, ventures, or tax incentive investments for which they act as counsel. In addition, in a letter undertaking, the firm agreed to review its procedures and practices respecting preparation of registration statements and offering circulars during the 60 days following the entry of the Final Order. The firm also agreed that a partner of equal seniority in the firm would review any registration statement or offering circular prepared in whole or in part by Raphael to assure its compliance with the 1933 and 1934 Acts. By letter the Commission agreed that if D'Elia and the firm comply with the terms of the Final Order and undertakings the Commission will not institute proceedings under Rule 2(e) based on the matters alleged in the complaint or the entry of the Final Order. Such letter also states that the Commission's Division of Enforcement views a breach of any of the above stated undertakings or the Final Order as constituting an independent ground for the institution of a proceeding under Rule 2(e) but that such proceeding would not involve the facts

alleged in the Commission's complaint.

A Final Order with respect to Roberts requires him "to take all reasonable actions including all reasonable and appropriate inquiry and investigation to assure himself that, in connection with any securities offering by any company of which he is an officer, director or counsel or any partnership of which he is a general partner or counsel, or any issuer controlled by such company or partnership," no violation of the antifraud provisions of the Exchange Act occurs. In addition, such Order requires Roberts, an attorney, to conduct a review of his policies, practices, and procedures during the sixty days immediately following the entry of the Final Order. In a separate letter to the Commission, Roberts undertook that he would not practice before the Commission during the above stated review. The Commission, in a letter to Roberts, stated that it would not institute any proceedings under Rule 2(e) of its Rules of Practice against Roberts based on the allegations in the Commission's complaint or the entry of the Final Order so long as he complies with his representations and undertakings.

The Commission terminated its action against the one remaining defendant, Judge Edward C. Coulson, on the basis of an exchange of letters between the Commission and Judge Coulson. In his letter to the Commission, Judge Coulson stated that, in view of the Code of Judicial Conduct of the State of Texas, which prohibits the private practice of law, he commits that he will not represent Petrofunds Inc., or its affiliated companies, and he will not practice as an attorney before the Commission. He further stated that if he should desire to practice before the Commission, which would be inconsistent with his commitment, he will notify the Commission in writing. The Commission in its letter to counsel for Coulson stated that in reliance on the commitment contained in the letter it would not institute a proceeding under Rule 2(e) based upon the allegations in the Commission's complaint, but that in the view of the Commission any action by Judge Coulson inconsistent with that commitment might constitute a basis for a decision regarding his right to practice before the Commission.

SEC v. Solon Automated Services, Inc. et al. - On April 25, 1977, a complaint for injunctive and other relief was filed by the Commission in the United States District Court for the District of Columbia against Solon Automated Services, Inc. (Solon), a supplier of coin-operated laundry equipment throughout the United States with principal offices in Washington, D.C.[25] The complaint also named various officers, directors and employees of Solon and charged all defendants with violating certain of the antifraud provisions of the Federal securities laws.

The complaint alleged that from the 1940's to the present, the defendants variously caused Solon to enter into lease agreements with lessors whereby Solon, in exchange for the right to install and maintain coin-operated laundry equipment, agreed to pay the lessors "commissions," in the form of an agreed upon percentage of the gross proceeds from the machines, an agreed upon flat rate, or some other form of agreed upon amount. Generally on a monthly basis, employees of Solon would collect the gross proceeds from the machines, and commission checks would be pre-

pared and delivered to the lessors. The defendants, in calculating the commissions owing to certain of the lessors, generally to those on a percentage rate basis, would take "deductions" from the commissions due and owing to the lessors. Certain of these deductions were not permitted by the lease agreements and were taken without the knowledge or consent of the lessors. The practice of taking deductions from commissions originated in the 1940's at the time of Solon's inception, and grew to the extent that deductions of approximately $225,000 were taken during fiscal year ending in 1974, deductions of approximately $350,000 were taken during fiscal year ending in 1975, and deductions of approximately $350,000 were taken during the fiscal year ending in 1976.

The complaint further alleged that the practice of taking unauthorized deductions, the amount of monies deducted, and contingent liabilities which Solon may have as a result of the practice of taking unauthorized deductions were not disclosed in Solon's financial statements or other public filings, or to purchasers, sellers, or prospective purchasers or sellers of Solon's securities, or to Solon's customers.

The Honorable William B. Bryant, United States District Judge, entered judgments on April 25, 1977 against the defendants permanently enjoining them from violating the antifraud provisions of the Federal securities laws in connection with the offer and sale of Solon common stock or any other securities. The judgment further ordered the defendants in Solon to pay to the benefit of its customers (the lessors) the sum of $900,000 in accordance with a "Plan of Distribution" filed with the Court and ordered all defendants to institute new policies, practices and procedures with respect to the payment of commissions owing to the lessors of Solon in accordance with a "Statement of Policy Concerning the Payment of Commissions" filed with the Court. The defendants consented to the entry of these judgments without admitting or denying the allegations of the complaint.

SEC v. First Pittsburgh Securities Corporation, et al. — On January 31, 1977, the Commission filed a complaint in the United States District Court for the Western District of Pennsylvania, seeking to enjoin First Pittsburgh Securities Corporation, a registered broker-dealer, and others from further violations of the securities registration, antifraud and books and records provisions of the Federal securities laws.[26] The Commission alleged that the defendants fraudulently offered and sold approximately 1.7 million dollars in unregistered securities to certain of the insolvent defendant corporations. The Commission also alleged that investor monies obtained by the defendants through the sale of the unregistered securities were disbursed to certain of the defendants through interest free loans.

Extensive ancillary relief affecting certain of the defendants in this matter was granted and lengthy litigation ensued. Relief included the issuance of a restraining order, a preliminary injunction, the freezing of assets and the issuance of protective orders. A hearing on the merits

took place on June 10, 1977. The Commission is currently awaiting a decision.

SEC v. Diplomat National Bank, et al. — On September 28, 1977, the Commission filed a complaint for permanent injunction in the U.S. District Court for the District of Columbia against the Diplomat National Bank (Diplomat), Charles C. Kim (Kim), Bo Hi Pak (Pak), Tongsun Park (Park), and Spencer Robbins (Robbins), charging them with violations of the antifraud provisions of the securities laws in connection with offer, sale and purchase of Diplomat common stock.[27]

The complaint alleged that in 1975, during the initial offering of Diplomat common stock, the defendants variously participated in a scheme whereby Pak and Park, through undisclosed nominees, respectively purchased in excess of 43 percent and 10 percent of Diplomat's outstanding stock. The purchases were in direct violation of stock ownership limitations established by the Comptroller of the Currency for Diplomat and contrary to express representations regarding maximum stockholdings by investors in Diplomat's disclosure document used in the offering. The complaint further alleged that, during the resales of Diplomat stock by Diplomat on behalf of Pak, Park and others, defendants variously made misrepresentations and omissions of material fact regarding, among other things: (1) the existence of shareholders who owned in excess of Diplomat's previously established maximum limitation on stock ownership; (2) Diplomat's financial condition; (3) risks attendant to an investment in Diplomat; (4) the existence of a substantial demand deposit at Diplomat which was controlled by Pak; (5) the number of shares of stock which had been tendered to Diplomat for resale; and (6) that a letter from the Comptroller of the Currency, concluding that there were no improprieties by Diplomat in connection with its initial stock offering, was obtained as a result of misrepresentations to that agency by Kim, who was at the time Diplomat's chairman.

On September 28, 1977, the Honorable John Pratt of the U.S. District Court for the District of Columbia entered Judgments of Permanent Injunction restraining and enjoining Diplomat and Kim from violating the antifraud provisions of the securities laws. The defendants consented to the entry of the Court's Final Judgment and Order without admitting or denying the allegations in the Commission's complaint. Additionally, the Court ordered Diplomat to institute additional safeguards to prevent a recurrence of violations.

On September 30, 1977, Judge Pratt entered Judgments of Permanent Injunction restraining and enjoining defendants Robbins, Park and Pak from violating the antifraud provisions of the Federal securities laws. The defendants consented to the entry of the Court's Final Judgement and Order without admitting or denying the allegations in the Commission's complaint. Additionally, the Court ordered that Park and Pak shall not directly or indirectly exercise voting rights or solicit proxies in connection with Diplomat's stock.[28]

SEC v. Gamble-Skogmo, Inc., Herbert B. Nelson, Samuel Luftig — On September 14, 1977, the Commission filed an injunctive action in the United States District Court for the Northern District of Illinois against Gamble-Skogmo, Inc. (G–S), a Delaware corporation primarily engaged in retail op-

erations; Herbert B. Nelson (Nelson), former president of Gamble Import Corporation (GIC), a subsidiary of G–S; and Samuel Luftig (Luftig), former senior vice president of GIC.[29]

The complaint alleged that defendant G–S violated the proxy solicitation and reporting provisions of the Exchange Act in that G–S failed to disclose certain kickbacks and rebates in various annual reports and proxy statements. It was alleged that these kickbacks and rebates were paid to GIC by various foreign ocean carriers and Japanese television manufacturers.

The complaint further alleged that defendants Nelson and Luftig, officers of GIC during this period of time, caused the company to enter into the kickback and rebate agreements. It was alleged that these actions by Nelson and Luftig aided and abetted the proxy solicitation and reporting violations of G–S and constituted violations of the antifraud provisions of the Exchange Act.

Without admitting or denying the allegations of the complaint, defendant G–S consented to the entry of a Judgment of Permanent Injunction enjoining it from further violations of the reporting and proxy provisions of the securities laws. The action is still pending against Nelson and Luftig.

SEC v. Fisco, Inc., et al. — The Commission filed a civil injunctive action against FISCO, Inc. (FISCO), a Pennsylvania automobile insurance holding company; William Rush (Rush), a founder, director and former president of FISCO; Robert J. Reilly (Reilly), a director and former officer of FISCO, Leonard P. Connolly (Connolly), a former officer of FISCO and its sole employee; Robert K. Greenfield (Greenfield), formerly FISCO's Chairman of the Board and a member of a law firm which represented FISCO; and Lawrence J. Lee (Lee), also a former member of that law firm. The injunctive action involves allegations of violations of the antifraud and reporting provisions of the Federal securities laws.[30]

The Commission's complaint alleged that, during periods in which it was reporting substantial increases in earnings, in fact, FISCO should have been reporting substantial losses. As a result, all of FISCO's filings with the Commission during these periods were materially false and misleading.

The Commission's complaint also alleged that a FISCO prospectus, as well as other public statements of FISCO, was materially false and misleading as a result of failing to disclose the true state of facts in connection with the transfer of liability for a substantial block of insurance to FISCO's wholly-owned insurance subsidiary, Gateway Insurance Company, on September 30, 1971. According to the complaint, the reserves for claims attributable to such insurance, as audited by an independent certified public accounting firm, were materially deficient. As a result, FISCO's income for the current period reflected in the prospectus was overstated by approximately $4 million.

The complaint further alleged that, in order to report income improperly, FISCO used a variety of devices, primarily the understatement of reserves for losses. The methods by which FISCO understated loss reserves ranged from management orders to reduced reserves to deliberate adoption of computer programs designed to prohibit reserve increases.

The complaint alleged that Lee prepared and Greenfield reviewed opinions with respect to FISCO's acquisition of Prestige Casualty Company, an Illinois insurance company. The opinions con-

tained certain statements which Lee and Greenfield knew or should have known were factually false. According to the complaint, the opinions were one of the bases upon which FISCO's accountants permitted FISCO wrongfully to include in its financial statements material amounts of Prestige's income. As a result, FISCO's income for the year 1972 was materially overstated.

Simultaneously with the filing of the Commission's complaint, each of the defendants consented to the entry by the District Court for the District of Columbia of Judgments of Permanent Injunction enjoining them from violations of the antifraud and reporting provisions of the Securities Act and the Exchange Act.

In addition to the Judgments of Permanent Injunction, the Court ordered that, except with respect to FISCO, Rush, Reilly and Connolly shall not act as officers or directors or make any significant policy decision or prepare or be responsible for the preparation of financial statements of any publicly held company. The Court also ordered that Mitchell shall not act as an officer or director of any publicly held company.

Lee and Greenfield represented, in stipulations filed with the Court, that they do not practice before the Commission. They agreed to give prior written notice to the Commission in the event that they intend to practice before the Commission and that, in the event that such prior written notice is given within three (Greenfield) or two (Lee) years, the Commission may use the entry of the Judgment as the sole basis for a proceeding pursuant to Rule 2(e) of the Commission's Rules of Practice.

SEC v. General Dynamics Corporation and Lester Crown – In July 1977, the Commission filed a complaint against General Dynamics Corporation and Lester Crown to enjoin them from further violations of the proxy provisions of the Federal securities laws and from making and causing to be made certain false and fictitious entries in the books and records of General Dynamics Corporation.[31] The complaint alleged that General Dynamics' proxy materials for 1974, 1975, and 1976, in which Crown was nominated as a director of General Dynamics, failed to disclose that Crown provided funds to others to make payments intended to influence certain members of the General Assembly of the State of Illinois in connection with proposed legislation and that he directed officers and employees of Material Services Corporation, wholly-owned subsidiary of General Dynamics, to submit and receive payment on expense accounts which included false expenses pursuant to a plan to reimburse Crown for the aforementioned payments. The defendants, simultaneously with the filing of the complaint, and without admitting or denying the allegations, consented to the entry of a Final Judgment of Permanent Injunction against further violations of the proxy provisions of the Federal securities laws and against making false and fictitious entries in the books and records of Material Service Corporation, General Dynamics Corporation or any other issuer.

In addition, the order required that General Dynamics correct and amend its proxy statements for 1974, 1975 and 1976 to detail the information concerning the aforementioned payments. The defendants also were required to cause General Dynamics and its subsidiaries to issue to their officers and appropriate employees intracorporate guidelines

for the proper use in disbursement of corporate funds.

SEC v. Mexletter Business & Investment Service, et al. — On September 7, 1976, the Commission filed a complaint in the United States District Court for the District of Columbia seeking injunctive relief against Mexletter-Mexican Business and Investment Service (Mexletter), a registered investment adviser with the Commission located in Mexico City, Mexico and Eugene C. Latham (Latham), controlling shareholder and president of Mexletter.[32]

The Commission's complaint alleged that, from 1967 until the filing of the complaint, Mexletter and Latham offered for sale and sold to U.S. investors unregistered securities, including promissory notes, certificates of deposits, "financial bonds" and "financial certificates" issued by certain Mexican investment banks (financieras), in violation of the registration provision of the Securities Act.

The complaint further alleged violations of the antifraud provisions of the Securities Act and the Exchange Act in that the distribution of unregistered securities was effected by means of promotional materials containing numerous false and misleading statements of material fact and omissions to state material facts necessary to enable investors to make informed investment decisions. As part of the alleged violations, the complaint alleged that Mexletter and Latham made false and misleading statements regarding the risks of investment in securities of Mexican financieras and failed to disclose certain risks of investment in such securities.

The complaint further alleged violations by Mexletter and Latham of the Investment Advisers Act of 1940, including the antifraud, recordkeeping and reporting requirements of the Advisors Act.

The complaint further alleged that Mexletter and Latham acted as broker-dealers without registering with the Commission under the Exchange Act.

The Court, on July 8, 1977, entered Judgments of Permanent Injunction against the defendants, enjoining them from violations of the registration and antifraud provisions of the Federal securities laws. In a Consent and Undertaking filed with the Court, the defendants consented to the entries of the Judgments, without admitting or denying the allegations in the complaint.

SEC v. Uniroyal Inc. — On January 27, 1977, as part of the Commission's ongoing management fraud program, the Commission instituted a civil injunctive action against Uniroyal Inc. in the United States District Court for the District of Columbia.[33]

The Commission's complaint alleged violations of various provisions of the Federal securities laws in connection with (a) the making of substantial improper and illegal payments, involving approximately $2.3 million in corporate funds, to officials and employees of various foreign governments, including Mexico's; (b) the falsification of corporate books and records of Uniroyal; (c) the payment of questionable commissions; (d) the utilization of unrecorded and unaccounted for funds for improper purposes; (e) violations of foreign currency exchange laws; (f) the making of domestic political contributions; and (g) the filing of materially false and misleading annual and periodic reports and proxy statements with the Commission, concerning the aforementioned matters.

Simultaneously with the filing of the complaint, the Court entered a Judgment of Permanent Injunction re-

straining and enjoining Uniroyal from further violations of the antifraud, reporting and proxy provisions of the Exchange Act and ordering certain other relief. Uniroyal consented to the entry of the Court's Judgment without admitting or denying the allegations in the Commission's complaint.

The ancillary relief obtained in this case included independent review of an investigation conducted by Uniroyal regarding political contributions and other improper payments, and orders of the Court directed to certain unlawful conduct.

SEC v. Sucrest Corporation, et al. – On June 1, 1977, the Commission filed a complaint in the United States District Court for the District of Columbia seeking injunctive relief against Sucrest Corporation (Sucrest), a New York sugar refiner, certain of its officers and directors, and Czarnikow Rionda Company, Inc. (RIONDA) a sugar broker located in New York City.[34]

The complaint charged the defendants with violations of antifraud and reporting provisions of the Exchange Act and the Securities Act. The complaint alleged that Sucrest and Rionda had engaged in sham transactions when Sucrest orally agreed with Rionda to resell to Rionda, after Sucrest's year-end, the same quantity of raw sugar which Sucrest had purchased from Rionda prior to Sucrest's year-end at a price which would assure both companies of no monetary gain or loss between them, except for fees which Sucrest paid to Rionda. The complaint further alleged that these transactions materially affected Sucrest's year-end inventory quantities and the income computed therefrom for its fiscal 1975 and 1976 years, and resulted in the dissemination of false and misleading press releases stating Sucrest's income, and in the filing of misleading reports with the Commission. The complaint further alleged that officers of both Sucrest and Rionda made materially false and misleading statements to Sucrest's auditors in order to conceal the existence of the oral agreement from their auditors.

All of the defendants consented to the entry of Judgments of Permanent Injunction which granted certain ancillary relief without admitting or denying the allegations in the Commission's complaint.

SEC v. Charles Jacquin, Et Cie., Inc. et al. – On October 17, 1977, the Commission filed a complaint in the United States District Court for the District of Columbia seeking injunctive and ancillary relief against Charles Jacquin et Cie., Inc. (Jacquin), which produces and imports alcoholic beverage products, and two of its officers, Jerome J. Cooper (J. Cooper) and Norton Cooper (N. Cooper), secretary-treasurer and vice president respectively, alleging violations of the antifraud, proxy and reporting provisions of the Federal securities laws.[35]

The complaint alleged that during the period from at least 1969 to 1977, Jacquin, J. Cooper and N. Cooper made undisclosed payments of money and transferred other assets of Jacquin to customers and others, including payments to state alcoholic beverage control officials, as inducements to purchase Jacquin products. These inducements included the distribution of cases of alcoholic beverages free of charge to retail customers, the value of which approximated $300,000 to $500,000 per year, the payment of money to certain retail customers by means of fictitious invoices for goods or services never actually received by Jacquin, and the

payment of money and other valuable items to members or employees of a state liquor control board.

The Commission also alleged that J. Cooper and N. Cooper, without disclosure, diverted and caused the diversion of Jacquin funds and assets for their own benefit and for the benefit of members of their family, including Elsie Cooper (E. Cooper) and Ruth Cooper (R. Cooper) president and executive employee, respectively, of the company, and mother and sister, respectively, of J. Cooper and N. Cooper. This diversion of funds and assets was accomplished in several different ways, including the payment of salaries to members of J. Cooper's and N. Cooper's family although they rendered no substantial services to Jacquin, and the payment of a variety of personal expenses of the Cooper family such as apartment rentals, maintenance fees for condominiums, utility and real estate tax expenses on personal residences, and college tuition payments for certain children of Jacquin's officers and directors.

The complaint further alleges that in 1973 and 1975 J. Cooper requested certain Jacquin employees to make political contributions to, among other candidates for elective office, a candidate for the presidency, which contributions J. Cooper caused Jacquin to reimburse by causing false and misleading expense vouchers to be prepared.

Jacquin, J. Cooper and N. Cooper consented, without admitting or denying the allegations, to Judgments of Permanent Injunction and Ancillary Relief restraining them from further violations of the antifraud, proxy and reporting provisions of the Federal securities laws. E. Cooper and R. Cooper signed Undertakings agreeing to be bound by the provisions of the aforementioned Judgments.

The ancilllary relief included (1) the expansion of Jacquin's board of directors to include two additional independent directors and provision for additional independent directors in the event Jacquin increases the size of its board; (2) the establishment of an audit committee of Jacquin's board; and (3) the appointment of a Special Counsel for Jacquin to conduct an investigation, and upon the approval of Jacquin's board, to take appropriate action against any officer, director or employee of Jacquin.

SEC v. Potter Instrument Company Inc., et al. – On March 9, 1977, the Commission, having filed a complaint in the United States District Court for the District of Columbia, obtained a Judgment of Permanent Injunction by consent against Potter Instrument Company Inc. (PICO) and John T. Potter, PICO's largest shareholder and the chairman of its board of directors.[36]

The complaint alleged that PICO and Potter had violated certain antifraud and proxy solicitation provisions of the Federal securities laws by failing to disclose that Potter had received substantial benefits from PICO in addition to his stated salary during the period from 1970 through 1974. These additional benefits included the yearly expenditures of approximately $100,000 in corporate funds to maintain Potter's residence and personal racing yacht and to pay the salaries of domestic servants and crew members who were reflected on the company's personnel and payroll records as maintenance personnel and engineers.

The complaint additionally alleged that PICO and Potter had attempted to conceal PICO's deteriorating financial condition during 1974 by issuing false and misleading press

releases and by filing interim reports with the Commission which failed to reflect necessary adjustments for obsolescence in its inventory and rental equipment.

In addition to consenting to the entry of the Judgment of Permanent Injunction against it, PICO undertook to prepare and disseminate to its shareholders a report containing a summary of recent corporate developments and the allegations in the Commission's complaint. PICO further undertook to establish certain committees, including an audit committee, from among the members of its present board of directors, and to appoint only outside directors approved by the Commission to fill any vacancies on its board of directors for a period of three years. The Court's Judgment and Order against Potter placed certain permanent restrictions upon the scope of his activities at PICO and prohibited him from voting his shares to defeat any motion, resolution or course of action recommended by a majority of PICO's board of directors for a period of three years.

SEC v. Banque de Paris et des Pays-Bas (Suisse) S.A. – On May 10, 1977, the Commission filed a complaint in the United States District Court for the District of Columbia seeking injunctive relief against the Banque de Paris et des Pays-Bas (Suisse) S.A. (the Banque), a Swiss banking corporation in Geneva, Switzerland.[37] The complaint alleged that the Banque filed Schedules 13D which contained untrue statements of material fact and omitted to state material facts required to be stated in such Schedules. These Schedules 13D pertained to the Banque's ownership of securities in Amicor Corp. (Amicor); Florida Water and Utilities Co., (Florida Water); Hygrade Food Products Corp. (Hygrade); Princeton Electronic Products, Inc. (PEP); and Electro Audio Dynamics Inc. (EAD).

The Commission's complaint alleged that the Banque acquired approximately 26 percent of the outstanding common stock of Hygrade and stated in its Schedule 13D that such securities were acquired for the Banque's own account and accounts over which the Banque had sole discretionary authority. The complaint alleged that the Banque did not disclose the names of those persons over whose account it acted in a fiduciary capacity.

The Commission's complaint stated that the Banque acquired approximately 7 percent of the common stock of Amicor for its own account and accounts over which it had sole discretionary authority. The complaint alleged that the Banque failed to file either the purchase agreement or the discretionary account agreement, as it was required to do, with the Schedule 13D pertaining to Amicor. In an amendment to the Amicor 13D, the Banque stated that it had purchased the Amicor securities for its own account and for a limited number of accounts not exceeding 20 depositors. Eventually, the Banque admitted that only one account was involved, and that the beneficial owner of the account was an associate of the law firm which acted on behalf of the Banque in negotiating the purchase of the Amicor securities. The Commission's complaint alleged further misrepresentation in that the Banque did not have unfettered discretionary control over this account, since, when requested by the account holder, the Banque bought certain securities back from the account and the account holder would have been able to cancel his account and withdraw all the securities from the account.

The Commission's complaint stated that the Banque acquired 5.1 percent

of the stock of Florida Water and filed a Schedule 13D which stated the securities were purchased for its own account and accounts over which it had sole discretionary authority, pursuant to a loan agreement among Florida Water, the Banque and an unaffiliated party. The complaint alleged that the Banque failed to disclose the identity of either the unaffiliated party or the identity of the discretionary account holders for which it purchased the securities.

The Commission's complaint stated that the Banque filed a Schedule 13D pertaining to the acquisition of 40.5 percent of EAD's common stock for the Banque's own account and accounts over which the Banque had sole discretionary accounts. The complaint alleged that the Banque failed to disclose the identity of the discretionary account holders and that when the Banque disposed of 205,000 shares of EAD pursuant to a registered public offering the Banque failed to file an amended Schedule 13D required to be filed.

The Commission's complaint further stated that the Banque filed a Schedule 13D pertaining to the acquisition of 11.6 percent of the common stock of PEP for its own account and accounts over which it had sole discretionary authority. The complaint alleged that the Banque failed to disclose the identity of the discretionary account agreements as exhibits to the PEP 13D. The complaint also alleged that the Banque failed to disclose that the Banque and two other purchasers were given the right to nominate a person to PEP's board of directors and that such designee was a representative of one of the discretionary account holders.

The Court entered a Judgment of Permanent Injunction against the Banque, enjoining the Banque from violations of the security acquisition reporting provisions of the Federal securities laws. The Banque consented to the entry of the Judgment without admitting or denying the allegations in the complaint. In addition, certain ancillary relief was ordered by the Court, including the following: (a) The Banque is to establish adequate procedures to insure compliance with the reporting requirements of the security acquisition provisions of the Securities Exchange Act of 1934; (b) Within two years the Banque is to dispose of all its holdings and the holdings of those accounts for which it purchased the equity securities of Florida Water, EAD, and PEP; and (c) Until these securities are disposed of, the Banque is to escrow these securities with an agent in the United States who would vote the securities in the same proportion as all other shares in the pertinent issuer are voted.

SEC v. Vanguard Security Funding Corporation – On March 16, 1977, the Commission filed a complaint in the United States District Court for the District of Columbia seeking injunctive relief against Vanguard Security Funding Corporation (Vanguard) of Montgomery, Alabama.[38] Simultaneously, the Court entered a Judgment of Permanent Injunction enjoining Vanguard from violating the antifraud and reporting provisions of the Federal securities laws based upon its consent in which it neither admitted nor denied the allegations of the Commission's complaint. Vanguard, through a subsidiary, is engaged in underwriting group life and health insurance and group disability insurance.

The complaint alleged that in 1974, in order to report an improved legally-required surplus, Vanguard's subsidiary entered into sham transactions

in which it acquired real estate in exchange for surplus debentures. The obligation to pay the surplus debentures was contingent upon achievement of predetermined levels of the Alabama statutory surplus. The complaint alleged that, by reason of accounting treatment given to the sham transactions, real estate and subordinated debt were substantially overstated and net loss and retained earnings deficit were substantially understated in financial statements of Vanguard's subsidiary, included in the Annual Report on Form 10–K, and that footnote assertions therein, that the transactions removed an impairment of capital, were false.

The complaint also alleged that Vanguard failed to disclose: (1) That the fair market value and cost of the real estate was substantially less than reported; (2) The existence of an agreement providing for reversion of title to certain of the real estate should the subsidiary be placed in receivership; and (3) That Vanguard filed false and misleading statutory surplus reports with the Alabama Department of Insurance, including false and misleading appraisals of certain of the real estate.

SEC v. William R. Lummis, et al., Administrators of Estate of Howard R. Hughes, et al.[39] — In March 1975, as previously reported, the Commission instituted a civil proceeding for injunctive and other relief alleging numerous violations of the Federal securities laws arising from the bid by Howard R. Hughes to purchase the assets of Air West, an airline carrier.[40]

On September 20, 1976, the District Court for the Northern District of California issued Findings of Fact and Conclusions of Law in connection with the defaults of Howard R. Hughes, Summa Corporation and Hughes Air Corp. Subsequently, an interlocutory appeal was taken by the defaulted defendants (the Administrators of the Estate of Howard R. Hughes having been substituted as parties defendant). That appeal has been briefed; no date for argument has been set.

On August 19, 1977, the District Court issued a Final Order (on consent) permanently enjoining Patrick Hillings (Hillings) from violating the proxy solicitation provisions of the Federal securities laws. On August 10, 1977, the court issued a Judgment of Permanent Injunction on Consent permanently enjoining David B. Charnay (Charnay) from violating the antifraud and antimanipulative provisions of the Federal securities laws and ordering Charnay to disgorge $19,500, such payment being deemed satisfaction of the claim for disgorgement in the Commission's action. Both Hillings and Charnay consented to the court's orders without admitting or denying the allegations of the Commission's complaint.

SEC v. Jos. Schlitz Brewing Company – On April 8, 1977, the Commission filed a complaint in the United States District Court for the District of Columbia seeking injunctive and ancillary relief against Jos. Schlitz Brewing Company (Schlitz), a Wisconsin corporation which is the second largest brewer of beer and malt beverages in the United States, alleging violations of the antifraud, proxy and reporting provisions of the Federal securities laws.[41]

The complaint alleged that during the period from 1969 to 1977, Schlitz disbursed millions of dollars in undisclosed payments in cash and other items of value to its customers and others, including approximately $3 million in payments to beer and malt beverage retailers, as inducements

to purchase Schlitz products, in violation of Federal, state and local liquor laws and regulations. These inducements were accomplished by (1) the payment of cash to retailers and their agents and the furnishing of goods and services to retailers; (2) the reimbursement of its nationwide network of 1,000 wholesalers who made cash payments and provided other items of value to retailers; (3) the concealment of these payments through sham contracts, invoices, agreements and other documents; (4) the direction of cash payments through third parties, including certain of Schlitz' and its wholesalers' outside advertising agencies, as well as those of its retailers.

A permanent injunction against violations of the Federal securities laws by Schlitz and the appointment of a Special Agent with the power to investigate the acts and practices alleged in the complaint was requested by the Commission. The case is being litigated.

SEC v. H.K. Porter Company – On March 21, 1977, the Commission filed a complaint in the United States District Court for the District of Columbia, seeking injunctive relief against H.K. Porter Company (Porter), a Delaware corporation with its principal executive offices in Pittsburgh, Pennsylvania.[42] Simultaneous with the filing of the complaint, the Court entered a Judgment of Permanent Injunction against Porter restraining and enjoining Porter from further violations of the filing requirements of the ownership reporting and tender offer provisions of the Federal securities laws and ordering certain other relief.

The complaint alleged that Porter had violated Sections 13(d) and 14(d) of the Exchange Act and the rules promulgated thereunder in filing with the Commission false and misleading statements on Schedule 13D with respect to Porter's intentions in purchasing securities of Missouri Portland Cement Company (Missouri) and making a tender offer for Missouri common stock. The complaint further alleged that Porter's statements and amendments to statements on Schedule 13D, reporting Porter's purchase of a block of Missouri common stock from Cargill, Inc., in August 1975, were false and misleading in stating that the purpose of the purchases was "for investment," when in fact, such purchases were part of Porter's plan to make a tender offer for additional shares of Missouri and to acquire control of Missouri.

The complaint further charged that Porter's amended and restated Schedule 13D and amendments thereto reporting terms of a new tender offer and purchases of Missouri shares pursuant to the tender offer from December 1975 through January 1976, were false and misleading in stating that Porter did not intend to seek representation on Missouri's board of directors or participate in the management of Missouri, when in fact, Porter intended to do so.

SEC v. Arthur T. Mudd and Bobby Hodges – On May 19, 1977, the Commission filed a complaint against Arthur T. Mudd and Bobby Hodges, both of Memphis, Tennessee, alleging violations of the municipal securities registration and antifraud provisions of the Federal securities laws.[43]

The Commission alleged that the defendants were engaging in the business of offering and selling municipal securities to the public without registering with the Commission as municipal securities dealers.

It was further alleged that in the conduct of such business, Mudd and Hodges sold municipal securities to their customers at prices not reasonably related to current market prices. Both defendants consented to the entry of an Order of Permanent Injunction.[44]

This was one of the first cases where an action was brought against a municipal securities dealer for failure to register with the Commission as required by the Securities Acts Amendments of 1975.

SEC v. T.A.S. Investments and Gary R. Paro – On July 20, 1977, the Commission filed a complaint in the United States District Court for the Northern District of New York, seeking to enjoin T.A.S. Investments (T.A.S.) and Gary R. Paro, President of T.A.S., both of Syracuse, New York, from further violations of the registration and antifraud provisions of the securities laws.[45] The Commission's complaint alleged that the defendant's violations arose in the course of their offer and sale of unregistered securities in the form of investment interests in advertising and promotional campaigns. The Commission alleged that the defendants made numerous misrepresentations and omissions of material facts in a brochure mailed nation-wide which offered these securities. These misrepresentations and omissions concerned, among other things, the use of the funds raised from investors, the experience of defendants in the advertising business, and the safety of and return on the investments.

Simultaneously with the filing of the Commission's complaint, a Final Judgment of Permanent Injunction and Order of Ancillary Relief was entered, enjoining T.A.S. and Paro from violating the registration and antifraud provisions of the securities laws. T.A.S. and Paro consented to the entry of the Judgment without admitting or denying the allegations contained in the complaint. The court also ordered, as ancillary relief, that the defendants (1) return to investors all monies received, (2) send a letter to investors and prospective investors informing them of the Commission's action and withdrawing the defendants' offer, and (3) submit affidavits to the court and the Commission demonstrating compliance with this portion of the Court's order.

SEC v. Shelby Bond Service Corporation, et al.—The Commission, on April 18, 1977, filed a complaint against Shelby Bond Service Corporation (Shelby Bond), a defunct Tennessee corporation which conducted business as an unregistered municipal securities broker-dealer prior to January 1, 1976, and others, alleging violations of the antifraud provisions of the Federal securities laws in connection with the offer, purchase and sale of municipal securities, including industrial development revenue bonds.[46] The Commission's complaint alleged that Shelby Bond, its principals, and its salesmen used high pressure sales techniques and charged excessive markups and that Shelby Bond salesmen made fraudulent misrepresentations and omissions concerning such material facts as the speculative nature of the securities and the financial condition of the issuers.

The Commission's complaint further alleged that Precision Optical Laboratory, Inc. (Precision Optical), Shelby Bond, and the principals of Shelby Bond violated the antifraud provisions of the Federal securities laws in connection with the offer and sale of industrial development revenue bonds which were issued to finance Precision

Optical and were underwritten by Shelby Bond.

Six of the defendants consented to permanent injunctions and three defendants were enjoined by default. Three defendants have been preliminarily enjoined until further order of the Court.[47] One of the defendants subsequently consented to the entry of a permanent injunction. No trial date has been set for the remaining two defendants.

SEC v. Charles A. Carter, et al.—This civil injunctive action followed the failure of Bankers Trust Savings and Loan Association (Bankers Savings & Loan), the largest state-chartered savings and loan association in Mississippi.[48] At the time of its failure in May 1976, Bankers Savings & Loan held savings accounts of over $210 million in the form of passbook accounts and certificates of deposit. The savings accounts of Bankers Savings & Loan were not Federally insured by the Federal Savings and Loan Insurance Corporation (FSLIC) but were privately insured along with accounts in other state-chartered associations in Mississippi and Tennessee by American Savings Insurance Company (American Savings) of Jackson, Mississippi.

On June 20, 1976, after Bankers Savings & Loan and other state-chartered savings and loan associations in Mississippi had been unable to honor requests for withdrawals, the Mississippi legislature passed an emergency plan calling for a moratorium on withdrawals and providing for a conservator for all non-Federally insured savings and loan associations in Mississippi. The plan affected about 150,000 depositors having a total of over $450 million deposited in savings accounts in 34 non-Federally insured savings and loan associations. Under the terms of the plan, until an association obtained approval from the conservator to reopen, its depositors could not withdraw any of their funds. This ranged from a few days to a matter of months in some instances. Bankers Savings & Loan has since reorganized, obtained FSLIC insurance and reopened under the name of Depositors Savings Association.

The Commission's complaint, filed on May 13, 1977 in the United States District Court for the Southern District of Mississippi, charged Charles A. Carter (Carter), C. D. Shields (Shields), Ray A. Jones (Jones), American Savings, Plaza Investment Company (Plaza) and Edwin L. Figg (Figg) with violations of the antifraud provisions of the Securities Act and the Exchange Act. The complaint charged that Carter, Shields, Jones and American Savings made misrepresentations and omissions in the offer and sale of the savings accounts of Bankers Savings & Loan concerning, among other things, the insurance of the savings accounts and the financial condition of Bankers Savings & Loan and American Savings. The complaint further charged Carter, Shields, Jones, Plaza and Figg with violations in the offer and sale of securities issued by Bankers Trust Company, the parent holding company of Bankers Savings & Loan, which filed for proceedings under Chapter X of the Bankruptcy Act. The complaint alleged, among other things, that purchasers of debentures and promissory notes of Bankers Trust Company were falsely led to believe that such securities were issued by Bankers Savings & Loan, and that the defendants failed to disclose the operating losses and financial condition of Bankers Trust Company to the purchasers of such securities. All the defendants consented to the entry of permanent injunction against them.

SEC v. American Hospital Supply Corporation—On December 29, 1976,

the Commission filed a complaint against American Hospital Supply Corporation (American Hospital) alleging violations of certain of the reporting and proxy provisions of the Exchange Act in connection with disclosures concerning contracts providing for American Hospital's equipping of the King Faisal Specialist Hospital in Riyadh, Saudi Arabia.[49] According to the complaint, American Hospital's reports filed with the Commission failed to disclose certain facts concerning purported agency, commission and consulting arrangements entered into in connection with the American Hospital contracts. The Commission also charged in the complaint that questionable payments had been made by American Hospital's foreign subsidiaries during the period from 1970 through 1976 and that American Hospital had filed and had caused to be filed with the Commission annual and periodic reports that were materially false and misleading in that they failed to disclose such payments. American Hospital, without admitting or denying the allegations of the Commission's complaint, consented to the entry of a Final Judgment of Permanent Injunction and Ancillary Relief restraining and enjoining American Hospital, or any of its affiliates and subsidiaries, from further violations of the reporting and proxy provisions of the Exchange Act and ordering certain other relief.

Ancillary relief ordered by the Court, among other things, prohibits American Hospital, its employees and agents from, directly or indirectly: (a) making unlawful payments or causing unlawful payments to be made of any corporate funds of American Hospital or any of its affiliates or subsidiaries for the purpose either of obtaining business, whether private or governmental, or avoiding substantial compliance with the legal requirements of any governmental jurisdiction; (b) using or aiding and abetting the use of corporate funds of American Hospital or any of its affiliates or subsidiaries for any unlawful political contributions or any other unlawful political purposes; (c) making or causing to be made any materially false or fictitious entries in the books and records of American Hospital and its affiliates and subsidiaries; and (d) establishing, maintaining or causing to be established or maintained any secret or unrecorded fund of corporate monies or other assets or making or causing to be made any payments or disbursements thereof.

American Hospital was also ordered to institute and maintain enforcement and control measures to assure compliance with its internal business ethics code of conduct and with the provisions of the Final Judgment.

SEC v. Invesco International Corp.— In June 1977, the Commission filed a complaint for injunctive and ancillary relief in the United States District Court for the Northern District of Georgia against Invesco International Corporation, Security Management Company, Inc. and three of Invesco's officers, including its chairman of the board of directors, alleging violations of the reporting and antifraud provisions of the Federal securities laws. The complaint sought injunctions and an order directing the appointment to the board of directors of a majority of independent directors.

The Commission's complaint alleged that Bruce R. Davis, chairman of Invesco's Board of Directors and its chief executive officer, aided and abetted by two other officers, purchased stock from Invesco for inadequate consideration, sold other stock to Invesco at inflated prices, and received other remuneration in the form of loans and

advances and concealed such information by filing false and misleading reports on Forms 8–K and 10–K.

On June 28, 1977, Judge William C. O'Kelly issued orders permanently enjoining Invesco and its chief executive officer from violations of the reporting provisions of the Exchange Act, and the two corporate and three individual defendants from violations of antifraud provisions of the securities laws.[50] In addition, the Court issued orders directing the Invesco board of directors to nominate and recommend for election a number of independent directors who were not unacceptable to the Commission and who would then comprise a majority of said board.

SEC v. Orofino, et al.[51]—This action was instituted in December, 1976 in the United States District Court for the Southern District of New York to enjoin Frank X. Orofino (Orofino), Colonial Securities, Inc., Intermountain Transfer Corp. (Intermountain) and 16 others from further violations of the registration and antifraud provisions of the Federal securities laws in connection with the offer and sale of the common stock of Tucker Drilling Company, Inc. (Tucker). Thereafter, all of the defendants, with the exception of TAO & Co. (TAO), consented to the entry of Final Judgments of Permanent Injunction without admitting or denying the allegations in the Commission's complaint. The Commission stipulated to the dismissal of its complaint against TAO upon the basis that it was a sole-proprietorship of the son of defendant Orofino and not an entity under Orofino's control.

The Commission's complaint alleged that Orofino and certain of the other defendants gathered approximately 300,000 shares of the common stock of Tucker representing approximately 19 percent of the issued and outstanding stock. These 300,000 shares included approximately 150,000 shares which had previously been distributed pursuant to a public offering and subsequently accumulated by certain of the defendants and approximately 150,000 unregistered shares. Thereafter, Orofino and several of the other defendants sold approximately 290,000 of these 300,000 shares through their own and various nominee accounts at several broker-dealers. No registration statement for the offer and sale of these approximately 290,000 shares was ever filed with, or declared effective by, the Commission, nor was any exemption from registration available.

The complaint further alleged that in order to facilitate the distribution of these Tucker shares, the defendant Intermountain improperly removed restrictive legends from approximately 100,000 Tucker shares. Additionally, the Commission charged that various undisclosed sums of cash and amounts of securities were given to the brokerage industry-related defendants who, in return, solicited purchasers for Tucker stock. Finally, the complaint stated that in an attempt to maximize their profits, Orofino and several of the other defendants aided the distribution of Tucker stock by bidding for, purchasing and inducing others to purchase Tucker stock while engaged in said distribution.

SEC. v. Forest Laboratories, Inc. et al.—In June, 1977, the Commission filed a complaint in the United States District Court for the Southern District of New York against Forest Laboratories, Inc. (Forest), a New York based pharmaceutical company, Hans Lowey (Lowey), former chairman of the board and president of Forest, Ian Stewart (Stewart), former treasurer of Forest, Milton Dorison (Dorison), former president of Forest, and Roberto Sein (Sein), manager of a Forest subsidiary in Puerto Rico, seeking to enjoin the de-

fendants from violations of the antifraud, reporting and proxy provisions of the Federal securities laws.[52]

The Commission's complaint alleged violations of the Federal securities laws in connection with Forest's falsely inflating revenues recorded on its books and records by approximately $4 million in connection with sales and purported sales by Forest to three of its major European customers. This was accomplished, in part, by the preparation and maintenance of two sets of invoices, one set for the customer and shipper which reflected the true price of the goods sold, and the other set for recordation on the books and records of Forest, which reflected an inflated price for the goods sold, in some cases two, three or more times the true price. The complaint alleged that the above schemes resulted (in most years from 1963 through 1973) in reported earnings of Forest being inflated to levels substantially higher than the true earnings of Forest for such years.

Forest consented to the entry of a Permanent Injunction enjoining it from further violations of the above-mentioned provisions of the Federal securities laws and ordering certain other relief without admitting or denying the allegations of the Commission's complaint. The Court's order provides that Forest's counsel and independent public accountants shall conduct an investigation of and prepare a report covering the period from April 1, 1963 to the date of the entry of the Judgment, encompassing the matters set forth in the complaint. Under the terms of the Court's Order, such investigation will be reviewed by a Special Review Counsel. In September 1977, Sein consented to the entry of a similar Permanent Injunction without admitting or denying the allegations of the complaint.

SEC v. Max Wilson, Inc., et al.—This case resulted from an investigation concerning the promotional and sales activities of Max Wilson, Inc., a "File-for-You-Agent" (FFYA), in connection with the U.S. Bureau of Land Management's (BLM) Simultaneous Oil and Gas Lease Filing System.[53] Under the system, the BLM each month posts a list of public land available for oil and gas leases and leases that have expired or were terminated because the former holder did not pay the annual rental. If more than one U.S. citizen wants the lease, the names are drawn in a lottery. The winner gets the lease.

According to the complaint, Max Wilson, Inc., one of a growing number of companies engaged in this type of business, recommended that its clients file on certain BLM parcels that were made available to the public each month. The company received $10 per parcel for each entry. The company also guaranteed to pay each successful client a fixed amount (varying with each parcel) plus a 3 percent overriding royalty interest, if production were to commence, for his parcel. In addition, Max Wilson, Inc. would provide all clerical functions necessary to enter the lottery, pay the yearly rentals for a successful client (if he sold the lease to Max Wilson, Inc.) and notify the client if he were successful.

The Commission filed a civil complaint on March 9, 1977 in the U.S. District Court for the District of New Mexico against Max Wilson, Inc., Max Wilson and Robert Wilson alleging violations of the registration and antifraud provisions of the Federal securities laws in the offer and sale of, among other things, investment contracts.

The complaint further alleged that in connection with the offer and sale of the securities, the defendants made untrue statements of material facts including, among others, that: (1) there were no others interested in purchas-

ing investors' leases when, in fact, others had made offers to purchase the investors' leases; and (2) the defendants knew who would pay the highest cash consideration plus overriding royalties for oil and gas leases and that this information would be made available to investors when, in fact, competitive offers were usually not forwarded to investors by defendants. In addition, the complaint also alleged that in connection with the offer and sale of the securities, defendants omitted to state, among other things, that: (1) the use of defendants' address on the BLM Simultaneous Oil and Gas drawing entry card isolated the winner from those who might pay substantially more for the lease than the defendants' guaranteed price; and (2) competing offers for the investors' leases would not be forwarded to the investors.

The defendants consented to the entry of a permanent injunction without admitting or denying the allegations of the Commission's complaint.

SEC v J. Ray McDermott & Co., Inc., et al.—On October 6, 1976, the Commission filed a complaint against J. Ray McDermott & Co., Inc. and several of its past and present officers and directors to enjoin them from further violations of the antifraud, reporting and proxy provisions of the Securities Exchange Act of 1934.[54] The complaint alleged that the above defendants made secret cash payments of corporate funds totaling at least $509,000 to co-defendant Schacht McCollum, a former officer of Tenneco Oil Company, a corporate subsidiary of Tenneco, Inc., to aid in procuring and maintaining certain contracts and billings with the Tenneco Oil Company.

Each of the defendants consented, without admitting or denying the facts set forth in the complaint, to the entry of permanent injunctions prohibiting future violations of the Federal securities laws. In addition, McDermott undertook to prepare a written report describing its internal investigations into the matters set forth in the Commission's complaint together with the results thereof and to make appropriate disclosure of the matters involved in the report to its shareholders.

SEC v Exxon Corporation, et al.—On September 27, 1977, the Commission filed a civil injunctive action against Exxon Corporation (Exxon) and Vincenzo Cazzaniga (Cazzaniga)—a former president and managing director of Esso Italiana, S.p.A., Exxon's wholly-owned subsidiary in Italy, seeking to enjoin the defendants from further violations of the reporting and proxy provisions of the Exchange Act.[55]

The Commission's complaint alleged that during the period from at least 1963 and continuing to at least 1972, defendants Exxon and Cazzaniga, and others, directly and indirectly, expended at least $55.25 million in Italy as payments to political parties, government officials and employees, commercial bribes and other illegal, improper, noncorporate or unaccountable payments. Some or all of these payments to political parties, government officials and government employees were made in connection with governmental action and were made in order to secure or influence such governmental action. Defendants Exxon, Cazzaniga and others, directly and indirectly, disguised said payments by means of false and improper accounting and the use of unrecorded bank accounts.

In addition, the complaint alleged that from at least 1963 and continuing to at least 1975, defendant Exxon and others expended at least an additional $1.25 million in at least 15 other foreign countries as payments to political parties, government officials and em-

ployees, commercial bribes and other illegal, questionable, noncorporate or unaccountable payments.

Without admitting or denying the allegations contained in the Commission's complaint, defendant Exxon consented to the entry of a Final Judgment of Permanent Injunction enjoining the company from further violations of the reporting and proxy provisions of the Exchange Act. In addition, Exxon was required to disclose in a current report for September 1977 on a Form 8–K, filed with the Commission simultaneously with the filing with the Court of the Commission's complaint, further details with respect to matters concerning the Italian and other payments.

On January 9, 1978, the Court entered a Judgment against Cazzaniga, by default, enjoining him from further violations of the reporting and proxy provisions of the Exchange Act. This default judgment was signed after Cazzaniga advised the Court that he would not appear or file an answer or other pleading to the Commission's complaint.

SEC v. Indonesian Enterprises, Inc., et al.—On February 2, 1977, the Commission filed a complaint against Indonesian Enterprises, Inc., Ramayana Indonesian Restaurant of New York, Inc., P. N. Pertamina (the National Oil State Enterprise of the Republic of Indonesia) and Ibnu Sutowo, to enjoin them from further violations of the registration and antifraud provisions of the securities laws.[56] The complaint alleged that the defendants sold over $1 million of Class A common, nonvoting stock of Indonesian Enterprises, Inc., when no registration statement was filed or in effect. Sales were made to 54 of the largest foreign and domestic corporations in the world including Mobil Oil, Ashland Oil, Monsanto Company and Esso Standard Eastern, Inc. The complaint further alleged that the defendants coerced individuals and corporations having business relationships with the defendant Pertamina to purchase shares of the defendant Indonesian Enterprises.

Each of the defendants consented, without admitting or denying the facts set forth in the complaint, to the entry of a permanent injunction prohibiting further violations of the Federal securities laws.

SEC v. Diversified Industries, Inc., et al.—On November 15, 1976, the Commission filed a civil injunctive action seeking to enjoin Diversified Industries, Inc. (Diversified), a metal processing and manufacturing company, and Ben Fixman, Sam Fox, Morris Lefton, Jack Kootman and E. Allen Payne, all present or former officers and/or directors of Diversified or its subsidiaries, from future violations of the registration, proxy and reporting provisions of the Exchange Act. The complaint also sought certain ancillary relief.[57]

The complaint alleged, among other things, that since at least 1968, Diversified, through certain of its subsidiaries, engaged in a course of business involving underpayments and deliveries of materials of lower quality or quantity than actually due. The complaint further alleged that since 1971, Diversified, again through certain of its subsidiaries, falsified corporate records to generate over $400,000 in cash which was used, in part, to make payments to representatives of companies doing business with Diversified. The complaint alleged that the individual defendants participated in certain of these activities, knew of others, and should have known, if they did not know, of still others.

Without admitting or denying the allegations contained in the Commission's complaint, defendant

Diversified, simultaneous with the filing of the complaint, consented to the entry of a Final Judgment of Permanent Injunction enjoining the company from future violations of the antifraud, proxy and reporting provisions of the Exchange Act. In addition, the Judgment provided for certain ancillary relief, including provisions requiring Diversified to appoint a Special Review Committee and Special Counsel, satisfactory to the Commission, to investigate the allegations contained in the Commission's complaint and other matters relevant thereto, to file a report of its findings with the Commission and the Court, and to seek redress and take further action if warranted.

Defendants Ben Fixman, Morris Lefton, Jack Kootman, and E. Allen Payne also consented, without admitting or denying the allegations contained in the Commission's complaint, to the entry of Final Judgments of Permanent Injunction enjoining them from, among other things, future violations of Sections 10(b) (antifraud), 13 (a) (reporting), and 14(a) (proxy) of the Exchange Act. Fixman has also been enjoined from future violations of Section 13(d) (requirement to file report when acquiring over 5% of beneficial interest in securities of public companies) of the Exchange Act. Additionally, the judgments provide for certain ancillary relief, including the payment of $8,000 by Kootman to Diversified.

In other counts, the complaint sought to enjoin Penn-Dixie Industries, Inc. (Penn-Dixie), a company engaged in the manufacture of construction materials, Jerome Castle (Castle), its then chairman and president, Arnold Y. Aronoff (Aronoff), a Detroit businessman, and the JDL Trust, a Cayman Islands trust allegedly created and controlled by Aronoff, from future violations of the antifraud provisions of the Exchange Act. The complaint also sought to enjoin Penn-Dixie, Castle and Aronoff from future violations of the reporting provisions and Penn-Dixie and Castle from future violations of the proxy provisions of the Exchange Act.

The complaint alleged, among other things, that the defendants by fraud and deceit caused Penn-Dixie, in October of 1973, to purchase a parcel of Florida land for approximately $5.9 million. The parcel was less than fifty percent of a larger parcel of land which Aronoff, through the JDL Trust, had purchased the previous day for approximately $5.8 million.

The complaint asked the court to impress a trust on the entire tract of land with a view toward causing appropriate restitution to Penn-Dixie and depriving the non-corporate defendants of unlawfully or improperly obtained benefits, money or property.

Finally, in still another count, the complaint sought to enjoin Castle, Fixman and Penn-Dixie from future violations of Section 13(d) (requirement to file report when acquiring over 5% of beneficial interest in securities of public companies) of the Exchange Act in connection with their alleged efforts during 1974 and 1975 to take over control of Diversified.

Without admitting or denying the allegations contained in the Commission's complaint, Penn-Dixie consented to the entry of a Final Judgment of Permanent Injunction which was entered on July 7, 1977. The Judgment against Penn-Dixie permanently enjoins it from future violations of the antifraud reporting and proxy provisions of the Exchange Act. In addition, the Judgment provides for certain ancillary relief.

Pursuant to the terms of the Judgment and attached Undertaking,

Penn-Dixie is required to appoint to its board three new directors, satisfactory to the Commission, who are neither present nor former employees of Penn-Dixie. These directors will serve on a new Audit Committee of the board created pursuant to the terms of this settlement. Penn-Dixie is further required to maintain a Special Counsel previously appointed by the company.

Pursuant to the terms of the Judgment, the Audit Committee, together with the Special Counsel will, among other things, investigate and report on the allegations contained in the Commission's complaint. Additionally, the judgment provides for review by the Audit Committee of all future transactions between the company and certain persons, including Castle and Aronoff, and provides that the company will enter into only such transactions as are approved by the Audit Committee.

The Commission is currently in litigation with defendants Fox, Castle, Aronoff and the JDL Trust.

SEC v. General Telephone and Electronics Corporation – In January 1977, the Commission filed a complaint seeking to enjoin General Telephone and Electronics Corporation (GTE) from further violations of the antifraud, reporting and proxy provisions of the Federal securities laws.[58]

The complaint alleged that GTE had made numerous payments in the United States and 27 other countries totalling approximately $14 million, a significant portion of which were or may have been to or for the benefit of government officials or their intermediaries or in the nature of commercial bribes, kickbacks and rebates to officials of private foreign customers.

The complaint also alleged that in connection with the financing of the sale of GTE's 28 percent equity interest in Philippine Long Distance Telephone Company (PLDT) to, and subsequent related transactions with, several Philippine nationals, GTE agreed to pay and did pay $484,000 in cash, $2,813,000 in credits, and accrued but did not pay $1,678,000 in the form of commissions, to the group of Philippine nationals on sales of telecommunications equipment by GTE to PLDT as well as $1 million in personal loans and the promise of an additional $1 million in commissions given to the Philippine nationals by GTE in exchange for their directing PLDT to sign a $20 million supply contract with GTE.

The complaint contains similar allegations regarding GTE payments in connection with its efforts to obtain a multi-million dollar telecommunications contract with a state enterprise in Iran.

GTE consented to the entry of a Judgment of Permanent Injunction enjoining it from further violations of the above mentioned provisions of the Federal securities laws without admitting or denying the allegations of the complaint. In addition, GTE adopted, and, pursuant to the Judgment, is to maintain, policy guidelines and procedures relative to commercial practices with respect to payments by GTE to any official or employee of any private customer or any government, or any official or employee of any entity owned and/or controlled by any government which is unlawful under the laws of the United States or such foreign country, which guidelines were consistent with the terms of the Injunction.

Theodore F. Brophy, chairman of the board of directors of GTE, John J. Douglas, vice-chairman of the board

of directors of GTE, and William F. Bennett, executive vice-president–staff of GTE, who were not named as defendants in this action, acknowledged in a Court-ordered Acknowledgement and Undertaking that, as officers and/or directors of GTE, they were bound by the terms of the Permanent Injunction and undertook, as officers and directors of GTE, to comply fully with its terms and conditions and to use their best efforts to cause GTE to continue in full compliance with its terms and conditions.

SEC v. Philippine Long Distance Telephone Corporation, et. al. — In January 1977 the Commission filed a complaint seeking to enjoin Philippine Long Distance Telephone Company (PLDT), Philippine Telecommunications Investment Corporation (PTIC) and Stamford Trading Company, Limited (STC) from further violations of the antifraud and reporting provisions of the Federal securities laws.[59]

The complaint alleged that there was an agreement among Ramon Cojuangco (Cojuangco), president of PLDT; Alfonso Yuchengco (Yuchengco), chairman of the board of PLDT; Luis Tirso Rivilla (Rivilla), an officer and director of PLDT; and Antionio M. Meer (Meer), another stockholder in PTIC, (referred to hereinafter as the PTIC Group); and General Telephone and Electronics Corporation (GTE) to have GTE pay the above-named stockholders of PTIC undisclosed commissions of from five to seven percent on sales of telecommunications equipment by GTE to PLDT in connection with the financing of PTIC's 1967 purchase of GTE's controlling interest in PLDT. The complaint further alleged that the PTIC Group received $1 million in personal loans and the promise of an additional $1 million in commission payments from GTE in 1971 in exchange for their directing PLDT to sign an approximately $20 million supply contract with GTE.

The PTIC Group received commissions from GTE of $484,000 in cash and $2,813,000 in credits. GTE accrued but did not pay an additional $1,678,000 in commissions, and GTE assigned to an independent escrow agent for no consideration the personal promissory notes of the members of the PTIC group, totalling approximately $1 million, given to GTE in 1971 in connection with GTE's $20 million supply contract with PLDT, on which notes no principal or interest had ever been paid. Such assignment irrevocably instructed such escrow agent to deliver the notes in accordance with the instructions of the members of the PTIC Group or, if not so delivered by maturity, to destroy the notes.

PLDT, PTIC and STC consented to the entry of a permanent injunction enjoining them from further violations of the above-mentioned provisions of the Federal securities laws without admitting or denying the allegations of the complaint. In addition to the entry of the permanent injunction against PLDT, PTIC and STC, certain ancillary relief was ordered by the Court and undertaken by PLDT, PTIC, STC, Cojuangco, Yuchengco, Rivilla, and Meer, including the payment by PTIC to PLDT irrevocably of an amount of cash equal to $1 million.

SEC v.Kodiak Industries, et al.—On October 28, 1976, the Commission filed a civil injunctive action in the United States District Court for the Southern District of California seeking to enjoin Kodiak Industries (Kodiak), Dominic J. Alessio (Alessio), Anthony Alessio (A. Alessio), Alvin G. Rosa (Rosa) and C. Arnholt Smith (Smith) from further violations of the antifraud,

reporting, Williams Act proxy and tender offer provisions of the Exchange Act, and Fortuna Corporation (Fortuna) from further violations of the antifraud, reporting and proxy provisions of the Exchange Act.[60]

The complaint alleged that since approximately May 1972, the individual defendants engaged in a scheme to conceal their intentions to effect a merger of Fortuna, a publicly held corporation which operated race tracks in New Mexico, into Kodiak, a private corporation owned by the Alessios and Rosa. The complaint further alleged that the purpose of this merger was to enable the individual defendants to appropriate the assets and cash flow of Fortuna for their personal benefit. The complaint also alleged that the defendants engaged in a scheme to conceal Smith's control of, relationship to and business transactions with Kodiak and Fortuna.

The Commission alleged that the defendants effected these schemes by, among other means, filing with the Commission and disseminating to Fortuna shareholders false and misleading annual reports, proxy materials, Schedules 13D and tender offer statements, which statements were utilized in connection with a cash tender offer made by Kodiak for Fortuna shares in December 1974.

Without admitting or denying the allegations contained in the Commission's complaint, defendants Kodiak, Fortuna, Alessio, A. Alessio and Rosa, consented to the entry of Final Judgments of Permanent Injunction against them, enjoining them from further violations of the aforementioned provisions of the Exchange Act.

In addition to enjoining these defendants from further violation of provisions of the Exchange Act, the injunctions provided for the following ancillary relief: (1) The defendants were required to offer rescission rights to all Fortuna shareholders who tendered shares in response to Kodiak's cash tender offer of December 2, 1974; (2) that with respect to the proposed merger of Kodiak and Fortuna described in Fortuna's definitive proxy material filed with the Commission on October 19, 1976, the enjoined defendants were not able to vote the Fortuna shares owned or controlled by them unless the merger was approved by a majority of the minority shareholders of Fortuna voting; (3) that should the merger proposal not be so approved, the enjoined defendants will be able to vote the Fortuna shares owned and controlled by them in any other proposed merger between Kodiak and Fortuna only with the approval of the Court, pursuant to a plan approved by the Court which provided that Kodiak must demonstrate that the merger is for a legitimate corporate purpose and that the consideration to be paid to Fortuna shareholders was fair and reasonable; and (4) the enjoined defendants were also ordered to make certain corrected filings with the Commission and distribute them to Fortuna shareholders.

On May 19, 1977, without admitting or denying the allegations contained in the Commission's complaint, defendant Smith also consented to the entry of a Final Judgment of Permanent Injunction against him, enjoining him from further violations of the aforementioned provisions of the Exchange Act.

SEC v. World Radion Mission, et al.—On January 16, 1976, the Commission filed suit in the Federal District Court for the District of New Hampshire charging World Radion Mission and Clinton D. White with violating the antifraud provisions of the Federal securities laws. The complaint, alleging that the defendants were fraudu-

lently selling "loan plans" in the form of 8 percent, 9 percent, 10 percent, 11 percent and 12 percent interest-bearing notes, sought injunctive relief and the appointment of a receiver.[61]

After an evidentiary hearing, the Court found that the Commission had made a prima facie showing of a violation of the Federal securities laws and the likelihood that future violations would occur; it nevertheless declined to issue a preliminary injunction on the basis that the issuance of an injunction would have a substantial adverse impact on a bona fide religious organization, and that there was no evidence that denial of an injunction would cause any harm to the public.

The Commission appealed; and, on November 4, 1976, the Court of Appeals for the First Circuit reversed the decision and directed the District Court to issue an injunction preliminarily enjoining the defendants from further violations of the antifraud provisions of the Federal securities laws.[62]

In reversing, the Court of Appeals disagreed with the District Court's finding that the public investors would not suffer harm; noted defendants' stated intent to continue the activities found by the trial court to be deceptive; and dismissed defendants' protestations of good faith, stating that a Commission injunction "is designed to protect the public against conduct; not to punish a state of mind."

SEC v. Mor-Film Fare, Inc., et al.[63] and *SEC v. International Film Corp., et al.*[64]—The cited cases were companion civil injunctive actions filed by the Commission in the United States District Court for the Central District of California in May and June, 1977 against a total of twelve corporate and individual defendants. The complaints alleged the fraudulent, unregistered distribution of securities consisting of limited partnership interests purportedly for the purpose of financing motion picture and other business interests. The fraudulent nature of the distributions involved false representations concerning the tax shelter features and benefits of such investment programs and the existence of contracts with prominent entertainment personalities.

In the International Film Corp. case, District Judge A. Andrew Hauk entered temporary restraining orders against all nine defendants, ordering them not to dispose of assets or destroy property related to the allegations set forth in the Commission's complaint. Both actions are otherwise still pending before the court.

SEC v. E. L. Aaron & Co., Inc.[65]—On May 3, 1977, after a trial on the merits, the Honorable Lee P. Gagliardi of the United States District Court for the Southern District of New York found that defendant Peter E. Aaron (Aaron) had violated the registration and antifraud provisions of the Federal securities laws in connection with the offer and sale of the common stock of Lawn-A-Mat Chemical & Equipment Corp. (LAM).[66] On May 19, 1977, Judge Gagliardi signed a final Judgment of Permanent Injunction enjoining Aaron from further violations of the aforementioned provisions.

The Court found that Aaron violated and aided and abetted violations of the antifraud provisions by failing to restrain E. L. Aaron & Co., Inc. (Aaron & Co.) registered representatives under his supervision from making false and misleading statements in connection with the offer and sale of LAM stock.

In addition, Judge Gagliardi found that Aaron violated the registration provisions and Rule 144 thereunder, by arranging for the purchase of 21,000 unregistered LAM shares for the trading account of Aaron & Co. at a time

when Aaron & Co. was soliciting customers' orders for the purchase of LAM stock. The court found that Aaron & Co. had purchased these unregistered shares in pre-arranged, sham transactions through another brokerage firm acting as an intermediary and, in so doing, functioned not as an agent or broker for a customer, but as a principal or dealer for its own account in violation of Rule 144. This is the first case in which a Federal court has issued an opinion involving a violation of Rule 144.

SEC v. Equity Service Corp., et al.—On April 27, 1977, the Commission filed a complaint in the United States District Court for the Eastern District of Pennsylvania, naming Equity Service Corporation, Robert H. Mortimer (Mortimer), Pacific-Atlantic Oil Co. (PAOCO) and others.[67] The complaint and other motions filed sought preliminary and permanent injunctions, protective orders, an accounting and the appointment of a temporary receiver.

The complaint alleged that the defendants violated the securities registration and antifraud provisions of the Federal securities laws in connection with the offer and sale of fractional undivided working interests in oil and gas leases, limited partnership interests and investment contracts concerning oil and gas leases located in Arkansas, Colorado and Louisiana. The complaint further alleged that the defendants made numerous misrepresentations and omissions to investors concerning, among other things, the use of investor funds, the employing of a psychic and a "Radiation Survey Vehicle" to select sites and the production which had been achieved from wells which had previously been drilled. Mortimer was also charged with misappropriation of investor funds.

In May 1977, District Judge Edward N. Cahn entered Judgments of Permanent Injunction by consent against all defendants.[68] Judge Cahn also appointed a receiver over all the subject oil and gas programs and ordered the defendants to account for assets, including income, derived from their participation in the scheme.

SEC v. American Centennial Corporation—In May 1977, the Commission filed suit in the United States District Court for the Middle District of Tennessee against American Centennial Corporation (ACC), and four of its officers and directors for violations of the antifraud provisions of the Federal securities laws in connection with the offer and sale of common stock of ACC, a publicly held insurance company.[69]

The Commission's complaint alleged that the defendants, in preparing the sales literature for the public offering and in training young inexperienced college students to sell the stock, made material omissions and failed to include information necessary to make that disclosed not misleading. The sales presentation relied heavily upon management's prior association with another company which had a market increase of 2400 percent over an 18-month period before settling at a price near its initial offering price. In both the literature and the oral sales presentations, the complaint alleged that the defendants stressed the rise in the market price of the above shares while failing to include the fact that the market price decreased as dramatically as it rose and was then trading at a price substantially lower than the figures used in the sales literature.

The complaint alleged that the sales presentation also included a comparison of ACC and the other insurance company which ended with the projection that since ACC had more sales representatives, more capital, a wider area of distribution and a greater price per share it would be at least 25 per-

cent more profitable than the other company; in other words, a purchase of the stock was to yield a 600 percent profit according to projections made by the sales personnel.

PARTICIPATION AS AMICUS CURIAE

Tannenbaum v. Zeller[70]—This case presented the question of whether fully informed and truly independent directors of a mutual fund are precluded, under the Investment Company Act, from exercising any discretion and good faith business judgment in determining whether to use a portion of the commissions paid by the fund on brokerage transactions to reward broker-dealers which sold fund shares or provided research services instead of recapturing such excess commissions for the fund's direct cash benefit.

The issue arose because of the minimum fixed-brokerage commission rate structure that prevailed on the exchanges until May 1, 1975, when it was prohibited by the Commission. Under that system, persons were compelled to pay brokerage commissions according to a fixed rate which did not reflect economies of scale. As a result, the brokerage commissions paid by mutual funds far exceeded the actual cost to the broker. The mutual funds had essentially two ways to use these excessive commissions—they could channel the excess to brokers which provided the fund with sales or research services or they could, through a variety of devices, recapture the excess in the form of a direct cash benefit for the funds.

The fund in *Tannenbaum* had chosen to use the excess to reward brokers providing sales and research services. The plaintiff sued on the ground that the defendant investment adviser had caused the fund to take this course in violation of its fiduciary duty. As a defense, the adviser argued that the decision to forego recapture of the excess commission had been made by the disinterested members of the board of directors in the exercise of a good faith business judgment, and that the advisor could not be held liable for carrying out the instructions of the board. The district court agreed with defendant, and plaintiff appealed to the Court of Appeals for the Second Circuit.

In an *amicus curiae* brief, the Commission argued that the recapture decision was one that could be committed to the discretion of the disinterested members of the board of directors. Crucial to this position was the fact that this case arose in the context of rapidly changing market conditions which created substantial equities in favor of the defendants in this case. In addition, the structure of the Investment Company Act and two prior decisions by courts of appeals indicated that the recapture question was one area where independent and disinterested directors could exercise business judgment. In the context of this case, the Commission observed that, contrary to its general experience, the district court had found that the directors were truly independent of the investment advisor. The court had also found that the directors' judgment to forego recapture was not unreasonable.

In an opinion which closely follows the reasoning of the Commission's *amicus curiae* brief, the Court of Appeals held that the defendants had not violated their fiduciary duty to the fund because of their failure to recapture the excess commissions. The Court also held, however, that the defendants had violated the proxy solicitation provisions of the securities laws by failing adequately to inform fund shareholders of the recap-

ture alternative. The Commission had not addressed this issue in its *amicus curiae* brief.

Sanders v. John Nuveen & Co.[71]—In this case, upon remand for its reconsideration,[72] the Seventh Circuit Court of Appeals reversed its earlier finding that an underwriter of commercial paper who had acted in the "mistaken but honest belief that the financial statements prepared by certified public accountants correctly presented the condition of the issuer is liable to its customers for losses sustained as a result of the issuer's default."[73] In so doing, the court of appeals noted that *Hotchfelder* required a finding of a "scienter," whether knowing or reckless conduct, where violations of the antifraud provisions of the Exchange Act are alleged, and that the record in this case was barren of an actual intent to deceive by the underwriter. The court also disposed of plaintiff's claim under the antifraud provisions of the Securities Act when it stated that, even if there is a private right of action under that section, which it did not have to decide, plaintiff had not shown "scienter." The court also rejected plaintiff's argument that a private right of action could be implied under Rule 27 of the National Association of Securities Dealers, Inc., in the absence of a finding of fraud. Since the record was insufficient for the court of appeals to decide whether the underwriter was liable to the plaintiff purchaser of commercial paper under Section 12(2) of the Securities Act, the court of appeals remanded the case to the district court on that issue.

In its *amicus* brief, the Commission had argued that liability in this case could be premised on Section 12(1) of the Securities Act, which prohibits the sale of unregistered securities. Since the plaintiff had waived this argument, the court did not decide the issue.[74]

The Commission had also urged that Section 12(2) of the Act might provide a basis of recovery for the plaintiff. The Commission noted, however, that the standard of care imposed by that section varies with the circumstances under which the securities were sold.

Daniel v. International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America[75] — In this case arising under the antifraud provisions of the securities laws, the Court of Appeals for the Seventh Circuit held that an interest in a noncontributory, compulsory pension plan was a "security" which had been "sold" to the plaintiff in violation of the antifraud provisions. The plaintiff alleged that he had been a member of the Teamsters union and had worked for employers covered by union contracts for 22½ years. During that period, his employers made contributions on his behalf to a pension fund maintained jointly by representatives of the union and his employers. The only break in this 22½ years of service was a three month involuntary layoff after the plaintiff had worked ten years. When the plaintiff applied for his pension, however, he was informed that the three month layoff had caused him to forfeit his pension. In his complaint, the plaintiff claimed, *inter alia*, that the union and the trustees of his pension fund had made false and misleading representations to him concerning the break-in-service requirement, in violation of the antifraud provisions of the Federal securities laws. In response to the defendants' motion to dismiss the securities laws counts for a failure to state a claim upon which relief may be granted, the district court held that the plaintiff's interest in the fund was a security that had been the sub-

ject of a sale within the meaning of the antifraud provisions.

In an *amicus curiae* brief, the Commission argued that the court of appeals should affirm the district court and allow the plaintiff the opportunity to prove his case in the court below. With respect to the question of whether the interest in the fund was a security, the Commission noted that the prior Supreme Court law on the definition of the term "investment contract" demonstrated that the pension interest was a security. Thus, the Commission argued that the employee invests money, in the form of his services, for which he receives compensation, including wages, fringe benefits and the pension interest. Moreover, this investment is placed in a common trust fund where the promised profit on the investment is dependent upon the managerial efforts of the pension fund trustees. Finally, the Commission pointed out its long-standing position that interests in pension funds were securities, and the Congress' agreement with that position, as evidenced by the Investment Company Act Amendments of 1970 which added a section to the Securities Act providing that interests in pension funds are securities which need not be registered under the Act.

With respect to the question of whether the pension interest was the subject of a "sale" within the meaning of the Federal securities laws, the Commission argued that its previous "no-sale" rationale applicable to the registration of interests in noncontributory (the employer makes the pension contributions on behalf of the employee) and compulsory (the employee has no choice but to participate in the pension plan) plans should not be extended to the antifraud provisions. In addition to the inherent differences between the registration and antifraud provisions, the Commission noted that important changes in the legal and economic significance of pensions rendered the "no-sale" rationale inappropriate for purposes of the antifraud provisions.

The Commission's brief then discussed the question of whether there was some other reason that the antifraud provisions should not apply to the sale of pension interests. The Commission examined the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and concluded that there was no indication in that act that Congress intended to preempt the Federal securities laws. Indeed, the Commission moved that the disclosure requirements of ERISA were not at all comparable to the protections afforded by the antifraud provisions. Finally, the Commission addressed the argument that application of the antifraud provisions could be disruptive and unfair to existing plans by pointing out that those provisions are only a generalized self-executing prohibition against fraud which does not require any filing with the Commission and that the plaintiff in this and any other case must still show that he relied, to his detriment, on false or misleading representations.

The decision of the court of appeals closely parallels the Commission's *amicus curiae* brief. The Supreme Court has granted petitions for *certiorari.*

Piper, et al. v. Chris-Craft Industries, Inc., et al.[76]—This action arose out of a contest for corporate control of Piper Aircraft Corporation which began in 1969. Piper was the subject of two competing tender offers, one made by Chris-Craft Industries, Inc., and the other by Bangor Punta Corporation. Chris-Craft, the loser in the battle for control of Piper, had won the ensuing litigation, in which it had been held, among other things, that

Bangor Punta, members of the Piper family and an investment banker had violated the Federal securities laws—Section 14(e) of the Exchange Act and Rule 10b–6 under that Act—in connection with Bangor Punta's obtaining control of Piper.[77]

The primary issues in the Supreme Court were whether there was an implied private right of action under Section 14(e) (Williams Act) on behalf of a competing tender offeror against those whose misleading statements injured it; whether any limitations should be imposed on the maintenance of, or on the relief granted under, such an action; if indeed such a right existed; whether private purchases of Piper shares by Bangor Punta, while its exchange offer for the Piper stock was in registration, constituted a violation of Rule 10b–6; whether the alleged violations caused the injury complained of —i.e., Chris-Craft's loss of an opportunity to gain control of Bangor Punta; and whether the court of appeals correctly computed damages to compensate Chris-Craft for its loss and whether the liability had been apportioned properly among the defendants. The Commission filed an *amicus curiae* brief, in which it addressed only the first three issues referred to above.

In its brief the Commission traced the history of tender offers, which prior to the passage of the Williams Act in 1968, had not been regulated, in sharp contrast to the comprehensive regulation of proxy contests under Section 14(a) of the Exchange Act and rules thereunder. Since tender offers were found by Congress to be alternatives to proxy contests as a means of preserving or gaining control,[78] it patterned the protections under the Williams Act on the existing proxy regulation. Since Congress took great care to provide an equal opportunity to the offeror and the target and to "avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid",[79] the Commission urged that the legislative history showed that Congress intended to protect all persons involved in tender offers.

The Commission argued that, since the Williams Act has created a pervasive regulatory scheme similar to that under the proxy rules, a defeated tender offeror who seeks to vindicate provisions of the Williams Act should be accorded standing to sue for the same reasons that the Court previously had implied private remedies for violations of the proxy regulations.[80] Additionally, the Commission, relying on *Cort v. Ash*,[81] asserted that a private right of action should be implied in this case because (1) the Williams Act created such a right in favor of each participant in a tender offer contest;[82] (2) there was no explicit denial of such a right, and, in fact, Congress was aware that language similar to that proposed in Section 14(e) had been used to imply private remedies on behalf of participants in proxy contests; (3) a private right of action was necessary to supplement the Commission's efforts to effectuate the Congressional purposes in enacting the Williams Act; and (4) the Williams Act was an intrusion of Federal law into an area that was the subject of state corporation law, and the state laws to a great extent were inconsistent with the purposes of the Williams Act.

The Commission also argued that Section 14(e) of the Exchange Act, which proscribes misleading, as well as fraudulent, statements made in connection with tender offers, does not require a showing of knowing or

intentional wrongdoing. While injured persons should be compensated for their losses when Section 14(e) is violated, courts should be guided by the express remedies provided in the securities laws and make an award which restores the injured parties to their prior status.

With respect to Rule 10b–6, the Commission noted that the rule proscribes persons distributing securities to the public from bidding in the market place for either the same securities or securities convertible into the securities being distributed. The purpose of the rule is to avoid the situation where a potential purchaser is induced into buying securities being distributed because secret purchases by the issuer, or those affiliated with him, is driving the price up. It was the Commission's position that the announcement of the acquisition of shares so obtained has the same effect since it could lead the target's shareholders to believe that the violator's offer will succeed and that the public investors must tender immediately in order to participate. Accordingly, the Commission urged that any person injured by a violation of Rule 10b–6 should be accorded standing to pursue a private remedy by implication or under one of the several express remedies granted by Section 9(e) of the Exchange Act.

The Court held that a tender offeror, suing in its capacity as a competing takeover bidder, does not have standing to sue for damages under Section 14(e) of the Exchange Act and that the creation of an implied cause of action for damages is not necessary to effectuate the Congressional objective of protecting the shareholders of target companies. The Court also held that Rule 10b–6, which is aimed at maintaining an orderly market for the distribution of securities free from manipulative influences, is not available to compensate a takeover bidder who may have lost an opportunity to gain control of a target because of violations of the Federal securities laws.[83]

LITIGATION INVOLVING COMMISSION LITIGATION

Subpoena Enforcement Actions

SEC v. Touche Ross & Co. and Misag Tabibian—This subpoena enforcement action arose from the staff's investigation into possible violations of the securities laws by The Bohack Corporation (Bohack) (a publicly held corporation which operates a chain of grocery supermarkets) and its officers and directors. Specifically, the staff had been investigating possible material misstatements in, or omissions from, Bohack's financial statements from on or about January 24, 1973, and thereafter.

On July 30, 1974, Bohack filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. Prior to the filing of the Chapter XI petition, Peat, Marwick, Mitchell & Co. (PMM), a national auditing firm, had served as Bohack's independent accountants. The Commission's staff learned that National Bank of North America (NBNA), a major Bohack creditor, had hired Touche Ross & Co. (Touche Ross), another national auditing firm, to review the audit of Bohack (conducted by PMM) for the fiscal year ending January 26, 1974. The purpose of Touche Ross' review was to determine whether NBNA had any basis for prosecuting a civil action against PMM. Misag Tabibian, a partner in Touche Ross' New York City office, actually conducted the review.

The respondents refused to comply with subpoenae duces tecum served on them by the staff, asserting that any substantive information gathered

in the course of their review was protected from disclosure to the Commission on several grounds, including, among others, that: (1) the Touche Ross review was in the nature of "peer review"; and (2) there was a "confidentiality" agreement among the parties to the review, i.e., Touche Ross, NBNA, and PMM.

In its decision, the court considered and ultimately rejected the respondents' arguments and held, *inter alia*, that courts and administrative agencies are "entitled to every man's evidence." The court also held that the Commission's investigation was proper and stated that "the public interest will be served by a full and vigorous exploration of all relevant evidence, and information which could lead to relevant evidence."

In accordance with its decision, on October 28, 1977, the court issued an order compelling the respondents to comply with the subpoenae served upon them.

SEC v. Charles Jacquin et Cie., Inc.[85]—In connection with its investigations in the Matters of Emersons, Ltd. (Emersons) and Charles Jacquin et Cie., Inc. (Jacquin), the Commission's staff issued two subpoenae duces tecum to Jacquin, a distiller, and its principal officer, requesting the production of certain documents regarding payments by Jacquin of bribes, rebates and kichbacks to retailers of its liquor products as an inducement to purchase these products.

After a failure to comply with the subpoenae, the Commission applied to the United States District Court for the District of Columbia for an order requiring Jacquin to comply with the Commission's subpoenae. On September 8, 1976, after a hearing, the Court issued such an order. Subsequently, Jacquin failed to produce the documents which were required by the subpoenae and the Court's order.

The Commission thereupon moved the District Court for an order adjudging Jacquin and its two principal officers in civil contempt of the September 8 order, and further fining the company and its two principal officers and appointing a Special Agent to secure compliance with the September 8 subpoena enforcement order.

On December 2, 1976, after a hearing, the Court issued an order finding Jacquin and its two principal officers in civil contempt of the September 8 Order, fining the two officers $1,000 per day for each day after the order that the September 8 Order was not complied with, and appointing a Special Agent to gather from Jacquin's premises all material responsive to the Commission's subpoenae and to take such other necessary action to assure compliance with the Court's September 8 Order. The Special Agent's fees and expenses were ordered by the Court to be paid by Jacquin.

During the course of his 30 day mandate, the Special Agent conducted a thorough review of Jacquin's files and interviews of its personnel in an effort to secure compliance with the Court's Orders. As a result, the Special Agent delivered numerous documents to the Commission and filed with the Court a detailed report covering the methods and results of his inquiry.

The appointment of the Special Agent and his activities and findings, as set forth in his report, constituted an invaluable aid to the Commission's investigation and ultimately helped lead to the filing of a civil injunctive action against Jacquin and entry of a Judgment by consent against the company and its two principal officers.[86]

DELINQUENT REPORTS PROGRAM

Fundamental to the success of the disclosure scheme of the Federal securities laws is the timely filing in proper form and content of annual, periodic, current reports and other filings required of issuers and individuals. The Delinquent Reports Program was commenced by the staff three years ago to identify those situations wherein required reports have not been timely filed and, when appropriate, to recommend remedial enforcement action. Such enforcement actions can include suspension of trading in the securities of a registrant, thus alerting the public to the lack of current and accurate information and/or, when necessary, the initiation of an enforcement action which may include (1) the seeking of a court order requiring the filing of delinquent reports coupled with an injunction against further violations of the Exchange Act's reporting provisions and (2) a revocation or temporary suspension of a registrant's securities pursuant to Exchange Act Section 12(j).

The staff of the Commission continuously monitors compliance with the reporting requirements of Sections 13 and 15(d) of the Exchange Act. When Commission records indicate a delinquency in filing a report required to be filed by Exchange Act Section 13(a), the staff will attempt to, among other things, mail the registrant a notice of detected delinquency and request that a written explanation be filed under cover of Form 8–K. On July 14, 1975[87], the Commission announced its intention to include thereafter in a registrant's public file certain correspondence to and from a registrant concerning its delinquency notwithstanding the registrant's continued filing responsibilities. This procedure makes available to the public a delinquent registrant's reasons for failing to meet its statutory disclosure obligations.

The Commission suspended trading in the securities of approximately thirty registrants during the 1977 fiscal year primarily based on their failure to file at least one required annual report on Form 10–K. These suspensions were temporary—they ran for one ten-day period for each delinquent registrant.

During this fiscal year, the Commission initiated six civil actions against delinquent registrants and other persons seeking court orders compelling the immediate filing of delinquent reports or other required filings and permanently enjoining future analagous Exchange Act violations. Three of those actions were resolved by consents to the entry of, *inter alia*, final judgments of permanent injunction.[88] One case, *SEC v. Aminex Resources Corporation*, was resolved by the grant of a summary judgment in favor of the Commission which included a final judgment of permanent injunction after a preliminary injunction had previously been entered by the Court.[90] Two actions are pending.[89] Another civil action under this Program, *SEC v. MacMillan Ring-Free Oil Co. and John M. Shaheen*, is noteworthy because the Commission sought and obtained injunctive relief by consent against both the delinquent registrant and its chief executive officer.

In this fiscal year, the Commission also initiated three civil contempt proceedings based on delinquencies in spite of court ordered injunctions against such violations. One of these proceedings deserves particular mention. *SEC v. Southwestern Research Corporation* was a civil injunctive action settled by consent upon which a Final Judgment of Permanent In-

junction was entered on June 12, 1975 by the United States District Court for the District of Columbia. Having detected subsequent violations of this injunction, the Commission initiated a civil contempt proceeding on December 26, 1976 against both Southwestern Research Corporation and its president and chief executive officer. After a hearing on the matter, on February 28, 1977, the Court entered an order finding both parties in civil contempt of the Final Judgment of Permanent Injunction and ordering that the delinquent reports be filed and caused to be filed by a specified date. In addition, the Court ordered that should the delinquent reports not be filed by the specified date or, thereafter, if reports were not filed and caused to be filed in proper form with the Commission in compliance with the Final Judgment of Permanent Injunction, a civil fine would be imposed separately against the corporation in the amount of $100 and the named chief executive officer and president in the amount of $1000 for each report for each day that each report is not timely filed with the Commission.[91]

Two administrative proceedings were initiated by the Commission under the Program pursuant to Section 12(j) of the Exchange Act to determine whether the registration of securities with the Commission should be suspended or revoked due to the failure of the registrant to file, *inter alia*, Form 10–K annual reports and thus to comply with the reporting provisions of Section 13 (a) of the Exchange Act. These proceedings were the first instituted after the 1975 Amendments to the Securities Act which expanded Commission authority to suspend or revoke the registration of a security. Exchange Act Section 12(j) provides that the Commission, for the protection of investors, may deny, suspend for a period of not exceeding twelve months, or revoke the registration of a security, if the issuer has failed to comply with any provision of the Exchange Act. Thereafter, broker-dealers are prohibited from engaging in any transaction or inducing the purchase or sale of any such security. One of the proceedings has been concluded by the revocation of the registration of the security[92], and the other administrative proceeding is pending.[93]

CRIMINAL PROCEEDINGS

Members of the staff of the Commission who have investigated a case and are familiar with the facts involved and the applicable statutory provisions and legal principles are often requested by the Department of Justice to participate and assist in the trial of a criminal case referred to the Department, and to participate and assist in any subsequent appeal from a conviction.

The criminal cases that were handled during the fiscal year demonstrate the great variety of fraudulent practices that have been devised and employed against members of the investing public.

U. S. v. William H. Brown, et al.— In July 1977, Judge William W. Knox of the United States District Court for the Western District of Pennsylvania imposed the two longest white collar sentences in the history of the District upon two securities law violators.[94] This action was the culmination of an extensive investigation by attorneys from the Philadelphia Branch Office, the U. S. Attorney's Office, Pittsburgh, Pennsylvania, and the Fraud Section of the Criminal Division, United States Department of Justice. In the 22 count indictment, William H. Brown, Dale R. McDonald and Robert E. Lindsay, Jr., were charged with con-

spiracy, securities fraud, mail fraud and the sale of unregistered securities. The indictment alleged that, from January 1971 until November 1976, the defendants devised a scheme to defraud over 120 investors of more than $1,732,000 by the sale of unregistered investment contracts in Investors Security Leasing Corporation, Monroeville, Pennsylvania. Brown was also the former president of Investors Security Corporation, a broker-dealer which had been registered with the Commission until August 1975, when it was placed in SIPC trusteeship in connection with an injunctive action brought by the Commission staff based on alleged violations of the net capital and antifraud provisions of the Federal securities laws.

Many of the investors were unsophisticated persons who lived in remote areas of Pennsylvania and West Virginia and had invested their life savings in Investors Security Leasing Corporation. The indictment charged that as a result of this scheme, defendant Brown received in excess of $310,000; defendant McDonald in excess of $93,000; and defendant Lindsay in excess of $45,000.

Prior to trial,defendant Lindsay pled guilty to one count of conspiracy and one count of securities fraud. Lindsay was sentenced to three years imprisonment and three years probation. However, the court suspended all but sixty days of Lindsay's prison sentence and ordered Lindsay to serve the remaining sixty days imprisonment on thirty consecutive weekends.

In April 1977, following a three week jury trial, Brown and McDonald were convicted on 19 counts of the indictment. Brown was sentenced to a term of two years imprisonment on each of the mail fraud counts, such sentences to run concurrently; and a term of two years imprisonment on the conspiracy count. The court further ordered that each of Brown's two year sentences were to run consecutively.

McDonald was sentenced to a term of two years imprisonment on the conspiracy count. He received a term of one year imprisonment on each of the securities related counts, such sentences to run concurrently. He also was sentenced to a term of one year on each of the mail fraud counts, such sentences to run concurrently. The court further ordered that the above sentences were to run consecutively.

U.S. v. Maurice A. Lundy, et al.— On October 21, 1977, Maurice A. Lundy, a Rhode Island securities broker, pleaded guilty to two counts of an indictment charging him with violations of the registration and antifraud provisions of the Federal securities laws in connection with the offer and sale of scotch whiskey warehouse receipts.[95] The case was significant in that the underlying security was an investment contract in the form of a whiskey warehouse receipt representing ownership of raw spirits in the United Kingdom.

In 1973, Lundy had been a defendant in a civil action which resulted in the first judicial determination that scotch whiskey warehouse receipts were securities within the contemplation of the Securities Act.[96]

The criminal action, which developed from the civil action, involved the participation among the Company Fraud Department of Scotland Yard as well as the Commission and the Department of Justice and was based, among other things, upon the fact that, in selling the receipts, Lundy had misrepresented the investment as being "insured for profit" and omitted to disclose that the whiskey covered by the receipts was "not in good

order, set up properly or under expert supervision in the United Kingdom".

U.S. v. Robert W. Bradford and Bertsil L. Smith—On February 22, 1977, as a result of the Commission's referral of its investigative files to the Department of Justice concerning Robert W. Bradford and Bertsil L. Smith, both of Memphis, Tennessee, a Federal grand jury in Atlanta returned an indictment charging Bradford with eight counts of wire fraud and Smith with five counts of wire fraud in connection with transactions involving municipal securities.[97]

The indictment charged, among other things, that Smith and Bradford induced investors to purchase municipal bonds and converted the proceeds to their personal use.

After a four day jury trial Bradford was convicted on five counts of wire fraud and sentenced to two years of imprisonment and two years probation.

Smith pleaded guilty to two counts of wire fraud and was sentenced to serve eighteen months on one count and three years on the second count to run consecutively with the first count. The sentence on the second count was suspended, and Smith is to be placed on probation after serving eighteen months imprisonment.

U. S. v. Robert Berkson, et al.,—In June 1975, after investigations by the Commission and the United States Attorney for the Southern District of New York, a grand jury indicted Wilbur Hyman, Robert Berkson, Maurice Rind, and James Gallentine, former officers and employees of Packer, Wilbur & Co., Inc., a now defunct broker-dealer, for violations of, *inter alia*, the antifraud provisions of the Exchange Act. The defendants were charged with misappropriating customer securities held in trust by Packer, Wilbur & Co., Inc., selling and pledging those securities, and using the proceeds, which were in excess of $200,000, for their own benefit. The sales and pledges were accomplished by the use of forged stock transfer powers. After the return of the indictment, defendant Hyman fled to Spain, where he remains a fugitive.

In April 1976, prior to the trial of this matter, defendant Gallentine pleaded guilty to one count of the 10 count indictment and, thereafter, was sentenced to a term of imprisonment of 15 months and was fined $1,500. (Imposition of 12 months of the sentence was suspended.)

In June 1976, after a jury trial, defendants Berkson and Rind were found guilty. Defendant Berkson was sentenced to a term of imprisonment of five years, imposition of which was suspended, and was fined $25,000. Defendant Rind was sentenced to a term of imprisonment of 18 months and was fined $10,000.[98] Appeals by both of these defendants were argued before the Court of Appeals for the Second Circuit, which affirmed the convictions in December 1976. Thereafter, the United States Supreme Court refused to grant certiorari.

On April 13, 1977, the Commission ordered the institution of public administrative proceedings against Berkson, Rind, and Gallentine, based *inter alia*, on the above plea and convictions. On July 26, 1977, the order for administrative proceedings was amended as to Berkson and Rind, to include additional convictions arising from other, unrelated facts.

U.S. v. Larry L. Stevens, a/k/a Frank Goodman—In September 1977, a 39 count indictment was returned in the United States District Court for the Western District of Washington alleging violations of the mail fraud, securities fraud, and bankruptcy fraud statutes by Larry L. Stevens, a/k/a

Frank Goodman, former president of Northwestern Mortgage Investors Corporation (Northwestern), Seattle, Washington.[99] The defendant, through Northwestern and its related companies, and by numerous misstatements and omissions, raised over $5 million from approximately 1,700 investors under various estate oriented investment programs, the primary one being a four-year 8 percent promissory note secured by a fractional interest in real property. The company made extensive use of newspaper, magazine, television, radio and mail advertising, and attracted many elderly people on fixed incomes as investors. The alleged violations of the bankruptcy fraud statute arise out of concealment of assets and false statements in connection with the Chapter X Reorganization of Northwestern, in which the Commission, through the Seattle Regional Office, is a party. A trial date of March 6, 1978 was set by the court.

U. S. v. Dale E. Baker and Jake Evenblij—A 27 count indictment was returned by a grand jury on November 19, 1977, in the Western District of Washington after investigation by the Commission and the F.B.I.[100] The indictment charges the defendants with mail fraud, wire fraud, and securities fraud in connection with an "advance fee" scheme. It is alleged that the defendants used a Cayman Island, British West Indies company controlled by Baker and its purported United States agent, Insured Leasing Services, to obtain fees ranging from 1 percent to 10 percent of the promised loan from various borrowers in five states in exchange for "loan commitments," lease-purchase agreements, and letters of intent totaling over $11 million.

It is further alleged that the defendants promised to maintain the advance deposit in a trust account and utilized a forged letter from a Cayman Island bank verifying $5.5 million in funds to them in order to obtain the deposits. It is also alleged the defendants falsely claimed that a well-known brokerage firm was acting as their agent and had given them authority to use its name and reputation in connection with obtaining advance deposits from borrowers. The defendants are awaiting trial, which is scheduled for early 1978.

U.S. v. E. M. "Mike" Riebold— A 14 count indictment was returned by a Federal Grand Jury in Kansas City, Missouri charging E. M. "Mike" Riebold with 6 counts of securities fraud, 3 counts of wire fraud, and 5 counts of sales of unregistered securities.[101] The indictment alleged that Riebold defrauded purchasers of Time-Western Corporation's common stock and fractional undivided interests in oil and other mineral rights by means of false representations concerning the assets of Time-Western, the nature of the securities being sold, the rate the investor would receive on his investment and the use of the proceeds obtained from the sale of the securities. The indictment also alleged that Riebold failed to disclose the fact that he had been criminally convicted of securities fraud violations on December 19, 1975;[102] that the assets of Time-Western were inflated; and that a well of Time-Western had been tested by an expert and shown not to be commercially feasible. The indictment also alleged that Riebold converted substantial sums of money paid by purchasers of Time-Western securities to his own personal use and benefit.

On February 2, 1977, Time-Western and Riebold were enjoined by consent from further violations of the registration and antifraud provisions of the

Securities Act and Exchange Act in connection with the offer and sale of Time-Western securities.

USA, ex rel. SEC v. Syphers[103] — On January 13, 1977, the Commission instituted a criminal contempt proceeding in the United States District Court for the District of Arizona against John A. Syphers (Syphers). Syphers was charged with wilfully violating and disobeying an order of permanent injunction issued by the Honorable William P. Copple in 1974 enjoining him from violating the registration and antifraud provisions of the Federal securities laws in connection with the securities of Techni-Culture, Inc., or any other securities.[104] In the instant action Syphers was charged with engaging in conduct violative of this injunction. Specifically, he was charged with improperly removing restrictive legends from the securities of Tucker Drilling Company, Inc. in violation of the registration provisions of the Securities Act.

On June 24, 1977 Syphers entered a plea of guilty to criminal contempt and, on August 15, 1977, Judge Copple imposed a fine of $500.[105]

U.S. v. Barry S. Marlin — This case involved a scheme to defraud numerous investors of more than $12 million through a series of fraudulent schemes as alleged in an indictment returned on July 27, 1977.[106] One of the alleged schemes involved real estate limited partnerships with a significant tax shelter feature. In fact, the indictment alleges that no properties were purchased, but amounts invested were, in small part, returned to investors as purported income and the investors were induced to falsely report tax deductions. Other schemes alleged in the indictment include the fraudulent promotion of a Grand Cayman Island bank which had no real existence, the fraudulent solicitation of funds for purported deposit in that bank and the raising of funds through the sale of various securities to finance other fraudulent ventures of the defendant. The indictment further alleges that the defendant diverted a large part of the funds raised to his own use and benefit. The case is awaiting trial in Los Angeles.

U.S. v. Robert Waldman, et al.[107] — After an eight day trial, Robert Waldman and David Dick, general partners of several Massachusetts real estate limited partnerships were found guilty of fifteen counts of a fifty-eight count indictment charging them with securities fraud in the sale of limited partnership interests to 7,000 Massachusetts residents for approximately $35 million. The defendants were found to have defrauded investors by misrepresenting the financial condition of the partnerships, paying dividends out of capital or loans and by illegally diverting funds to companies controlled by the defendants. Dick was sentenced to ten years imprisonment and Waldman was sentenced to five years imprisonment.

U.S. v. Nicholas Chiola[108] — On February 27, 1976, Nicholas Chiola was indicted by a Federal Grand Jury in Chicago, Illinois. The indictment charged that while an employee of a registered broker-dealer, Chiola caused that broker-dealer to fail to make and keep certain records required under the Commission's recordkeeping rules. The case against Chiola was developed by the Commission's staff following the discovery that Chiola had embezzled substantial sums of money from his employer and concealed the theft through false and inaccurate entries on the broker-dealer's books and records.

Chiola was subsequently convicted and sentenced to a term of two years in prison based upon his plea of guilty.

After sentencing, Chiola appealed the conviction to the United States Court of Appeals for the Seventh Circuit. Among other things, Chiola challenged the sufficiency of the indictment on the grounds that because he himself was not a registered broker-dealer, he was unable to violate the Commission's recordkeeping rules, which apply only to broker-dealers.

The Court rejected Chiola's contention and affirmed the conviction. In doing so, it noted that under 18 U.S.C. §2(b), an accessory who lacks capacity for the crime is punishable as a principal if he causes another with capacity to perform the offense. The Court concluded that it was not necessary for the government to separately allege a specific violation of 18 U.S.C. §2(b) in order to hold Chiola as a principal to the crime charged. The Court also refused to find any ambiguity between the language of 18 U.S.C. §2(b) and the criminal provisions of the Securities Exchange Act of 1934.

In October, 1977, the Supreme Court denied Chiola's petition for *certiorari*.

U.S. v. Joseph B. Erni — This case involved the criminal prosecution for securities fraud of an individual with a long history of engaging in fraudulent activities. Joseph B. Erni had prior convictions in the District of Columbia and in United States District Court in Colorado.

In January 1971 and continuing through 1975, Erni created a series of enterprises which raised monies from the investing public under the guise of engaging in a variety of businesses including the ownership of lands located in Colorado, subdivision and residential development of real estate, and the manufacture, sale and installation of a patented waste disposal system. In fact the enterprises had little or no assets or operations. Monies raised from the public to fund these enterprises were diverted by Erni to repay investors in previous ventures and to pay his personal expenses.

On February 17, 1975 Erni consented to the entry of a final judgment of permanent injunction.[109]

On August 11, 1977 a Federal grand jury at Milwaukee, Wisconsin returned a multi-count indictment charging Erni with violations of the antifraud and registration provisions of the Federal securities laws and with interstate transportation of money obtained by fraud in connection with the offer and sale of securities of Western Armon Systems, Inc. The indictment also charged Erni with making materially false and misleading statements concerning that company including its ownership of franchise rights to manufacture and sell a waste treatment system, its projected gross profits and the expected market value of the company's common stock.[110]

U.S. v. Institutional Securities of Colorado, Inc., et al. — This case involves both a civil and criminal action against a Denver, Colorado broker-dealer Institutional Securities of Colorado, Inc. (ISOC) and three of its principles who, by falsifying records and bookkeeping entries and by misappropriating customers' assets, continued in business while insolvent and in violation of the Commission's net capital rule.

In the fall of 1976, the Commission filed a civil action seeking a temporary restraining order and permanent injunction. The Temporary Restraining Order was entered September 29, 1976.

The Commission's files were subsequently referred to the Department of Justice, and the matter was presented to a Federal grand jury for the District of Colorado in Denver. A Denver Regional Office staff attorney was ap-

pointed Special Assistant U.S. Attorney to assist in the presentation of the matter to the grand jury and trial of the case.

On April 15, 1977, a 40-count indictment was returned charging ISOC, Abraham Goldberg, William Bernhard, and Stanley Richards, with violations of the net capital provisions of the securities laws, false filings with the Commission, falsification of books and records, fraud in the sale of stock, misappropriation and hypothecation of customers' funds and securities, mail fraud and wire fraud, among other things.[111]

On July 28, 1977 Goldberg and Bernhard pleaded guilty to a three-count information charging them with violating the antifraud and net capital provisions of the Exchange Act and with conspiracy to violate the antifraud, net capital, record keeping and broker-dealer reporting provisions of the Exchange Act as well as certain sections of Title 18 of the U.S. Code. Also on July 28, 1977 ISOC pleaded *nolo contendere* to violating the net capital provisions of the Exchange Act. On September 2, 1977 Goldberg and Bernhard were sentenced to eight days in jail, a $5,000 fine and two years probation which was conditioned upon each performing 408 hours of charitable work. On the same day, ISOC, presently in SIPC trusteeship, was sentenced to a fine of one dollar. At the time of sentencing, the 40-count indictment against the defendants was dismissed.

On September 29, 1977 Stanley Richards, who had also been charged in the indictment was found not guilty.[112]

The Richardson & Co. Cases — As a result of an extensive Commission and Grand Jury investigation involving the collapse in April 1975 of Richardson & Co., a brokerage firm located in Century City, California, four indictments were returned in Los Angeles, California against 10 individuals alleging conspiracy, securities fraud, wire fraud and misapplication of bank funds, and one criminal action was brought in New York City against one person charging willful failure to comply with the broker-dealer recordkeeping requirements.

Richardson & Co. was a "third market" broker which arranged for the purchase and sale of large blocks of stock negotiated directly between major financial institutions without using the national stock exchanges. The prosecutions involved a massive illegal short selling scheme involving large blocks of exchange listed securities and secret kickback schemes between Richardson & Co. and employees of four major financial institutions. Ten of the eleven defendants named in the indictments pleaded guilty to various counts of the indictments and have been sentenced. Eight of the ten received prison sentences. The remaining defendant, Thomas Patrick Richardson, president and controlling shareholder of Richardson & Co., was convicted on May 1, 1976 in a bench trial before the Honorable W. Matthew Byrne and sentenced to a six year prison term, which conviction is currently on appeal. He is awaiting trial on a second indictment in which the other co-defendants have already been convicted and sentenced.

U.S. v. Thomas P. Richardson, et al.[113]—This case involved a 46-count indictment alleging that Thomas Patrick Richardson, Thomas C. Thomas, Jr., treasurer of Richardson & Co., and Kevin Kelley and John E. Kelley, vice presidents and traders at Richardson & Co., effected in excess of $25 million worth of illegal short sales of stock and fraudulently represented to various brokerage firms that

Richardson & Co. owned the stock it purported to be selling through these brokerage firms. The indictment further alleged that the defendants borrowed in excess of $25 million of stock from various stock lenders including Harvard University, Yale University, Columbia University and Bowery Savings Bank and used this borrowed stock to make delivery to the various stock brokerage firms to whom they fraudulently represented that they owned the stock. The indictment further alleged that the defendants concealed their short sales and stock borrowings by creating fictitious and fraudulent entries on Richardson & Co.'s books and records and by filing false financial statements with the Commission and the NASD which failed to reveal the short sales and the liability resulting from the stock borrowings.

Also included in the indictment, on one count of wire fraud, was Joseph C. Werba, former president of Wells Fargo Security Clearance Corporation, a wholly-owned subsidiary of Wells Fargo Company. Werba was charged with the unauthorized clearing of stock transactions for Richardson & Co. and making of unauthorized loans to the firm. In addition to the 6 year prison sentence for Thomas Patrick Richardson, Thomas C. Thomas was sentenced to two years imprisonment; Kevin Kelley and John Kelley were both sentenced to one year imprisonment and Werba was sentenced to nine months imprisonment.

U. S. v. John C. Gammage[114]—This case concerned a one-count information filed in New York City charging the defendant with fraudulently obtaining money from the New York City brokerage firm of Shields Model Roland, Inc. The scheme, as alleged, involved a charging of interest by Wells Fargo Securities Clearance Corporation at the direction of Joseph C. Werba to the Shields firm when, in fact, no interest was charged or received by Wells Fargo Clearance Corporation. According to the information, Werba and Gammage divided the purported interest payments of $10,700 made by the Shields firm. The defendant Gammage pleaded guilty to the charge of fraudulently falsifying the brokerage firm's books and, on February 15, 1977, he was sentenced to one year imprisonment, which was suspended, and he was placed on probation for one year.

U.S. v. Charles Kummer, et al.[115]—The case involved a 23 count indictment alleging that Charles Kummer, while employed as a Senior Securities Trader at Bankers Trust Co. of New York, received secret cash kickbacks amounting to approximately $800,000 from the defendants Thomas Patrick Richardson, John Richardson, and James Richardson in return for causing Bankers Trust Co. of New York to sell in excess of 8.8 million shares of stock of various companies owned by pension funds through Richardson & Co. The indictment further alleged that the defendant Kummer intentionally bought stocks for pension funds managed by Bankers Trust Co. of New York from Richardson & Co. at prices which were higher, and sold stocks to Richardson & Co. at prices which were lower, than those available at the time the trades were executed resulting in losses to the pension funds of approximately $3 million during the period 1972 through 1974. The indictment further alleged that Kummer received the secret kickbacks based upon a percentage of profits Richardson & Co. made in stock trades with Bankers Trust Co. of New York.

Defendants Kummer, John Richardson and James Richardson pleaded

guilty to various counts of the indictment. Kummer was sentenced to six months imprisonment, and an additional five years probation. Additionally, Kummer was fined $5,000 and ordered to make restitution in the amount of $222,500. John Richardson was sentenced to six months in jail and a $5,000 fine and James Richardson to 4-½ months in jail and a $5,000 fine. Thomas P. Richardson is awaiting trial.

U.S. v. Richard Douglas Avery[116]—The indictment charged that defendant Avery, while employed as a senior securities trader at Financial Programs, Inc., an investment adviser which furnished investment advice to a number of Denver based mutual funds, violated provisions of the Investment Company Act by accepting secret cash kickbacks of $6,000 and $9,000 from Richardson & Co. in return for causing the mutual funds affiliated with Financial Programs, Inc., to buy and sell substantial amounts of securities through Richardson & Co. Avery pleaded guilty to both counts of the indictment and was sentenced to 9 months in jail and fined $10,000 for each count.

U.S. v. Peter Klaus[117]—This indictment charged that the defendant Peter Klaus, while employed as a stock trader in the trading department of Fidelity Union Trust Company, Newark, New Jersey, engaged in securities fraud by accepting a cash kickback of $10,000 from Richardson & Co. in return for causing Fidelity Union Trust & Co. to sell 114,900 shares of Travelers Corp. common stock in the amount of $3,734,250 through T.P. Richardson & Co. Klaus pleaded guilty to the charge and was fined $4,000 and placed on three years probation.

U.S. v. Westco Financial Corporation et al.—This case involves the fraudulent unregistered interstate distributions of the securities of two corporations and one limited partnership. The principal of Westco Financial Corporation (Westco), a Denver, Colorado broker-dealer, and an officer, director or general partner in all three issuers effected these distributions through Westco in participation with the other general partner and corporate officers and directors.

As a part of the same course of conduct, securities and other assets of Westco customers were misappropriated and converted in a number of ways, including the placing of worthless securities in discretionary accounts, executing unauthorized transactions, converting customers' securities and free credit balances and hypothecating customers' securities. In addition, in order to conceal the financial condition of Westco and to conceal the aforementioned conduct, Westco's books and records were falsified and Westco filed a false report with the Commission.

On November 11, 1975 the Commission filed a civil action alleging violations of the registration, antifraud, record keeping and reporting provisions of the Federal securities laws. The Commission sought injunctions against Westco, its principal, Old Colorado City Corporation, its officers and directors, Westco Investment Corporation, its president and controlling shareholder, Tanglewood Ranch 50 –A, Ltd. and its general partners. The Commission also sought appointment of receivers for Old Colorado City Corporation, Westco Investment Corporation and Tanglewood Ranch 50 –A, Ltd. As a part of the same action, the Securities Investors Protection Corporation applied for the appointment of a SIPC trustee. On November 14, 1975, the Court entered an Order granting the Commission's

and SIPC's request for permanent injunction. The defendants neither admitted nor denied the Commission's allegations.[118]

The Commission files were subsequently referred to the Department of Justice, and the matter was presented to a Federal grand jury for the District of Colorado. A Denver Regional Office staff attorney was appointed Special Assistant U.S. Attorney to assist in the prosecution of this case.

On May 12, 1977 an indictment was returned charging Westco and Charles Julius Johnson (Johnson), an officer and director of Westco, with violating the antifraud and broker-dealer reporting provisions of the Exchange Act and Milford A. Sims (Sims), of Cody, Wyoming, with violating the antifraud provisions of the Exchange Act.[119]

On July 26, 1977, Johnson pleaded guilty to two counts of securities fraud, and on September 1, 1977, he was sentenced to 3–1/2 years probation, with the requirement he make restitution to investors. On July 29, 1977, Sims pleaded guilty to one count of securities fraud, and on September 1, 1977, he was sentenced to 3–1/2 years probation with the requirement he make restitution to investors. On September 16, 1977, a plea of *nolo contendere* by Westco was accepted to one count of securities fraud, and the company was fined $5,000.[120]

Organized Crime Program

The prosecution of securities cases is often based primarily on circumstantial evidence requiring extensive investigation by highly trained personnel. The difficulties in such investigations and prosecutions are compounded when elements of organized crime are involved. Witnesses are usually reluctant to cooperate because of threats or fear of physical harm. Books, records, and other documentary evidence essential to the investigation and to a successful prosecution may be destroyed or nonexistent. The organized crime element is adept at disguising its participation in transactions, through the use of aliases and nominee accounts, by operating across international boundaries, and by taking advantage of foreign bank secrecy laws. It frequently operates through "fronts" and infiltrates legitimate business concerns. Organized crime also has an extensive network of affiliates throughout this country in all walks of life, and in many foreign nations. As a result of these problems, civil and criminal litigation involving organized crime can result in unusually lengthy proceedings. Despite these difficulties, the Commission, working in cooperation with other enforcement agencies, has been able to make major contributions to the fight against organized crime.

During the fiscal year 1977, the organized crime program focused principally on two goals: (1) increasing the Commission's effectiveness in obtaining current reliable information relating to organized criminal activity in the securities industry; and (2) aggressively pursuing to completion investigations of situations brought to the Commission's attention as potentially involving the infiltration of elements of organized crime into the industry.

In order to increase the flow of reliable data, an intelligence unit was established in 1974 in the Division of Enforcement. Its principal function is to maintain channels of communication with state, local and other Federal agencies, as well as comparable agencies of foreign governments, which might have information on organized criminal activity in the securities industry. Information received by

this unit is correlated with other available information and evaluated in light of the Commission's responsibilities under the Federal securities laws. Information indicating possible securities law violations by organized criminal elements is relayed by the intelligence unit to those other members of the staff whose principal duties are to investigate activity by organized crime. This program has already generated a significant number of new cases, as well as contributing new sources of information to ongoing investigations.

In furtherance of the intelligence function, members of the staff have continued to participate in seminars and lectures sponsored by state and local governments, and their representatives have been included in the Commission's training programs. This has alerted local authorities to the role of the Commission in curtailing organized criminal activity in the securities industry. Members of the Commission staff are also assigned on a full time basis to certain of the Justice Department's Organized Crime Strike Forces. Both the Strike Forces and the Commission staff have benefited thereby in learning more about organized criminal activity in the securities industry.

As a result of the organized crime unit's enforcement efforts during the past fiscal year, the Commission filed injunctive actions naming 32 persons and contributed to the return of indictments naming 18 individuals and the convictions of 14 of them. Four persons considered to be important members of organized crime were enjoined, two such members were indicted and one was convicted on indictments returned in prior years.

The Commission staff assigned to the New York Organized Crime Division Strike Force conducted an extensive investigation into the activities of Tri-State Energy, Inc. (Tri-State). The investigation disclosed that from June 1972 through June 1973 certain officers and principal shareholders of Tri-State joined forces with an officer of Bankers Trust Company, of New York and several known securities violators for purposes of enriching themselves at the expense of lending institutions, creditors and the general investing public through a sophisticated bank and stock swindle.

In order to accomplish their objectives, they caused the issuance of false and misleading financial statements and reports, prepared fraudulent purchase orders, misrepresented certain material facts to banks, artificially inflated the market price of certain securities, and distributed unregistered stock. Following the end of the fiscal year, as a result of this investigation, a Federal grand jury in the Southern District of New York indicted C. W. Deaton, Leonard James, William Rubin, Otto Sebold, Peter Crosby and Raymond J. Ludwig.

Cooperation With Other Enforcement Agencies

In recent years the Commission has given increased emphasis to cooperation and coordination with other enforcement agencies, including the self-regulatory organizations, enforcement agencies at the state and local level, and certain foreign agencies. Its programs in this area cover a broad range. For example, the Commission believes that certain cases are more appropriately enforced at the local rather than the Federal level where the activities, while perhaps violating the Federal securities laws, are essentially of a local nature. In these instances, the Commission authorizes the referral of the case to the appropriate state or local agency, and members of the staff familiar with it are made available for

direct assistance to that agency in its enforcement action. A member of the staff has been specifically designated as a liaison with state enforcement and regulatory authorities.

The Commission also has fostered programs designed to provide a comprehensive exchange of information concerning mutual enforcement problems and possible securities violations. During the fiscal year, it continued its program of annual regional enforcement conferences. These conferences are attended by personnel from state securities agencies, the U.S. Postal Service, Federal, and state and local offices of self-regulatory associations, such as the NASD. They provide a forum for the exchange of information on current enforcement problems and new methods of enforcement cooperation. One result of these conferences has been the establishment of programs for joint investigations. Although the conferences were initially hosted by the Commission's regional offices, many state and local agencies are now serving as sponsors or co-sponsors.

FOREIGN RESTRICTED LIST

The Commission maintains and publishes a Foreign Restricted List which is designed to put broker-dealers, financial institutions, investors and others on notice of unlawful distributions of foreign securities in the United States. The list consists of names of foreign companies whose securities the Commission has reason to believe have been, or are being, offered for public sale in the United States in violation of the registration requirements of Section 5 of the Securities Act. The offer and sale of unregistered securities deprives investors of all the protections afforded by the Securities Act, including the right to receive a prospectus containing the information required by the Act for the purpose of enabling the investor to determine whether the investment is suitable for him. While most broker-dealers refuse to effect transactions in securities issued by companies on the Foreign Restricted List, this does not necessarily prevent promoters from illegally offering such securities directly to investors in the United States by mail, by telephone, and sometimes by personal solicitation. During the past fiscal year, two corporations were added to the Foreign Restricted List, bringing the total number of corporations on the list to 101. The following companies were added during the year:

Mercantile Bank & Trust Company, Limited[121] — Information came to the attention of the Commission that this corporation, with an office in Kingstown, on St. Vincent in the Windward Islands, was offering and selling by mail, instruments purporting to be certificates of deposit, among other things, to investors in the United States. No registration statement under the Securities Act of 1933 has been filed with the Commission covering any of these instruments. Accordingly these offers and sales are in violation of Section 5 of the Securities Act.

Among the other instruments issued were letters of credit, cashiers checks, lines of credit, numbered-account checks and other evidence purporting to reflect cash on deposit.

International Trade Development of Costa Rica, S.A.[122] — The Commission received information that International Trade Development of Costa Rica, S.A. was engaged in publicly offering its securities, represented to be promissory notes, in the United States. No registration statement under the Securities Act has been filed with the Commission covering these

securities. Accordingly, the offering is in violation of Section 5 of the Securities Act.

NOTES TO PART 4

[1]See Office of Consumer Affairs Report.
[2]Securities Act Release No. 5841 (July 5, 1977), 12 SEC Docket 1098.
[3]Securities Exchange Act Release No. 13225 (February 1, 1977), 11 SEC Docket 1628.
[4]Securities Exchange Act Release No. 12851 (October 1, 1976), 10 SEC Docket 655.
[5]76 Civ. 4489 (CBM).
[6]Securities Exchange Act Release Nos. 13766 and 13769 (July 19, 1977), 12 SEC Docket 1277, 1284.
[7]Securities Exchange Act Release No. 13770 (July 19, 1977), 12 SEC Docket 1286.
[8]Securities Exchange Act Release No. 13766 (July 19, 1977), 12 SEC Docket 1283.
[9]Securities Exchange Act Release No. 13801 (July 25, 1977), 12 SEC Docket 1378.
[10]Litigation Release No. 7579 (September 23, 1976), 10 SEC Docket 544.
[11]Securities Exchange Act Release No. 13268 (February 16, 1977), 11 SEC Docket 1724.
[12]Securities Exchange Act Release No. 12752 (September 1, 1976), 10 SEC Docket 327.
[13]Securities Exchange Act Release No. 13976 (September 21, 1977), 13 SEC Docket 120.
[14]Securities Exchange Act Release No. 12930 (October 27, 1976), 10 SEC Docket 790.
[15]Securities Exchange Act Release No. 13213 (January 28, 1977), 11 SEC Docket 1623.
[16]Litigation Release No. 8163 (October 17, 1977), 13 SEC Docket 407.
[17]Litigation Release No. 7845 (March 24, 1977), 11 SEC Docket 2147.
[18]Litigation Release No. 6349 (May 2, 1974), 4 SEC Docket 258. See 41st Annual Report, p. 38.
[19]SEC v. Penn Central Co., et al., 425 F. Supp. 593 (E.D. Pa. 1976).
[20]Litigation Release No. 8057 (August 5, 1977), 12 SEC Docket 1510.
[21]Litigation Release No. 8059 (August 8, 1977), 12 SEC Docket 1511.
[22]Litigation Release No. 8116 (September 15, 1977), 13 SEC Docket 105.
[23]Litigation Release No. 7412 (May 26, 1976), 9 SEC Docket 754.
[24]Litigation Release No. 8001 (June 28, 1977), 12 SEC Docket 1093.
[25]Litigation Release No. 7887 (April 26, 1977), 12 SEC Docket 271.
[26]Litigation Release No. 7777 (February 10, 1977), 11 SEC Docket 1112.
[27]Litigation Release No. 8134 (September 30, 1977), 13 SEC Docket 296.
[28]Litigation Release No. 8132 (September 28, 1977), 13 SEC Docket 259.
[29]Litigation Release No. 8146 (September 6, 1977), 13 SEC Docket 7.
[30]Litigation Release No. 8073 (August 18, 1977), 12 SEC Docket 1563.
[31]Litigation Release No. 8026 (July 13, 1977), 12 SEC Docket 1153.
[32]Litigation Release No. 7550 (September 7, 1976), 10 SEC Docket 437.
[33]Litigation Release No. 7759 (January 27, 1977), 11 SEC Docket 1581.
[34]Litigation Release No. 7951 (June 1, 1977), 12 SEC Docket 747.
[35]Litigation Release No. 8164 (October 17, 1977), 13 SEC Docket 407.
[36]Litigation Release No. 7816 (March 9, 1977), 11 SEC Docket 1984.
[37]Litigation Release No. 7915 (May 10, 1977), 12 SEC Docket 418.
[38]Litigation Release No. 7828 (March 16, 1977), 11 SEC Docket 2039.
[39]Litigation Release No. 7464 (June 24, 1976), 9 SEC Docket 982.
[40]See 42nd Annual Report, p. 118.
[41]Litigation Release No. 7863 (April 8, 1977), 11 SEC Docket 2260.
[42]Litigation Release No. 7841 (March 23, 1977), 11 SEC Docket 2145.
[43]Litigation Release No. 7939 (May 19, 1977), 12 SEC Docket 506.
[44]Litigation Release No. 8036 (July 25, 1977), 12 SEC Docket 1410.
[45]Litigation Release No. 8050 (August 2, 1977), 12 SEC Docket 1453.
[46]Litigation Release No. 7888 (April 27, 1977), 12 SEC Docket 272.
[47]Litigation Release No. 7965 (June 9, 1977), 12 SEC Docket 811.
[48]Litigation Release No. 7929 (May 20, 1977), 12 SEC Docket 501.
[49]Litigation Release No. 7717 (December 30, 1976), 11 SEC Docket 1398.
[50]Litigation Release No. 8031 (July 19, 1977), 12 SEC Docket 1342.
[51]Litigation Release No. 7709 (December 27, 1976), 11 SEC Docket 5.
[52]Litigation Release No. 7596 (June 7, 1977), 12 SEC Docket 806.
[53]Litigation Release No. 7998 (June 28, 1977), 12 SEC Docket 1092.
[54]Litigation Release No. 7603 (October 6, 1976), 10 SEC Docket 687.
[55]Litigation Release No. 8131 (September 27, 1977), 13 SEC Docket 258.
[56]Litigation Release No. 7770 (February 2, 1977), 11 SEC Docket 1109.
[57]Litigation Release No. 7650 (November 15, 1976), 10 SEC Docket 980.
[58]Litigation Release No. 7760 (January 31, 1977), 11 SEC Docket 1662.
[59]Litigation Release No. 7736 (January 13, 1977), 11 SEC Docket 1504.
[60]Litigation Release No. 7622 (October 28, 1976), 10 SEC Docket 831.
[61]Litigation Release No. 7248 (January 23, 1976), 8 SEC Docket 1176.

[62]Litigation Release No. 7837 (March 23, 1977), 11 SEC Docket 2143.

[63]Litigation Release No. 7986 (June 22, 1977), 12 SEC Docket 1007.

[64]Litigation Release No. 7937 (May 25, 1977), 12 SEC Docket 505.

[65]Litigation Release No. 7297 (February 26, 1976), 9 SEC Docket 2.

[66]*SEC v. E.L. Aaron & Co., Inc., et al.*, Litigation Release No. 7966 (June 9, 1977), 12 SEC Docket 8.

[67]Litigation Release No. 7909 (May 5, 1977), 12 SEC Docket 339.

[68]Litigation Release No. 7970 (June 10, 1977), 12 SEC Docket 894.

[69]Litigation Release No. 7949 (June 1, 1977), 12 SEC Docket 747.

[70]552 F.2d 402 (C.A. 2, 1977).

[71]554 F. 2d 790 (C.A. 7, 1977).

[72]The Supreme Court had remanded the case in light of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1975). See 425 U.S. 929 (1976).

[73]524 F. 2d 1064, 1066 (C.A. 7, 1975).

[74]554 F.2d at 794.

[75]CCH Fed. Sec. Rep., para. 96,141.

[76]U.S. Sup. Ct., Nos. 75–353, 75–354, 75–355.

[77]*Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 303 F. Supp. 191 (S.D.N.Y., 1969), *affirmed in part and reversed and remanded in part*, 426 F.2d 569 (C.A. 2, 1970) (*en banc*); on remand, 337 F. Supp. 1128 (S.D.N.Y., 1971), *reversed and remanded*, 480 F.2d 341 (C.A. 2), *certiorari denied*, 414 U.S. 910 (1973); on remand, 384 F. Supp. 507 (S.D.N.Y., 1974), *modified*, 516 F.2d 172 (C.A. 2, 1975). In addition to the Commission's action against Bangor Punta and Piper for violation of Section 5 of the Securities Act, in which a consent injunction was entered, without defendants admitting or denying any of the allegations, the Commission sued Bangor Punta alleging violations of Section 17a of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, with respect to Bangor Punta's misleading registration statement. *SEC v. Bangor Punta Corp.*, 331 F. Supp. 1154 (S.D.N.Y., 1971), *affirmed in part and reversed in part*, 480 F.2d 341 (C.A. 2), *certiorari denied*, 414 U.S. 910 (1973).

[78]Senate Committee on Banking and Currency, Hearings Before the Subcommittee on Securities on S.510, 90th Cong., 1st Sess. 16, 33 (1967).

[79]S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967); H.R. Rep. No. 1711, 90th Cong., 2nd Sess. 4 (1968).

[80]*J.I. Case. Co. v. Borak*, 377 U.S. 426 (1964), which had also relied on Section 27 of the Exchange Act.

[81]422 U.S. 66, 78 (1975).

[82]*See, e.g., Lowenschuss v. Kane*, 520 F.2d 255 (C.A. 2, 1975) (tendering shareholder may sue offeror); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579 (C.A. 5), *certiorari denied*, 419 U.S. 873 (1974) (non-tendering shareholder); *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (C.A. 2, 1969) (target company may sue for an injunction offeror); *H.K. Porter Co. v. Nicholson File Co.*, 482 F.2d 421 (C.A. 1, 1973) (offeror may sue to enjoin target from making misleading statements). *Cf. Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 798-99 (C.A. 2, 1969); *Union Pacific Railroad Co. v. Chicago and North Western Railway Co.*, 226 F. Supp. 400, 406 (N.D. Ill., 1964) (proxy contest).

[83]430 U.S. 1 (1977).

[84]Fed. Sec. L. Rep. (CCH), Par. 96,184 at 92,337 (S.D.N.Y. September 30, 1977).

[85]United States District Court for the District of Columbia, (Misc. No. 76-0141 filed August 23, 1976).

[86]Litigation Release No. 8164 (October 17, 1977), 13 SEC Docket 407.

[87]Securities Exchange Act Release No. 11534 (July 14, 1975), 7 SEC Docket 405.

[88]*SEC v. Getty Financial Corporation*, Litigation Release No. 7743 (January 19, 1977), 11 SEC Docket 1543; *SEC v. MacMillan Ring-Free Oil Co. and John M. Shaheen*, Litigation Release No. 7900 (May 2, 1977), 12 SEC Docket 335–336; and *SEC v. Ormont Drug & Chemical Co., Inc.*, Litigation Release No. 7987 (June 23, 1977), 12 SEC Docket 1008.

[89]Litigation Release Nos. 7884 (March 24, 1977), 11 SEC Docket 2147, and 8124 (September 23, 1977), 13 SEC Docket 256.

[90]*SEC v. Canadian Javelin Ltd., et al.*, Litigation Release Nos. 7642 (November 10, 1976), 10 SEC Docket 948 and 7779 (February 14, 1977), 11 SEC Docket 1772 and *SEC v. Bethmann Bank et al.*, Litigation Release No. 7933 (May 23, 1977), 12 SEC Docket 504.

[91]Litigation Release No. 7823 (March 16, 1977), 11 SEC Docket 2038.

[92]*In the Matter of Western Orbis Company*, Securities Exchange Act Release No. 13610 (June 9, 1977), 12 SEC Docket 772.

[93]*In the Matter of Ametex Corporation*, Securities Exchange Act Release No. 13418 (March 31, 1977), 11 SEC Docket 2156.

[94]Litigation Release No. 8026 (July 14, 1977), 12 SEC Docket 1153.

[95]Litigation Release No. 8168 (October 26, 1977), 13 SEC Docket 503.

[96]*SEC v. M. A. Lundy*, 362 F. Supp. 226 (D.C.R.I., 1973).

[97]Litigation Release No. 7813 (March 7, 1977), 11 SEC Docket 1983.

[98]Litigation Release Nos. 6955 (June 30, 1975), 7 SEC Docket 369; 7477 (July 1, 1976), 9 SEC Docket 1011; and 7530 (August 20, 1976), 10 SEC Docket 308.

[99]Litigation Release No. 8176 (October 31, 1977), 13 SEC Docket 630.

[100]Litigation Release No. 8185 (November 7, 1977), 13 SEC Docket 728.

[101]Litigation Release No. 8007 (June 30, 1977), 12 SEC Docket 1138.

[102]Litigation Release No. 7164 (November 12, 1975), 8 SEC Docket 514.

[103]CR. 77–15–PHX–WPC (D. Ariz).

[104]*SEC v. Techni-Culture, Inc., et al.*, Civil Action File No. 73–473–PHX– WPC.

[105]Litigation Release No. 8102 (September 6, 1977), 13 SEC Docket 1.

[106]Litigation Release No. 8113 (September 13, 1977), 13 SEC Docket 103.

[107]Litigation Release No. 8030 (July 19, 1977), 12 SEC Docket 1369.

[108]Litigation Release No. 7513 (August 5, 1976), 10 SEC Docket 4.

[109]Litigation Release No. 7272 February 10, 1976), 8 SEC Docket 1291; Litigation Release No. 7309 (March 11, 1976), 9 SEC Docket 176.

[110]Litigation Release No. 8086 (August 25, 1977), 12 SEC Docket 1594. Subsequently, Erni pleaded guilty to one count of the indictment.

[111]Litigation Release No. 7934 (May 25, 1977), 12 SEC Docket 504.

[112]Litigation Release No. 8167 (October 26, 1977), 13 SEC Docket 502.

[113]Litigation Release Nos. 7155 (November 7, 1975), 8 SEC Docket 428; and 7438 (June 9, 1976), 9 SEC Docket 868.

[114]U.S.D.C., S.D.N.Y., 76 CR 1155 (TPG).

[115]Litigation Release No. 8136 (September 30, 1977), 13 SEC Docket 297.

[116]U.S.D.C. C.D. Cal., CR–76– 1556–LEW.

[117]U.S.D.C. C.D. Cal., CR–76– 1557–LTL.

[118]Litigation Release No. 7177 (November 25, 1975), 8 SEC Docket 584.

[119]Litigation Release No. 7942 (May 26, 1977), 12 SEC Docket 507.

[120]Litigation Release No. 8158 (October 14, 1977), 13 SEC Docket 405.

[121]Securities Act Release No. 5751 (October 5, 1976), 10 SEC Docket 692.

[122]Securities Act Release No. 5725 (July 16, 1976), 10 SEC Docket 57.

Part 5
Investment Companies and Advisers

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Under the Investment Company Act of 1940 and the Investment Advisers Act of 1940, the Commission is charged with extensive regulatory and supervisory responsibilities over investment companies and investment advisers. The responsibility for discharging these duties lies with the Division of Investment Management.

Unlike other Federal securities laws, which emphasize disclosure, the Investment Company Act provides a regulatory framework within which investment companies must operate. Among other things, the Act: (1) prohibits changes in the nature of an investment company's business or its investment policies without shareholder approval; (2) protects against management self-dealing, embezzlement or abuse of trust; (3) provides specific controls to eliminate or mitigate inequitable capital structures; (4) requires that an investment company disclose its financial condition and investment policies; (5) provides that management contracts be submitted to shareholders for approval and that provision be made for the safekeeping of assets; and (6) sets controls to protect against unfair transactions between an investment company and its affiliates.

Persons in the business of advising others about securities transactions for compensation must register with the Commission under the Investment Advisers Act. This requirement was extended by the Investment Company Amendments Act of 1970 to include advisers to registered investment companies. The Advisers Act, among other things, prohibits fraudulent, deceptive or manipulative practices, performance fee contracts which do not meet certain requirements, and advertising which does not comply with certain restrictions.

The assets of investment companies and assets under the management of investment advisers constitute important resources for investment in the nation's capital markets. In order to continue their role of channeling individual savings into capital needed for industrial development, investment companies and investment advisers must have the confidence of investors. The safeguards provided by the Investment Company and Investment Advisers Acts contributes to sustaining such confidence.

NUMBER OF REGISTRANTS AND INSPECTIONS

As of September 30, 1977, there were 1,333 active investment companies registered under the Investment Company Act. This represents an increase of 22 in the number of active

registered companies since September 30, 1976. The 1,311 active investment companies registered on that date represented an increase of 25 over the number of active registered companies on June 30, 1976. On September 30, 1977, 4,823 investment advisers were registered with the Commission representing an increase of 781 from September 30, 1976. The 4,042 investment advisers registered on that date represented an increase of 185 since June 30, 1976. Further data is presented in Part 9 of the Report.

During the Transitional Quarter the Commission's staff conducted examinations of 52 investment companies and 92 investment advisers, and during the 1977 fiscal year 286 investment companies and 459 investment advisers were examined. It is the Commission's ultimate objective to examine all investment companies and investment advisers within the first year after registration, and once every other year thereafter. This should provide effective regulatory oversight. As a result of the Commission's examination and investigation program in the Transitional Quarter, numerous violations of the Investment Company Act and of the Investment Advisers Act were uncovered. Two investment company and five investment adviser matters were referred to the Division of Enforcement for possible action during the Transitional Quarter, and during the 1977 fiscal year 16 investment company and 25 investment adviser matters were referred to Enforcement.

RULES

Rules Concerning Applications for Orders Filed Under Investment Advisers Act

On May 13, 1976, the Commission proposed the adoption of Rules 0–4, 0–5 and 0–6[1] under the Advisers Act, to establish rules governing the filing and processing of applications for orders under the Advisers Act. The proposed rules, which were similar to the rules under the Investment Company Act concerning applications, were intended to provide the Commission with the kind of formal and complete record normally required as the basis for Commission action on applications for orders. On September 3, 1976, the Commission announced the adoption of Rules 0–2, 0–5 and 0–6, effective October 21, 1976, substantially as proposed.[2]

Rule 15a–2

On September 17, 1976, the Commission announced the adoption of Rule 15a–2 under the Investment Company Act to become effective October 29, 1976.[3]

The primary purpose of Rule 15a–2 is to eliminate uncertainty as to when the required approval of the investment advisory contract must be obtained. The Commission believes that for contract continuances extending past the initial two-year term permitted by the Investment Company Act the votes of approval ought to be taken at intervals of not more than approximately one year and at times when there is meaningful information as to performance over the preceding year on which to base a judgment as to continuing the contracts. An additional purpose of the rule is to eliminate certain practices which the Commission, upon the basis of its experience, considers to be contrary to the policy and purposes of Section 15 of the Act. One such practice would be scheduling votes within successive calendar years so that there may be an interval of substantially more than 365 days between them as where votes are scheduled in January of one year and in December of the following year.

Another such practice would be scheduling votes so far in advance of the date on which the continuance of the contract is to take effect that there is no meaningful information on which either the directors or shareholders can base their votes.

Rule 15a–2 provides that the first continuance of a contract shall be deemed to have been approved at least annually if such contract is specifically approved by the board of directors or by vote of a majority of the investment company's outstanding voting securities during the 90 days prior to and including the earlier of (1) the specified termination date of the contract or (2) the second anniversary of the date on which the contract was executed. The section further provides that any subsequent continuance of a contract shall be deemed to have been approved in compliance with Sections 15(a)(2) or 15(b)(1) if such contract is specifically approved by the board of directors or by a majority of the investment company's outstanding voting securities during the 90 days prior to and including the first anniversary of the date upon which the most recent previous annual continuance of such contract became effective.

Rule 2a–5

On June 3, 1977, the Commission published for comment proposed Rule 2a–5 and, on August 10, 1977, the Commission announced its adoption essentially as proposed.[4] Rule 2a–5 provides an exemption under specified circumstances to a broker or dealer, or any affiliated person of such broker or dealer, who would otherwise be deemed an interested person of an investment company, or an investment company's investment adviser or principal underwriter. It obviates the need for exemptive applications under circumstances in which the Commission has granted a large number of orders.

Proposed Rule 8f–1

The Commission released for public comment on July 21, 1977, proposed rules, a proposed form and a proposed amendment to a form, which would: (1) create a form to be used by certain investment companies registered under the Investment Company Act in requesting orders of the Commission declaring that such companies have ceased to be investment companies and (2) require the quarterly reports of management investment companies to contain specified information in the event that any such company was the surviving company of a merger into or consolidation with another registered company, so as to provide, among other things, a basis for a determination that the latter company has ceased to be an investment company.[5] These proposals represent another step in the Division's program to examine its regulation of investment companies and institute appropriate modifications where practicable. The Division believes that such rules and forms would facilitate the deregistration of companies which have ceased to be investment companies. At the close of the year, the Division was evaluating the information received in response to its request for comments.

Proposed Rule 24f–2 and Proposed Amendment to Rule 24f–1

On July 8, 1976, the Commission published for public comment a proposed Rule 24f–2 under the Investment Company Act of 1940 for registration under the Securities Act of 1933 of an indefinite number of securities

of certain investment companies.[6] One purpose of the proposed rule is to allow the registration fee paid on such securities to be based upon actual sales in certain circumstances, rather than on estimates of the amount of securities to be sold. In addition, the proposed rule might relieve certain investment companies and indirectly their security holders of certain costs associated with the monitoring of the amounts of securities sold and the triple filing fee presently required for retroactive registration of shares. The Commission also published for public comment a conforming amendment to Rule 24f–1 under the Investment Company Act to require the filing of an opinion of counsel with respect to the legality of the issuance of securities registered retroactively under the rule.

In 1970, Section 24(f) of the Investment Company Act was amended to permit the Commission to adopt rules concerning the retroactive registration of securities under the Securities Act where the number of shares sold exceeded the number of shares registered. Pursuant to this authority, the Commission has adopted Rule 24f–1 allowing the retroactive registration of securities if: (1) the securities are retroactively registered within six months of their sale, (2) a filing fee three times the usual fee is paid, and (3) a current prospectus was delivered to persons purchasing the oversold shares.

The amendment to Section 24(f) also empowered the Commission to adopt rules to allow the registration of an indefinite number of securities offered by certain investment companies. The Commission believes, in view of its experience with Rule 24f–1 and proposed Rule 24f–2, investors would have the protections afforded under the Securities Act since they would receive a current prospectus with respect to the security and would have the remedies specified in the Act.

Rule 206(3)–2

On December 2, 1976, the Commission published a proposed Rule 206(3)–2 which provided a nonexclusive method for compliance with the Investment Advisers Act in connection with an agency cross transaction for an advisory client by persons who otherwise might be considered to be acting in a conflict of interest in violation of their fiduciary duties to the client.[7] It requires that the transaction be effected pursuant to a written consent for a period not to exceed one year and executed by the advisory client after full written disclosure that the investment adviser and/or an affiliated broker-dealer are acting as agent for and receiving commissions for both parties and, accordingly, have a conflicting division of loyalties and responsibilities. The rule was adopted, essentially as proposed, on June 1, 1977.[8]

APPLICATIONS

One of the Commission's principal activities in the regulation of investment companies and investment advisers is the consideration of applications for exemptions from various provisions of the Investment Company and Investment Advisers Acts or for certain other relief under these Acts. Applicants may also seek determinations of the status of persons or companies. During the Transitional Quarter, 65 applications were filed under the Investment Company Act, and final action was taken on 44 applications. There were 2 applications filed under the Advisers Act, and no final action was taken on any applications. On September 30,

1976, 203 applications were pending under both Acts.

During fiscal year 1977, 226 applications were filed under the Investment Company Act, and final action was taken on 222. There was 1 application filed under the Advisors Act, and final action was taken on 2 applications. On September 30, 1977, there were 136 applications pending under both Acts.

Under Section 6(c) of the Investment Company Act, the Commission, by order upon application, may exempt any person, security or transaction from any provision of the Act, if and to the extent such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and purposes fairly intended by the policies and provisions of the Act. Under Section 206A of the Advisers Act, the Commission has identical authority with regard to provisions of that Act. Under Section 17 of the Investment Company Act, affiliates of a registered investment company cannot sell to or purchase from the registered company unless they first obtain an order from the Commission. Many of the applications filed with the Commission relate to these sections.

One such application of particular interest was filed by American Bakeries Company (Bakeries). In 1974, Bakeries was contacted by Mathers Fund (Fund) (a registered investment company) and told that the Fund owned 178,200 shares of Bakeries' common stock that it wanted to sell, and offered to sell, the shares to Bakeries. Because this block of stock represented more than 5 percent of Bakeries' outstanding voting securities, under the law Bakeries was an affiliated person of the Fund and therefore prohibited by Section 17(a) from entering into the transaction before filing an application with the Commission. Both parties to the transaction overlooked the applicability of Section 17(a) and executed the transaction without an application having been filed.

Later, by coincidence, the value of the outstanding common stock of Bakeries' began to rise after the sale, and when the Fund discovered that the transaction had been in violation of Section 17(a), and on advice of counsel, it sought to rescind the transactions on the grounds that, because it was in violation of the Act, it was void. When Bakeries refused to return the shares, the Fund brought suit against Bakeries in the United States District Court for the Northern District of Illinois. Bakeries then filed an application with the Commission for an order retroactively exempting the transaction from the prohibitions of Section 17(a). A hearing was held on the matter, and the Commission granted the application after concluding that the transaction was fair to the Fund, that is would have been granted if the application had been filed at the proper time, and that there were special circumstances in this case which justified the granting of retroactive relief.[9]

Also, in the past fiscal year, the Vanguard group of investment companies, a complex of fourteen funds each with identical boards of directors, proposed to internalize the distribution of their shares. Previously, Wellington Management Company served as adviser, manager, and distributor for the funds. In 1975, the Vanguard complex internalized their corporate administrative functions by capitalizing and operating a service company known as the Vanguard Group, Inc. (Van-

guard). The proposal to internalize the distribution function came in February of this year after the boards of directors of each of the Vanguard funds which charged a sales load determined that those funds should become no-load funds immediately. By internalizing their distribution function, the Vanguard funds expect to save approximately $831,000 in the first year of operation. The amount is primarily attributable to reduced advisory fees negotiated with Wellington Management Company by each of the funds. In addition to cost savings, the arrangement is expected to reduce the dependence of each of the Vanguard funds on its outside adviser by placing a function essential to fund existence in the hands of the complex. The arrangement is also expected to enhance the ability of the funds to evaluate services provided to them.

Because of the affiliations among the fourteen funds and Vanguard, the funds and Vanguard filed an application on February 24, 1977 seeking a conditional order by the Commission pursuant to Rule 17d–1 which would permit Vanguard Marketing Corporation, a wholly-owned subsidiary of Vanguard, to undertake the distribution of shares of the Vanguard funds. Conditional orders were also sought pursuant to Sections 17(b) and 6(c) which would facilitate operation of the distribution proposal. The Commission issued a notice of the filing of the application, as amended, on July 15, 1977.[10] A request for hearing was filed on August 8, 1977, by a shareholder of Wellington Fund, Inc., the largest of the Vanguard funds.

After consideration of the matter, the Commission determined that it was appropriate in the public interest of investors that a hearing be held with respect to the application. The Commission also deemed it appropriate, in view of the cost savings that the Applicants had represented would inure to the benefit of the Vanguard Funds during the first year of operation of the Vanguard distribution proposal, to grant an interim and temporary order of exemption. Accordingly, on September 13, 1977, the Commission issued a notice of and order for hearing and a temporary order of exemption.[11] The hearing was scheduled to commence on December 5, 1977, in Philadelphia, Pennsylvania.

OTHER DEVELOPMENTS

In light of the fact that the Division of Investment Management is now responsible for, among other things, processing registration statements and post-effective amendments filed by registered investment companies and similar issuers under the Securities Act of 1933 (14 U.S.C. 77a-1 et. seq.) and consistent with the Commission's practice of publishing the views of its staff to assist registrants, their counsel and accountants, and other interested persons, the Commission authorized publication of a release setting forth procedures for filing and processing registration statements and post-effective amendments filed by registered investment companies.[12]

The enactment of the Tax Reform Act of 1976 affected investment companies in several ways. The most significant effect from the Commission's perspective was the enactment of a provision under the tax laws which allowed registered investment companies organized in corporate or business trust form to "pass through" the tax-exempt status of the income from certain securities of United States states

and territories and the political subdivisions. This "pass through" treatment had under previous tax law been allowed only to managed investment companies which were organized as limited partnerships or to unit investment trusts whose portfolios could not be managed under the Investment Company Act. However, until just a few months prior to the enactment of the Tax Reform Act, several problems under the securities laws had prevented such partnerships from receiving the exemptive orders under the Investment Company Act necessary for them to operate in compliance with the law.

At the time of the enactment of the Tax Reform Act, only a few partnerships with the objective of tax-exempt income had filed registration statements under the 1933 and 1940 Acts, and only two had effective 1933 Act registration statements. After the enactment of the Tax Reform Act, several of the partnerships' registrations were abandoned or withdrawn. Others were amended to indicate a change of the company into corporate form. In addition, during the month prior to, and the two months subsequent to, the enactment of the Tax Reform Act, approximately 30 new investment companies of the management type with the objective of tax-exempt income registered with the Commission.

Another effect of the Tax Reform Act of 1976 was to end a brief flourish of registrations of "exchange funds" in partnership form. Exchange funds are investment companies in which investors have pooled appreciated stock in return for shares of the investment company without paying capital gains tax on the appreciation. In 1966, the tax laws were amended to discontinue the favorable tax treatment when corporations were used as the depositories for the appreciated securities. When the problems under the securities laws which had prevented the use of partnerships as investment companies were overcome and when the Internal Revenue Service issued a ruling that publicly syndicated limited partnerships could be formed tax-free with such appreciated securities, several such partnership exchange funds registered with the Commission. The Tax Reform Act of 1976 had a provision which ended this favorable tax treatment on transfers to partnerships also.

In the face of all this activity, the Commission published a release giving the Division's views with respect to certain regulatory and disclosure matters pertinent to companies investing in securities the income from which is exempt from federal income taxation.[13] The Commission also issued an interpretation of a rule under the Investment Company Act indicating, generally, that it shall be considered inappropriate for "money market" funds and certain other open-end investment companies to determine the fair value of debt portfolio securities on an amortized cost basis, except in the case of securities with remaining maturities of 60 days or less.[14]

NOTES TO PART 5

[1]Investment Advisers Act Release No. 516 (May 13, 1976), 9 SEC Docket 661.

[2]Investment Advisers Act Release No. 532 (September 3, 1976), 10 SEC Docket 433.

[3]Investment Company Act Release No. 9451 (September 17, 1976), 10 SEC Docket 532.

[4]Investment Company Act Release No. 9886 (August 10, 1977), 12 SEC Docket 1509.

[5]Investment Company Act Release No. 9861 (July 21, 1977), 12 SEC Docket 1320.

[6]Investment Company Act Release No. 9347 (July 8, 1976), 10 SEC Docket 206.

[7]Investment Advisers Act Release No. 557 (December 2, 1976), 11 SEC Docket 1072.

[8]Investment Advisers Act Release No. 589 (June 1, 1977), 12 SEC Docket 740.

[9]Investment Company Act Release No. 9924 (September 13, 1977), 12 SEC Docket 88.

[10]Investment Company Act Release No. 9850 (July 15, 1977), 12 SEC Docket 1301.

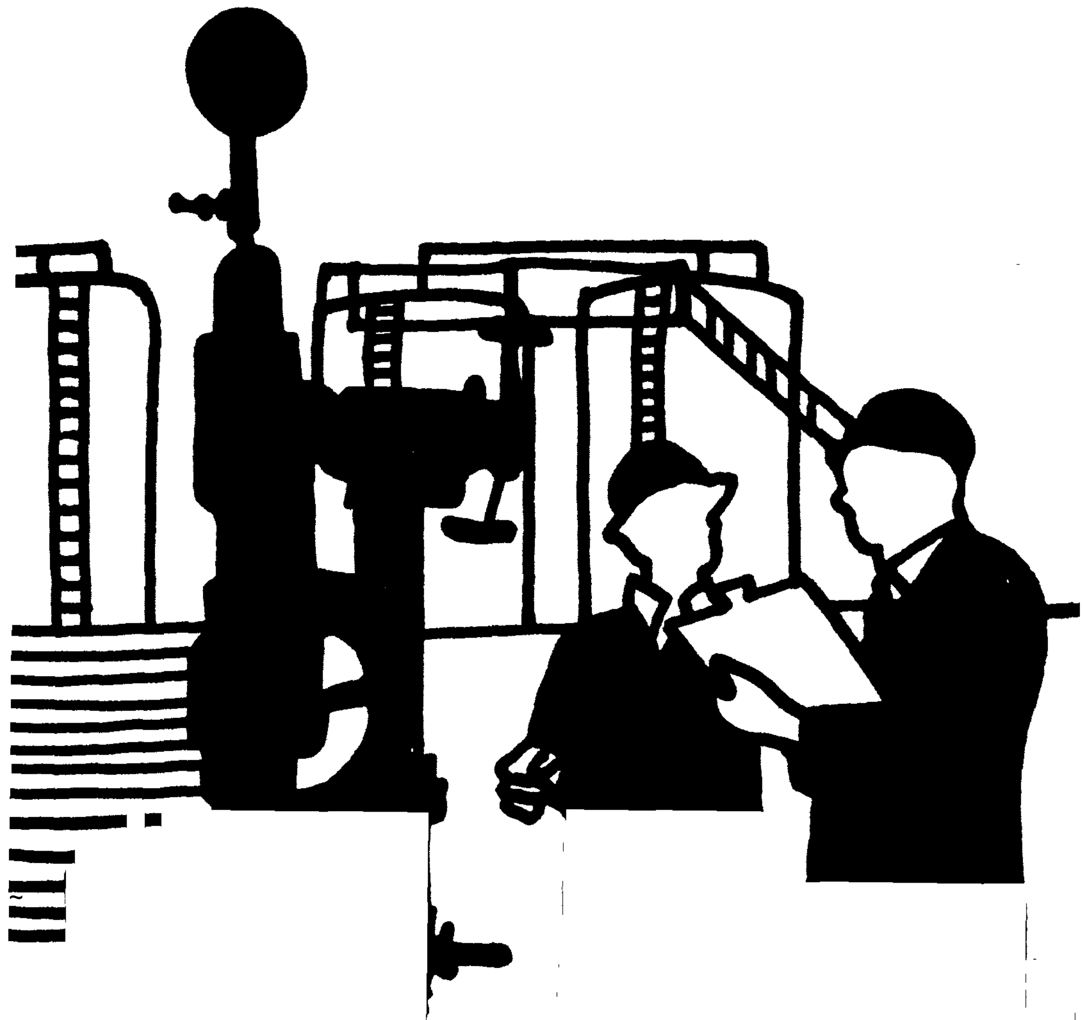
[11]Investment Company Act Release No. 9927 (September 13, 1977), 13 SEC Docket 92.

[12]Investment Company Act Release No. 9426 (September 3, 1976), 10 SEC Docket 404.

[13]Investment Company ACt Release No. 9785 (May 31, 1977), 12 SEC Docket 713.

[14]Investment Company Act Release No. 9786 (May 31, 1977), 12 SEC Docket 715.

Part 6
Public Utility Holding Companies



Part 6 Public Utility Holding Companies

Under the Public Utility Holding Company Act of 1935, the Commission regulates interstate public utility holding company systems engaged in the electric utility business and/or retail distribution of gas. The Commission's jurisdiction also covers natural gas pipeline companies and other nonutility companies which are subsidiaries of registered holding companies. There are three principal areas of regulation under the Act: (1) the physical integration of public utility companies and functionally related properties of holding company systems, and the simplification of intercorporate relationships and financial structures of such systems; (2) the financing operations of registered holding companies and their subsidiary companies, the acquisition and disposition of securities and properties and certain accounting practices, servicing arrangements, and intercompany transactions; (3) exemptive provisions relating to the status under the Act of persons and companies, and provisions regulating the right of persons affiliated with a public utility company to become affiliated with another such company through acquisition of securities.

COMPOSITION

For the fiscal year 1977, there were 18 holding companies registered under the Act. There were 17 registered holding companies within the 14 "active" registered holding company systems.[1] The remaining registered holding company is relatively small, and not included among the "active" systems. In the 14 active systems, there were 67 electric and/or gas utility subsidiaries, 55 nonutility subsidiaries, and 22 inactive companies, or a total of 161 system companies, including the top parent and subholding companies. Table 35 in Part 9 lists the active systems and their aggregate assets.

FINANCING

Volume

During fiscal 1977, a total of 12 active registered holding company systems issued and sold 49 issues of long-term debt and capital stock aggregating $2.4 billion pursuant to authorization by the Commission under Sections 6 and 7 of the Act. Table 36B in Part 9 presents the amount and types of securities issued and sold by these holding company systems.

The aggregate amount of these financings represents a 29 percent decrease over the previous fiscal year. Bonds and debentures issued and sold

decreased 20 percent, preferred stock decreased 62 percent, and the amount of common stock issued and sold decreased 26 percent.

During the transition quarter, July 1 to September 30, 1976, a total of 8 active registered holding company systems issued and sold 13 issues of long-term debt and capital stock aggregating $275.6 million pursuant to Sections 6 and 7 of the Act. Table 36A in Part 9 presents the amount and types of securities issued and sold by these holding company systems.

PROCEEDINGS

Central and South West Corporation[2]—On January 30, 1976, the Commission issued a Notice of and Order for Hearing[3] in this proceeding to examine whether the electric utility facilities of the subsidiaries of Central and South West Corporation (CSW) are operated as a single integrated system or are capable of being operated economically as a single integrated public utility system, as required by Section 11(b)(1) of the Act and, if so, whether engineering plans submitted by CSW for implementing extensive operating changes for its utility system represent a reasonable prospect for achieving such economical operations.

By Order dated May 18, 1977,[4] the Commission amended its January 30, 1976 Order for Hearing to expressly permit an examination of whether the Commission's determination of February 16, 1945, that the electric utility facilities of CSW's subsidiaries constituted a single integrated system, should be modified or set aside in the event the record in the instant proceeding fails to support a finding now that those facilities are operated as a single integrated system or are capable of such operation under any of the proposals submitted by CSW to comply with the standards of Section 11(b)(1).

This is a contested proceeding. Initial hearings before an administrative law judge were held in October 1976. Further testimony was filed in May 1977, and hearings resumed in September 1977.

Lykes Brothers, Inc. – Lykes Brothers, Inc. (Lykes), on behalf of itself and its subsidiaries, filed an application for an exemption by order under Section 3(a) of the Act after the Commission, acting pursuant to Rule 6, notified Lykes of the termination of its claim to exemption under Rule 2. The Division of Corporate Regulation is opposing Lyke's application for exemption claiming that nonutility diversification in the holding company system renders such exemption detrimental to the public interest or the interests of investors or consumers within the meaning of the "unless and except" clause of Section 3(a) of the Act. There are no factual disputes, and the proceeding is being presented on a stipulated record. Lykes and the Division of Corporate Regulation have agreed to a schedule for filing briefs with the Commission. After submission of briefs, the matter will be before the Commission for decision.

The plan provides for the issuance by Union of its shares of common stock, par value $5 per share, in exchange for the publicly held shares of MU's common stock on the basis of 1.1 shares of Union common stock for each share of MU common stock. Consummation of the plan is stayed until the plan is approved and ordered enforced by a United States District Court, in accordance with the Act.

British American Utilities Corporation—British American Utilities Corporation (British American) and North East Heat & Light Company (North

East) have filed a plan with the Commission pursuant to Section 11(e) of the Act providing for the exchange of shares of North East for the outstanding shares of British American and for the liquidation of British American as a corporate entity.

Under the plan, North East will amend its Articles of Incorporation to effect a change in the authorized stock structure of North East. The newly authorized stock of North East will coincide with the present authorized stock of British American. British American will direct that a portion of the newly issued North East stock be delivered to the existing shareholders of British American to replace, on a share for share basis, the shares held by those shareholders. At the closing, British American will convey all of its properties, rights and assets to North East. At that time North East will assume all of British American's liabilities, contracts and obligations.

Colonial Gas Energy System—Colonial Gas Energy System (Colonial), a parent holding company of Lowell Gas Company and Cape Cod Gas Company, both Massachusetts gas utility companies, was notified by the Commission, by letter dated September 9, 1977, issued pursuant to Rule 6, that a substantial question exists as to whether Colonial is entitled to an exemption from the registration requirements of the Act. Colonial's exemption pursuant to Rule 2 terminates thirty days after such notification. In the interim, Colonial is entitled to file an application for exemption by order of the Commission pursuant to the applicable provisions of Section 3(a). Upon such filing, an administrative proceeding is held to explore the questions prompting the Commission to terminate Colonial's exemption.

Union Electric Company—In its opinion of April 29, 1977, the Commission approved a plan filed pursuant to Section 11(e) of the Act under which Union Electric Company (Union) proposed to retire the publicly held minority interest in the common stock of Missouri Utilities Company (MU), a public utility subsidiary of Union.[5]

Upon completion of these transactions British American will be liquidated.

A hearing was held before an administrative law judge and the matter will be submitted to the Commission for decision upon receipt of approval of the plan by the state regulatory body.

NOTES TO PART 6

[1]Three of the 18 are subholding utility companies in these systems. They are The Potomac Edison Company and Monongahela Power Company, public utility subsidiaries of Allegheny Power System, Inc., and Southwestern Electric Power Company, a public utility subsidiary of Central and South West Corporation.

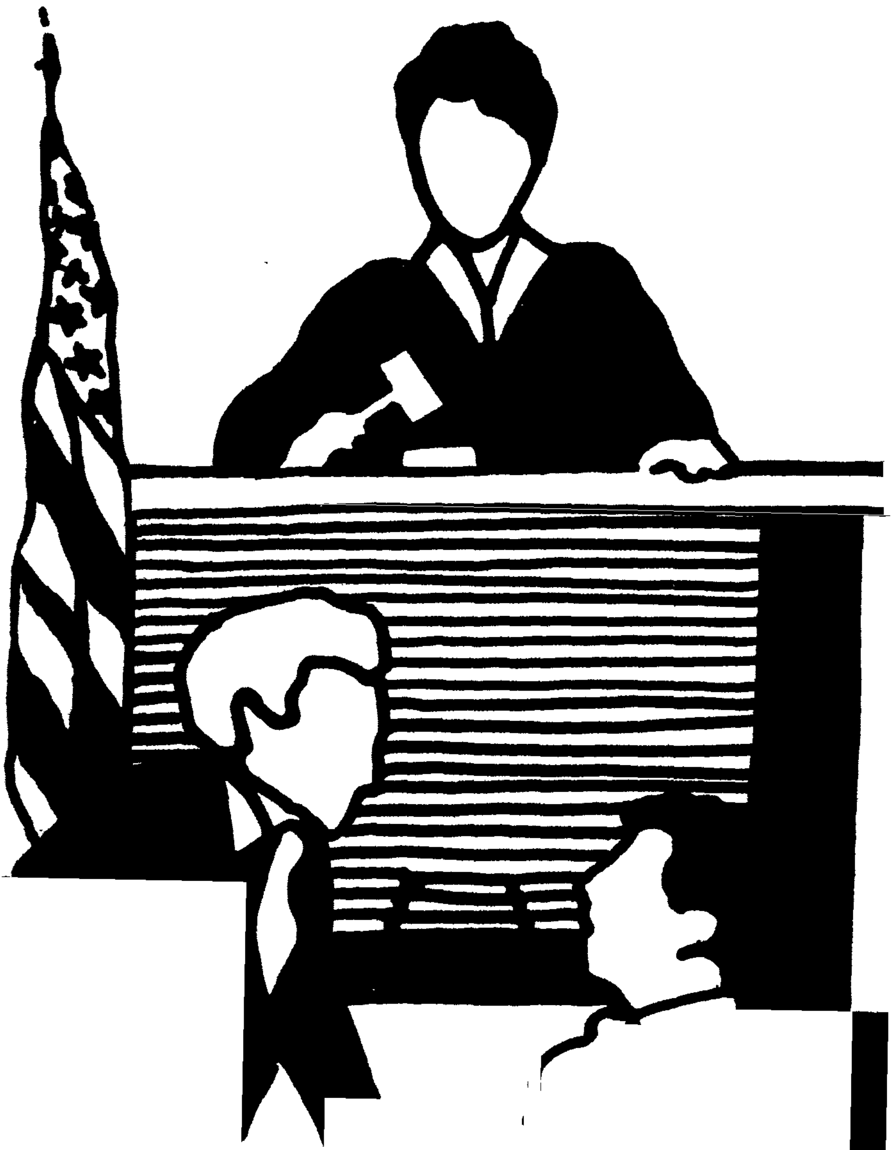
[2]See 42nd Annual Report, p. 146.

[3]Holding Company Act Release No. 19361 (January 30, 1976), 8 SEC Docket 1202.

[4]Holding Company Act Release No. 20031 (May 18, 1977), 12 SEC Docket 443.

[5]Holding Company Act Release No. 20012 (April 29, 1977), 12 SEC Docket 312.

Part 7
Corporate Reorganizations



Part 7 Corporate Reorganizations

The Commission's role under Chapter X of the Bankruptcy Act, which provides a procedure for reorganizing corporations in the United States district courts, differs from that under the various other statutes which it administers. The Commission does not initiate Chapter X proceedings or hold its own hearings, and it has no authority to determine any of the issues in such proceedings. The Commission participates in proceedings under Chapter X to provide independent, expert assistance to the courts, participants, and investors in a highly complex area of corporate law and finance. It pays special attention to the interests of public security holders who may not otherwise be represented effectively.

Where the scheduled indebtedness of a debtor corporation exceeds $3 million, Section 172 of Chapter X requires the court, before approving any plan of reorganization, to submit it to the Commission for its examination and report. If the indebtedness does not exceed $3 million, the court may, if it deems it advisable to do so, submit the plan to the Commission before deciding whether to approve it. When the Commission files a report, copies or summaries must be sent to all security holders and creditors when they are asked to vote on the plan. The Commission has no authority to veto a plan of reorganization or to require its adoption.

The Commission has not considered it necessary or appropriate to participate in every Chapter X case. Apart from the excessive administrative burden, many of the cases involve only trade or bank creditors and few public investors. The Commission seeks to participate principally in those proceedings in which a substantial public investor interest is involved. However, the Commission may also participate because an unfair plan has been or is about to be proposed, public security holders are not represented adequately, the reorganization proceedings are being conducted in violation of important provisions of the Act, the facts indicate that the Commission can perform a useful service, or the court requests the Commission's participation.

The Commission in its Chapter X activities has divided the country into four geographical areas. The New York, Chicago, Los Angeles and Seattle regional offices of the Commission each have responsibility for one of these areas. Supervision and review of the regional offices' Chapter X work is the responsibility of the Division of Corporate Regulation of the Commission which, through its Branch of

Reorganization, also serves as a field office for the southeastern area of the United States.

CHAPTER IX OF THE BANKRUPTCY ACT

Chapter IX provides for a voluntary reorganization procedure for the adjustment of the debts of any state's political subdivision or public agency or instrumentality.

The recent revision of Chapter IX, together with the new Chapter XI Rules of Bankruptcy Procedure effective August 1, 1976, now provide for Commission intervention and participation in Chapter IX cases. The presiding judge may also request the Commission's participation in the proceeding. The Commission appeared in two Chapter IX proceedings, one during the transitional quarter[1] and one during the fiscal year.[2]

Fort Cobb, Oklahoma Irrigation Fuel Authority—Upon the filing of the debtor's petition, the district court requested that the Commission enter an appearance in the proceedings as provided under Chapter IX.

The debtor is a public trust, organized under the laws of the State of Oklahoma, whose principal asset is a rural retail gas distribution system, which provides natural gas to commercial and residential customers in a five county area in the western part of Oklahoma. The principal customers are farmers, who are engaged in peanut and potato farming. The debtor financed the acquisition and construction of its gas distribution system by three public offerings of revenue bonds between 1969 and 1973, totalling $4.5 million. The proceeds from the third offering of revenue bonds, totalling $1.5 million, were misappropriated. The debtor contends that it gave the proceeds from the third offering to the general contractor, who failed to perform under the contractual agreement. As of the date of the petition, the debtor had assets of $2.9 million and liabilities of about $3.7 million, excluding the third issue.

The debtor filed a plan to adjust its debts at the time the proceeding was commenced. The plan provided for payment of the defaulted principal and interest within five years of confirmation of a plan of debt adjustment and resumption of the scheduled principal and interest payments after confirmation of the plan.

A holder of revenue bonds from the third offering commenced a civil action, which has been authorized to proceed as a class action, alleging violations of the fraud provisions of the Federal securities laws and common law fraud and deceit in connection with the sale of the same. The plaintiff also challenged the good faith of the petition, since the proposed plan did not provide for payment of the claims of the defrauded bondholders. The court held the petition to be filed in good faith and adopted the Commission's contention that the need for financial rehabilitation establishes "good faith" in a Chapter IX proceeding.[3]

In order to project the amount of revenues that would be available on a yearly basis to service and retire the revenue bonds, the court appointed a consultant with the debtor's consent to report to the court concerning the prospective earnings capacity of the debtor and ways in which it could be improved. The consultant has completed and filed his report, which will be the basis to evaluate specific plan proposals.

SUMMARY OF ACTIVITIES - CHAPTER X

In fiscal year 1977, the Commission entered 9 new Chapter X proceedings

involving companies with aggregate stated assets of approximately $895 million and aggregate indebtedness of approximately $878 million. During the transitional quarter, July 1 to September 30, 1976, the Commission entered 2 new Chapter X proceedings while closing 2 proceedings. Including the new proceedings, the Commission was a party in a total of 124 reorganization proceedings during the fiscal year. The stated assets of the companies involved in these proceedings totaled approximately $5.3 billion and their indebtedness about $4.8 billion.

During the fiscal year 12 proceedings were closed, leaving 112 in which the Commission was a party at year end.

ADMINISTRATIVE MATTERS

In Chapter X proceedings, the Commission seeks to protect the procedural and substantive safeguards afforded parties in such proceedings. The Commission also attempts to secure judicial uniformity in the construction of Chapter X and the procedures thereunder.

GAC Corporation, et al.[4] — The debtors, including its major operating subsidiaries, are one of the nation's largest land developers involving about 40,000 public investors and over $300 million in assets. The bulk of these assets consists of land under development and receivables generated by the land sales contracts. Over 100,000 lot purchasers at six major developments have bought homesites from GAC under installment land sales contracts that impose future land development obligations on GAC. Accordingly, the effort to reorganize GAC assumes that continued development will (1) permit collection of balances due on the land already sold, (2) eliminate the possibility of extensive damage claims by lot purchasers against GAC for failure to deliver developed lots as promised, and (3) enhance the value of the remaining unsold land.

The GAC trustees have proposed a long range development program, since approved by the court, that will reduce and consolidate GAC's land developments thereby placing GAC's development costs within its financial capabilities. The essential element in the program has involved a lot exchange offer which enables lot purchasers to exchange their lots in areas no longer scheduled for development to other areas where development will be completed. The exchange offer, which reportedly has been accepted by over 80 percent of involved lot purchasers, is considered a success.

The bankruptcy court, to afford the lot purchasers a measure of protection, in light of certain adverse events which have since been eliminated, ordered $19.2 million of the lot purchasers' post-petition payments placed in an interest-bearing escrow account as a guarantee that GAC will have funds available to complete its development obligations. This ruling was appealed to the district court by certain of GAC's bond indenture trustees who argued: (1) that the lot purchasers were not entitled to such special protection, (2) that a formal adversary proceeding pursuant to Rule 10–701 was necessary before the court could escrow the funds, and (3) that diverting the payments into an escrow fund would impair the debtor's estate by depriving it of necessary funds.

The Commission filed in the district court a brief supporting the bankruptcy court and arguing: (1) that the lot purchasers had potential administrative claims for their post-petition installment payments

should the debtor fail to complete the promised development,[5] (2) that requirements of an adversary proceeding under Rule 10–701 apply only to disputes over pre-petition claims and have no application to the determination of post-petition administrative matters,[6] and (3) that placing a portion of lot purchasers' payments in an escrow fund, in fact, furthers the prospects of a successful reorganization because, by granting lot purchasers some measure of protection that GAC will be financially able to fulfill its development obligations, it encourages lot purchasers to continue their installment payments without which a reorganization would be impossible. The matter is still pending at the end of the fiscal year.

Interstate Stores, Inc.[7] — As previously reported,[8] a $38 million claimant appealed to the Second Circuit a decision of the district court retaining jurisdiction in the Chapter X court to determine that claim. A date for trial on the claim before the Chapter X court was set. An expedited appeal was sought and granted. The trustees and the Commission sought affirmance of the district court's decision. After oral argument, claimant sought a stay of the trial pending disposition of the appeal. The Second Circuit granted the motion and further ordered the parties to proceed to trial in the California state court.

The California jury returned a verdict dismissing the claim and awarding $1.6 million to the debtors for rent arrearages plus attorney's fees. A judgment was accordingly entered in the California state court. Motions by claimant for a judgment notwithstanding the verdict and for a new trial were denied. Claimant then appealed to an intermediate California appellate court.

The trustees sought an order from the bankruptcy judge expunging the $38 million proof of claim filed in this case on the basis of the California judgment. The bankruptcy court declined to expunge the proof of claim, pending resolution of the California appeal. The trustees appealed the bankruptcy court's decision to the district court, which appeal was pending at the close of the fiscal year.

Gulfco Investment Corporation, et al.[9] — The debtor is a publicly held holding company operating various businesses, including land development, mortgage banking and consumer financing, through 26 related corporations.

The trustee applied for an order substantively consolidating all of the debtors since they were operated as a single entity and it was impossible, because of the inadequate records, to determine intercompany claims between the debtors. Claimants holding pledges of the stock of the two operating companies opposed the consolidation urging that these companies were solvent, and that a consolidation would effect an unconstitutional taking of their security interests without compensation.

The Commission suggested that as a practical matter it would be preferable to deal with the consolidation issue within the context of a proposed plan of reorganization as creditors could then know specifically what they were to receive as opposed to considering consolidation in the abstract. However, the Commission did support consolidation of all the debtors, but urged recognition of creditors' equitable rights to preferred treatment where warranted by the facts. The Commission noted that unilateral misconduct of the debtors could not effect a forfeiture

of creditors' rights vis-a-vis a debtor company which dealt with its creditors as the sole enterprise receiving the extension of credit. The Commission also concluded that it would be wasteful and destructive to accept the objectors' suggestion of splitting the estate into a number of separate trusteeships charged with litigating with each other to establish the rights of different creditors groups.

The court approved the form of consolidation as recommended by the Commission. After the close of the fiscal year certain creditors appealed the court's order to the United States Court of Appeals for the Tenth Circuit.

Carolina Caribbean Corp.[10] — The trustee had determined that reorganization was impossible and proposed an orderly liquidation for this publicly held company which was engaged in land development and in the operation of related resort facilities. The debtor's development operations mainly involved the installment sale of subdivided homesite lots with title remaining in the seller until the buyer rendered payment in full. The trustee sought to reject as executory about 2,000 such installment contracts, including about 1,300 contracts where buyers had rendered full payment but had not been deeded lots; such rejection of the contracts would have enabled a bank claimant, as mortgagee of the underlying land, to foreclose on the land in satisfaction of its claims against the estate.

The Commission objected to the trustee's proposed rejection of the contracts arguing that (1) land sales contracts which are fully performed save for the granting of deeds by the seller are not "executory" within the meaning of the Bankruptcy Act and thus may not be rejected, and (2), under Chapter X, a trustee may reject only contracts that are "burdensome" to the estate and it would not be "fair and equitable", as part of a Chapter X plan, to reject the contracts and deprive fully paid buyers of their lots where the granting of deeds is the sole act remaining to be performed by the seller, an act imposing no "burdensome" obligations on the estate. As a result, the trustee offered a compromise enabling the lot buyers to obtain lots. Under the terms of the compromise, which was subsequently approved by the court, land was made available to fully paid lot buyers, with the proviso that, to obtain a lot, an eligible buyer pay to the estate an amount covering costs of transfer and survey so that no additional costs were placed on the already bankrupt estate.

C.I.P. Corporations.[11]—The district court agreed with the Commission and permitted the trustee to utilize proceeds from the sale of mortgaged property for the purpose of completing roads contiguous to property which the mortgagee held as additional collateral. The blanket mortgage contained a provision providing for a release price of 125 percent of the pro rata debt plus an additional $500 upon the sale of a parcel of property. The trustee needed that portion of the proceeds exceeding 100 percent of the pro rata debt to complete roads which would enhance the value of surrounding property and enable the trustee to maximize the value of the debtor's real estate holdings.

The Commission argued that the bankruptcy court has the power to use the collateral of secured creditors where adequate protection for their rights can be demonstrated. The court had found that there was a reasonable possibility of a successful reorganization, and the evidence indicated that

the value of the mortgagee's collateral substantially exceeded the amount of the debt. Under these circumstances the court was justified in the exercise of its equitable discretion to modify the release provisions of the mortgage and permit the trustee to apply a portion of the proceeds to the contemplated construction.

TRUSTEE'S INVESTIGATION AND STATEMENTS

A complete accounting for the stewardship of corporate affairs by the prior management is a requisite under Chapter X. One of the primary duties of the trustee is to make a thorough study of the debtor to assure the discovery and collection of all assets of the estate, including claims against officers, directors, or controlling persons who may have mismanaged the debtor's affairs. The staff of the Commission often aids the trustee in his investigation.

Investors Funding Corporation of New York.[12]—As a result of his investigation, the trustee commenced a plenary lawsuit in the Federal court in New York against 188 defendants.[13] The defendants include the debtors' former officers, directors, accountants and consortium of lending banks. The complaint alleges, among other things, that the debtors' officers and directors engaged in a "massive" fraud upon the debtors, its creditors, debenture holders, stockholders and the public and, further, that the accountants failed to properly audit the books and records of the debtors and that the banks received preferential transfers of property. The relief sought includes the subordination of the banks' asserted senior position to the claims of debenture holders and other creditors, as well as damages in an amount yet to be ascertained.

The trustee's report under Section 167 of the Bankruptcy Act concluded that, *inter alia*, the debtors are hopelessly insolvent and that there is no reasonable possibility for reorganization as a going concern. Accordingly, the trustee recommended that the debtors be liquidated in an orderly manner.

Omega-Alpha, Inc.[14]—The trustees resolved through settlements major claims against the estate, involving the LTV Corporation (LTV), Security Mortgage Investors (SMI) and the class action suit known as the Mesh/Shlensky litigation.

The LTV claims and the Mesh/Shlensky litigation were resolved in a single settlement. They both arose out of the sale in 1971 of The Okonite Company by LTV to Omega-Alpha. Mesh and Shlensky were shareholders of LTV at the time of that sale. They brought a consolidated suit seeking rescission of that sale or in the alternative compensatory damages of $21.5 million and other monetary relief. LTV asserted claims of over $39 million based mostly on debentures held by it by virtue of the conversion privilege which allows holders of Omega-Alpha's 4–3/4 percent convertible subordinated debentures to convert into LTV common stock. The settlement required a cash payment by the debtor to LTV of $13.5 million, the equivalent of 34.2 percent of its claim, and fees of the attorneys for Mesh/Shlensky not to exceed $125,000.

The co-trustees deemed the settlement to be in the best interest of the estate because of (1) the complexity and uncertainty of the outcome of the litigation involved, (2) the expense to the estate of prosecuting and defending the claims and counterclaims, and (3) avoidance of delay in distribution of dividends to creditors on account of these controversies until they are resolved by extended litigation.

SMI had objected to the proposed settlement claiming that it violated its rights as a senior creditor to priority in payment before LTV since the settlement would pay LTV unsecured claims in advance of SMI's claim. This objection was resolved by a settlement under the terms of which SMI agreed to receive $8.6 million in cash in full payment of its $9.1 million senior claim. Both settlements were approved by the court.

Stirling Homex Corporation.[15]—The debtor was found insolvent with no hope of rehabilitation. Unsecured creditor claims are approximately $46 million, and an anticipated $15 to $16 million will be available to pay those claims. Shareholders, who were induced by fraud into purchasing the debtor's securities, sought *pari passu* classification with unsecured creditors under Section 197 of Chapter X and Bankruptcy Rule 10–302. Their damage claims aggregate $100 million.

The trustee acknowledged in his report under Section 167 of Chapter X that the information issued by the debtor at the time it offered and sold its shares was distorted and misleading. Additionally, the Commission has sued and obtained injunctive relief based upon materially false financial statements,[16] and former management has been convicted of defrauding its investors.[17] The Commission filed a memorandum with the district court supporting the shareholders' position seeking parity with unsecured creditors.[18] The Commission argued that defrauded purchasers may assert claims on the fraud rather than the instrument and that "an investor who has been swindled by a debtor into purchasing a worthless security suffers as real a loss as that of a supplier of merchandise, a bank that has made a loan, or a pedestrian who has been injured by a debtor's vehicle."

The district court subordinated defrauded shareholders to the rights of unsecured creditors, and those shareholders appealed that decision. At the close of the fiscal year the appeal was pending.

PLANS OF REORGANIZATION

Generally, the Commission files a formal advisory report only in a case which involves substantial public investor interest and presents significant problems. When no such formal report is filed, the Commission may state its views briefly by letter, or authorize its counsel to make an oral or written presentation. During the transitional quarter the Commission published two advisory reports, dealing with two plans of reorganization.[19] During the fiscal year the Commission supplemented one advisory report dealing with one plan of reorganization.[20] Its views on 10 other plans of reorganization were presented to the courts either orally or by written memoranda.[21]

The Commission also filed a staff advisory report on the trustee's plan of reorganization for the Penn Central Transportation Company under Section 77 of the Bankruptcy Act concluding that the plan was fair, equitable and feasible. The report was filed at the invitation of the presiding judge, the Honorable John P. Fullam and is similar to that customarily filed under Chapter X of the Bankruptcy Act.

Imperial-American Resources Fund, Inc.[22]—At the conclusion of the plan hearings, the court referred the trustee's internal plan of reorganization to the Commission for report. The plan created a reorganized company to carry on the oil and gas business which the debtor conducted as sole general partner of 13 limited partnerships. The provisions of the plan consolidated the limited partnership into a reorganized corporate entity and substituted stock

of the reorganized corporation for the limited partnership interests now held by the limited partners.

The plan provides for full payment in cash of administrative, priority claims, and unsecured claims of creditors of the limited partnerships. The plan treats the interests of the limited partners as a claim against the property of the debtor, although the investment is not a loan or debt. Since these claims exceed by far the value of the estate, the common stock of the debtor owned by a subsidiary of the Colorado Corporation, a corporation controlled by John M. King, will not participate in the reorganized company. In addition, the plan provides for the equitable subordination of the claims of the Colorado Corporation as well as John M. King individually.

The proceeding involved a unique situation where a corporate general partner initiated a Chapter X proceeding while the limited partnerships did not. The plan does not change the purpose of the partnerships, nor does the pooling of the partnership assets depart radically from the original investment intent of the limited partners. Indeed, the investors had no advance knowledge of what properties would be purchased by the partnership they were placed in. In fact, there was cross-investing by limited partnerships into each other.

Under the terms of a settlement of a class action claim, based principally on allegations of violations of the Federal securities laws in connection with the sale of the limited partnership interests, 12–1/2 percent of the stock of the reorganized company will be distributed to this class of limited partners on the basis of their damages, and the remaining 87–1/2 percent of the stock will be distributed to limited partners for their present interest in the limited partnerships. Therefore, while the ultimate beneficiaries are the same, the two blocks of shares will be allocated among them on a different basis. The 87–1/2 percent of the stock will be distributed directly to limited partners in proportion to the net present value of their respective interests in the assets acquired by the reorganized company. The 12–1/2 percent block of shares which represents substantially half of the defendants' alleged interest in Imperial will be distributed through the class action court to the class of limited partners in proportion to their losses, defined as the difference between the present value of their partnership interests and their original investment.

The Commission concluded that the plan was fair, equitable and feasible. The Commission did recommend that the plan be amended to provide for cumulative voting for the common stock of the new corporation. This amendment was proffered by the trustee and approved by the court.

R. Hoe & Co., Inc.[23]—The trustees proposed an internal plan of reorganization based upon the continuing operations of the debtor's saw division. Under the plan, common stock in the reorganized company would be distributed to creditors, and Class A stockholders were to be accorded a minimal equity interest in the reorganized company.

The Commission filed an advisory report[24] concluding that the plan was not fair and equitable in that the trustees undervalued the debtor. The Commission placed a value of $19.2 million on the gross estate, as compared to the trustees' value of $17 million. The Commission found such additional value in the going-concern value of the saw division and excess cash and inventory. In addition, the Commission advised that post-petition interest to unsecured creditors should

be computed at the 6 percent judgment rate rather than at the higher legal rate proposed by the trustees. The difference between the trustees' computation and the 6 percent judgment rate was about $800,000.

The Commission urged that the plan be amended to reflect the recommended valuation, and that it should be further amended to provide distribution to unsecured creditors of cash and notes equal to 25 percent of their claims. Under these suggestions, which the Commission stated would render the plan fair and equitable, Class A stockholders would retain a 25 percent equity interest in the reorganized company.

The court's valuation was between the Commission's and the trustee's. Approximately 12 percent of the reorganized company's equity was to be retained by the Class A stockholders. The Commission advised and the court agreed that: (1) a cash distribution should be made to general unsecured creditors; (2) the issuance of warrants to general unsecured creditors should be eliminated; and (3) post-petition interest to unsecured creditors should be computed at the 6 percent New York judgment rate,[25] rather than the higher legal rate (7-1/2 percent to 8-1/2 percent) proposed by the trustee.

The plan was amended in accordance with the court's decision and as amended was approved and confirmed.

King Resources Co.[26]—In a special report the trustee updated the engineering reports indicating substantially higher values for the debtor's oil and gas properties. Based upon this new information, the Commission filed a second advisory report,[27] stating that the debtor may be solvent and recommended that further valuation hearings be held before votes were solicited for the trustee's plan. The report concluded that, since the new valuation evidence reflected a value above the amount of pre-petition claims, the plan was unfair to subordinated debenture holders by virtue of the conversion rights given to senior creditors.

The conversion feature, which allows senior creditors a greater number of new shares of stock per claim than subordinated debt, was originally intended to satisfy the contractual subordination provisions of the indentures which require that senior debt be paid in full before subordinated debt can receive a distribution. Since the senior debt is now fully satisfied by reason of the higher valuation, the conversion privilege is no longer necessary.

The district court rejected the Commission's recommendation and approved the plan. The plan was subsequently voted upon and approved by creditors. The court, in conjunction with the confirmation hearing, conducted further valuation hearings, wherein both the trustee and a stockholders' protective committee offered testimony. The court nevertheless found the debtor insolvent, denied the motion to eliminate the conversion feature, and confirmed the plan. Appeals were filed by the indenture trustees and a stockholders' protective committee, among others, from the confirmation order.

U. S. Financial, Inc.[28]—The trustees filed a plan of orderly liquidation for this San Diego based real estate company. The plan will transfer the debtor's assets to a liquidating corporation whose life is to terminate in 1982 unless holders of two-thirds of the new liquidating common stock vote to permit continuation of the business.

The plan is designed to produce a non-public company with creditors, other than banks and financial institutions, being paid the value of their claim

in cash. The larger creditors will receive the liquidating common stock with proceeds of the ongoing liquidation to be distributed quarterly.

The trustees proposed a conservative liquidation value of the debtor estate of about $44 million but noted that under a more optimistic set of assertions the value could reach $52 million.

The subordinated debenture holders and public shareholders of the debtor will not participate based on their instruments since the value of the debtor estate was found insufficient to satisfy in full senior creditors. However, the plan proposes to compromise the class action claims of public debenture holders and shareholders which are based on, among other things, violation of Federal securities laws, by allocating 15 percent and 5 percent, respectively, of the debtor's value, payable in cash, to the defrauded public investors.

The losses of debenture holders are estimated at about the principal amount of the debentures, $35 million, and the losses of stockholders are estimated at about $100 million.

The Commission filed an advisory memorandum concluding that if certain minor amendments are made the trustees' plan may be found to be "fair, equitable and feasible." The memorandum noted, however, that while the valuation of the estate was within the range of reasonableness it did resolve all significant financial doubts against the small creditors who are to receive cash for their claims.

Aldersgate Foundation, Inc.[29]—The debtor is a non-profit corporation which operates two retirement centers in central Florida. Acquisition of property and development of the centers were accomplished solely through charitable contributions and debt financing consisting primarily of $20 million of 7 percent first mortgage bonds sold to about 3,000 persons.

Seven plans were proposed for the reorganization of Aldersgate, and three of them were referred to the Commission for examination and report. Each of the plans proposed that a profit corporation, controlled by the respective contributors of new equity capital, would acquire the retirement centers and some of the debtor's other properties. Taxes and administrative costs would be paid in full in cash under each plan.

In general, each plan proposed compensating the bondholders up to the court-determined values of the properties securing the respective bond issues since the bond indentures contain nonrecourse provisions which preclude the bondholders from asserting deficiency claims against the debtor. Two of the plans proposed that the reorganized debtor carry about $19 million of debt, about 97 percent of total capitalization, consisting largely of 7 percent first mortgage bonds to be issued to the bondholders. The third plan would have required the reorganized debtor to carry $15 million of debt, consisting of 7 percent debentures and a $7.4 million loan obtained by mortgaging the debtor's properties. The cash proceeds of the loan, the 7 percent debentures and preferred stock would be issued to bondholders in exchange for their claims.

The debtor originally acquired land for its primary retirement center by giving a mortgage to the seller, who agreed to be subordinated to first mortgage bonds sold by the debtor to finance the center's development. The mortgagee has brought an adversary proceeding seeking to avoid the subordination. All three plans proposed to compromise this litigation by offering the mortgagee payment in cash and

securities equal to the full principal of the mortgage.

The Commission, in an advisory memorandum, concluded that none of the plans is feasible because they proposed unrealistic capital structures which required debt service far in excess of the debtor's reasonably foreseeable earnings capacity. The Commission also concluded that the plans' proposals for settling the litigation regarding the relative priorities of the purchase money mortgagee and bondholders are too generous to the mortgagee, in view of the probable recoveries, and, hence, are not fair and equitable.

The Commission agreed that equal treatment of the three issues of bonds sold to construct the debtor's primary retirement center and secured by different portions thereof was proper since, among other things, there was evidence of routine commingling of funds without regard to the stated terms of the respective bond issues.

The Commission also noted that the additional capital expected to be supplied to the debtor if reorganized as a profit corporation in exchange for a controlling interest was minimal in comparison to the debtor's size and that a profit corporation would incur substantial taxes and other expenses for which the debtor has never been obligated. Accordingly, the Commission recommended that an internal plan be devised which would maintain the debtor's non-profit status and that contingent income securities be issued for the portion of creditors' claims left uncompensated after issuance of a realistic amount of senior debt. Shortly after the close of the fiscal year, the court refused approval of the three plans and directed the Chapter X trustee to develop a non-profit plan according to the Commission's recommendations.

Dolly Madison Industries Inc.[30] — The trustee filed a plan of reorganization based upon the continuance of the debtor's furniture manufacturing and convenience retail food store operations. The plan was predicated on the debtor's insolvency. It cured certain defects pointed out by the Commission in an earlier report:[31] that is, (1) the classes of creditors and their treatment were more clearly delineated; (2) the provision for the issuance of warrants was eliminated; and (3) the issuance of non-voting stock was prohibited. The plan, among other things, provided for the payment of creditor claims as follows: (1) bank claims, $1.1 million in cash; $1.6 million in preferred stock and $14.9 million in common stock at the rate of one share for each $20 of claims; and (2) general unsecured creditors, common stock at the rate of one share for each $20 of claims. Included in the general unsecured creditor class are $1.5 million in claims asserted by shareholder fraud claimants as a result of a settled class action.[32]

The Commission reported to the court that the plan was feasible and equitable, if the court found certain compromises with creditors to be fair. The Commission did not find enough evidence in the record to make a recommendation on the proposed compromises. The court found that the plan complied with the statutory standards of fairness and feasibility. The plan was approved and confirmed by the court.

American Mortgage & Investment Company, Inc.[33] — The debtor is a publicly held, South Carolina land development company which suffered financial difficulties in 1972, and 1973 by relying too heavily upon bank debt secured by its principal source of income, land sale contracts. By December 1974, the debtor was forced

to seek relief under Chapter X of the Bankruptcy Act.

Two plans of reorganization were proposed, one by the trustee and another by the debtor. The plans were premised upon the debtor's solvency. The Commission filed a memorandum concluding that certain additional evidence was required before either plan could be found feasible and that in certain respects, the plans were not fair and equitable. Thereafter, the trustee withdrew his plan and adopted an amended version of the debtor's plan as the trustee's amended plan of reorganization.

The trustee's amended plan provides for the continuation of the debtor's land development business. Costs of administration, taxes and wage claims will be paid in full in cash. The secured bank creditor will be paid in full over a four-year period from the current receivables subject to its claim, which will be preserved absent certain after-acquired collateral provisions. Purchase money mortgages on land inventory will be repaid in full at 8 percent interest in three annual installments commencing three years after confirmation. Other secured claims will be repaid in full from the sale of the collateral in the course of the debtor's future operations.

The amended plan proposes to pay unsecured creditors in full in interest bearing notes. Those creditors with claims between $500 and $4,999 will receive two-year notes and those in excess of $5,000 five-year notes with larger payments in the later years. Creditors with claims less than $500 or who reduce their claim to $500 will be paid in full in cash. The rights of stockholders are altered only to the extent of prohibiting payment of dividends until the creditors are repaid.

In a supplemental memorandum, the Commission concluded that the amended plan was feasible but that it was unfair in that payment to the purchase money mortgagees was unnecessarily deferred and that no provision was included for the potential rescission claims of purchasers of lots which were not likely to be developed in accordance with representations by the debtor's sales personnel. The court approved the plan on the basis of presentations by the trustee and the debtor aimed at showing the necessity for the deferred payments and the improbability of viable rescission claims arising in the future. The plan was accepted and confirmed in February 1977.

Detroit Port Development Corp.[34] — The debtor is a non-profit municipal corporation which sold $9 million of revenue bonds to public investors in order to finance the acquisition of an existing port and terminal facility along the Detroit River. Thereafter, the debtor leased the facilities under a 30-year lease to a business corporation. The lessee was to operate the facilities and its rental payments were to go towards retirement of the bonds. However, after several years of operating deficits the lessee-operator defaulted. The debtor clearly lacked the management and the equity capital needed to take over and operate the business for its own account, and accordingly, filed a petition for reorganization under Chapter X.

The trustees' proposed amended plan of reorganization provides for a continuation of the original concept of a lessee-operator. After months of negotiations with several prospective lessees, the trustees signed a letter

of intent with a corporation which has successfully operated a competing port and terminal facility for many years. The letter of intent embodied a temporary operating agreement and a 40-year lease subject to approval by the court and the bondholders.

The trustees' amended plan contemplates extending the maturity date of the outstanding revenue bonds so it will coincide with the termination date of the proposed long-term lease. The bonds now outstanding will be exchanged for new bonds modified as to maturity. Due to a shortage of funds necessary to meet administrative and priority claims, the plan provides for an invasion, up to a maximum amount, of the existing funds held by the indenture trustee in the bondholders' sinking fund. The bondholders will receive a 50 percent cash payment upon confirmation for three delinquent semi-annual interest payments.

Bondholders will be compensated for the balance of lost interest by receipt of additional revenue bonds identical in every regard, except face value, to the modified bonds. The plan further provides for real estate taxes of over $1 million in arrearage to be recomputed based upon a lower assessed valuation, and the resultant figure to be paid to the taxing authorities by the new lessee over a 20-year period. At the close of the fiscal year, the amended plan had been referred to the Commission for its advisory memorandum. Subsequent to the close of the fiscal year, the Commission filed an advisory memorandum with the court advising that the amended plan may be found fair, equitable and feasible.

C.I.P. Corporation.[35]—The debtor is engaged in acquiring, developing and selling real estate and has approximately 880 shareholders. The debtor relied heavily on debt financing to carry its real estate, most of which was nonincome producing.

The trustee's plan of reorganization was premised upon the concept of paying creditors, most of whom are secured, in parcels of real estate in lieu of cash or securities. Creditors will select their land in kind from the real estate securing their mortgages. Title to the land, subject only to real estate taxes, will then be transferred to the creditors. Values placed on the individual parcels of land have been set by court approved appraisals. Creditors holding first and second mortgages were to be entitled to discounts of 25 percent and zero percent, respectively, against the appraised value of the land so selected to compensate them for the market risks of accepting in kind payment. The discounted valuation will then be used in computing value received in satisfaction of the claim.

The Commission filed an advisory memorandum finding the plan fair, equitable and feasible if amendments were made to modify the wide difference in treatment of first and second mortgagees under the plan. Certain mortgagees also opposed this disparity of treatment and sought payment in cash or notes. Following negotiations between the trustee and various mortgagees, an amended plan of reorganization was proposed.

Under the amended plan, first mortgagees who hold purchase money mortgages are given the option of payment in full in kind with a 15 percent discount, or payment in full in cash with no discount within six months of confirmation. Second mortgagees will be given payment in kind with a 5 percent discount. The largest mortgage creditor which holds both first and second mortgages on debtor's land will receive an overall discount of 9.6 percent. These discounts respond to and

satisfy objections raised in the Commission's original report.

Subsequent to the close of the fiscal year, the Commission filed a supplemental advisory memorandum advising the court that the amended plan may be found fair, equitable and feasible.

Arlan's Department Stores, Inc.[36]—The trustee reported to the court, creditors and stockholders that reorganization of the debtor as a viable entity was impossible. In this connection, he cited the progressive deterioration of the estate both prior to and during the Chapter XI case. The debtor's continuing inability to purchase goods on normal credit terms, an inadequate supply of merchandise and an irreversible decline in consumer confidence were insurmountable obstacles to rehabilitation. Accordingly, after obtaining court authorization, the trustee terminated operations and proposed a plan of orderly liquidation.[37] The plan proposed a distribution of the cash resulting from the liquidation of the debtor's assets in accordance with the order of priorities set forth in Section 64 of the Bankruptcy Act.[38] The Commission reported that the plan complied with the statutory standards of "fairness and feasibility". Subsequently, the plan was approved and confirmed by the court.

ACTIVITIES WITH REGARD TO ALLOWANCES

Every reorganization case ultimately presents the difficult problem of determining the compensation to be paid to the various parties for services rendered and for expenses incurred in the proceeding. The Commission, which under Section 242 of the Bankruptcy Act may not receive any allowance for the service it renders, has sought to assist the courts in assuring economy of administration and in allocating compensation equitably on the basis of the claimants' contributions to the administration of estates and the formulation of plans. During the transitional period, 144 applications for compensation totaling about $13.5 million were reviewed. During the fiscal year, 616 applications totaling about $21 million were reviewed.

North American Acceptance Corp.[39]—Trustee's general and special counsel filed a joint fee application in connection with the settlement of adversary proceedings with Security Mortgage Investors (SMI) and The Chase Manhattan Bank, N.A. Counsel each sought $1 million for their services, representing a final award, with respect to this litigation.

The litigation involved the issue of ownership of a $66 million ($44 million on a discounted basis) loan portfolio. A comprehensive settlement was effected resolving the interrelated claims among the parties. This settlement resulted in the estate receiving about $15 million in cash in exchange for relinquishing its claims to the portfolio and its interest in various securities, including certain SMI debentures held by the debtor. The settlement permitted the debtor to continue to service the portfolio.

The Commission concluded that this phase of the Chapter X proceeding was sufficiently distinguishable to justify a separate allowance. The Commission's recommendations were $650,000 for the general counsel and $625,000 for special counsel. The bankruptcy court awarded $637,500 to each. These awards have been appealed to the district court.

Imperial '400' National, Inc.[40] — Twenty-one applications were filed seeking final fees and reimbursement of expenses totalling $3.3 million. The Commission advised the court that, exclusive of $331,000 in interim allow-

ances already paid, further fees and expenses in excess of $1.5 million would imperil the successful reorganization of the debtor. The court awarded the aggregate sum of $1,474,000.[41]

Certain applications raised interesting questions. An unsuccessful plan proponent, who was neither a creditor nor stockholder, sought reimbursement of $516,000 for legal and other expenses. The Commission advised that, notwithstanding the efforts made, only persons who, like a creditor or stockholder, have a financial interest in the estate or have a cognizable administrative interest in the proceedings, have standing to seek fees.[42] The court awarded $25,000 to this unsuccessful proponent.

The attorneys for the debtor requested $100,000. The Commission pointed out that a substantial amount of time expended by counsel in the debtor's superseded Chapter XI proceeding was of dubious value to the estate. Such services included futile attempts to promulgate arrangements far beyond the scope permissible in Chapter XI and opposition to the Commission's transfer motion.[43] Taking these factors into account, the court awarded $52,500.

First Home Investment Company of Kansas, Inc.[44] — Nine applicants sought final allowances (including amounts previously paid) and reimbursement of expenses aggregating about $895,000. The Commission recommended payment of about $533,000. The court awarded fees and expenses totalling about $523,000.

The trustee and his counsel requested $350,000 and $300,000, respectively, for services rendered over a three year period. The Commission recommended $165,000 and $200,000, respectively, noting that exorbitant fees should not be allowed simply because the estate is in a position to pay such fees. The court awarded $200,000 to the trustee and $180,000 to his counsel.

The co-counsel for Investors' Protective Committee "A" requested allowances of $103,585 and $30,742, respectively. The Commission recommended allowances of $75,000 and $25,000, respectively. The Commission pointed out that, although unrecorded time may be a common experience among lawyers, the applicants have the burden of proof of establishing the value of their services. When a substantial volume of services has been recorded, as was the case, it is not unreasonable to presume that unrecorded time was omitted because it was unimportant; such time should not be compensable. The Commission also pointed out that duplication of services cannot be tolerated and that it is unreasonable to have the estate bear the full cost of consultations and preparation for and attendance at meetings and hearings by two sets of counsel. The court awarded the applicants $60,000 and $30,000, respectively.

Interstate Stores, Inc.[45] — The Commission appealed a decision of the bankruptcy court which granted in full interim allowance requests of, among others, general counsel for the trustees. General counsel sought and was awarded $575,000 for services rendered over a 17-½-month period plus $33,717.26 for reimbursement of expenses. The bankruptcy court in granting the application, however, failed to set forth any reasons in law or fact why it declined to follow the Commission's recommendation of $450,000 and disallowance of certain expenses.[46]

On appeal, the Commission reiterated its contention that 22 percent of general counsel's claimed time expenditures of 9,670 hours were inadequately documented and that the requirements of "strict economy" man-

dated a reduced interim fee. The Commission again argued that certain expenses were not properly chargeable to the estate. The district court modified the bankruptcy court's award and granted $525,000. In this connection, the district court stressed the importance of maintaining adequate and contemporaneous time records.[47] With respect to disbursements, the district court found that meals, cab fares and overtime wages to non-legal personnel are ordinary expenses incurred in the operation of a law firm, i.e., overhead, and reduced the award by about $12,000. General counsel returned $62,000 plus interest to the estate.

Investors Funding Corporation of New York.[48] — Applications for allowances, the bulk of which were interim requests, were filed by the trustee, his attorneys and accountants. The aggregate sum sought was $1.3 million. The Commission recommended $995,000 stressing that interim awards in Chapter X do not purport to measure the value of the services rendered but are intended only to alleviate economic hardship and thereby to assure efficient administration of an estate. The court, with but one exception, awarded the sums recommended by the Commission.[49] Based upon its holding that "interim allowances are designed only to keep body and soul together" and the submissions of general counsel reflecting its overhead, the court awarded $422,527 to the trustee's general counsel, rather than the $360,000 recommended by the Commission. General counsel sought $503,000.

INTERVENTION IN CHAPTER XI

Chapter XI of the Bankruptcy Act provides a procedure by which debtors can effect arrangements with respect to their unsecured debts under court supervision. Where a proceeding is brought under that chapter but the facts indicate that it should have been brought under Chapter X, Section 328 of Chapter XI and Rule 11–15 of the Rules of Bankruptcy Procedure authorize the Commission or any other party in interest to make application to the court to transfer the Chapter XI proceeding to Chapter X.

Under Rule 11–15, the Commission, as well as other parties in interest, except the debtor, have 120 days from the first date set for the first meeting of creditors to file a motion. The time may be extended for good cause. A motion made by the debtor for transfer, however, may be made at any time. The rule requires a showing that a Chapter X reorganization is feasible. This in effect means that a motion can be granted only if the court finds both that Chapter XI is inadequate and reorganization under Chapter X is possible.

Attempts are sometimes made to misuse Chapter XI so as to deprive investors of the protection which the Securities Act and the Exchange Act are designed to provide. In such cases the Commission's staff normally attempts to resolve the problem by informal negotiations. If this proves fruitless, the Commission intervenes in the Chapter XI proceeding to develop an adequate record and to direct the court's attention to the applicable provisions of the Federal securities laws and their bearing upon the particular case.

United Merchants & Manufacturers, Inc.[50]—Shortly after the filing of petitions under Chapter XI by the debtor and 374 subsidiaries, the Commission filed a motion, under Section 328 of the Bankruptcy Act and Bankruptcy Rule 11–15, to transfer the case to Chapter X. The Commission argued that Chapter X is the appropriate proceeding for the debtor because,

among other things, (1) more than a minor adjustment of the rights of public debenture holders is necessary; and (2) a comprehensive reorganization and the scrutiny of a disinterested Chapter X trustee, rather than a simple composition of unsecured debt, is required.

The debtor is one of the largest diversified textile companies in the United States, employing about 32,000 people, with substantial foreign operations as well. Other businesses include commercial factoring and finance operations and a nationwide retail clothing chain (Robert Hall Clothes). The petitions reflected consolidated assets and liabilities of $903 million and $677 million, respectively. Subsequent to the filing of the Chapter XI petitions, the debtor sold its factoring division (United Factors, Inc.) and liquidated its nationwide retail clothing chain.

The debtor's capitalization includes $66 million in debentures held by more than 2,000 public investor-creditors and close to six million shares of common stock held by more than 17,000 public investors.

At the close of the fiscal year, a hearing on the Commission's transfer motion had been postponed at the request of the debtor to enable it to file a Chapter XI arrangement. The debtor states that it can propose an arrangement which will not affect in a major way the rights of public debt holders.

Continental Mortgage Investors.[51]—As previously reported,[52] the Commission moved to transfer this Chapter XI case to Chapter X. On September 30, 1976, a hearing was held on the transfer motion. On that date, certain bank and institutional creditors withdrew their transfer motion, and the official creditors' committee, nine of whose eleven members were representatives of the banks that filed the creditors' transfer motion, filed an unverified answer in opposition to the Commission's transfer motion. On the same date, the debtor filed a consent to a transfer to Chapter X and its own transfer motion. Three days earlier, on September 27, 1976, the indenture trustee for the debtors' $46 million of debentures and certain debenture holders also filed a transfer motion.

At the conclusion of the hearing, the bankruptcy court took the Commission's transfer motion and other matters raised at the hearing under advisement. The bankruptcy court never did render a decision. Instead, on application of the official creditors' committee, the bankruptcy court adjudicated the debtor a bankrupt and directed that bankruptcy be proceeded with pursuant to Section 376 of the Bankruptcy Act and Rule 11-42 (b) (1) of the Rules of Bankruptcy Procedure. The Commission appealed to the district court which affirmed the bankruptcy judge's adjudication of the debtor.

The Commission, joined by the debtor, appealed the order of adjudication to the United States Court of Appeals for the First Circuit.[53] The Commission sought a reversal of the adjudication order and a remand with instructions that the various pending transfer motions, including the one filed by the Commission, which were never decided before the adjudication, be acted upon without further delay.

The Commission argued, among other things, that there was no "want of prosecution" within the meaning of Bankruptcy Rule 11-42(b) (1), particularly since the debtor demonstrated its desire to pursue its rehabilitation effort by filing a consent to the Commission's transfer motion and its own

motion to transfer the case to Chapter X. The Commission further stressed that the debtor should be allowed to pursue a Chapter X rehabilitation effort absent the stigma and prejudice of a bankruptcy adjudication.

At the close of the fiscal year, the appeal and hearings before the bankruptcy judge on the debtor's voluntary Chapter X petition,[54] filed after the adjudication, were pending.

Continental Investment Corporation.[55] —The Commission had sought the transfer of this diversified financial service holding company from Chapter XI to Chapter X arguing (1) Chapter X is required where more than a minor adjustment of the rights of public debenture holders is necessary; (2) public debenture holders are entitled to "fair and equitable" treatment; (3) the plan of arrangement was not feasible because, among other things, certain litigation claims against the debtor were not dischargeable in Chapter XI; (4) a comprehensive reorganization rather than a "simple composition" of unsecured debt was required; (5) there was a need for a new management and an investigation by a disinterested trustee into the debtor's past activities; and (6) the debtor sought to circumvent the protections afforded public investors by Chapter X through the use of prefiling acceptances.

The bankruptcy judge denied the Commission's transfer motion holding that, under the facts of the case, the debtor's "needs to be served"[56] were adequately met in the Chapter XI case. The Commission appealed to the district court and obtained a stay of confirmation of the debtor's proposed Chapter XI arrangement pending resolution of its appeal. The Commission stressed, among other things, that the bankruptcy judge did not have "open-ended discretion" to decide the merits of a transfer motion.[57] The discretion of the court, the Commission argued, must be exercised within the framework of the principles enunciated by the cases, and under those principles a transfer to Chapter X was required.[58] At the close of the fiscal year, the matter was still pending before the district court.

Great American Management & Investment.[59]—The Commission filed a motion pursuant to Section 328 of Chapter XI and Rule 11−15 of the Rules of Bankruptcy Procedure to transfer this proceeding to Chapter X. The debtor is a large real estate investment trust with assets of $280 million and liabilities of about $330 million. GAMI invested primarily in short-term construction, land acquisition and development loans. Of these assets only about $61 million are still accruing interest as of the date of the Chapter XI petition.

The debtor has outstanding about $58 million of three classes of subordinated debentures held by 1,500 public investor-creditors, and $4.5 million shares of beneficial interest are held by over 8,300 public investors.

The Commission in its transfer motion argued, among other things, that there was a need for a thorough investigation by an independent trustee and that rehabilitation of the debtor will require a substantial adjustment of widely held public debt. At the close of the fiscal year, a hearing on the Commission's transfer motion had not been held.

Duplan Corporation.[60]—The Commission filed a motion pursuant to Section 328 of the Bankruptcy Act and Rule 11−15 of the Rules of Bankruptcy Procedure to transfer this proceeding to Chapter X. The debtor is a diversified textile and apparel

company which directly and indirectly, through its various subsidiaries and divisions, is engaged in the manufacture and sale of various textile lines, buttons, children's sleepwear and ladies' intimate apparel. The Chapter XI petition reflected assets and liabilities of $84.1 million and $78.6 million, respectively. Its capitalization includes $19.2 million outstanding principal amount of convertible subordinated debentures held by about 1,300 persons and 2.6 million shares outstanding of common stock held by more than 5,000 persons.

The court granted the Commission's transfer motion. It agreed that there was need for a thorough investigation by an independent trustee and that rehabilitation of the debtor required a substantial adjustment of widely held public debt.

Crown Corporation.[61]—The Commission filed a motion pursuant to Section 328 of Chapter XI and Rule 11–15 of the Rules of Bankruptcy Procedure to transfer this proceeding to Chapter X. The debtor is a holding company whose subsidiaries are in such diverse businesses as commercial printing, supplying food packing products, roofing and manufacturing of women's apparel. Crown also has major investments in real estate. The Chapter XI petition reflected assets of $23.7 million, liabilities of $21.5 million and shareholders' equity of $21 million. Also, there are $7.8 million of subordinated debentures held by about 1,900 persons and about 2.1 million shares of outstanding common stock held by about 2,300 persons.

The debtor had filed a plan of arrangement which was accepted by creditors and conditionally confirmed by the court. A key element of the plan of arrangement provided for a proposed settlement of various class action suits pending against the debtors which alleged fraudulent activity on the part of the debtor as well as violations of the securities laws. The suits raised complex issues, were in the early stages of litigation, and appeared too far from being settled, leaving the plan in limbo.

The Commission moved to transfer the case to Chapter X arguing that (1) the plan of arrangement is not feasible because, among other things, the class action suits pending against the debtor assert claims that are not dischargeable in Chapter XI and it is unreasonable to expect that these class suits are capable of settlement within the near future; (2) Chapter X is required when more than a minor adjustment of the rights of public debenture holders is necessary; (3) public debenture holders are entitled to "fair and equitable" treatment; and (4) there is a need for an independent investigation of possible causes of action against former management of Crown.

At the close of the fiscal year, the bankruptcy court had not rendered a decision on the Commission's transfer motion.

NOTES TO PART 7

[1]*Reclamation District No. 2090,* N.D. Calif., No. C–76–1207–RHS.

[2]*Fort Cobb, Oklahoma Irrigation Fuel Authority,* W.D. Okla., No. Bk–76–679–E.

[3]*Ashton v. Town of Deerfield Beach,* 151 F.2d 40.44 (C.A. 5, 1946).

[4]S.D. Fla., No. Bk–76–131–NCR–H.

[5]*In re Los Angeles Land & Investments, Ltd.,* 282 F.Supp. 448, 453 (D. Hawaii, 1968), *affirmed per curiam,* 447 F.2d 1366 (C.A. 9, 1971). See also, *In re Carolina Caribbean Corp.,* W.D. N.C., No. A–B–75–123, Chapter X filed February 28, 1975.

[6]The purposes and kinds of cases covered by Rule 10–701 are described in the Adversary Committee's note to Rule 701.

[7]S.D.N.Y., No. 74–B–614–802, inclusive. Previously reported in 42nd Annual Report, pp. 152–53, 159; 41st Annual Report, pp. 157–58.

[8]42nd Annual Report, pp. 152–53.

[9]W.D. Okla., Nos. Bk-74-484, 512, 525, 554 and 731.

[10]W.D. N.C., No. A-B-75-123.

[11]S.D. Ohio, No. B-1-75-1181. Previously reported in 42nd Annual Report, p. 153.

[12]S.D.N.Y., Nos. 74-B-1454, 1455 and 74-B-1511-1542, inclusive. Previously reported in 41st Annual Report, pp. 150-51.

[13]*Bloor v. Dansker, et al.*, 76 Civ. 4679 (HEW), (S.D.N.Y., 1976).

[14]N.D. Texas, No. Bk-3-74-454-G. Previously reported in 42nd Annual Report, pp. 156-57.

[15]W.D.N.Y., No. Bk-72-1399.

[16]*SEC v. Stirling Homex Corp., et al.*, No. 75-1065 (D. D.C.), Litigation Release No. 6960, July 2, 1975.

[17]*U.S. v. Stirling Homex Corp., et al.*, 76 Crim. 685 (MEF) (S.D.N.Y.), appeal docketed No. 77-11-40-(C.A. 2, March 24, 1977).

[18]*Oppenheimer v. Harriman National Bank & Trust Co*, 301 U.S. 206 (1937); *Associated Gas & Electric Co*, 149 F.2d 996 (C.A. 2), *cert. den.*, 326 U.S. 736 (1945); *Four Seasons Nursing Centers of America, Inc.*, 472 F.2d 747 (C.A. 10, 1973).

[19]*In re R. Hoe & Co., Inc.*, Corporate Reorganization Release No. 319 (September 8, 1976), 10 SEC Docket 441: *In re Imperial-American Resources Fund, Inc.*, Corporate Reorganization Release No. 320 (September 28, 1976), 10 SEC Docket 630.

[20]*In re King Resources Co.*, Corporate Reorganization Release No. 321 (July 1, 1977), 12 SEC Docket 1144.

[21]*In re Aldersgate Foundation, Inc.*, M.D. Fla., No. 74-383-Orl-Bk-P; *In re American Mortgage & Investment Co., Inc.*, D. S.C., No. 74-323; *In re Arlan's Department Stores, Inc.*, S.D.N.Y., No. 73-B-468; *In re C.I.P. Corp.*, S.D. Ohio, No. B-1-75-1181; *In re Detroit Port Development Corp.*, E.D. Mich., No. 76-92807-K; *In re Dolly Madison Industries, Inc.*, E.D. Pa., No. 70-354; *In re U.S. Financial, Inc.*, S.D. Calif., No. 17007-K.

[22]D. Colo., No. 72-B-556. Previously reported in 39th Annual Report, p. 119.

[23]S.D.N.Y., No. 69-B-461. Previously reported in 37th Annual Report, pp. 183, 194-195; 36th Annual Report, p. 179.

[24]*In re R. Hoe & Co, Inc.*, Corporate Reorganization Release No. 319 (September 8, 1976), 10 SEC Docket 441.

[25]CPLR 5004.

[26]D. Colo., No. 71-B-2921.

[27]July 1, 1977.

[28]S.D. Calif., No. 17007-K. Previously reported in 42nd Annual Report, p. 158, 41st Annual Report, p. 158.

[29]M.D. Fla., No. 74-383-Orl-Bk-P.

[30]E.D. Pa., No. 70-354. Previusly reported in 41st Annual Report, p. 151, 153-54; 39th Annual Report, p. 122.

[31]See 41st Annual Report, pp. 153-54.

[32]*Bershad v. Dolly Madison Industries, Inc., et al.*, (E.D. Pa., No. 70-2585).

[33]D. S.C., No. 74-323.

[34]E.D. Mich., No. 76-92807-K.

[35]S.D., Ohio, No. B-1-75-1181.

[36]S.D.N.Y., No. 73-B-468. Previously reported in 41st Annual Report, p. 153; 40th Annual Report, p. 131.

[37]A plan of reorganization under Chapter X may contemplate an orderly liquidation. *Country Life Apartments v. Buckley*, 145 F.2d 935 (C.A. 2, 1944); *In re Lorraine Castle Apartments Bldg. Corp.*, 149 F.2d 55 (C.A. 7, 1944); *Bankers Life & Casualty v. Kirtley*, 338 F.2d 1006 (C.A. 8, 1964).

[38]11 U.S.C. §104.

[39]N.D. Ga., B-74-290-A.

[40]D. N. J., No. B-656-65. Previously reported in 42nd Annual Report, p. 156; 40th Annual Report, p. 128; 39th Annual Report, pp. 124-25; 38th Annual Report, pp. 117, 122, 125; 36th Annual Report, pp. 176-77, 190; 35th Annual Report, p. 161; 33rd Annual Report, pp. 132, 137; 32nd Annual Report, p. 94.

[41]*In re Imperial '400' National, Inc.*, 431 F. Supp. 155 (D. N.J., 1977).

[42]11 U.S.C. §§671-73.

[43]See *In re Ulen & Co.*, 130 F.2d 303 (C.A. 2, 1942).

[44]D. Kans., No. 28075-B-2. Previously reported in 42nd Annual Report, p. 156; 40th Annual Report, pp. 125-26.

[45]S.D.N.Y., Nos. 74-B-614-802, inclusive. Previously reported in 42nd Annual Report, pp. 152-53; 41st Annual Report, pp. 157-58.

[46]Such reasons are necessary if the reorganization court declines to follow the Commission's fee recommendations. *Finn v. Childs Co.*, 181 F.2d 431 (C.A. 2, 1950); *Surface Transit, Inc. v. Saxe, Bacon & O'Shea*, 266 F.2d 862 (C.A. 2, 1959); *Ruskin v. Griffiths*, 269 F.2d 827 (C.A. 2, 1959).

[47]See *In re Hudson & Manhattan RR Co.*, 339 F.2d 114 (C.A. 2, 1964); *In re Orbit Liquor Store*, 439 F.2d 1351 (C.A. 5, 1951); *In re Meade Land & Development Co., Inc.*, 527 F.2d 80 (C.A. 3, 1975); *York International Bldg., Inc. v. Chaney*, 527 F.2d 1061 (C.A. 9, 1975).

[48]S.D.N.Y., Nos. 74-B-1454, 1455 and 74-B-1511-1542, inclusive. Previously reported in 41st Annual Report, pp. 150-51.

[49]*In re Investors Funding Corporation of New York, et al.*, 442 F.Supp. 461 (S.D.N.Y., 1976).

[50]S.D.N.Y., Nos. 77-B-1513-1888; 77-B-2003-2015.

[51]D. Mass., No. 76-0593.

[52]42nd Annual Report, pp. 161-62.

[53]Nos. 77–1216 and 1217.

[54]Before a Chapter X petition can be approved, it must be shown that the petition was filed in "good faith". This means, among other things, that it is not unreasonable to expect a successful reorganization §146(3), 11 U.S.C. §546(3).

[55]D. Mass., No. 76–1158–G. Previously reported in 42nd Annual Report, p. 161.

[56]*General Stores Corp.* v. Shlensky, 350 U.S. 462 (1950).

[57]*SEC v. American Trailer Rentals Co.*, 379 U.S. 594 (1965); *Schreibman v. Mason*, 377 F.2d 99 (C.A. 1, 1967); *SEC v. Burton*, 342 F.2d 783 (C.A. 1, 1965); *SEC v. Canandaigua Enterprises Corp.*, 339 F.2d 14 (C.A. 2, 1964).

[58]*SEC v. American Trailer Rentals Co., supra; General Stores Corp., supra; SEC v. U.S. Realty Improvement Co.*, 310 U.S. 434 (1940).

[59]N.D. Ga., No. B–77–760–A.

[60]S.D.N.Y., Nos. 76–B–1967–68.

[61]D. Hawaii, No. 77–30.

Part 8
SEC Management Operations

Part 8
SEC Management Operations

In 1977, the Commission made a number of changes designed to make the most effective use of its resources and provide improved service to the public.

ORGANIZATIONAL CHANGES

Although no major reorganization occurred in 1977, the Commission made several improvements designed to enhance its effectiveness and assure the best allocation of its resources.

The Office of Public Affairs was created by merging the functions of the former offices of Congressional Affairs and Public Information. The new organizational arrangement was created to improve coordination between the Commission's press relations and Congressional relations and provide increased emphasis in both areas.

During 1977, the Office of Public Affairs coordinated agency responses to in-depth Congressional inquiries, including detailed oversight hearings by subcommittees of the House Interstate and Foreign Commerce Committee; tracked approximately 500 House and Senate bills (from both the 94th and 95th Congress); received approximately 1,250 letters and an estimated 20,000 telephone calls; wrote and circulated approximately 300 memoranda to Commissioners and Commission staff members; held approximately ten news conferences; coordinated, edited, and published the Commission's annual report to Congress; and coordinated arrangements for the "SEC Major Issues Conference," an assembly of 64 representatives of the SEC, industry, public interest groups, and the academic community, which considered key major policies confronting the Commission. In addition, the Office initiated a new publication entitled "SEC Employee News," which is being disseminated to the Commission's staff on a monthly basis.

The Branch of Investor Service, formerly part of the Office of Reports and Information Services, became a major component of the Office of Consumer Affairs in April 1977. As a result, the Office of Consumer Affairs has been assigned primary responsibility for processing and responding to inquiries and complaints from individual investors. The Commission attempts to resolve complaints regarding registered entities by requesting reports on the subject of the complaint. In addition, inquiries and complaints from members of the public often provide valuable information about practices within the securities industry. The Office of Consumer Affairs gathers statistics from these

communiques and prepares reports about the entities subject to the Commission's jurisdiction to assist other offices and divisions in carrying out their regulatory and enforcement responsibilities. During 1977, the Commission received, analyzed, and answered approximately 4,000 complaints and inquiries about registered brokers and dealers. Most of the complaints involved operational problems such as failure to deliver funds or securities or the alleged mishandling of accounts. In addition, there were approximately 9,100 complaints and inquiries concerning investment advisers, issuers, banks transfer agents, and mutual funds.

During 1977, the Office of Consumer Affairs concentrated much of its efforts on the development of a uniform system for the resolution of disputes between broker-dealers and small investors. The system will be made available nationwide through the self-regulatory organizations and is to include a simplified procedure for the expeditious resolution of claims involving small dollar amounts. Following two public forums on this subject, the Commission announced on April 26, 1977, that it would consider related proposals to be generated by a conference of representatives of self-regulatory organizations and members of the public. The conference was convened and participants agreed to submit proposed rules for a simplified procedure for resolving small claims by the end of the calendar year and a uniform arbitration code shortly thereafter.

The position of the Director of Regional Office Operations was also established in the Executive Director's Office during this time frame. Before 1977, there was no real "regional presence" in the home office. Although several divisions have branches which have responsibility for assisting the regions with particular programs, these units' primary allegiance resides with their parent divisions.

The creation of a Director of Regional Office Operations, provides the regions with an advocate in headquarters who can represent their interests in the variety of problems and issues which arise in the normal course of business. The Director is responsible for coordinating the regions' response to and participation in a variety of substantive programs being undertaken by the Commission or any of its home office units.

In this same vein, it is the duty of the Director of Regional Office Operations to direct the regions in initiating proposals relating to potential substantive programs and regulatory reform. The regional offices are in a unique position to submit a variety of suggestions impacting upon the substantive and administrative work of the Commission due to their responsibilities for implementing rules and regulations while performing their inspection function and because they are often the first units in the Commission to confront novel enforcement problems. It is the job of the Director of Regional Office Operations to encourage the regions to play an active role in addressing the regulatory and enforcement concerns they perceive and in proposing possible solutions to them.

To assist the Director of Regional Office Operations in carrying out his functions, every six months one of the regional administrators is appointed to be the Director's principal contact point in the field. During his tenure, the Advising Regional Administrator acts as the Director's sounding board on regional issues, consults with the Director and meets with head-

quarters staff to explain the regional viewpoint. The Advising Regional Administrator also helps by evaluating suggestions from other regional administrators and forwarding proposals of his own for consideration at headquarters.

PERSONNEL MANAGEMENT

The permanent personnel strength of the Commission totalled 1,959 employees on September 31, 1977 as shown below:

Commissioners	4
Staff:	
Headquarters Offices	1,237
Regional Offices	718
Total Staff	1,955

Recognizing the importance of sharpening staff skills and keeping abreast of new developments, the Commission expanded its involvement in staff training and development by nearly three-fold. In 1977, over 600 staff members attended nearly 1,000 training programs. Categorically, the greatest increases in training occurred in the areas of executive and management development, litigation and communication. While outside institutions continued to be the major source of staff training, a four-fold increase was experienced in "in-house" courses designed specifically for SEC staff.

The agency commitment to training excellence was illustrated by several noteworthy examples. Over 100 senior staff managers throughout the Commission attended an "in-house" seminar entitled the "Manager's Role in EEO," which was the first such program ever offered at the SEC. Eight senior staff attorneys represented the Commission at the prestigious National Institute of Trial Advocacy in Boulder, Colorado, while another twenty-six staff attorneys attended a one-week securities litigation program developed for the Commission's legal staff by the Columbia Law School. The Commission also began participating in the three-week Harvard University program for government executives and the Brookings Institute Conferences for Senior Executives.

An attorney hiring committee, composed of representatives of each of the Commission's legal divisions, was established to coordinate the SEC's attorney interview and selection processes for 1977. The Committee expanded the Commission's recruiting efforts by contacting more than 100 law schools and by increasing the number of locations at which initial interviews were conducted. The committee, in conjunction with the Personnel Office developed a novel but standardized procedure for rating applications to insure that all attorney candidates receive consideration using the same criteria. The Commission was also successful in recruiting experienced litigators to strengthen enforcement staffs in both the headquarters and regional offices.

The Commission's affirmative action program resulted in the hiring of increased numbers of women and minority attorneys. During 1977, the percentage of female attorneys on the legal staff rose from 12.9 percent to 16.7 percent, and the percentage of minority attorneys rose from 6.3 percent to 6.7 percent.

In the area of recruitment and placement of the handicapped, the Civil Service Commission commended the SEC for its "'...comprehensive and results-oriented system which will continue to enhance employment opportunities for qualified handicapped individuals in professional as well as support positions...'" The CSC further stated that the SEC's affirmative action plan for the hiring, placement and advancement of handicapped individuals "...could serve as an example

for other Federal agencies of similar size."

Seven of the regional offices received on-site personnel management evaluation and assistance visits from headquarters classification, staffing, and training personnel during 1977. These visits provided staff of the Personnel Office with an opportunity to perform job audits, conduct supervisory training sessions, and meet with individual supervisors and employees to discuss personnel-related problems and concerns.

The Commission is continuing its effort to establish meaningful distinctions between grade levels for professional positions. Guidelines distinguishing senior level broker-dealer compliance examiners from journeyman and junior level examiners have been completed. Similar guidelines for investment company examiners, investment adviser examiners, investigators, and financial analysts are now being considered.

INFORMATION SYSTEMS MANAGEMENT

During 1977, several major programs were initiated to improve the utilization of information at the Commission. In the area of records management, an extensive microfilm system was introduced to begin to address internal storage and dissemination problems associated with the Commission's voluminous paper files. The use of this technology, which is presently being utilized by an outside contractor to make Commission filings available to the public, will eventually result in the elimination of much of the manual handling and transfer of files among offices. This comprehensive micrographics program will, over a period of three or four years, convert all official public filings and formal correspondence to microform. At headquarters, access to these documents will be provided by furnishing copies of individual microfiche. Regional and branch offices will have complete sets of all filmed documents on ultra high reduction film strips with paper copies available as needed.

The Commission's current use of automatic data processing was enhanced by the addition of a teleprocessing capability and the development of associated data entry and retrieval functions for selected applications. The computer terminals, printers, and special computer software required for teleprocessing were procured and installed in the latter part of 1977. The initial teleprocessing applications to be implemented include a microform index to support the microfilm operation described above, a centralized index of unique identifying numbers for SEC registrants, and a workload system to control the internal processing of documents filed with the Commission.

For the microfilm operation, teleprocessing will provide a rapid means of keeping the film index of filings up-to-date and will allow users to obtain that information directly without consulting unwieldy and often incomplete paper listings. The unique identifier will be utilized initially in the microfilm index and the filings workload system and will provide a means of linking various information related to the same SEC registrant. The on-line workload system will reduce chronic delays in recording the receipt of filings, reduce data input errors, and streamline processing, resulting in disposition data which is more timely and accurate.

In order to ensure that adequate computer resources will be available for teleprocessing and other projected needs, the decision was made to up-

grade the in-house computer on an interim basis, pending development of long-term computer requirements. Permanent installation of the replacement computer is scheduled for late 1978. This upgrade will make it possible for the Commission to continue its program of providing effective computer support to its staff.

In line with its commitment to improving its computer capability, the staff completed a five-year plan addressing the role of data processing in the Commission's work and set long-range goals for applying new technology. As the first phase of this plan, a detailed, agency-wide systems requirements analysis was initiated in the last quarter of 1977 by a team of management consultants. A major aim of this study is to find ways to enhance the quality and accessibility of information available both to the Commission's staff and to the general public. Some of the specific areas to be addressed are document indexing, case tracking, direct inquiry of computer maintained information, management reporting, and information services for the regional offices. The requirements analysis is scheduled for completion during 1978. Follow-up work will include computer system designs to meet the identified data requirements and identification of alternative ways of implementing the proposed systems.

FINANCIAL MANAGEMENT

The Commission's 1977 appropriation of $56,270,000 was offset in part by fees collected by the Commission amounting to approximately 56 percent of its operating expenses. The Commission is required by law to collect fees for : (1) registration of securities issued; (2) qualification of trust indentures; (3) registration of exchanges; (4) registration of brokers and dealers who are not members of the NASD; and (5) certification of documents filed with the Commission. In addition, the Commission imposes fees for certain services such as filing annual reports and proxy material.

During 1977, the Commission began developing its annual budget estimate using zero-base budget (ZBB) techniques. Application of this method produced several important benefits:

— The ZBB process highlighted major issues. This process forced the agency to develop a program-oriented budget which focuses attention on objectives and methods of attaining them, thereby facilitating consideration of important substantive issues.

— Zero-base budgeting assisted in identifying trade-offs between programs. For the first time, the Commission was afforded a well ordered opportunity to consider whether to apply an increment of resources to maintaining a marginal activity at its current level or to enhance a critical program of higher priority. The same analysis took place within individual programs, as program coordinators analyzed trade-offs among competing decision packages contributing to the same overall program goal.

— While the content of the Commission's budget justification was enhanced, the size was reduced as a result of the new approach. The material submitted to OMB for its 1979 budget request contained 46 percent fewer pages than in 1978, while the corresponding Congressional

budget justification is only 81 pages, compared with 121 pages the previous year.

In general, the ZBB process worked well throughout the Commision. The emphasis given to sharpening objectives succeeded in convincing managers to support development of a case management system. Further improvement in the use of ZBB to manage Commission resources will depend in large measure on the agency's success in redesigning a manpower reporting system which complements and measures progress toward achieving major program objectives.

FREEDOM OF INFORMATION ACT

Commission rules pursuant to the Freedom of Information Act (FOIA), as revised on February 19, 1975, provide that the public can inspect or obtain copies of all records maintained by the SEC with the exception of certain specified categories of information. Most financial data and other information filed by registered companies has always been available for inspection by the public. However, the public was traditionally denied access to certain categories of material, notably investigatory records. Pursuant to various FOIA requests, the Commission has made available for public inspection many records which had previously been considered confidential. Among these records are portions of the broker-dealer manual and the entire investment advisers and investment company inspection manuals, the summary of administrative interpretations under the Securities Act of 1933, and the periodic securities violations bulletin. Moreover, the Commission has made available, pursuant to specific FOIA requests, staff letters of comment on registration statements and Wells Committee submissions. The Commission received a total of 1,250 requests for information under the FOIA between July 1, 1976 and September 30, 1977.

Part 9
Statistics

Part 9
Statistics

THE SECURITIES INDUSTRY
Income, Expenses and Selected Balance Sheet Items

Registered broker-dealers recorded total revenue of $8.9 billion in 1976, 21.4 percent above the 1975 figure of $7.3 billion. Securities commissions are by far the most important source of revenue; however, the industry appears to be diversifying its business activity. Since 1973, when 53.6 percent of total revenue was generated from this source, commissions have accounted for a steadily declining portion of total revenue. They contributed 46 percent of total revenue in 1975 and 41 percent in 1976. Trading and underwriting revenues were the second and third most important revenue contributors, together accounting for 29 percent of total revenue in 1975 and 32 percent in 1976.

Pre-tax income came to approximately $1.5 billion, bringing the 1975 industry profit margin of 15.2 percent up to 16.9 percent in 1976. Pre-tax income increased 34.8 percent on a 21.4 percent growth in revenue. Ownership equity at the end of 1976 was nearly $5.3 billion, reflecting a 16.9 percent increase during the year.

Table 1

FINANCIAL INFORMATION FOR BROKER-DEALERS 1975–1976

(Millions of Dollars)

		1975	1976
A. Revenue and Expenses			
1	Securities Commissions	$ 3,374 1	$ 3,656 2
2	Gain (Loss) in Trading	1,201 1	1,827 4
3	Gain (Loss) in Investments	131 7	269 2
4	Profit (Loss) From Underwriting and Selling Groups	930 3	1,022 6
5	Interest Income	601 7	556 7
6	Other revenue Related to Securities Business	697 5	706 1
7	Revenue From All Other Sources	394 3	860 2
8	Total Revenue	7,330 7	8,898 4
9	Total Expenses*	6,215 9	7,395 1
10	Pre-Tax Income	$ 1,114 8	$ 1,503 3
B. Assets, Liabilities and Capital			
11	Total Assets	$ 31,181 1	$ 48,987 2
12	Liabilities		
	a Total liabilities (excluding subordinated debt)	25,824 4	42,842 8
	b Subordinated debt	834 7	858 1
	c Total liabilities (11a + 11b)	26,659 1	43,700 9
13	Ownership Equity	4,522 0	5,286 3
14	Total Liabilities and Ownership Equity	$ 31,181 1	$ 48,987 2
	Number of Firms	4,015	4,347

* Expenses include Partners' Compensation
Source Form X-17A-10

Historical Financial Information of Broker-Dealers with Securities Revenue of $500,000 or More[1]

Every source of broker-dealer revenues with the exception of interest income increased in 1976 due to the record trading volume. Common stock volume on all registered exchanges increased 12.9 percent in 1976 over 1975. The three most important revenue components increased as follows: Securities Commissions 9 percent to $3.5 billion; Trading Activities 59 percent to $2.0 billion; Underwriting 10 percent to $1.0 billion.

Interest income declined 7 percent in 1976, primarily due to the decline in interest rates. Total revenue increased 22 percent for the year to $8.6 billion and pre-tax income of $1.4 billion was 36 percent higher than the 1975 results. Total assets increased $17.2 billion, or 56 percent in 1976. Of this increase, $16.4 billion was balanced by corresponding increases in liabilities. Other liabilities alone accounted for $10 billion of this increase. The remaining growth in assets, $847 million, represented growth in equity capital, with ownership equity increasing 22 percent in 1976.

[1]The Financial and Operational Combined Uniform Single (FOCUS) reporting system requires larger firms to report in greater detail than smaller broker-dealers Firms with $500,000 or more in securities related revenue, the level at which reporting becomes more detailed, held approximately 98 percent of the industry's assets and reported over 96 percent of all revenue in 1976

Table 2

HISTORICAL REVENUE AND EXPENSES FOR BROKER-DEALERS WITH TOTAL REVENUE OF $500,000 OR MORE

(Millions of Dollars)

			1970	1971	1972	1973	1974	1975	1976
A. Revenue and Expenses									
1		Commissions							
	a	Commissions earned on equity securities transactions executed on a national securities exchange	$1,904 1	$2,727 2	$2,747 3	$2,385 2	$2,081 1	$2,599 3	$2,684 9
	b	Other commission revenue	362 4	560 1	656 3	430 6	357 1	616 3	822 5
	c	Total commissions	2,266 5	3,287 3	3,403 6	2,815 8	2,438 2	3,215 6	3,507 4
2		Gain (Loss) on Firm Securities Trading and Investment Accounts							
	a	Gain (loss) in trading	823 5	1,056 0	994 2	590 2	722 4	1,136 6	1,756 6
	b	Gain (loss) in investments	74 9	242 5	208 6	−3 1	54 5	131 0	253 1
	c	Total gain (loss)	898 4	1,298 5	1,202 8	587 1	776 9	1,267 6	2,009 7
3		Profit (Loss) from Underwriting and Selling Groups	601 3	957 0	915 6	493 5	496 3	912 7	1,007 8
4		Revenue From Sale of Investment Company Securities							
	a	As underwriter	N/A	N/A	N/A	N/A	N/A	48 8	59 9
	b	Other than as underwriter (retail transactions)	N/A	N/A	N/A	N/A	N/A	70 9	86 1
	c	Total revenue from sale of investment company securities	184 2	195 5	151 0	148 8	78 8	119 7	146 0
5		Interest Income	378 6	363 8	527 0	620 9	622 0	591 3	549 5
6		Fees for Account Supervision, Investment Advisory and Administrative Services	63 6	82 3	98 6	82 8	84 6	154 5	205 5
7		Commodity Revenue	88 2	98 3	124 6	177 5	168 2	186 6	235 8
8		Other Revenue Related to Securities Business	N/A	N/A	N/A	N/A	N/A	381 3	689 8
9		Revenue From All Other Sources	266 2	300 4	306 2	323 3	399 7	167 1	200 0
10		Total Revenue	$4,747 0	$6,583 1	$6,729 4	$5,249 7	$5,064 7	$6,996 4	$8,551 5
B Expenses									
11		Compensation to registered representatives	$ 777 7	$1,139 0	$1,198 0	$ 937 4	$ 949 4	$1,274 5	$1,571 8
12		Employee compensation and benefits	1,085 7	1,299 7	1,392 2	1,184 2	1,096 6	1,375 5	1,660 2
13		Commissions paid to other brokers	128 0	182 0	185 7	188 0	151 0	210 8	346 6
14		Interest	539 9	519 8	633 7	795 7	749 7	580 0	838 9
15		Communications	370 0	433 8	488 0	461 0	462 6	481 7	588 4
16		Occupancy and equipment rental	348 7	412 8	459 6	433 4	439 7	463 0	484 2
17		Promotional	156 8	187 7	214 0	185 7	172 1	156 8	202 0
18		All other operating expenses	606 3	787 4	793 5	685 9	633 7	1,413 0	1,445 1
19		Total expenses	4,013 1	4,962 2	5,364 7	4,871 3	4,654 8	5,955 3*	7,137 2*
C. Pre-Tax Income									
20		Pre-tax income	$ 733 9	$1,620 9	$1,364 7	$ 378 4	$ 409 9	$1,041 7	$1,414 3
Number of Firms			655	788	817	652	609	764	930

*Expenses include partners' compensation
Source Form X−17A−10

Table 3

HISTORICAL CONSOLIDATED BALANCE SHEET FOR BROKER-DEALERS WITH TOTAL REVENUES OF $500,000 OR MORE

(Millions of Dollars)

	1970	1971	1972	1973	1974	1975	1976
A Assets							
1 Cash, clearing funds, and other deposits	$ 1,161 7	$ 1,220 5	$ 1,280 6	$ 1,139 4	$ 940 3	$ 922 7	$ 1,133 7
2 Receivables from brokers or dealers							
a Securities failed to deliver	2,318 9	2,230 3	2 567 9	1,843 6	1,219 9	1,446 1	2,213 7
b Securities borrowed	864 8	1,022 2	1,363 9	1,096 0	889 0	1,336 2	2,076 3
c Other receivables	197 7	295 1	382 2	330 0	905 2	1,069 7	1,092 4
3 Receivables from customers	7,077 0	9,643 6	13,372 8	9,056 2	7,450 1	8,455 1	12,796 9
4 Market value or fair value of securities and commodities accounts							
a Trading accounts	NA	NA	NA	NA	NA	10,573.3	17,742 4
b Other accounts	NA	NA	NA	NA	NA	2,192 4	3,646 3
c Total market value or fair value of securities and commodities accounts	10,261 4	11,667 0	11,870 1	9,721 6	10,788 5	12,865 7	21,388 7
5 Memberships in exchanges (market value)	210 2	200 1	207 9	123 0	100 5	117 7	141 0
6 Property, furniture, equipment leasehold improvements and rights under lease agreements (net of depreciation)*	228 6	278 1	306 7	279 9	268 5	255 4	303 4
7 Other assets	1,163 8	1,368 1	1,397 5	1,599 0	1,224 8	4,276 4	6,889 9
8 Total assets	$23,484 1	$27,925 0	$32,749 6	$25,188 7	$23,786 8	$30,775 0	$48,036 0
B. Liabilities							
9 Money borrowed							
a Secured by customer collateral	NA	NA	NA	NA	NA	2,212 5	4,629 8
b Secured by firm collateral	NA	NA	NA	NA	NA	7,123 1	6,915 0
c Unsecured	NA	NA	NA	NA	NA	142 2	250 6
d Total money borrowed	8,994 1	11,285 7	14,398 4	9 878 1	10,421 0	9,477 8	11,795 4
10 Payables to brokers or dealers							
a. Securities failed to receive	2,705 7	2,419 6	2,732 2	1,724 3	1,281 0	1,398 9	2,151 2
b Securities borrowed	835 5	983 6	1,284 3	846 9	579 2	1,063 1	1,602 1
c Other payables to brokers or dealers	197 8	345 2	354 2	364 7	1,058 5	1,084 3	1,018 4
d Total payables to brokers or dealers	3,739 0	3,748 4	4,370 7	2,935 9	2,918 7	3,546 3	4,771 7
11 Payables to customers							
a Free credit balances	2,125 5	2,103 8	2,149 8	2,184 4	1,732 5	1,732 9	2,023 1
b All other payables to customers	2,116 5	2,632 6	3,078 3	2,793 1	2,253 6	2,958 5	4,144 2
c Total payables to customers	4,242 0	4,736 4	5,228 1	4,977 5	3,986 1	4,691 4	6,167 3
12 Short positions in securities and commodities accounts	707 4	906 8	1,525 1	1,158 3	1,038 2	1,163 8	2,554 6
13 Other liabilities	2,343 0	2,858 7	2,505 4	2,549 7	2,098 5	7,195 8	17,170 2
14. Total liabilities excluding subordinated borrowings	20,025 5	23,536 0	28,027 7	21,499 5	20,462 5	26,075 1	42,459 2
15 Subordinated borrowings	641 0	728 1	773 9	642 2	593 5	767 0	796 7
16 Total liabilities	$20,666 5	$24,264 1	$28,801 6	22,141 7	21,056 0	$26,842 1	$43,255 9
C. Ownership Equity							
17 Ownership equity	2,817 6	3,660 9	3,948 0	3,047 0	2,730 8	3,932 9	4,780 1
18 Total liabilities and capital	$23,484 1	$27,925 0	$32,749 6	$25,188 7	$23,786 8	$30,775 0	$48,036 0
Number of Firms	655	788	817	652	609	764	930

*Item 6 not net of amortization
Source Form X-17A-10

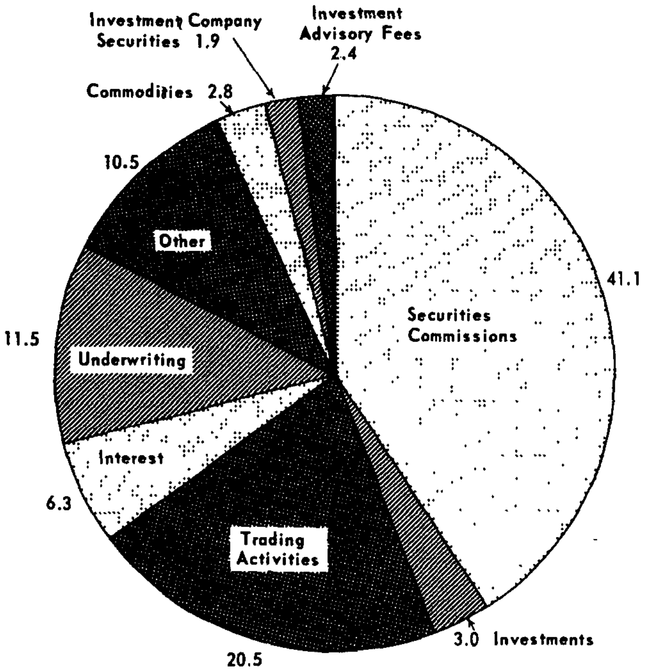
Securities Industry Dollar

Securities commissions represented 41 cents of each dollar of securities industry revenue. Another 20.5 cents of each dollar came from trading activities and underwriting revenue contributed 11.5 cents. Together, these three activities accounted for 73 cents of each revenue dollar.

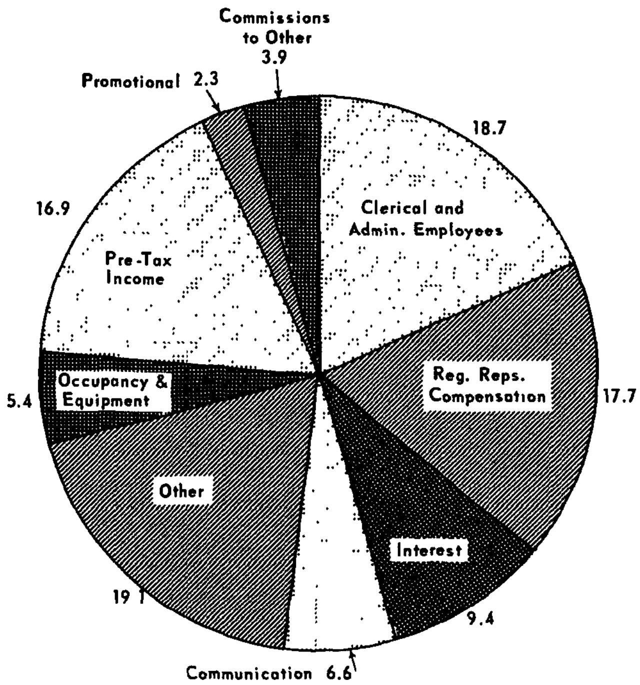
The largest portion of this revenue dollar — 36.4 cents — went to pay registered representatives and support personnel (clerical and administrative employees). Another 12 cents was spent on communications, occupancy and equipment. After all expenses, including partners' compensation, 16.9 cents of the revenue dollar remained. This was the industry's largest pre-tax profit margin since 1972.

SECURITIES INDUSTRY DOLLAR: 1976

SOURCES OF REVENUE



EXPENSES AND PRE-TAX INCOME



NOTE Includes information for firms with securities related revenues of $500,000 or more in 1976.

SOURCE X-17A-10 REPORTS

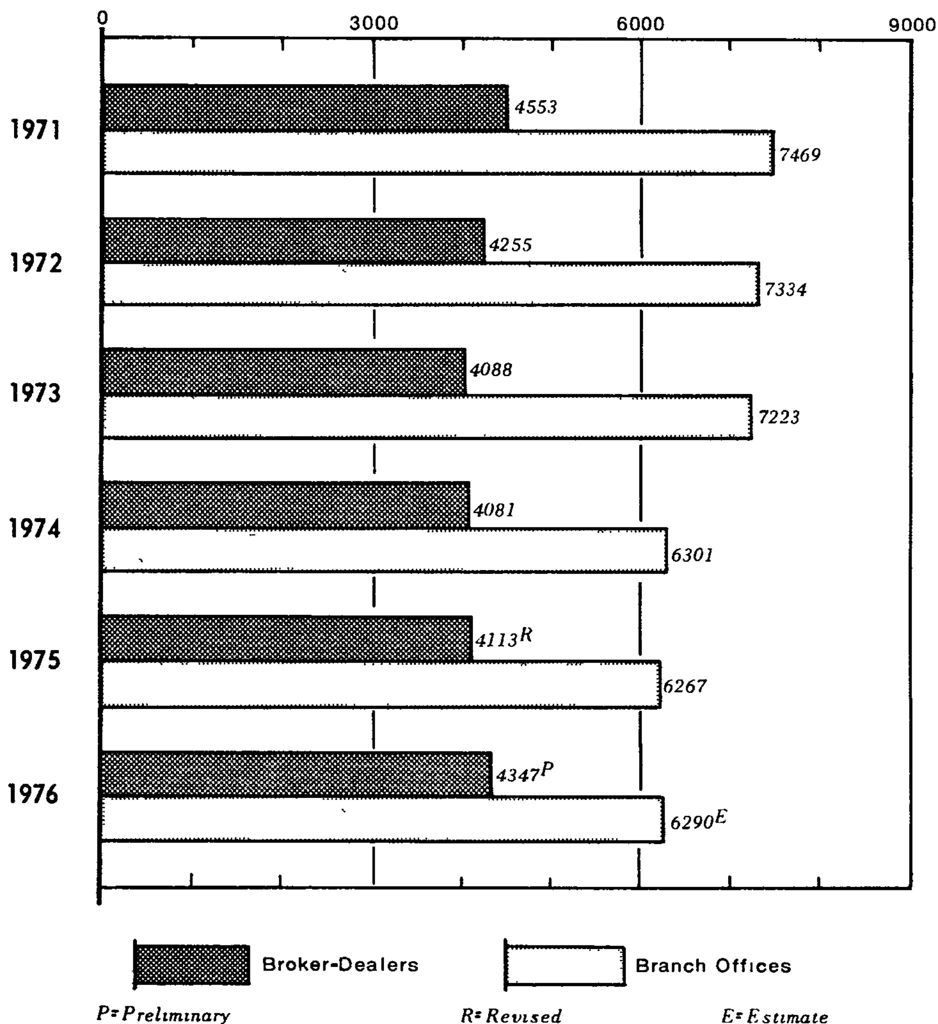
GA-042178-4

Broker-Dealers, Branch Offices, Employees

The number of broker-dealers increased from 4,113 in 1975 to 4,347 in 1976. Following the upward trend of the broker-dealers the number of branch offices increased to 6,290.

The number of full-time broker-dealer employees stood at 200 thousand at the end of 1976. There were approximately 73 thousand full-time registered representatives employed in the industry at the close of the year, 31 percent of the industry's total employment.

BROKER-DEALERS AND BRANCH OFFICES



SOURCE: X-17A-10 REPORTS

GA-042178-8

Table 4A

BROKERS AND DEALERS REGISTERED UNDER THE SECURITIES EXCHANGE ACT OF 1934—EFFECTIVE REGISTRATIONS AS OF SEPTEMBER 30, 1976 CLASSIFIED BY TYPE OF ORGANIZATION AND BY LOCATION OF PRINCIPAL OFFICES.

Location of Principal Offices	Number of Registrants				Number of Proprietors, Partners, Officers, etc [1] [2]			
	Total	Sole proprietorships	Partnerships	Corporations[3]	Total	Sole proprietorships	Partnerships	Corporations[3]
ALABAMA	26	3	1	22	134	3	3	128
ALASKA	0	0	0	0	0	0	0	0
ARIZONA	28	4	1	23	105	4	4	92
ARKANSAS	23	2	0	21	109	2	0	107
CALIFORNIA	477	145	44	288	2,545	145	243	2,157
COLORADO	60	6	3	51	401	6	56	339
CONNECTICUT	58	6	10	42	424	6	117	301
DELAWARE	12	3	0	9	32	3	0	29
DISTRICT OF COLUMBIA	28	2	5	21	268	2	25	241
FLORIDA	111	10	4	97	3,449	10	8	3,431
GEORGIA	38	1	1	36	257	1	2	254
HAWAII	17	0	0	17	93	0	0	93
IDAHO	6	1	0	5	20	1	0	19
ILLINOIS	1,466	1,163	83	220	2,804	1,163	486	1,155
INDIANA	50	7	2	41	259	7	5	247
IOWA	35	2	1	32	210	2	6	202
KANSAS	30	2	2	26	148	2	9	137
KENTUCKY	10	1	1	8	70	1	3	66
LOUISIANA	23	6	4	13	181	6	14	161
MAINE	12	1	4	7	49	1	21	27
MARYLAND	35	2	4	29	229	2	72	155
MASSACHUSETTS	154	33	13	108	1,078	33	95	950
MICHIGAN	56	5	5	46	383	5	108	270
MINNESOTA	74	4	1	69	612	4	2	606
MISSISSIPPI	19	1	4	14	78	1	11	66
MISSOURI	70	3	6	61	781	3	144	634
MONTANA	3	1	0	2	20	1	0	19
NEBRASKA	16	0	0	16	112	0	0	112
NEVADA	2	1	0	1	4	1	0	3
NEW HAMPSHIRE	3	1	0	2	11	1	0	10
NEW JERSEY	183	38	26	119	624	38	77	509
NEW YORK (excluding New York City)	260	93	19	148	613	93	51	469
NORTH CAROLINA	28	5	1	22	145	5	2	138
NORTH DAKOTA	5	0	0	5	27	0	0	27
OHIO	90	5	15	70	683	5	216	462
OKLAHOMA	22	4	1	17	111	4	2	105
OREGON	24	3	1	20	100	3	3	94
PENNSYLVANIA	191	26	41	124	1,127	26	220	881
RHODE ISLAND	18	5	2	11	45	5	8	32
SOUTH CAROLINA	12	1	1	10	49	1	2	46
SOUTH DAKOTA	2	1	0	1	12	1	0	11
TENNESSEE	53	3	2	48	325	3	29	293
TEXAS	151	24	5	122	1,038	24	23	991
UTAH	31	3	4	24	123	3	12	108
VERMONT	5	2	1	2	22	2	2	18
VIRGINIA	39	8	3	28	332	8	13	311
WASHINGTON	54	7	1	46	282	7	4	271
WEST VIRGINIA	5	1	0	4	17	1	0	16
WISCONSIN	35	3	0	32	343	3	0	340
WYOMING	7	2	0	5	24	2	0	22
TOTAL (excluding New York City)	4,164	1,651	322	2,191	20,948	1,651	2,103	17,194
NEW YORK CITY	1,216	373	247	596	10,545	373	2,365	7,807
SUBTOTAL	5,380	2,024	569	2,787	31,493	2,024	4,468	25,001
FOREIGN[4]	29	2	2	25	226	2	9	215
GRAND TOTAL	5,409	2,026	571	2,812	31,719	2,026	4,477	25,216

[1] Includes directors, officers, trustees and all other persons occupying similar status or performing similar functions
[2] Allocations made on the basis of location of principal offices of registrants, not actual locations of persons
[3] Includes all forms of organizations other than sole proprietorships and partnerships
[4] Registrants whose principal offices are located in foreign countries or other jurisdictions not listed

Table 4B

BROKERS AND DEALERS REGISTERED UNDER THE SECURITIES EXCHANGE ACT OF 1934—EFFECTIVE REGISTRATIONS AS OF SEPT. 30, 1977 CLASSIFIED BY TYPE OF ORGANIZATION AND BY LOCATION OF PRINCIPAL OFFICES

Location of Principal Offices	Number of Registrants				Number of Proprietors, Partners, Officers, etc [2] [3]			
	Total	Sole proprietorships	Partnerships	Corporations[4]	Total	Sole proprietorships	Partnerships	Corporations[4]
ALABAMA	25	2	1	22	133	2	3	128
ALASKA	0	0	0	0	0	0	0	0
ARIZONA	31	4	1	26	112	4	5	103
ARKANSAS	28	7	0	21	105	7	0	98
CALIFORNIA	503	177	46	280	2,530	177	254	2,099
COLORADO	63	5	3	55	409	5	56	348
CONNECTICUT	54	7	8	39	412	7	113	292
DELAWARE	11	3	0	8	37	3	0	34
DISTRICT OF COLUMBIA	30	3	5	22	264	3	25	236
FLORIDA	126	12	4	110	489	12	8	469
GEORGIA	39	1	2	36	256	1	4	251
HAWAII	16	0	0	16	90	0	0	90
IDAHO	6	2	0	4	18	2	0	16
ILLINOIS	1,649	1,251	119	279	3,213	1,251	678	1,284
INDIANA	49	6	2	41	261	6	5	250
IOWA	14	4	1	9	80	4	6	70
KANSAS	28	2	2	24	144	2	9	133
KENTUCKY	11	1	1	9	72	1	3	68
LOUISIANA	18	4	4	10	162	4	16	142
MAINE	13	1	4	8	52	1	21	30
MARYLAND	41	4	4	33	247	4	72	171
MASSACHUSETTS	149	28	13	108	970	28	84	858
MICHIGAN	60	6	5	49	389	6	112	271
MINNESOTA	79	3	1	75	613	3	2	608
MISSISSIPPI	22	1	4	17	88	1	11	76
MISSOURI	71	2	5	64	789	2	141	646
MONTANA	4	2	0	2	21	2	0	19
NEBRASKA	15	0	0	15	108	0	0	108
NEVADA	2	1	0	1	4	1	0	3
NEW HAMPSHIRE	4	1	0	3	15	1	0	14
NEW JERSEY	188	37	25	126	664	37	75	552
NEW MEXICO	7	1	0	6	40	1	0	39
NEW YORK (excluding New York City)	261	98	19	144	605	98	52	455
NORTH CAROLINA	31	6	1	24	147	6	2	139
NORTH DAKOTA	7	1	0	6	40	1	0	39
OHIO	94	5	17	72	682	5	226	451
OKLAHOMA	20	4	0	16	101	4	0	97
OREGON	29	4	1	24	115	4	3	108
PENNSYLVANIA	194	27	45	122	1,150	27	169	954
RHODE ISLAND	18	5	2	11	45	5	8	32
SOUTH CAROLINA	10	0	1	9	44	0	2	42
SOUTH DAKOTA	3	1	0	2	17	1	0	16
TENNESSEE	54	3	2	49	358	3	29	326
TEXAS	157	18	7	132	1,085	18	29	1,038
UTAH	27	2	2	23	115	2	7	106
VERMONT	5	1	1	3	32	1	2	29
VIRGINIA	37	7	3	27	323	7	13	303
WASHINGTON	53	6	0	47	278	6	0	272
WEST VIRGINIA	5	1	0	4	17	1	0	16
WISCONSIN	39	5	0	34	349	5	0	344
WYOMING	5	1	0	4	20	1	0	19
TOTAL (excluding New York City)	4,405	1,773	361	2,271	18,310	1,773	2,245	14,292
NEW YORK CITY	1,320	469	252	599	10,491	469	2,177	7,845
SUBTOTAL	5,725	2,242	613	2,870	28,801	2,242	4,422	22,137
FOREIGN [1]	31	3	2	26	229	3	9	217
GRAND TOTAL	5,756	2,245	615	2,896	29,030	2,245	4,431	22,354

[1] Registrants whose principal offices are located in foreign countries or jurisdictions not listed
[2] Includes directors, officers, trustees and all other persons occupying similar status or performing similar functions
[3] Allocations made on the basis of location of principal offices of registrants, not actual locations of persons
[4] Includes all forms of organizations other than sole proprietorships and partnerships

SECO Broker-Dealers

The number of broker-dealers who are not members of the NASD (SECO broker-dealers) increased from 302 to 309 in fiscal year 1976. This was the third consecutive year in which the number of SECO broker-dealers increased by a small amount despite an overall contraction in the size of the total broker-dealer firm community. This increase is attributable primarily to the registration as broker-dealers of exchange members primarily engaged in an exchange commission business and of persons engaged in the distribution of oil and gas or limited partnership interests. On the other hand there was a decline in the number of firms selling real estate related securities, exchange members primarily engaged in floor activities and put and call broker-dealers.

Table 5

PRINCIPAL BUSINESS OF SECO BROKER-DEALERS

	Fiscal year-end			
	1973	1974	1975	1976
Exchange member primarily engaged in floor activities	17	17	21	11
Exchange member primarily engaged in exchange commission business	28	20	19	28
Broker or dealer in general securities business	66	65	67	61
Mutual fund underwriter and distributor	24	18	19	14
Broker or dealer selling variable annuities	18	18	15	10
Solicitor of savings and loan accounts	9	7	7	5
Real estate syndicator and mortgage broker and dealer	21	33	43	33
Broker or dealer selling oil and gas interests	3	6	4	12
Put and call broker or dealer or option underwriter	20	15	7	3
Limited Partnership interests	*	*	*	23
Broker or dealer selling securities of only one issuer or associated issuers (other than mutual funds)	18	19	20	21
Broker or dealer in municipal bonds	*	*	*	8
Broker or dealer selling church securities	16	17	16	20
Government bond dealer	3	7	8	2
Broker or dealer in other securities business	26	31	42	43
Broker or dealer in interests in condominiums	*	14	6	3
Inactive	7	13	8	22
TOTAL	276	300	302	309

*Not tabulated in prior years

Table 6A

APPLICATIONS AND REGISTRATIONS OF BROKERS AND DEALERS

Transition Quarter ending September 30, 1976

BROKER-DEALER APPLICATIONS		
Applications pending at close of preceding quarter		97
Applications received during quarter 1976		283
Total applications for disposition		380
Disposition of Applications		
Accepted for filing	213	
Returned	60	
Withdrawn	0	
Denied	0	
Total applications disposed of		273
Applications pending as of September 30, 1976		107

BROKER-DEALER REGISTRATIONS		
Effective registrations at close of preceding quarter		5,308
Registrations effective during quarter 1976		213
Total registrations		5,521
Registrations terminated during quarter 1976		
Withdrawn	108	
Revoked	3	
Cancelled	1	
Total registrations terminated		112
Total registrations at end of quarter 1976		5,409

INVESTMENT ADVISER APPLICATIONS		
Applications pending at close of preceding quarter		103
Applications received during quarter 1976		448
Total applications for disposition		551
Disposition of applications		
Accepted for filing	227	
Returned	156	
Withdrawn	3	
Denied	0	
Total applications disposed of		386
Applications pending as of September 30, 1976		165

INVESTMENT ADVISER REGISTRATIONS		
Effective registrations at close of preceding quarter		3,857
Registrations effective during quarter 1976		227
Total registrations		4,084
Registrations terminated during quarter 1976		
Withdrawn	41	
Revoked	0	
Cancelled	1	
Total registrations terminated		42
Total registrations at end of quarter 1976		4,042

Table 6B

APPLICATIONS AND REGISTRATIONS OF BROKERS AND DEALERS

Fiscal Year 1977

BROKER-DEALER APPLICATIONS		
Applications pending at close of preceding year		107
Applications received during fiscal 1977		1,360
Total applications for disposition		1,467
Disposition of Applications		
Accepted for filing	778	
Returned	163	
Withdrawn	5	
Denied	0	
Total applications disposed of		946
Applications pending as of September 30, 1977		521

BROKER-DEALER REGISTRATIONS		
Effective registrations at close of preceding year		5,409
Registrations effective during fiscal 1977		778
Total registrations		6,187
Registrations terminated during fiscal 1977		
Withdrawn	345	
Revoked	0	
Cancelled	86	
Total registrations terminated		431
Total registrations at end of fiscal 1977		5,756

INVESTMENT ADVISER APPLICATIONS		
Applications pending at close of preceding year		165
Applications received during fiscal 1977		1,861
Total applications for disposition		2,026
Disposition of applications		
Accepted for filing	948	
Returned	641	
Withdrawn	1	
Denied	0	
Total applications disposed of		1,590
Applications pending as of September 30, 1977		436

INVESTMENT ADVISER REGISTRATIONS		
Effective registrations at close of preceding year		4,042
Registrations effective during fiscal 1977		948
Total registrations		4,990
Registrations terminated during fiscal 1977		
Withdrawn	167	
Revoked	0	
Cancelled	22	
Total registrations terminated		189
Total registrations at end of fiscal 1977		4,801

Table 7A

APPLICATIONS AND REGISTRATIONS OF MUNICIPAL SECURITIES DEALERS AND TRANSFER AGENTS

Transition Quarter ending September 30, 1976

MUNICIPAL SECURITIES DEALERS APPLICATIONS		
Applications pending at close of preceding quarter		0
Applications received during quarter 1976		325
Total applications for disposition		325
Disposition of Applications		
Accepted for filing	323	
Returned	0	
Withdrawn	0	
Denied	0	
Total applications disposed of		323
Applications pending as of September 30, 1976		2
MUNICIPAL SECURITIES DEALERS REGISTRATIONS		
Effective registrations at close of preceding quarter		314
Registrations effective during quarter 1976		9
Total registrations		323
Registrations terminated during quarter 1976		
Withdrawn	1	
Cancelled	0	
Suspended	0	
Total registrations terminated		1
Total registrations at end of quarter 1976		322
TRANSFER AGENTS APPLICATIONS		
Applications pending at close of preceding quarter		2
Applications received during quarter 1976		16
Total applications for disposition		18
Disposition of Applications		
Accepted for filing	11	
Returned	2	
Withdrawn	0	
Denied	0	
Total applications disposed of		13
Applications pending as of September 30, 1976		5
TRANSFER AGENTS REGISTRATIONS		
Effective registrations at close of preceding quarter		783
Registrations effective during quarter 1976		11
Total registrations		794
Registrations terminated during quarter 1976		
Withdrawn	0	
Cancelled	0	
Suspended	0	
Total registrations terminated		0
Total registrations at end of quarter 1976		794

Table 7B

APPLICATIONS AND REGISTRATIONS OF MUNICIPAL SECURITIES DEALERS AND TRANSFER AGENTS

Fiscal Year 1977

MUNICIPAL SECURITIES DEALERS APPLICATIONS		
Applications pending at close of preceding year		2
Applications received during fiscal 1977		30
Total applications for disposition		32
Disposition of Applications		
Accepted for filing	10	
Returned	0	
Withdrawn	0	
Denied	0	
Total applications disposed of		10
Applications pending as of September 30, 1977		22
MUNICIPAL SECURITIES DEALERS REGISTRATIONS		
Effective registrations at close of preceding year		322
Registrations effective during fiscal 1977		10
Total registrations		332
Registrations terminated during fiscal 1977		
Withdrawn	0	
Cancelled	0	
Suspended	0	
Total registrations terminated		0
Total registrations at end of fiscal 1977		332
TRANSFER AGENTS APPLICATIONS		
Applications pending at close of preceding year		5
Applications received during fiscal 1977		54
Total applications for disposition		59
Disposition of applications		
Accepted for filing	43	
Returned	1	
Withdrawn	0	
Denied	0	
Total applications disposed of		44
Applications pending as of September 30, 1977		15
TRANSFER AGENTS REGISTRATIONS		
Effective registrations at close of preceding year		794
Registrations effective during fiscal 1977		43
Total registrations		837
Registrations terminated during fiscal 1977		
Withdrawn	0	
Cancelled	0	
Suspended	0	
Total registrations terminated		0
Total registrations at end of fiscal 1977		837

Table 8

CONSOLIDATED REVENUES AND EXPENSES OF SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

	1972	1973	1974	1975	1976	1st Qtr 1977	2nd Qtr 1977	3rd Qtr. 1977
Revenues								
Transaction Fees	$ 29,273	$ 26,458	$ 24,166	$ 32,884	$ 38,602	$ 10,144	$ 9,110	$ 9,194
Listing Fees	26,441	26,490	25,434	31,726	40,756	9,363	12,890	10,087
Communication Fees	18,591	21,376	20,822	25,947	33,335	9,594	10,525	10,760
Clearing Fees	36,296	32,602	30,070	35,451	41,185	2,323	2,164	2,074
Depository Fees	19,469	23,586	22,696	27,792	36,227	9,352	8,932	8,926
Tabulation Services	12,037	10,453	11,268	13,553	16,537	4,464	4,069	3,782
All Other Revenues	37,660	38,788	38,740	38,535	42,747	13,259	13,077	13,658
Membership Dues	9,937	11,103	11,156	11,313	13,053	3,593	3,624	3,593
Registration Fees	5,623	6,450	5,136	5,130	4,221	1,443	1,399	1,237
Floor Usage Revenue	4,685	4,777	4,860	6,972	9,022	2,588	2,619	2,762
Corporate Finance Fees	2,221	1,212	816	1,111	1,047	244	227	228
Other	15,194	15,246	16,772	14,009	15,404	5,392	5,208	5,839
Total Revenues	$179,768	$179,753	$173,197	$205,889	$249,388	$ 58,499	$60,767	$ 58,481
Expenses								
Employee Costs	$ 70,233	$ 77,744	$ 80,049	$ 84,342	$ 99,340	$ 25,523	$ 25,254	$ 25,759
Occupancy Costs	7,954	10,663	12,750	12,910	14,646	3,797	3,797	3,530
Equipment Costs	1,734	1,916	2,487	3,510	4,372	993	724	734
Professional and Legal Services	7,343	8,627	5,757	8,006	8,549	2,063	2,583	2,324
Depreciation and Amortization	2,719	3,360	4,093	4,824	5,703	1,494	1,420	1,557
Advertising, Printing and Postage	4,194	5,391	4,882	3,342	3,445	1,012	1,152	657
Communication, Data Processing and Collection	49,840	54,837	52,504	58,854	72,862	15,446	16,406	16,594
All Other Expenses	16,814	15,028	11,746	15,858	23,711	3,784	4,177	3,553
Total Expenses	$160,831	$177,565	$174,269	$191,647	$232,628	$ 54,111	$ 55,513	$ 55,109
Pre-Tax Income	$ 18,937	$ 2,188	$ -1,071	$ 14,243	$ 16,760	$ 4,388	$ 5,255	$ 3,372

NOTE Totals may not add due to rounding

SOURCE Survey of Self-Regulatory Organizations and Subsidiaries
Directorate of Economic and Policy Research
Office of Securities Industry And Self-Regulatory Economics

Table 8—cont.
CONSOLIDATED REVENUES AND EXPENSES OF SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

	AMEX		BSE		CBOE		CSE		ISE	
	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977
Revenues										
Transaction Fees	$ 6,517	$ 5,047	$ 494	$ 371	$ 6,765	$ 4,774	$ 0	$ 0	$ +	$ 0
Listing Fees	5,298	3,942	70	64	0	0	13	4	3	3
Communication Fees	15,980	15,826	0	0	1,370	1,208	6	13	0	0
Clearing Fees	3,181	479	1,456	875	0	0	0	0	0	0
Depository Fees	0	0	109	469	0	0	0	0	0	0
Tabulation Services	0	0	866	598	0	0	10	15	0	0
All Other Revenues	2,648	2,205	961	636	3,583	3,067	55	82	26	20
Membership Dues	600	481	208	153	1,047	780	1	0	6	5
Registration Fees	126	85	8	6	315	269	5	0	+	0
Floor Usage Revenue	768	588	30	20	644	575	43	78	0	0
Corporate Finance Fees	0	0	0	0	0	0	0	0	0	0
Other	1,154	1,051	714	458	1,577	1,442	6	4	20	15
Total Revenues	$33,624	$27,499	$3,956	$3,013	$11,719	$ 9,049	$ 84	$ 114	$ 29	$ 23
Expenses										
Employee costs	$10,168	$ 8,382	$1,897	$1,478	$ 4,294	$ 4,152	$ 33	$ 26	$ 10	$ 8
Occupancy Costs	1,917	1,268	250	208	985	873	16	18	12	9
Equipment Costs	500	374	138	75	747	490	17	14	0	0
Professional and Legal Services	1,246	1,034	172	200	601	806	12	13	2	2
Depreciation and Amortization	1,107	814	148	88	1,032	813	0	0	0	0
Advertising, Printing and Postage	1,008	764	122	84	742	617	7	3	1	+
Communication, Data Processing and Collection	15,490	12,897	580	504	741	816	13	11	+	+
All Other Expenses	690	644	500	356	1,239	1,030	4	9	2	2
Total Expenses	$32,126	$26,177	$3,806	$2,993	$10,380	$ 9,596	$103	$ 94	$ 27	$ 22
Pre-Tax Income	$ 1,498	$ 1,322	$ 150	$ 20	$ 1,339	$ −547	$ −18	$ 20	$ 2	$ 1

+ = less than 500

NOTE Totals may not add due to rounding

SOURCE Survey of Self-Regulatory Organizations and Subsidiaries
Directorate of Economic and Policy Research
Office of Securities Industry And Self-Regulatory Economics

Table 8—cont.

CONSOLIDATED REVENUES AND EXPENSES OF SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

	MSE		NASD		NYSE		PSE		PHLX		SSE	
	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977	1976	Jan-Sep 1977
Revenues												
Transaction Fees	$ 1,765	$ 1,370	$ 0	$ 0	$ 20,204	$14,135	$ 1,590	$ 1,581	$1,266	$1,170	$ 0	$ 0
Listing Fees	603	458	2,761	1,996	31,002	25,059	901	723	103	89	2	2
Communication Fees	3,892	3,135	0	0	11,987	10,056	59	502	41	138	0	0
Clearing Fees	3,179	2,324	9,461	0	18,650	0	3,000	1,971	2,257	1,539	0	0
Depository Fees	3,838	3,016	0	0	30,190	23,214	2,050	1,552	40	48	0	0
Tabulation Services	11,133	8,585	0	0	0	0	4,524	3,115	0	0	3	3
All Other Revenues	2,712	2,138	11,909	10,019	17,103	16,714	2,835	2,714	900	671	16	13
Membership Dues	653	605	6,752	5,536	2,049	1,537	1,339	1,420	384	280	16	12
Registration Fees	123	97	2,388	1,890	1,140	922	70	25	46	29	+	0
Floor Usage Revenue	174	137	0	0	6,998	6,253	217	197	148	120	0	0
Corporate Finance Fees	0	0	1,047	699	0	0	0	0	0	0	0	0
Other	1,762	1,299	1,722	1,894	6,916	8,002	1,209	1,073	322	243	+	+
Total Revenues	$27,122	$21,026	$24,131	$12,015	$129,135	$89,177	$14,959	$12,159	$4,606	$3,654	$ 21	$ 17
Expenses												
Employee Costs	$12,293	$10,465	$ 9,839	$ 7,034	$ 50,632	$38,473	$ 7,718	$ 4,595	$2,449	$1,919	$ 6	$ 5
Occupancy Costs	1,682	1,457	1,151	834	7,631	6,151	705	474	294	230	3	3
Equipment Costs	153	210	0	0	652	662	2,048	517	115	105	3	3
Professional and Legal Services	766	631	662	544	4,543	3,205	449	444	95	90	2	+
Depreciation and Amortization	373	356	342	0	2,394	2,100	243	192	63	107	0	0
Advertising, Printing and Postage	122	257	37	0	868	668	427	342	105	81	6	5
Communication, Data Processing and Collection	8,436	7,319	7,428	0	37,206	21,580	2,432	4,859	534	460	+	+
All Other Expenses	2,552	1,409	2,680	1,941	13,701	4,952	1,622	591	721	579	+	0
Total Expenses	$26,377	$22,103	$22,139	$10,353	$117,628	$77,791	$15,645	$12,015	$4,376	$3,572	$ 21	$ 16
Pre-Tax Income	$ 745	$ −1,077	$ 1,992	$ 1,662	$ 11,507	$11,387	$ −686	$ 144	$ 280	$ 81	$ 1	$ 1

\+ = less than 500

NOTE Totals may not add due to rounding

SOURCE Survey of Self-Regulatory Organizations and Subsidiaries
Directorate of Economic and Policy Research
Office of Securities Industry And Self-Regulatory Economics

Table 9

HISTORICAL FINANCIAL INFORMATION FOR SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

	AMEX	BSE	CBOE	CSE	ISE	MSE	NASD	NYSE	PSE	PHLX	SSE	Total
Total Revenues												
1972	$26,011	$2,045	$ 0	$129	$ 26	$18,813	$20,455	$ 98,002	$ 9,985	$4,145	$ 17	$179,628
1973	22,436	2,252	1,178	109	28	19,131	21,329	99,129	10,079	3,911	20	179,601
1974	19,770	2,556	3,658	115	30	19,473	20,267	93,698	10,221	3,261	19	173,067
1975	24,566	3,289	8,157	130	27	22,466	21,495	109,949	11,874	3,796	20	205,769
1976	33,624	3,956	11,719	84	29	27,122	24,131	129,135	14,959	4,606	21	249,388
Transaction Fees												
1972	5,986	207	—	20	1	1,404	—	19,474	1,492	647	—	29,230
1973	3,743	201	360	20	—	1,265	—	18,987	1,260	572	—	26,409
1974	2,302	187	2,109	16	1	1,127	—	17,026	896	463	—	24,126
1975	4,016	362	4,853	11	—	1,437	—	20,518	991	656	—	32,844
1976	6,517	494	6,765	—	+	1,765	—	20,204	1,590	1,266	—	38,602
Listing Fees												
1972	5,181	65	—	3	4	422	—	20,053	623	71	3	26,424
1973	4,153	70	—	4	6	334	—	21,333	507	60	3	26,471
1974	4,142	80	—	12	4	330	1,275	18,938	535	101	3	25,418
1975	4,898	90	—	10	4	532	2,581	22,688	822	82	2	31,709
1976	5,298	70	—	13	3	603	2,761	31,002	901	103	2	40,756
Communication Fees												
1972	8,981	—	—	—	—	1,211	—	8,399	—	—	—	18,591
1973	9,082	—	62	—	—	3,761	—	8,471	—	—	—	21,376
1974	9,304	—	110	—	—	3,553	—	7,855	—	—	—	20,822
1975	11,082	—	840	8	—	3,474	—	10,543	—	—	—	25,947
1976	15,980	—	1,370	6	—	3,892	—	11,987	59	41	—	33,335
Clearing Fees												
1972	2,876	998	—	49	—	3,022	7,621	15,466	3,412	2,853	—	36,296
1973	2,279	1,011	—	28	—	1,714	8,298	13,578	3,004	2,689	—	32,602
1974	1,776	988	—	—	—	1,629	7,638	13,275	2,507	2,257	—	30,070
1975	2,103	1,316	—	—	—	2,646	8,166	16,023	3,012	2,184	—	35,451
1976	3,181	1,456	—	—	—	3,180	9,461	18,650	3,000	2,257	—	41,185

+ = less than 500

NOTE: Totals may not add due to rounding. The Detroit Stock Exchange has been excluded from the above data

SOURCE: Survey of Self-Regulatory Organizations and Subsidiaries
Directorate of Economic and Policy Research
Office of Securities Industry And Self-Regulatory Economics

Table 9—cont.

HISTORICAL FINANCIAL INFORMATION FOR SELF-REGULATORY ORGANIZATIONS

(Thousands of Dollars)

	AMEX	BSE	CBOE	CSE	ISE	MSE	NASD	NYSE	PSE	PHLX	SSE	Total
Depository Fees												
1972	—	—	—	—	—	—	—	19,273	196	—	—	19,469
1973	—	—	—	—	—	137	—	22,601	848	—	—	23,586
1974	—	—	—	—	—	1,211	—	20,738	747	—	—	22,696
1975	—	—	—	—	—	1,393	—	25,259	1,133	7	—	27,792
1976	—	109	—	—	—	3,838	—	30,190	2,050	40	—	36,227
Tabulation Services												
1972	18	71	—	3	—	9,130	—	—	2,815	—	—	12,037
1973	28	107	—	1	—	7,914	—	—	2,403	—	—	10,453
1974	13	454	—	4	—	8,347	—	—	2,450	—	—	11,268
1975	36	676	—	3	—	9,197	—	—	3,642	—	—	13,553
1976	—	866	—	10	—	11,133	—	—	4,524	—	3	16,537
All Other Revenues												
1972	2,969	704	—	54	20	3,625	12,834	15,336	1,448	575	15	37,580
1973	3,151	863	756	55	21	4,005	13,031	14,158	2,058	589	17	38,704
1974	2,233	847	1,439	83	25	3,277	11,354	15,866	3,085	440	17	38,666
1975	2,431	845	2,464	98	23	3,787	10,748	14,918	2,274	867	18	38,472
1976	2,648	961	3,583	55	26	2,711	11,909	17,103	2,835	900	16	42,747
Total Expenses												
1972	25,847	1,734	—	319	31	18,517	17,912	81,652	10,772	3,897	18	160,700
1973	23,132	1,996	1,694	86	27	18,997	21,616	93,819	12,202	3,839	20	177,427
1974	20,816	2,544	4,103	18	27	19,403	21,023	92,885	9,703	3,603	19	174,144
1975	24,147	2,933	6,872	94	23	21,484	20,185	100,014	12,049	3,712	20	191,533
1976	32,126	3,806	10,380	103	27	26,378	22,139	117,628	15,645	4,376	21	232,629
Pre-Tax Income												
1972	164	311	—	(191)	(5)	296	2,543	16,350	(787)	248	(1)	18,828
1973	(696)	256	(516)	23	1	134	(287)	5,310	(2,123)	72	(0)	2,174
1974	(1,046)	11	(445)	97	3	70	(756)	813	517	(341)	—	(1,077)
1975	419	356	1,286	35	4	982	1,310	9,935	(175)	84	—	14,238
1976	1,498	150	1,339	(18)	2	745	1,992	11,507	(686)	230	1	16,760

+ = less than 500

NOTE Totals may not add due to rounding The Detroit Stock Exchange has been excluded from the above data

SOURCE Survey of Self-Regulatory Organizations and Subsidiaries
Directorate of Economic and Policy Research
Office of Securities Industry And Self-Regulatory Economics

Table 10

SELF-REGULATORY ORGANIZATIONS—CLEARING AGENCIES REVENUES AND EXPENSES[1]—FISCAL YEAR 1976

(Thousands of Dollars)

	American Stock Exchange Clearing Corporation 12/31/76	Boston Clearing Corporation 9/30/76	Bradford Securities Processing Service Inc 12/31/76	Depository Trust Company 12/31/76	Midwest Clearing Corporation 12/31/76	Midwest Securities Trust Company 12/31/76	National Clearing Corporation 9/30/76	Options Clearing Corporation 6/30/77	Pacific Clearing Corporation 12/31/76	Pacific Securities Depository Trust Company 12/31/76	Stock Clearing Corporation 12/31/76	Stock Clearing Corporation of Philadelphia 12/31/76	TAD Depository Corporation 12/31/76	Total
Revenues														
Clearing services[2]	$ 3,072	$ 1,761	$ 5,904		$ 3,180		$ 8,994	$ 4,715	$ 3,107		$ 17,969	$ 1,911		$ 50,613
Depository services[2]				$ 28,240		$ 3,838				$ 2,416			$ 302	34,796
Interest and other revenues	213	475	1,203	2,537	65	218	54	1,360	360	97	711	405	5	7,703
Total Revenue	$ 3,285	$ 2,236	$ 7,107	$ 30,777	$ 3,245	$ 4,056	$ 9,048	$ 6,075	$ 3,467	$ 2,913	$ 18,680	$ 2,316	$ 307	$ 93,112
Expenses														
Employee costs		$ 1,106	$ 2,380	$ 17,635	$ 1,792	$ 2,781	$ 429	$ 2,299	$ 1,594	$ 1,192		$ 1,308		$ 32,516
Data processing and communication costs		432	108	5,144	365	383		1,994	515	307		101		9,449
Occupancy costs		105	247	3,199	172	445		353	99	118		154		4,892
Services contract costs or allocated costs of affiliate shared facilities	2,685						7,788				18,192	721	287	29,673
All other expenses	210	594	1,620	4,765	807	467	584	1,349	854	760				12,010
Total Expenses	$ 2,895	$ 2,237	$ 4,355	$ 30,743	$ 3,136	$ 4,076	$ 8,801	$ 5,995	$ 3,162	$ 2,377	$ 18,192	$ 2,284	$ 287	$ 88,540
Excess of Revenues Over Expenses	$ 390	$ (1)	$ 2,752	$ 34	$ 109	$ (20)	$ 247	$ 80	$ 305	$ 136	$ 488	$ 32	$ 20	$ 4,572

[1] Any single revenue or expense category may not be completely comparable between any two particular clearing agencies because of (i) the varying classification methods employed by the clearing agencies in reporting operating results and (ii) the grouping methods employed by the Commission staff due to these varying classification methods

[2] Clearing and depository services revenue items reported in this table may differ from clearing and depository fees revenues reported in the statistical table "Consolidated Revenues and Expenses of Self-Regulatory Organizations" contained herein. This difference results from, among other things, differences in classification of revenue items

Sources: Self-Regulatory Organization Annual Report Filings (Forms 1-A and Form 15AJ-2) Clearing Agency Registration Filings (Forms CA-1), and Registration Statement under the Securities Act of 1933 (Form S-1)

Table 11

MUNICIPAL SECURITIES RULEMAKING BOARD STATEMENT OF REVENUE AND EXPENSES AND CHANGES IN FUND BALANCE

October 1, 1976 – September 30, 1977

(Unaudited)

REVENUE:	
Assessment fees	$1,259,983
Initial fees	50,600
Annual fees	100
Interest income	27,432
EXPENSES:	
Salaries and employee benefits	320,784
Meetings and travel	207,132
Mailing list, Board manual and other printing and postage	115,459
Rent, telephone and other occupancy costs	63,103
Professional and other services	25,114
Payroll taxes	13,840
Depreciation	12,747
Interest	—
Other	5,401
	763,580
EXCESS OF REVENUE OVER EXPENSES	574,535
FUND BALANCE—BEGINNING OF PERIOD	509,878
FUND BALANCE—END OF PERIOD	$1,084,413

FINANCIAL INSTITUTIONS

Stock Transactions of Selected Financial Institutions

During 1976, private noninsured pension funds, open-end investment companies, life insurance companies, and property-liability insurance companies purchased $40.6 billion of common stock and sold $33.1 billion, resulting in net purchases of $7.4 billion. In 1975 purchases were $35.6 billion, sales $30.8 billion, and net purchases $4.8 billion. Their 1976 common stock activity rate was 21.1 percent as compared to 23.2 percent one year earlier.

Table 12

COMMON STOCK TRANSACTIONS AND ACTIVITY RATES OF SELECTED FINANCIAL INSTITUTIONS

(Millions of Dollars)

	1969	1970	1971	1972	1973	1974	1975	1976
Private Noninsured Pension Funds[1]								
Purchases	15,231	13,957	21,684	23,222	20,324	11,758	17,560	20,329
Sales	10,271	9,370	12,800	15,651	14,790	9,346	11,846	13,089
Net purchases (sales)	4,960	4,587	8,884	7,571	5,534	2,412	5,714	7,240
Activity rate	21 3	20 5	22 1	19 7	17 3	14 1	18 3	16 5
Open-End Investment Companies[2]								
Purchases	22,059	17,128	21,556	20,943	15,561	9,085	10,949	10,633 r
Sales	19,852	15,901	21,175	22,552	17,504	9,372	12,144	13,279
Net Purchases (sales)	2,207	1,227	381	(1,609)	(1,943)	(287)	(1,195)	(2,646) r
Activity rate	51 0	45 6	48 2	44 8	39 0	30 5	35 8	32 4 r
Life Insurance Companies[3]								
Purchases	3,703	3,768	6,232	6,912	6,492	3,930	4,920 r	6,158 r
Sales	2,184	1,975	2,777	4,427	4,216	2,439	3,630 r	3,924 r
Net purchases (sales)	1,519	1,793	3,455	2,485	2,276	1,491	1,290 r	2,234 r
Activity rate	29 4	27 8	31 0	29 5	25 9	18 7	22 3 r	21 0 r
Property-Liability Insurance Companies								
Purchases	3,781	3,613	4,171	5,128	4,519	2,400	2,193	3,446
Sales	2,879	2,722	1,944	2,738	2,856	3,223	3,196	2,836
Net purchases (sales)	902	891	2,227	2,390	1,663	(823)	(1,003)	610
Activity rate	26 7	28 1	23 2	23 8	20 8	21 3	24 0	24 7
Total Selected Institutions								
Purchases	44,774	38,466	53,643	56,205	46,896	27,173	35,622 r	40,566 r
Sales	35,186	29,968	38,696	45,368	39,366	24,380	30,816 r	33,128 r
Net purchases (sales)	9,588	8,498	14,947	10,837	7,530	2,793	4,806 r	7,438 r
Activity rate	32 4	29 8	30 8	27 8	23 7	19 1	23 2 r	21 1 r
Foreign Investors[4]								
Purchases	12,428	8,927	11,625	14,360	12,768	7,634	15,316	18,228
Sales	10,941	8,301	10,893	12,173	9,977	7,094	10,637	15,475
Net purchases (sales)	1,487	626	732	2,187	2,791	540	4,679	2,753

r=revised

[1]Includes deferred profit sharing and pension funds of corporations, unions, multiemployer groups and nonprofit organizations
[2]Mutual funds reporting to the Investment Company Institute, a group whose assets constitute about ninety percent of the assets of all open-end investment companies
[3]Includes both general and separate accounts
[4]Transactions of foreign individuals and institutions in domestic common and preferred stocks Activity rates for foreign investors are not calculable
NOTE Activity rate is defined as the average of gross purchases and sales divided by the average market value of holdings
SOURCE Pension funds and property-liability insurance companies, SEC, investment companies, Investment Company Institute, life insurance companies, American Council of Life Insurance, foreign investors, Treasury Department

STOCKHOLDINGS OF INSTITUTIONAL INVESTORS AND OTHERS

At year-end 1976, the eleven institutional groups listed below held 375.4 billion of total corporate stock outstanding (both common and preferred). In comparison, they accounted for $313.4 billion of the stock held a year earlier. The resulting 19.8 percent increase in the value of the stockholdings of these institutions was significantly less than the 24.9 percent increase in the aggregate market value of all stock outstanding. Thus, the share of total stock outstanding that was held by these institutions declined to 38.7 percent at year-end 1976 from 41.4 percent a year earlier. During 1976, the share held by other domestic investors, which consist of individuals, brokers-dealers and institutions not listed, rose to 53.8 percent from 52.8 percent. Also, foreign investors increased their share of stockholdings to 6.5 percent from 5.7 percent.

Table 13

MARKET VALUE OF STOCKHOLDINGS OF INSTITUTIONAL INVESTORS AND OTHERS

(Billions of Dollars, End of Year)

		1969	1970	1971	1972	1973	1974	1975	1976
1	Private Noninsured Pension Funds	61 4	67.1	88 7	115 2	90.5	63 0	88 6	109.7
2	Open-End Investment Companies	45 0	43 9	52 6	58 0	43 3	30 3	38 7	43 0
3	Other Investment Companies	6 3	6 2	6.9	7.4	6 6	4 7	5 3	5.9
4	Life Insurance Companies	13 7	15.4	20.6	26 8	25 9	21 9	28 1	34.5
5	Property-Liability Insurance Companies[1]	13 3	13.2	16.6	21 8	19.7	12 8	14 2	17 1
6	Common Trust Funds	4 6	4 6	5.8	7 4	6 6	4 3	5 9	7 1
7	Personal Trust Funds	79 6	78 6	94 1	110.2	94 7	67 7	81 0	96 1
8	Mutual Savings Banks	2 5	2 8	3 5	4 5	4 2	3 7	4 4	4 4
9	State and Local Retirement Funds	7 3	10.1	15 4	22.2	20 2	16 4	24 3	30 1
10	Foundations	20 0	22 0	25 0	28 5	24 5	18 4	22 7	27 1
11	Educational Endowments	7 6	7.8	9 0	10 7	9 6	6 7	8 8	10 4
12	Subtotal	261.3	271.6	338 2	412.7	345.8	249 9	322.0	385 4
13	Less Institutional Holdings of Investment Company Shares	4 0	4 9	5 8	6 5	6.7	6.5	8 6	10 0
14	Total Institutional Investors	257.3	266 8	332 4	406 2	339 1	243 4	313 4	375 4
15	Foreign Investors[2]	26 9	28.7	32.9	41.3	37 0	28 4	43 5	61.4
16	Other Domestic Investors[3]	582 1	563 9	638 4	694 7	481 3	295.5	399 8	508 6
17	Total Stock Outstanding[4]	866 3	859 4	1003 7	1142 3	857 4	567 3	756 7	945 4

R=Revised

[1]Excludes holdings of insurance company stock
[2]Includes estimate of stock held as direct investment
[3]Computed as residual (line 16=17−14−15) Includes both individuals and institutional groups not listed above
[4]Includes both common and preferred stock. Excludes investment company shares but includes foreign issues outstanding in the U S

Number of Registrants

As of September 30, 1977, there were 1,333 active investment companies registered under the Investment Company Act, with assets having an aggregate market value of over $77 billion. These figures represent an increase of 22 in the number of registered companies since September 30, 1976. At September 30, 1977, 4,801 investment advisers were registered with the Commission, representing an increase of 759 from a year before.

Table 14A

COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940 AS OF SEPTEMBER 30, 1976

	Number of Registered Companies			Approximate Market Value of Assets of Active Companies (Millions)
	Active	Inactive[a]	Total	
Management open-end ("Mutual Funds")	801	32	833	
Funds having no load	257			
Variable annuity-separate accounts	58			
Capital Leverage Companies	2			
All other load funds	484			
Management closed-end	179	37	216	
Small business investment companies	38			
Capital leverage companies	7			
All other closed-end companies	134			
Unit investment trusts	324	20	344	[b]
Variable annuity-separate accounts	58			
All other unit investment trusts	266			
Face-amount certificates companies	7	3	10	
Total	1,311	92	1,403	

[a]"Inactive" refers to registered companies which as of Sept 30, 1976, were in the process of being liquidated or merged, or have filed an application pursuant to Section 8(f) of the Act for deregistration, or which have otherwise gone out of existence and remain registered only until such time as the Commission issues order under Section 8(f) terminating their registration

[b]Includes about $ billion of assets of trusts which invest in securities of other investment companies, substantially all of them mutual funds

Table 14B

COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940 AS OF SEPTEMBER 30, 1977

	Number of Registered Companies			Approximate Market Value of Assets of Active Companies (Millions)
	Active	Inactive[a]	Total	
Management open-end ("Mutual Funds")	816	37	853	55,979
Funds having no load	274			14,244
Variable annuity-separate accounts	59			1,344
Capital Leverage Companies	2			28
All other load funds	481			40,373
Management closed-end	174	41	215	7,644
Small business investment companies	40			271
Capital leverage companies	7			333
All other closed-end companies	127			7,040
Unit investment trusts	336	23	359	12,136[b]
Variable annuity-separate accounts	63			951
All other unit investment trusts	273			11,185
Face-amount certificates companies	7	3	10	1,145
Total	1,333	104	1,437	76,904

[a]"Inactive" refers to registered companies which as of September 30, 1977, were in the process of being liquidated or merged, or have filed an application pursuant to Section 8(f) of the Act for deregistration, or which have otherwise gone out of existence and remain registered only until such time as the Commission issues order under Section 8(f) terminating their registration

[b]Includes about $4 0 billion of assets of trusts which invest in securities of other investment companies, substantially all of them mutual funds

Table 15A

COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

Quarter ending September 30, 1976	Number of companies				Approximate market value of assets of active companies (millions)
	Registered at beginning of quarter	Registered during quarter	Registration terminated during quarter	Registered at end of quarter	
9/30/76	1,376	40	13	1,403	

Table 15B

COMPANIES REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

Fiscal year ended June 30	Number of companies				Approximate market value of assets of active companies (millions)
	Registered at beginning of year	Registered during year	Registration terminated during year	Registered at end of year	
1941	0	450	14	436	$ 2,500
1942	436	17	46	407	2,400
1943	407	14	31	390	2,300
1944	390	8	27	371	2,200
1945	371	14	19	366	3,250
1946	366	13	18	361	3,750
1947	361	12	21	352	3,600
1948	352	18	11	359	3,825
1949	359	12	13	358	3,700
1950	358	26	18	366	4,700
1951	366	12	10	368	5,600
1952	368	13	14	367	6,800
1953	367	17	15	369	7,000
1954	369	20	5	384	8,700
1955	384	37	34	387	12,000
1956	387	46	34	399	14,000
1957	399	49	16	432	15,000
1958	432	42	21	453	17,000
1959	453	70	11	512	20,000
1960	512	67	9	570	23,500
1961	570	118	25	663	29,000
1962	663	97	33	727	27,300
1963	727	48	48	727	36,000
1964	727	52	48	731	41,600
1965	731	50	54	727	44,600
1966	727	78	30	775	49,800
1967	775	108	41	842	58,197
1968	842	167	42	967	69,732
1969	967	222	22	1,167	72,465
1970	1,167	187	26	1,328	56,337
1971	1,328	121	98	1,351	78,109
1972	1,351	91	108	1,334	80,816
1973	1,334	91	64	1,361	73,149
1974	1,361	106	90	1,377	62,287
1975	1,377	88	66	1,399	74,192
1976	1,399	63	86	1,376	80,564
*1977	1,403	91	57	1,437	76,904

*Fiscal Year Ending September 30, 1977

Table 16

NEW INVESTMENT COMPANY REGISTRATIONS

	Quarter ending 9/30/76	FY 1977
Management open-end		
No-loads	1	12
Variable annuities	0	0
All others	27	52
Sub-total	28	64
Management closed-end		
SBIC's	0	2
All others	3	9
Sub-total	3	11
Unit investment trust		
Variable annuities	1	10
All others	8	5
Sub-total	9	15
Face amount certificates	0	1
Total Registered	40	91

Table 17

INVESTMENT COMPANY REGISTRATIONS TERMINATED

	Quarter ending 9/30/76	FY 1977
Management open-end		
No-loads	0	3
Variable annuities	0	0
All others	10	41
Sub-total	10	44
Management closed-end		
SBIC's	0	1
All others	1	11
Sub-total	1	12
Unit investment trust		
Variable annuities	0	0
All others	2	0
Sub-total	2	0
Face amount certificates	0	1
Total Terminated	13	57

Private Noninsured Pension Funds: Assets

The assets of private noninsured pension funds totaled $160.4 billion at book value and $173.9 billion at market value on December 31, 1976. A year earlier their comparable asset totals were $145.2 billion and $145.6 billion. The book value of common stock holdings increased to $93.4 billion at year-end 1976 from $83.7 billion the previous year. Valued at market, those holdings rose to $108.5 billion, or 62.4 percent of total assets, at the end of 1976 from $87.7 billion, or 60.2 percent of total assets, one year earlier.

Table 18A

ASSETS OF PRIVATE NONINSURED PENSION FUNDS

Book Value, End of Year

(Millions of Dollars)

	1969	1970	1971	1972	1973	1974	1975	1976
Cash and Deposits	1,619	1,804	1,641	1,857	2,336	4,286	2,962	2,199
U S Government Securities	2,792	3,029	2,732	3,689	4,404	5,533	10,764	14,713
Corporate and Other Bonds	27,613	29,666	29,013	28,207	30,334	35,029	37,809	39,070
Preferred Stock	1,757	1,736	1,767	1,481	1,258	1,129	1,188	1,250
Common Stock	47,862	51,744	62,780	74,585	80,593	79,319	83,654	93,359
Own Company	3,062	3,330	3,608	3,868	4,098	4,588	5,075	N A
Other Companies	44,800	48,414	59,172	70,717	76,495	74,731	78,579	N A
Mortgages	4,216	4,172	3,660	2,728	2,377	2,372	2,383	2,369
Other Assets	4,720	4,860	4,826	4,983	5,229	6,063	6,406	7,454
Total Assets	90,579	97,011	106,419	117,530	126,531	133,731	145,166	160,414

N A Not Available
NOTE Includes deferred profit sharing funds and pension funds of corporations, unions, multiemployer groups, and nonprofit organizations

Table 18B

ASSETS OF PRIVATE NONINSURED PENSION FUNDS

Market Value, End of Year

(Millions of Dollars)

	1969	1970	1971	1972	1973	1974	1975	1976
Cash and Deposits	1,619	1,804	1,641	1,857	2,336	4,286	2,962	2,199
U S Government Securities	2,568	2,998	2,772	3,700	4,474	5,582	11,097	14,918
Corporate and Other Bonds	21,262	24,919	26,111	26,232	27,664	30,825	34,519	37,858
Preferred Stock	1,598	1,631	2,014	1,869	985	703	892	1,212
Common Stock	59,827	65,456	86,636	113,369	89,538	62,582	87,669	108,483
Own Company	5,775	6,038	7,691	8,750	6,947	5,230	6,958	N A
Other Companies	54,052	59,418	78,945	104,619	82,591	57,352	80,711	N A
Mortgages	3,461	3,504	3,184	2,427	2,108	2,063	2,139	2,160
Other Assets	4,295	4,422	4,560	4,908	5,140	5,681	6,341	7,073
Total Assets	94,632	104,737	126,921	154,363	132,247	111,724	145,622	173,906

N A Not Available
NOTE Includes deferred profit sharing funds and pension funds of corporations, unions, multiemployer groups, and nonprofit organizations

Private Noninsured Pension Funds: Receipts and Disbursements

In 1975, the most recent year for which information on the receipts and disbursements of private noninsured pension funds is available, net receipts were $14.0 billion. Of the $26.6 billion in total receipts that year, employers contributed $19.8 billion and employees $1.6 billion. Investment income (interest, dividends and rent) and net loss on sale of assets were $6.7 billion and $1.7 billion, respectively. Of the $12.6 billion in total disbursements, beneficiaries received $12.3 billion.

Table 19

RECEIPTS AND DISBURSEMENTS OF PRIVATE NONINSURED PENSION FUNDS

(Millions of Dollars)

	1969	1970	1971	1972	1973	1974	1975	1976[1]
Total Receipts	14,151	13,195	17,545	20,070	19,673	21,063	26,583	0
Employer Contributions	8,487	9,717	11,324	12,745	14,368	16,971	19,828	0
Employee Contributions	1,011	1,074	1,120	1,199	1,273	1,460	1,604	0
Investment Income	3,549	3,866	4,102	4,302	4,843	5,982	6,703	0
Net Profit (Loss) on Sale of Assets	991	(1,592)	904	1,723	(924)	(3,477)	(1,659)	0
Other Receipts	113	130	95	101	113	127	107	0
Total Disbursements	5,428	6,180	7,263	8,493	9,539	11,030	12,597	0
Benefits Paid Out	5,290	6,030	7,083	8,297	9,313	10,740	12,334	0
Expenses and Other Disbursements	138	150	180	196	226	290	263	0
Net Receipts	8,723	7,015	10,282	11,577	10,134	10,033	13,986	0

[1]Series has been transferred to the Department of Labor

NOTE Includes deferred profit sharing and pension funds of corporations, unions, multiemployer groups and nonprofit organizations

SECURITIES ON EXCHANGES

Exchange Volume

Dollar volume of all securities transactions on registered exchanges totaled $207.0 billion in 1976. Of this total, $195.0 billion represented stock trading, $11.7 billion option trading, and the balance trading in rights and warrants. (Due to Section 22 of the Securities Acts Amendments of 1975, bond transactions are no longer reported by the exchanges.) The value of New York Stock Exchange transactions was $164.7 billion in 1976. NYSE share volume increased 11.7 percent from the 1975 total. On the American Stock Exchange, value of shares traded increased 31.5 percent to $7.5 billion. The AMEX volume of 637.0 million shares was up 17.8 percent from the 1975 figure. Share volume on regional exchanges increased 20.1 percent from the 1975 figure to 749.5 million shares, valued at $23.0 billion.

The Chicago Board Options Exchange contract volume for 1976 was 21.5 million, up 49 percent from 14.4 million in 1975. The value was $9.0 billion, an increase of 41 percent from $6.4 billion in 1975. The American Stock Exchange Option volume was 8.17 million contracts in 1976, an increase of 133 percent from the 3.5 million contracts in 1975. The value of AMEX options trading in 1976 was $2.2 billion. Philadelphia Stock Exchange option volume was 1.19 million in 1976, up 327 percent from 279 thousand in 1975, with a value of $325 million in 1976. Pacific Stock Exchange contract volume in 1976 was 550 thousand with a value of $161.4 million. The Midwest Stock Exchange began listed option trading on December 13, 1976. Their contract volume in 1976 was 15 thousand with a value of $3.2 million.

The Detroit Stock Exchange ceased operations June 30, 1976.

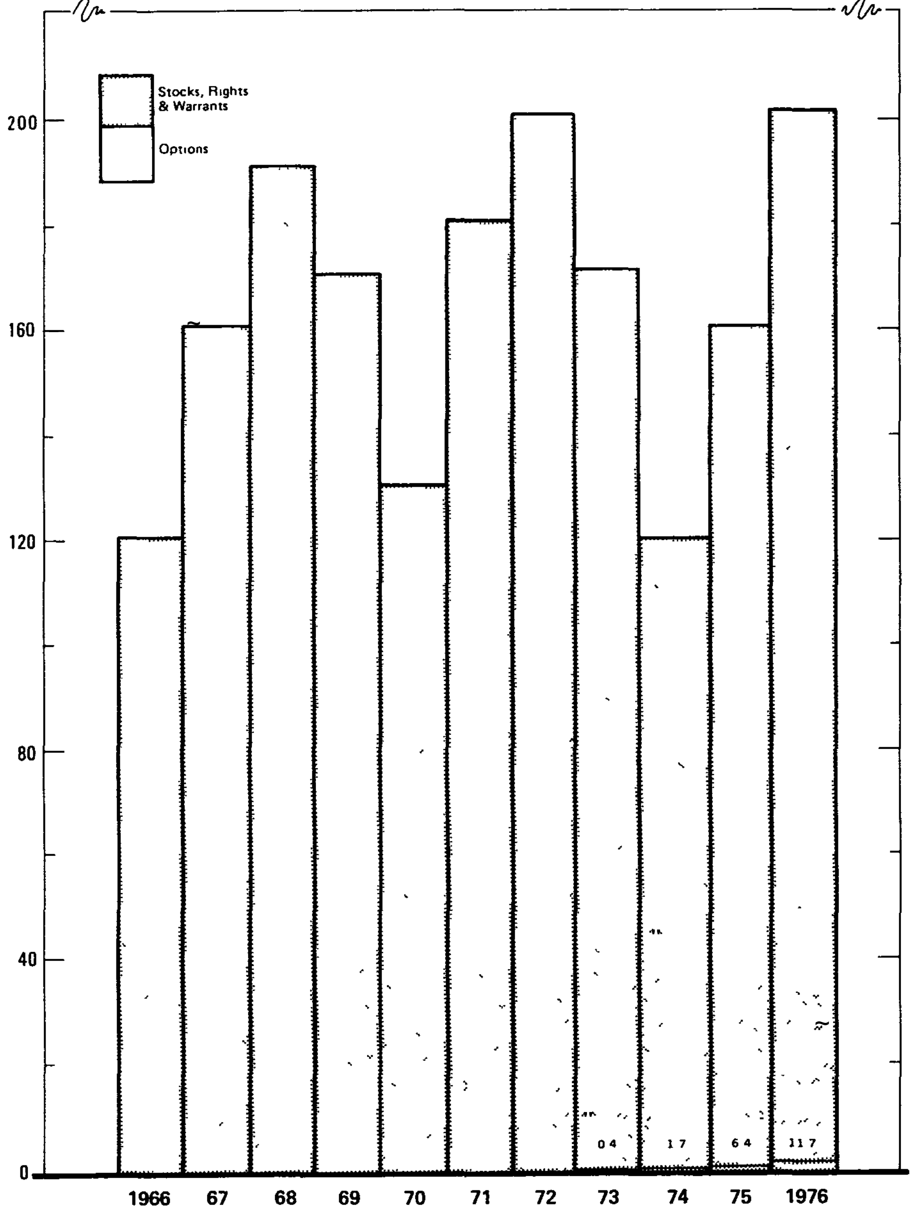
Table 20

EXCHANGE VOLUME: 1976

(Data in thousands)

	Total Dollar Volume	Options		Stocks		Rights and Warrants	
		Dollar Volume	Number of Contracts	Dollar Volume	Share Amount	Dollar Volume	Number of units
All Registered Exchanges	206,958,654	11,734,222	31,428	194,968,674	7,035,662	255,758	89,446
American	9,779,193	2,205,265	8,171	7,468,331	637,047	105,596	29,172
Boston	1,826,681	0	0	1,826,627	55,695	55	24
Chicago Board Options	9,039,849	9,039,849	21,501	0	0	0	0
Cincinnati	1,036,382	0	0	1,036,382	31,458	0	0
Detroit	47,899	0	0	47,899	1,671	0	0
Midwest	9,292,796	3,199	15	9,289,597	276,094	0	0
New York	164,678,859	0	0	164,545,430	5,649,152	133,429	53,497
Pacific Coast	7,629,905	161,374	550	7,456,384	274,220	12,148	6,032
Philadelphia	3,621,989	324,535	1,191	3,292,925	100,380	4,530	720
Intermountain	657	0	0	657	3,263	0	0
Spokane	4,442	0	0	4,442	6,680	0	0
Exempted Exchanges—Honolulu	383	0	0	383	94	0	0

MARKET VALUE OF SECURITIES TRADED ON ALL U.S. STOCK EXCHANGES



NASDAQ Volume

NASDAQ share volume and price information for over-the-counter trading has been reported on a daily basis since November 1, 1971. At the end of 1976, there were 2,627 issues in the NASDAQ system, an increase of 1.1 percent from 2,598 in 1975. Volume for 1976 was 1.7 billion share, up 21 percent from 1.4 billion in 1975. This trading volume reflects the number of shares bought and sold by market makers plus their net inventory changes.

Table 21A

SHARE VOLUME BY EXCHANGES[1]

Year	Total Share volume (thousands)	in Percentage								
		NYSE	AMEX	MIDW	PCSE	PHLE	BCSE	DTSE	CNSE	Other[2]
1935	681,971	73 13	12.42	1 91	2 69	1 10	0 96	0 85	0 03	6 91
1940	377,897	75 44	13 20	2 11	2 78	1 33	1 19	0 82	0 08	3 05
1945	769,018	65 87	21 31	1 77	2 98	1 06	0 66	0 79	0 05	5 51
1950	893,320	76 32	13.54	2 16	3 11	0 97	0 65	0 55	0 09	2 61
1955	1,321,401	68 85	19 19	2 09	3 08	0 85	0 48	0 39	0 05	5 02
1960	1,428,552	69 08	22 46	2 22	3 14	0 89	0 39	0 34	0 04	1 41
1961	2,121,050	65.65	25 84	2 24	3 45	0 80	0 30	0 31	0 04	1 33
1962	1,699,346	71 84	20 26	2 36	2 97	0 87	0 31	0 36	0 04	0 95
1963	1,874,718	73.17	18 89	2 33	2 83	0 83	0 29	0 47	0 04	1 10
1964	2,118,326	72 81	19 42	2 43	2 65	0 93	0 29	0 54	0 03	0 86
1965	2,663,495	70 10	22 59	2 63	2 34	0 82	0 26	0 53	0 05	0 64
1966	3,306,386	69 54	22 89	2 57	2 68	0 86	0 40	0 45	0 05	0 51
1967	4,641,215	64 48	28 45	2 36	2 46	0 87	0 43	0 33	0 02	0.57
1968	5,406,582	62 00	29 74	2 63	2 65	0 89	0 78	0 31	0 01	0 95
1969	5,133,498	63 17	27 61	2 84	3 47	1 22	0 51	0 12	0 00	1 00
1970	4,835,222	71 27	19 02	3 16	3 68	1 63	0 51	0 10	0 02	0 57
1971	6,172,668	71 34	18 42	3 52	3 72	1 91	0 43	0 15	0 03	0 44
1972	6,518,132	70 47	18 22	3 71	4 13	2 21	0 59	0 15	0 03	0 45
1973	5,899,678	74 92	13 75	4 09	3 68	2 19	0 71	0 18	0 04	0 39
1974	4,950,833	78 47	10.27	4 39	3 48	1 82	0 86	0 19	0 04	0 44
1975	6,371,545	81 05	8 97	4 06	3 10	1 54	0 85	0 11	0 13	0 15
1976	7,125,201	80 03	9 35	3 87	3 93	1 41	0 78	0 02	0 44	0 17

[1]Share Volume for Exchanges includes Stocks, Rights, and Warrants
[2]Others include Intermountain, Spokane, National, and Honolulu Stock Exchanges

Table 21B

DOLLAR VOLUME BY EXCHANGES[1]

Year	Total Dollar Volume (thousands)	in Percentage								
		NYSE	AMEX	MIDW	PCSE	PHLE	BCSE	DTSE	CNSE	Other[2]
1935	15,396,139	86 64	7 83	1 32	1 39	0 88	1 34	0 40	0 04	0 16
1940	8,419,772	85.17	7 68	2 07	1.52	1 11	1 91	0 36	0 09	0 09
1945	16,284,552	82.75	10 81	2 00	1 78	0.96	1 16	0 35	0 06	0 13
1950	21,808,284	85 91	6 85	2 35	2 19	1 03	1 12	0 39	0 11	0 05
1955	38,039,107	86 31	6 98	2 44	1 90	1.03	0 78	0 39	0 09	0 08
1960	45,276,616	83 86	9 35	2 72	1 95	1 04	0 60	0 34	0 07	0 03
1961	64,032,924	82 48	10 71	2 75	1 99	1 03	0 49	0 37	0 07	0 05
1962	54,823,153	86 37	6 81	2 75	2 00	1 05	0 46	0 41	0 07	0 04
1963	64,403,991	85 23	7 52	2 72	2 39	1 06	0 42	0 51	0 06	0 04
1964	72,415,297	83 54	8 46	3 15	2 48	1 14	0 42	0 66	0 06	0 04
1965	89,498,711	81 82	9 91	3 44	2 43	1 12	0 42	0 70	0 08	0 03
1966	123,643,475	79 81	11 84	3 14	2 85	1 10	0 56	0 57	0 07	0 02
1967	162,136,387	77 31	14 48	3 08	2 79	1 13	0 67	0 43	0 03	0 03
1968	197,061,776	73 57	18 00	3 12	2 66	1 13	1 04	0 35	0 01	0 08
1969	176,343,146	73 50	17 00	3 39	3 12	1 43	0 67	0 12	0 01	0 12
1970	131,707,946	78 44	11 11	3 76	3 81	1 99	0 67	0 11	0 03	0 04
1971	186,375,130	79 07	9 98	4 00	3 79	2 29	0 58	0 18	0 05	0 03
1972	205,956,263	77 77	10 37	4 29	3 94	2 56	0 75	0 17	0 05	0 05
1973	178,863,622	82 07	6 06	4 54	3 55	2 45	1 00	0 21	0 06	0 01
1974	118,828,272	83 62	4 39	4 89	3 50	2 02	1 23	0 22	0 06	0 01
1975	157,555,360	85 04	3 66	4 82	3 25	1 72	1 18	0 12	0 17	0 00
1976	195,224,815	84 35	3 88	4 76	3 83	1 69	0 94	0 02	0 53	0 00

[1]Dollar Volume for Exchanges includes Stocks, Rights, and Warrants
[2]Others include Intermountain, Spokane, National, and Honolulu Stock Exchanges

Special Block Distributions

In 1976, the total number of special block distributions increased 20 percent. The value of these distributions decreased 57.1 percent to $613.6 million from $1.4 billion in 1975.

Secondary distributions accounted for 60.0 percent of the total number of special block distributions in 1976 and 94.8 percent of the total value of these distributions.

The special offering method was employed 22 times, accounting for 23.2 percent of the total number of special block distributions in 1976, but, with an aggregate value of $18.5 million, these offerings accounted for only 3.0 percent of the value of all special block distributions.

The exchange distribution method was employed 16 times in 1976. The value of exchange distributions was $13.6 million, representing an increase of 64.1 percent from the 1975 figure.

Table 22

SPECIAL BLOCK DISTRIBUTIONS REPORTED BY EXCHANGES

(Value in thousands)

Year	Secondary distributions			Exchange distributions			Special offerings		
	Number	Shares sold	Value	Number	Shares sold	Value	Number	Shares sold	Value
1942	116	2,397,454	82,840				79	812,390	22,694
1943	81	4,270,580	127,462				80	1,097,338	31,054
1944	94	4,097,298	135,760				87	1 053,667	32,454
1945	115	9,457,358	191,961				79	947,231	29,878
1946	100	6,481,291	232,398				23	308,134	11,002
1947	73	3,961,572	124,671				24	314,270	9,133
1948	95	7,302,420	175,991				21	238,879	5,466
1949	86	3,737,249	104,062				32	500,211	10,956
1950	77	4,280,681	88,743				20	150,308	4,940
1951	88	5,193,756	146,459				27	323,013	10,751
1952	76	4,223,258	149,117				22	357,897	9,931
1953	68	6,906,017	108,229				17	380,680	10,486
1954	84	5,738,359	218,490	57	705,781	24,664	14	189,772	6,670
1955	116	6,756,767	344,871	19	258,348	10,211	9	161,850	7,223
1956	146	11,696,174	520,966	17	156,481	4,645	8	131,755	4,557
1957	99	9,324,599	339,062	33	390,832	15,855	5	63,408	1,845
1958	122	9,508,505	361,886	38	619,876	29,454	5	88,152	3,286
1959	148	17,330,941	822,336	28	545,038	26,491	3	33,500	3,730
1960	92	11,439,065	424,688	20	441,644	11,108	3	63,663	5,439
1961	130	19,910,013	926,514	33	1,127,266	58,072	2	35,000	1,504
1962	59	12,143,656	658,780	41	2,345,076	65,459	2	48,200	588
1963	100	18,937,935	814,984	72	2,892,233	107,498	0	0	0
1964	110	19,462,343	909,821	68	2,553,237	97,711	0	0	0
1965	142	31,153,319	1,603,107	57	2,334,277	86,479	0	0	0
1966	126	29,045,038	1,523,373	52	3,042,599	118,349	0	0	0
1967	143	30,783,604	1,154,479	51	3,452,856	125,404	0	0	0
1968	174	36,110,489	1,571,600	35	2,669,938	93,528	1	3,352	63
1969	142	38,224,799	1,244,186	32	1,706,572	52,198	0	0	0
1970	72	17,830,008	504,562	35	2 066,590	48,218	0	0	0
1971	204	72,801,243	2,007,517	30	2,595,104	65,765	0	0	0
1972	229	82,365,749	3,216,126	26	1,469,666	30,156	0	0	0
1973	120	30,825,890	1,151,087	19	802,322	9,140	91	6,662,111	79,889
1974	45	7,512,200	133,838	4	82,200	6,836	33	1,921,755	16,805
1975	51	34,149,089	1,409,933	14	483,846	8,300	14	1,252,925	11,521
1976	57	24,089,636	581,560	16	752,600	13,623	22	1,475,842	18,459

Value and Number of Securities Listed on Exchanges

The market value of stocks and bonds listed on U.S. Stock Exchanges at year-end 1976 was $1,301 billion, an increase of 25 percent from the previous year-end figure of $1,038 billion. The total was composed of $899 billion in stocks and $403 billion in bonds. The value of listed stocks increased by 25 percent in 1976 and the value of listed bonds increased 26 percent. Stocks with primary listing on the New York Stock Exchange were valued at $858 billion and represented 96 percent of the common and preferred stock listed on all U.S. exchanges. The value of NYSE listed stocks increased from their 1975 year-end total by $173 billion or 25 percent. Stocks with primary listing on the AMEX accounted for 4 percent of the total and were valued at $36 billion. The value of AMEX stocks increased $7 billion or 23 percent in 1976. Stocks with primary listing on all other exchanges were valued at $4.2 billion, a decrease of 1 percent from the 1975 total.

The net number of stocks and bonds listed on exchanges increased by 15 issues or 0.2 percent in 1976. The only gains were recorded on the NYSE, where listing increased by 123 issues, and on the Philadelphia Stock Exchange, where listings increased by 1 issue.

Table 23

SECURITIES LISTED ON EXCHANGES[1]

(December 31, 1976)

EXCHANGE	COMMON		PREFERRED		BONDS		TOTAL SECURITIES	
	Number	Market Value (Millions)	Number	Market Value (Millions)	Number	Market Value (Millions)	Number	Market Value (Millions)
Registered:								
American	1,118	$ 34,226	89	$ 1,834	185	$ N A	1,392	$ 36,060
Boston	81	353	2	1	1	1	84	355
Cincinnati	6	22	3	6	6	43	15	72
Midwest	21	284	7	83	1	10	29	377
New York	1,550	830,484	608	27,815	2,708	402,220	4,866	1,260,519
Pacific	47	1,950	10	144	18	398	75	2,491
Philadelphia	29	209	94	711	2	7	125	927
Intermountain	31	26	0	0	0	0	31	26
Spokane	25	2	0	0	0	0	25	2
Exempted:								
Honolulu	18	$ 366	7	$ 7	2	$ 5	27	$ 378
Total	2,926	$867,922	820	$30,601	2,923	$402,684	6,672	$1,301,207
Includes the following foreign stocks:								
New York	35	$ 20,018	1	$ 5	170	$ 5,425	206	$ 25,448
American	73	11,213	1	18	5	N A	79	11,231
Pacific	3	93	1	*	0	0	4	93
Honolulu	2	15	0	0	0	0	2	15
Total	113	$ 13,339	3	$ 23	175	$ 5,425	291	$ 36,787

[1]Excludes securities which were suspended from trading at the end of the year, and securities which because of inactivity had no available quotes

*Less than 5 million but greater than zero

Table 24

VALUE OF STOCKS LISTED ON EXCHANGES

(Dollars in billions)

Dec 31	New York Stock Exchange	American Stock Exchange	Exclusively on Other Exchanges	Total
1936	59 9	14 8		74 7
1937	38 9	10 2		49 1
1938	47 5	10 8		58 3
1939	46 5	10 1		56 6
1940	41 9	8 6		50 5
1941	35 8	7 4		43 2
1942	38 8	7 8		46 6
1943	47 6	9 9		57 5
1944	55 5	11 2		66 7
1945	73 8	14 4		88 2
1946	68 6	13 2		81 8
1947	68 3	12 1		80 4
1948	67 0	11 9	3 0	81 9
1949	76 3	12 2	3 1	91.6
1950	93 8	13 9	3 3	111 0
1951	109 5	16 5	3 2	129.2
1952	120 5	16 9	3 1	140 5
1953	117 3	15.3	2 8	135 4
1954	169 1	22 1	3 6	194 8
1955	207 7	27 1	4 0	238 8
1956	219 2	31 0	3 8	254 0
1957	195 6	25 5	3 1	224 2
1958	276 7	31 7	4 3	312 7
1959	307 7	25 4	4 2	337 3
1960	307 0	24 2	4 1	335 3
1961	387 8	33 0	5 3	426 1
1962	345 8	24 4	4 0	374 2
1963	411.3	26 1	4 3	441 7
1964	474 3	28 2	4 3	506 8
1965	537 5	30 9	4 7	573 1
1966	482 5	27 9	4 0	514 4
1967	605 8	43 0	3 9	652 7
1968	692 3	61 2	6 0	759.5
1969	629 5	47 7	5 4	682 6
1970	636 4	39 5	4 8	680 7
1971	741.8	49 1	4 7	795 6
1972	871 5	55 6	5 6	932 7
1973	721 0	38 7	4 1	763 8
1974	511 1	23 3	2 9	537 3
1975	685 1	29 3	4 3	718 7
1976	858 3	36 0	4 2	898 5

Securities on Exchanges

As of September 30, 1976, a total of 6,799 securities, representing 3,382 issuers, were admitted to trading on securities exchanges in the United States. Over 4,800 issues were listed and registered on the New York Stock Exchange, accounting for 33.8 percent of the stock issues and 88 percent of the bond issues.

As of September 30, 1977, a total of 6,798 securities, representing 3,283 issuers, were admitted to trading on securities exchanges in the United States. Over 4,950 issues were listed and registered on the New York Stock Exchange, accounting for 27.4 percent of the stock issues and 87 percent of the bond issues.

Data below on "Securities Traded on Exchanges" involves some duplication since it includes both solely and dually listed securities.

Table 25A

SECURITIES TRADED ON EXCHANGES

(September 30, 1976)

	Issuers	Stocks				Bonds[1]
		Registered	Temporarily exempted	Unlisted	Total	
American	1,255	1,260	1	39	1,300	201
Boston	849	143		750	893	16
Chicago Board Options	1	1			1	
Chicago Board of Trade	3	1		2	3	
Cincinnati	346	37		320	357	14
Detroit	373	65		317	382	
Honolulu[2]	35				44	5
Intermountain	52	50		2	52	
Midwest	621	360	1	346	707	29
New York	1,895	2,160	3		2,163	2,594
Pacific Coast	860	854	1	181	1,036	93
PBS	940	303		820	1,123	63
Spokane	37	35		5	40	

[1]Issues exempted under Section 3(a)(12) of the Act, such as obligations of U S Government, the states, and cities, are not included in this table

[2]Exempted exchange had 38 listed stocks and 6 admitted to unlisted trading

Table 25B

SECURITIES TRADED ON EXCHANGES

(September 30, 1977)

	Issuers	Stocks				Bonds[1]
		Registered	Temporarily exempted	Unlisted	Total	
American	1,172	1,179	1	44	1,224	188
Boston	832	147		736	883	16
Chicago Board Options	1	1			1	
Chicago Board of Trade	3	1		2	3	
Cincinnati	343	42		313	355	14
Detroit	1			1	1	
Honolulu[2]	34				44	2
Intermountain	49	48		1	49	
Midwest	614	361	1	333	695	31
New York	1,933	2,217	3		2,220	2,701
Pacific Coast	835	833	1	174	1,008	95
PBS	935	327		782	1,109	67
Spokane	36	34		5	39	

[1]Issues exempted under Section 3(a)(12) of the Act, such as obligations of U S Government, the states, and cities, are not included in this table

[2]Exempted exchange had 38 listed stocks and 6 admitted to unlisted trading

Table 26A

UNDUPLICATED COUNT OF SECURITIES ON EXCHANGES

(September 30, 1976)

Registered exchanges	Stocks	Bonds	Total	Issuers Involved
Registered and Listed	3,871	2,835	6,706	3,327
Temporarily exempted from registration	3	2	5	2
Admitted to unlisted trading privileges	40	13	53	31
Exempted exchanges				
Listed	23	6	29	16
Admitted to unlisted trading privileges	6	0	6	6
Total	3,943	2,856	6,799	3,382

Table 26B

UNDUPLICATED COUNT OF SECURITIES ON EXCHANGES

(September 30, 1977)

Registered exchanges	Stocks	Bonds	Total	Issuers Involved
Registered and Listed	3,761	2,949	6,710	3,227
Temporarily exempted from registration	4	2	6	2
Admitted to unlisted trading privileges	36	14	50	22
Exempted exchanges				
Listed	22	4	26	24
Admitted to unlisted trading privileges	6	0	6	8
Total	3,829	2,969	6,798	3,283

1933 ACT REGISTRATIONS

Effective Registration Statements Filed

During the fiscal year ending September 30, 1977, 2,912 securities registration statements valued at $93 billion became effective. For the fiscal transition quarter ending September 30, 1976, 639 registrations valued at $15 billion became effective. While the number of effective registrations in fiscal 1977 rose four percent from Fiscal 1976, the dollar value increased six percent. Among these statements, there were 637 first-time registrants in fiscal 1977 as compared with 540 in fiscal 1976 (168 in the fiscal transition quarter).

The number of registration statements filed rose two percent to 3,029 in fiscal 1977 from 2,976 in the previous fiscal year (648 in the fiscal transition quarter).

Purpose of Registration

Effective registrations for cash sale for the account of the issuers amounted to $78 billion in fiscal 1977, increasing from $70 billion in fiscal 1976. With respect to distribution of these registrations between equity and debt offerings, equity offerings increased from $40 billion in fiscal 1976 to $49 billion in fiscal 1977 — a 23 percent increase. Debt offerings in comparison, decreased from $29 billion to $28 billion — a four percent fall.

Among the securities registered for cash sales in fiscal 1977, nearly all debt issues were for immediate offerings, whereas 82 percent of the equity registrations were for extended cash sale. Registration of extended offerings totaled $40.0 billion with investment companies accounting for $30.9 billion and employee plans $8.1 billion. Corporate equity registrations accounted for 25 percent of immediate cash sale registrations, down 14 percent from fiscal 1976.

Securities registered for the account of the issuer for other than cash sale totaled $14.1 billion including $11.9 billion of common stock. The bulk of these registrations were common stock issues relating to exchange offers, mergers and consolidations. In fiscal 1977 common stock effectively registered for this purpose totaled $10 billion, a decrease of 11 percent from fiscal 1976.

Registrations for the purpose of secondary offerings (proceeds going to selling securities holders) typically involve sales of common stock. In fiscal 1977, these registrations amounted to $1.3 billion, representing a decline of 36 percent from fiscal 1976.

Table 27

EFFECTIVE REGISTRATIONS

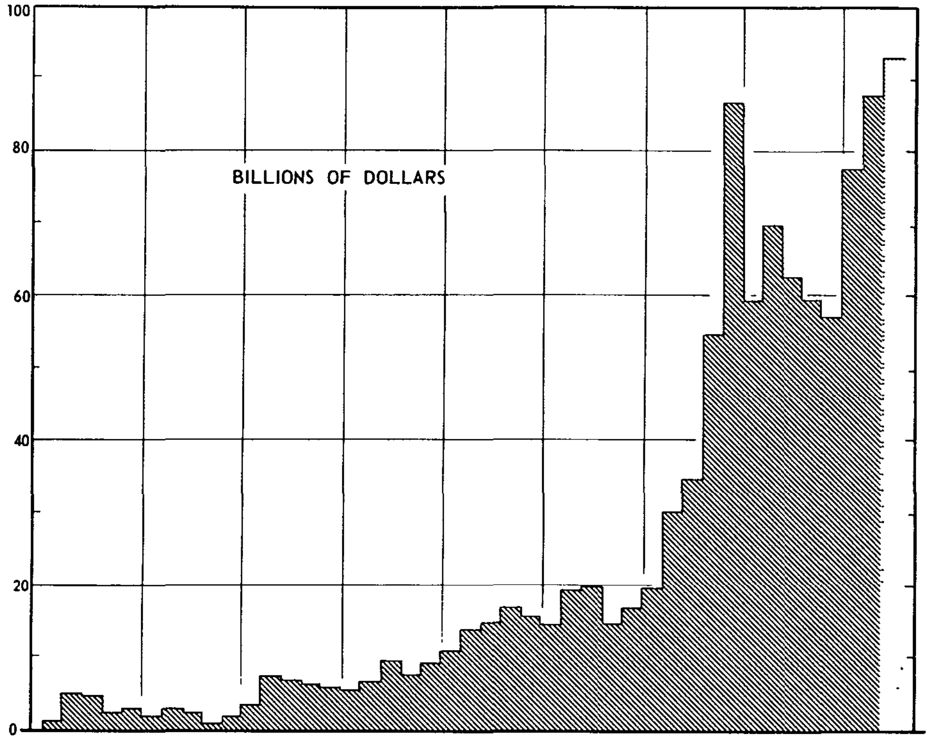
(Dollars in millions)

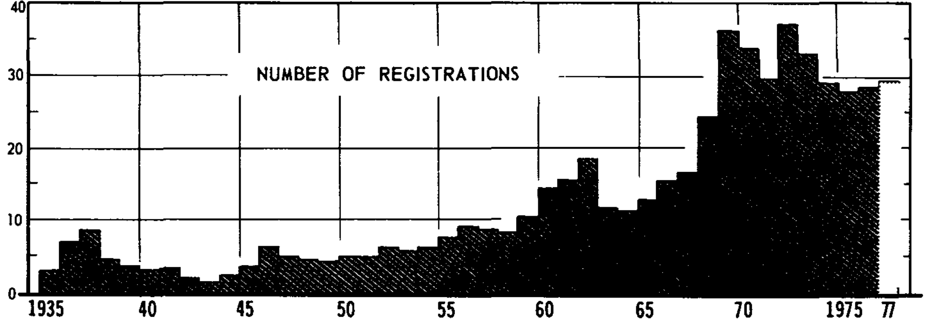
Fiscal year ended June 30	Total		Cash Sale for Account of Issuers			
	Number	Value	Common Stock	Bonds Debentures, and Notes	Preferred Stock	Total
1935[1]	284	$ 913	$ 168	$ 490	$ 28	$ 686
1936	689	4,835	531	3,153	252	3,936
1937	840	4,851	802	2,426	406	3,635
1938	412	2,101	474	666	209	1,349
1939	344	2,579	318	1,593	109	2,020
1940	306	1,787	210	1,112	110	1,433
1941	313	2,611	196	1,721	164	2,081
1942	193	2,003	263	1,041	162	1,465
1943	123	659	137	316	32	486
1944	221	1,760	272	732	343	1,347
1945	340	3,225	456	1,851	407	2,715
1946	661	7,073	1,331	3,102	991	5,424
1947	493	6,732	1,150	2,937	787	4,874
1948	435	6,405	1,678	2,817	537	5,032
1949	429	5,333	1,083	2,795	326	4,204
1950	487	5,307	1,786	2,127	468	4,381
1951	487	6,459	1,904	2,838	427	5,169
1952	635	9 500	3,332	3,346	851	7,529
1953	593	7,507	2,808	3,093	424	6,326
1954	631	9 174	2,610	4,240	531	7,381
1955	779	10,960	3,864	3,951	462	8,277
1956	906	13,096	4,544	4,123	539	9,206
1957	876	14,624	5,858	5,689	472	12,019
1958	813	16,490	5,998	6,857	427	13,281
1959	1,070	15,657	6,387	5,265	443	12,095
1960	1,426	14,367	7,260	4,224	253	11,738
1961	1,550	19,070	9,850	6,162	243	16,260
1962	1,844	19,547	11,521	4,512	253	16,286
1963	1,157	14,790	7,227	4,372	270	11,869
1964	1,121	16,860	10,006	4,554	224	14,784
1965	1,266	19,437	10,638	3,710	307	14,656
1966	1,523	30,109	18,218	7,061	444	25,723
1967	1,649	34,218	15,083	12,309	558	27,950
1968	2,417	54,076	22,092	14,036	1,140	37,269
1969	3,645	86,810	39,614	11,674	751	52,039
1970	3,389	59,137	28,939	18,436	823	48,198
1971	2,989	69,562	27,455	27,637	3,360	58,452
1972	3,712	62,487	26,518	20,127	3,237	49,882
1973	3,285	59,310	26,615	14,841	2,578	44,034
1974	2,890	56,924	19,811	20,997	2,274	43,082
1975	2,780	77,457	30,502	37,557	2,201	70,260
1976	2,813	87,733	37,115	29,373	3,013	69,502
Transition Quarter July-September 1976	639	15,010	6,767	5,066	413	12,246
1977[2]	2,912	92,997	47,024	28,132	2,425	77,580
Cumulative Total	56,367	1,051,542	450,415	343,061	34,679	828,161

[1]For 10 months ended June 30, 1935
[2]Fiscal year ended September 30, 1977

SECURITIES EFFECTIVELY REGISTERED WITH S.E.C.

1935 - 1977





FISCAL YEAR END CHANGED FROM JUNE TO SEPTEMBER

GA-042178-6

Table 28

EFFECTIVE REGISTRATIONS BY PURPOSE AND TYPE OF SECURITY

FISCAL 1976

(Dollars in millions)

Purpose of registration	Total	Type of security: Bonds, debentures, and notes	Preferred stock	Common stock
All registrations (estimated value)	87,726	30,954	3,573	53,200
For account of issuer for cash sale	69,502	29,373	3,013	37,115
Immediate offering	40,522	28,969	3,010	8,543
Corporate	36,949	25,396	3,010	8,543
Offered to				
General public	36,284	25,388	2,965	7,932
Security holders	664	8	45	611
Foreign governments	3,573	3,573	0	0
Extended cash sale and other issues	28,980	404	4	28,572
For account of issuer for other than cash sale	16,136	1,510	547	14,079
Secondary offerings	2,089	71	12	2,006
Cash sale	973	30	0	943
Other	1,116	40	12	1,063

TRANSITION QUARTER JULY-SEPTEMBER 1976

(Dollars in millions)

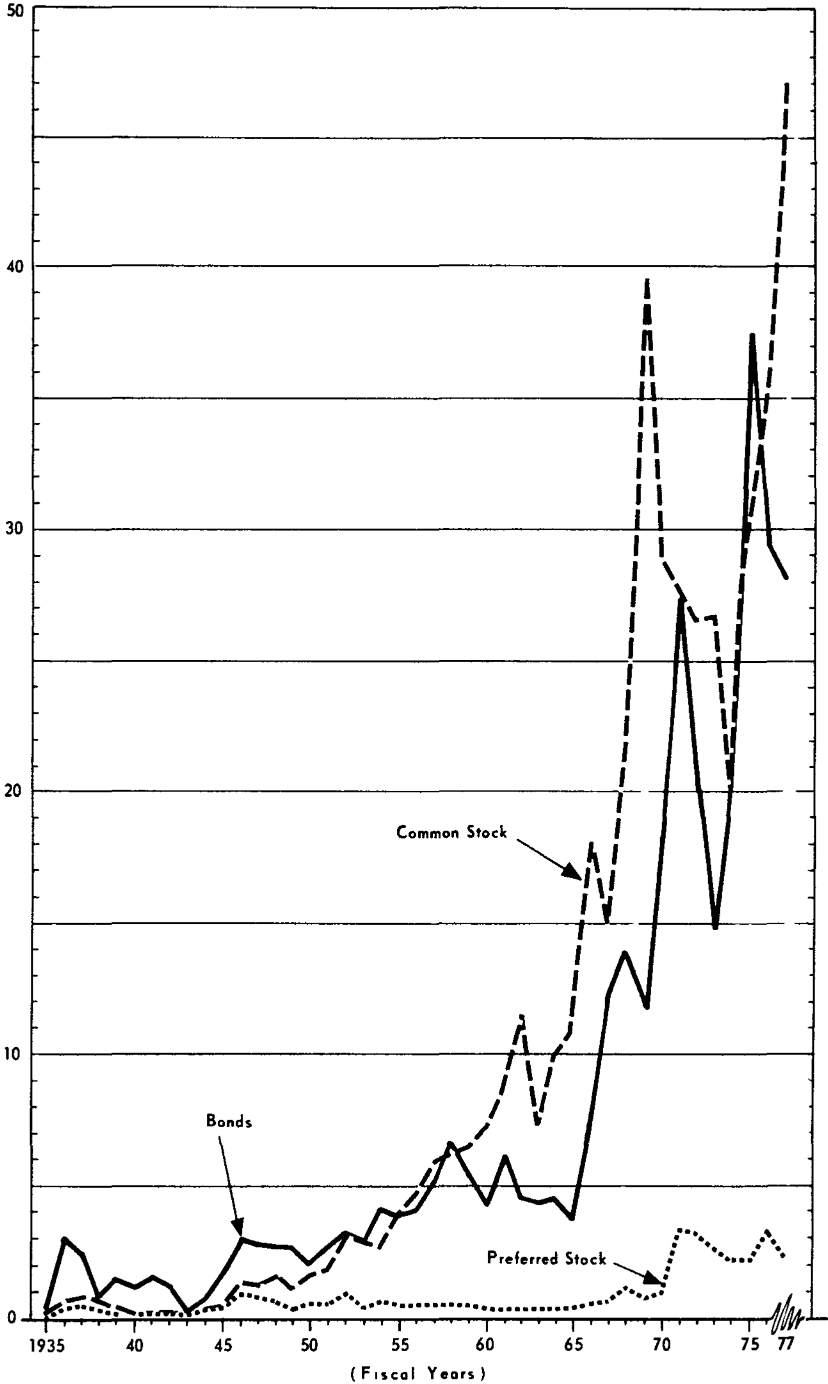
Purpose of registration	Total	Type of security: Bonds, debentures, and notes	Preferred stock	Common stock
All registrations (estimated value)	15,010	5,428	474	9,108
For account of issuer for cash sale	12,246	5,006	413	6,767
Immediate offering	6,876	5,050	413	1,414
Corporate	6,152	4,325	413	1,414
Offered to				
General public	6,024	4,325	411	1,288
Security holders	127	0	2	125
Foreign governments	725	725	0	0
Extended cash sale and other issues	5,369	16	0	5,354
For account of issuer for other than cash sale	2,508	362	58	2,088
Secondary offerings	257	0	4	253
Cash sale	88	0	0	88
Other	169	0	4	165

FISCAL 1977

(Dollars in millions)

Purpose of registration	Total	Type of Security: Bonds, debentures, and notes	Preferred stock	Common stock
All registrations (estimated value)	92,997	29,248	3,512	60,237
For account of issuer for cash sale	77,580	28,132	2,425	47,024
Immediate offering	37,091	27,997	2,416	6,679
Corporate	32,717	23,623	2,416	6,679
Offered to				
General public	31,895	23,613	2,320	5,962
Security holders	822	9	96	717
Foreign governments	4,375	4,375	0	0
Extended cash sale and other issues	40,489	135	9	40,345
For account of issuer for other than cash sale	14,069	1,107	1,020	11,942
Secondary offerings	1,347	9	67	1,272
Cash sale	402	0	0	402
Other	946	9	67	870

EFFECTIVE REGISTRATIONS
CASH SALE FOR ACCOUNT OF ISSUERS



FISCAL YEAR END CHANGED FROM JUNE TO SEPTEMBER

DATA FOR TRANSITION QUARTER JULY-SEPTEMBER 1976 NOT SHOWN ON CHART
BONDS $5.1 BILLION, PREFERRED STOCK $.4 BILLION, COMMON STOCK $6.8 BILLION

Regulation A Offerings

During the transitional quarter, 54 notifications were filed for proposed offerings under Regulation A. Issues between $400,000 and $500,000 in size predominated.

During fiscal year 1977, 218 notifications were filed for proposed offerings under Regulation A. Issues between $400,000 and $500,000 in size predominated.

Table 29

OFFERINGS UNDER REGULATION A

	Fiscal 1977	Transitional Quarter	Fiscal 1976	Fiscal 1975
Size				
$100,000 or less	17	4	24	28
$100,000 – $200,000	30	5	36	42
$200,000 – $300,000	30	8	27	39
$300,000 – $40,000	24	8	39	24
$400,000 – $500,000	117	29	114	132
Total	218	54	240	265
Underwriters				
Used	52	12	37	44
Not Used	166	42	203	221
Total	218	54	240	265
Offerors				
Issuing Companys	205	48	222	227
Stockholders	7	3	12	7
Issuers and Stockholders jointly	6	3	6	31
Total	218	54	240	265

ENFORCEMENT

Types of Proceedings

As the table below reflects, the securities laws provide for a wide range of enforcement actions by the Commission. The most common types of actions are injunctive proceedings instituted in the Federal district courts to enjoin continued or threatened securities law violators, and administrative proceedings pertaining to broker-dealer firms and/or individuals associated with such firms which may lead to various remedial sanctions as required in the public interest. When an injunction is entered by a court, violation of the court's decree is a basis for criminal contempt action against the violator.

Table 30

TYPES OF PROCEEDINGS

ADMINISTRATIVE PROCEEDINGS

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Broker-dealer, municipal securities dealer, investment adviser or associated person	
Willful violation of securities acts provision or rule, aiding or abetting such violation, failure reasonably to supervise others, willful misstatement or omission in filing with the Commission, conviction of or injunction against certain crimes or conduct	Censure or limitation on activities, revocation, suspension or denial of registration, bar or suspension from association (1934 Act §§15B (c) (2)-(4), 15(b) (4)-(6), Advisers Act §§203(e)-(f)) *
Registered securities association	
Organization or rules not conforming to statutory requirements	Suspension of registration or limitation of activities, functions, or operations (1934 Act, §19(h) (1))
Violation of or inability to comply with the 1934 Act, rules thereunder, or its own rules, unjustified failure to enforce compliance with the foregoing or with rules of the Municipal Securities Rulemaking Board by a member or person associated with a member	Suspension or revocation of registration, censure or limitation of activities, functions, or operations (1934 Act §19(h) (1))
Member of registered securities association, or associated person	
Being subject to Commission order pursuant to 1934 Act, §15(b), willful violation of or effecting transaction for other person with reason to believe that person was violating securities acts provisions, rules thereunder, or rules of Municipal Securities Rulemaking Board	Suspension or expulsion from the association, bar or suspension from association with member of association (1934 Act, §§19(h) (2)-(3))
National securities exchange	
Organization or rules not conforming to statutory requirements	Suspension of registration or limitation of activities, functions, or operations (1934 Act, §19(h) (1))
Violation of or inability to comply with 1934 Act, rules thereunder or its own rules, unjustified failure to enforce compliance with the foregoing by a member or person associated with a member	Suspension or revocation of registration censure or limitation of activities, functions, or operations (1934 Act, §19(h) (1)).
Member of national securities exchange, or associated persons	
Being subject to Commission order pursuant to 1934 Act, §15(b), willful violation of or effecting transaction for other person with reason to believe that person was violating securities acts provisions or rules thereunder	Suspension or expulsion from exchange, bar or suspension from association with member (1934 Act, §§19(h) (2)-(3))
Registered clearing agency	
Violation of or inability to comply with 1934 Act, rules thereunder, or its own rules, failure to enforce compliance with its own rules by participants	Suspension or revocation of registration censure or limitation of activities, functions, or operations (1934 Act, §19(h) (1))
Participant in registered clearing agency	
Being subject to Commission order pursuant to 1934 Act, §15(b) (4), willful violation of or effecting transaction for other person with reason to believe that person was violating provisions of clearing agency rules	Suspension or expulsion from clearing agency (1934 Act, §19(h) (2))
Securities information processor	
Violation of or inability to comply with provisions of 1934 Act or rules thereunder	Censure or operational limitations, suspension or revocation of registration (1934 Act, §11A(b) (6))
Transfer agent	
Willful violation of or inability to comply with 1934 Act, §§17 or 17A, or regulations thereunder	Censure or limitation of activities, denial, suspension, or revocation of registration (1934 Act, §17A(c) (3))

*Statutory references are as follows "1933 Act", the Securities Act of 1933, "1934 Act", the Securities Exchange Act of 1934, "Investment Company Act", the Investment Company Act of 1940, "Advisers Act", the Investment Advisers Act of 1940, "Holding Company Act", the Public Utility Holding Company Act of 1935, "Trust Indenture Act", the Trust Indenture Act of 1939, and "SIPA", the Securities Investor Protection Act of 1970

Table 30—cont.

TYPES OF PROCEEDINGS

ADMINISTRATIVE PROCEEDINGS

Persons Subject to, Acts Constituting, and Basis for, Enforcement Action	Sanction
Any person	
Willful violation of securities act provision or rule, aiding or abetting such violation, willful misstatement in filing with Commission	Temporary or permanent prohibition from serving in certain capacities for registered investment company (Investment Company Act, §9(b))
Officer or director of self-regulatory organization.	
Willful violation of 1934 Act, rules thereunder, or the organization's own rules, willful abuse of authority or unjustified failure to enforce compliance	Removal from office or censure (1934 Act, §19(h) (4))
Principal of broker-dealer	
Engaging in business as a broker-dealer after appointment of SIPC trustee	Bar or suspension from being or being associated with a broker-dealer (SIPC, §10(b))
1933 Act registration statement	
Statement materially inaccurate or incomplete	Stop order suspending effectiveness (1933 Act, §8(d))
Investment company has not attained $100,000 net worth 90 days after statement became effective	Stop order (Investment Company Act, §14(a))
Persons subject to Sections 12, 13 of 15(d) of the 1934 Act.	
Material noncompliance with such provisions	Order directing compliance (1934 Act, §15(c) (4))
Securities issue	
Noncompliance by issuer with 1934 Act or rules thereunder	Denial, suspension of effective date, suspension or revocation of registration on national securities exchange (1934 Act, §12(j))
Public interest requires trading suspension	Summary suspension of over-the-counter or exchange trading (1934 Act, §12(k))
Registered investment company	
Failure to file Investment Company Act registration statement or required report, filing materially incomplete or misleading statement of report	Revocation of registration (Investment Company Act , §8(e))
Company has not attained $100,000 net worth 90 days after 1933 Act registration statement became effective	Revocation or suspension of registration (Investment Company Act, §14(a))
Attorney, accountant, or other professional or expert	
Lack of requisite qualifications to represent others, lacking in character or integrity, unethical or improper professional conduct, willful violation of securities laws or rules, or aiding and abetting such violation	Permanent or temporary denial of privilege to appear or practice before the Commission (17 C F R §201 2(e) (1))
Attorney suspended or disbarred by court, expert's license revoked or suspended, conviction of a felony or misdemeanor involving moral turpitude.	Automatic suspension from appearance or practice before the Commission (17 C F R §201 2(e) (2))
Permanent injuction against or finding of securities violation in Commission-instituted action, finding of securities violation by Commission in administrative proceeding	Temporary suspension from appearance or practice before Commission (17 C F R §201 2(e) (3))
Member of Municipal Securities Rulemaking Board	
Willful violation of securities laws, rules thereunder, or rules of the Board	Censure or removal from office 1934 Act, §15B(c) (8))

Table 30—cont.

CIVIL PROCEEDINGS IN FEDERAL DISTRICT COURTS

Persons Subject to, Acts Constituting, and Basis for, Enforcement Act	Sanction
Any person	
Engaging in or about to engage in acts or practices violating securities acts, rules or orders thereunder (including rules of a registered self-regulatory organization)	Injunction against acts or practices which constitute or would constitute violations (plus other equitable relief under court's general equity powers) (1933 Act, Sec 20(b), 1934 Act, Sec 21(d), 1935 Act, Sec 18(f), Investment Company Act, §42(e), Advisers Act, §209(e), Trust Indenture Act, §321)
Noncompliance with provisions of law, rule, or regulation under 1933, 1934, or Holding Company Acts, order issued by Commission rules of a registered self-regulatory organization, or undertaking in a registration statement	Writ of mandamus, injuntion, or order directing compliance (1933 Act, §20(c), 1934 Act, §21(e), Holding Company Act, §18(g))
Securities Investor Protection Corporation	
Refusal to commit funds or act for the protection of customers	Order directing discharge of obligations or other appropriate relief (SIPA, §7(b))
National securities exchange or registered securities association	
Noncompliance by its members and persons associated with its members with the 1934 Act, rules and orders thereunder, or rules of the exchange or association	Writ of mandamus, injunction, or order directing such exchange or association to enforce compliance (1934 Act, §21(e))
Registered clearing agency	
Noncompliance by its participants with its own rules	Writ of mandamus, injunction, or order directing clearing agency to enforce compliance (1934 Act, §21(e))
Issuer subject to reporting requirements	
Failure to file reports required under §15(d) of 1934 Act	Forfeiture of $100 per day (1934 Act, §32(b))
Registered investment company or affiliate	
Name of company or of security issued by it deceptive or misleading	Injunction against use of name (Investment Company Act, §35(d))
Officer, director, member of advisory board, adviser, depositor, or underwriter of investment company	
Engage in act or practice constituting breach of fiduciary duty involving personal misconduct	Injunction against acting in certain capacities for investment company, and other appropriate relief Investment Company Act, §36(a))
Any person having fiduciary duty respecting receipt of compensation from investment company	
Breach of fiduciary duty	Injunction (Investment Company Act §36(a))

REFERRAL TO ATTORNEY GENERAL FOR CRIMINAL PROSECUTION

Persons Subject to Acts Constituting, and basis for Enforcement Action	Sanction
Any person	
Willful violation of securities acts or rules thereunder or willful misstatement in any document required to be filed by securities laws and rules or by self-regulatory organization in connection with an application for membership, participation or to become associated with a member thereof	Maximum penalties $10,000 fine and 5 years imprisonment, an exchange may be fined up to $500,000, a public-utility holding company up to $200,000 (1933 Act, Secs 20(b), 24, 1934 Act, Secs 21(d), 32(a), Holding Company Act, Secs 18(f), 29, 1939 Act, Sec 325, Investment Company Act, Secs 42(e), 49, Advisers Act, Secs 209(e), 217)

Table 31

INVESTIGATIONS OF POSSIBLE VIOLATIONS OF THE ACTS ADMINISTERED BY THE COMMISSION

Pending September 30, 1976	1,329
Opened	400
Total for Distribution	1,729
Closed	325
Pending September 30, 1977	1,404

During the fiscal year ending September 30, 1977, 224 formal orders were issued by the Commission upon recommendation of the Division of Enforcement.

Table 32

ADMINISTRATIVE PROCEEDINGS INSTITUTED DURING FISCAL YEAR ENDING SEPTEMBER 30, 1977

Broker Dealer Proceedings	93
Investment Adviser Proceedings	38
Stop Order, Reg A Suspension and Other Disclosure Cases	11

Injunctive Actions 1976–1977

During fiscal 1977, 166 suits for injunctions and 21 miscellaneous actions were instituted in the United States district courts by the Commission, and 26 district court proceedings were brought against the Commission. During that year this office handled 7 appellate cases involving petitions for review of Commission decisions, 3 appeals in reorganization matters and 35 appeals in injunction and miscellaneous cases. SEC participated and filed 6 amicus curiae briefs in 6 cases.

During fiscal 1977, the General Counsel referred to the Department of Justice 100 criminal reference reports. (This figure includes 7 criminal contempt actions.)

Table 33

INJUNCTIVE ACTIONS

Fiscal Year	Cases Instituted	Injunctions Ordered	Defendants Enjoined
1968	93	98	384
1969	94	102	509
1970	111	97	448
1971	140	114	495
1972	119	113	511
1973	178	145	654
1974	148	289	613
1975	174	453	749
1976	158	435	722
1977	166	336	715

Criminal Proceedings

During fiscal 1977, 100 cases were referred to the Department of Justice for prosecution. (This figure includes 7 criminal contempt actions.) As a result of these and prior referrals, 68 indictments were returned against 230 defendants during the fiscal year. There were also 135 convictions in 53 cases. Convictions were affirmed in 15 cases that had been appealed, and appeals were still pending in 6 other criminal cases at the close of the period. Of 19 defendants in 17 criminal contempt cases handled during the year, 4 defendants were convicted, prosecution was declined as to 2 defendants, and 9 defendants in 8 cases are still pending. Thirteen cases are pending in a Suspense Category.

Table 34

CRIMINAL CASES

Fiscal year	Number of cases referred to Justice Dept	Number of indictments	Defendants indicated	Convictions
1968	40	42	123	84
1969	37	64	213	83
1970	35	36	102	55
1971	22	16	83	89
1972	38	28	67	75
1973	49	40	178	83
1974	67	40	169	81
1975	88	53	199	116
1976	116	23	118	97
1977	100	68	230	135

List of All Foreign Corporations on the Foreign Restricted List

The complete list of all foreign corporations and other foreign entities on the Foreign Restricted List on June 30, 1975, is as follows:

Aguacate Consolidated Mines, Incorporated (Costa Rica)
Alan MacTavish, Ltd. (England)
Allegheny Mining and Exploration Company, Ltd. (Canada)
Allied Fund for Capital Appreciation (AFCA, S.A.) (Panama)
Amalgamated Rare Earth Mines, Ltd. (Canada)
American Industrial Research S.A., also known as Investigacion Industrial Americana, S.A. (Mexico)
American International Mining (Bahamas)
American Mobile Telephone and Tape Co., Ltd. (Canada)
Antel International Corporation, Ltd. (Canada)
Antoine Silver Mines, Ltd. (Canada)
ASCA Enterprises Limited (Hong Kong)
Atholl Brose (Exports) Ltd. (England)
Atholl Brose, Ltd. (England)
Atlantic and Pacific Bank and Trust Co., Ltd. (Bahamas)
Banco de Guadalajara (Mexico)
Bank of Sark (United Kingdom)
Briar Court Mines, Ltd. (Canada)
British Overseas Mutual Fund Corporation Ltd. (Canada)
California & Caracas Mining Corp., Ltd. (Canada)
Canterra Development Corporation, Ltd. (Canada)
Cardwell Oil Corporation, Ltd. (Canada)
Caribbean Empire Company, Ltd. (British Honduras)
Caye Chapel Club, Ltd. (British Honduras)
Central and Southern Industries Corp. (Panama)

Cerro Azul Coffee Plantation (Panama)
Cia. Rio Banano, S.A. (Costa Rica)
City Bank A.S. (Denmark)
Claw Lake Holybdenum Mines, Ltd. (Canada)
Claravella Corporation (Costa Rica)
Compressed Air Corporation, Limited (Bahamas)
Continental and Southern Industries. S.A. (Panama)
Credito Mineroy Mercantil (Mexico)
Crossroads Corporation, S.A. (Panama)
Darien Exploration Company, S.A. (Panama)
Derkglen, Ltd. (England)
De Veers Consolidated Mining Corporation, S.A. (Panama)
Doncannon Spirits, Ltd. (Bahamas)
Durman, Ltd., formerly known as Bankers International Investment Corporation (Bahamas)
Ethel Copper Mines, Ltd. (Canada)
Euroforeign Banking Corporation, Ltd. (Panama)
Financiera Comermex (Mexico)
Financiera de Eomento Industrial (Mexico)
Financiera Metropolitana (Mexico)
Finansbanken a/s (Denmark)
First Liberty Fund, Ltd. (Bahamas)
Global Explorations, Inc. (Panama)
Global Insurance Company, Limited (British West Indies)
Globus Anlage-Vermittlungsgesellschaft MBH (Germany)
Golden Age Mines, Ltd. (Canada)
Hebilla Mining Corporation (Costa Rica)
Hemisphere Land Corporation Limited (Bahamas)
Henry Ost & Son, Ltd. (England)
International Communications Corporation (British West Indies)
International Trade Development of Costa Rica, S.A.
Ironco Mining & Smelting Company, Ltd. (Canada)
James G. Allan & Sons (Scotland)
J. P. Morgan & Company, Ltd., of London, England (not to be confused with J. P. Morgan & Co., Incorporated, New York)
Jupiter Explorations, Ltd. (Canada)
Kenilworth Mines, Ltd. (Canada)
Klondike Yukon Mining Company (Canada)
Kokanee Moly Mines, Ltd (Canada)
Land Sales Corporation (Canada)
Los Dos Hermanos, S.A. (Spain)
Lynbar Mining Corp., Ltd. (Canada)
Mercantile Bank & Trust Company, Limited
Norart Minerals Limited (Canada)
Normandie Trust Company, S.A. (Panama)
Northern Survey (Canada)
Northern Trust Company, S.A. (Switzerland)
Northland Minerals, Ltd. (Canada)
Obsco Corporation, Ltd. (Canada)
Pacific Northwest Developments, Ltd. (Canada)
Panamerican Bank & Trust Company (Panama)
Paulpic Gold Mines, Ltd. (Canada)
Pyrotex Mining and Exploration Co., Ltd. (Canada)
Radio Hill Mines Co., Ltd. (Canada)
Rodney Gold Mines Limited (Canada)
Royal Greyhound and Turf Holdings Limited (South Africa)
S.A. Valles & Co., Inc. (Phillipines)
San Salvador Savings & Loan Co., Ltd. (Bahamas)
Santack Mines Limited (Canada)
Security Capital Fiscal & Guaranty Corporation, S.A. (Panama)
Silver Stack Mines, Ltd. (Canada)
Societe Anonyme de Refinancement (Switzerland)
Strathmore Distillery Company, Ltd. (Scotland)
Strathross Blending Company Limited (England)
Swiss Caribbean Development & Finance Corporation (Switzerland)

Tam O'Shanter, Ltd. (Switzerland)
Timberland (Canada)
Trans-American Investments, Limited (Canada)
Trihope Resources, Ltd. (Canada)
Trust Company of Jamaica, Ltd. (West Indies)
United Mining and Milling Corporation (Bahamas)
Unitrust Limited (Ireland)
Vactionland (Canada)
Valores de Inversion, S.A. (Mexico)
Victoria Oriente, Inc. (Panama)
Warden Walker Worldwide Investment Co. (England)
Wee Gee Uranium Mines, Ltd. (Canada)
Western International Explorations, Ltd. (Bahamas)
Yukon Wolverine Mining Company (Canada)

PUBLIC UTILITY HOLDING COMPANIES

Assets

At fiscal year 1977, there were 18 holding companies registered under the Act. There were 17 registered holding companies within the 14 "active" registered holding-company systems. The remaining registered holding company is relatively small, and not included among the "active" systems. In the 14 active systems, there were 67 electric and/or gas utility subsidiaries, 55 nonutility subsidiaries, and 22 inactive companies, or a total of 161 system companies, including the top parent and subholding companies. The following table lists the active systems and their agregate assets.

Table 35

PUBLIC-UTILITY HOLDING COMPANY SYSTEMS

	Soley Registered Holding Companies	Registered Holding Operating Companies	Electric &/or Gas Utility Subsidiaries	Non-Utility Subsidiaries	Inactive Companies	Total Companies	Aggregate System Assets, Net of Depreciation, on 12-31-76*
Allegheny Power System, Inc	1	2	1	4	0	8	$ 2,062,665,000
American Electric Power Co , Inc	1	0	10	11	6	28	6,879,459,000
Central & Southwest Corp	1	1	3	3	1	9	2,276,539,000
Columbia Gas System, Inc , The	1	0	8	10	1	20	3,243,759,000
Consolidated Natural Gas Co	1	0	5	6	0	12	1,946,717,000
Eastern Utilities Associates	1	0	4	1	2	8	286,004,000
General Public Utilities Corp	1	0	4	4	1	10	3,954,649,000
Middle South Utilities, Inc	1	0	7	2	3	13	4,136,235,000
National Fuel Gas Co	1	0	1	2	0	4	463,604,000
New England Electric System	1	0	4	2	0	7	1,713,833,00
Northeast Utilities	1	0	5	8	6	20	2,873,201,000
Ohio Edison Co	0	1	1	0	0	2	2,343,924,000
Philadelphia Electric Power Co	0	1	1	0	1	3	58,439,000
Southern Company, The	1	0	5	2	0	8	8,072,294,000
Subtotals	12	5	59	55	21	152	$40,311,322,000
Adjustments (a) to take amount of jointly-owned companies, (b) to add net assets of eight jointly-owned companies not included above**	0	5	(a)+8	0	1	9	(b)+688,231,000
Total companies & assets in active systems	12	5	67	55	22	161	$40,999,553,000

*Represents the consolidated net assets of each system as reported to the Commission on Form U5S for the year 1976 The figures for National Fuel Co are as of September 30, 1976

**These nine companies are Beechbottom Power Co , Inc , which is a currently inactive subsidiary that is equally owned by the American Electric Power Co , Inc and Allegheny Power System, Inc, Ohio Valley Electric Corp and its subsidiary, Indiana-Kentucky Electric Corp , which are owned 37 8 percent by American Electric Power Co , Inc , 16 5 percent of Ohio Edison Co , 12 5 percent by Allegheny Power System, Inc , and 33 2 percent by other companies, Cardinal Operating Co , an indirect subsidiary equally owned by American Electric Power Co , Inc and an electric utility company not associated with a registered system, The Arklahoma Corp which is owned 32 percent by Central & Southwest Corp system, 34 percent by Middle South Utilities, Inc system, and 34 percent by an electric utility company not associated with a registered system, Yankee Atomic Electric Co , Connecticut Yankee Atomic Power Co , Vermont Yankee Nuclear Power Corp and Maine Yankee Atomic Power Co , which are statutory utility subsidiaries of Northeast Utilities, New England Electric System, Eastern Utilities Associates and other electric utilities not associated with a registered system

Table 36A

FINANCING OF HOLDING COMPANY SYSTEMS

(Transition Quarter)
7-1-76 to 9-30-76

	In Million of Dollars[2]			
	Bonds	Debentures	Preferred Stock	Common Stock
American Electric Power Co				2 1
Appalachian Power Co	69 4			
Consolidated Natural Gas Co		74 6		0 7
Eastern Utility Associates		[4]20 0		
General Public Utilities Corp				2 6
Ohio Edison	59 7			1 1
Pennsylvania Power Co	15.0			
Middle South Utilities				0 3
Northeast Utilities				
Connecticut Yankee Atomic Power Co	[4]13 8	[4]10 0		
Southern Company, The				6 3
Total	157 9	104 6	0 0	[3]13 1

[1]This table does not include short-term financings, securities issued and sold by subsidiaries to their parent companies or obligations incurred by registered systems for pollution control facilities financed through the sale of revenue bonds by governmental agencies
[2]Debt securities are computed at price to company, preferred stock at offering price and common stock at offering or subscription price.
[3]All common stock issued during the transition quarter is attributable to dividend reinvestment plans
[4]Private placement.

Table 36B

FINANCING OF HOLDING COMPANY SYSTEMS[1]

(Fiscal 1977)

	In Millions of Dollars[2]			
	Bonds	Debentures[3]	Preferred Stock	Common[4] Stock
Alleghany Power Systems Inc	$	$	$	$ 6
Monongahela Power Co			15 2	
West Penn Power Co			20 3	
American Electric Power Co				213 8
Indiana & Michigan Electric Co			40 0	
Indiana & Michigan Power Co		[7] 60 0		
Kentucky Power Co	30 2			
Kingsport Power Co		[7] 12.0		
Michigan Power Co		[7] 5 0		
Ohio Power Co	[5] 120 4			
Ohio Electric Co	[6 7] 200 0			
Central and South West Corp				108 0
Central Power & Light Co	74 4			
Southwestern Electric Power Co			30 0	
Consolidated Natural Gas Co		74 4		5 5
Eastern Utilities Associates				10 7
General Public Utilities Corp		[7] 50 0		81 4
Jersey Central Power & Light Co	58 0			
Metropolitan Edison Co	34 4			
Middle South Utilities, Inc				135 7
Arkansas Power & Light Co			10 4	
Louisiana Power & Light Co	40 1			
Middle South Energy, Inc	[4 6 7] 200 0	[7] 138 0		
New England Electric System		[6 7] 27 5		30 8
Granite State Electric Co		[7] 8 0		
New England Power Co	50 0			
Northeast Utilities				9
Connecticut Light & Power Co	44 5			
Western Massachusetts Electric Co	29 9			
Ohio Edison Co	[5] 134 4		40 0	6 0
Southern Company, The				33 1
Alabama Power Co	99 2		50 0	
Gulf Power Co	34 4		15 0	
Southern Services, Inc		[6 7] 22 0		
Yankee Atomic Electric Co [8]		10 0		
Total	$1,149 9	$406 9	$220 9	$626 5

[1] The table does not include securities issued and sold by subsidiaries to their parent holding companies, short-term notes sold to banks, portfolio sales by any of the system companies, or securities issued for stock or assets of nonaffiliated companies Transactions of this nature also require authorization by the Commission, except, as provided by Sec 6(b) of the Act, the issuance of notes having a maturity of 9 months or less where the aggregate amount does not exceed 5 percent of the principal amount and par value of the other securities of the issuer then outstanding

[2] Includes notes to banks maturing in more than one year

[3] Debt securities are computed at price to company, preferred stock at offering price, common stock at offering or subscription price

[4] Common stock includes shares issued by dividend reinvestment plan.

[5] Two or more issues

[6] Private placement

[7] At least one issue negotiated.

[8] Statutory utility subsidiary of Northeast Utilities and New England Electric System

CORPORATE REORGANIZATIONS

Commission Participation

In fiscal year 1977, the Commission entered 9 new Chapter X proceedings involving companies with aggregate stated assets of approximately $895 million and aggregate indebtedness of approximately $878 million. During the transitional quarter, July 1 to September 30, 1976, the Commission entered 2 new Chapter X proceedings while closing 2 proceedings. Including the new proceedings, the Commission was a party in a total of 124 reorganization proceedings during the fiscal year. The stated assets of the companies involved in these proceedings totaled approximately $5.3 billion and their indebtedness about $4.8 billion. During the fiscal year 12 proceedings were closed, leaving 112 in which the Commission was a party at year end.

Table 37

REORGANIZATION PROCEEDINGS UNDER CHAPTER X OF THE BANKRUPTCY ACT IN WHICH THE COMMISSION PARTICIPATED

Fiscal Year 1977

Debtor	District Court	Petition Filed	SEC Notice of Appearance Filed
Air Industrial Research, Inc [4]	N D Cal	March 14, 1974	May 6, 1974
Aldersgate Foundation, Inc	M D Fla	Sept 12, 1974	Oct 3, 1974
American Associated Systems, Inc	E D Ky	Dec 24, 1970	Feb 26, 1971
American Land Corp	S D Ohio	Aug 8, 1973	Sept 25, 1973
American Loan & Finance Co [4]	E D Va	July 31, 1972	Aug 30, 1972
American Mortgage & Investment Co	D S C	Dec 13, 1974	Feb 6, 1975
Arizona Lutheran Hospital	D Ariz	May 11, 1970	May 25, 1970
Atlanta International Raceway, Inc [3]	N D Ga	Jan 18, 1971	Feb 3, 1971
Arlan's Dept Stores, Inc	S D N Y	March 8, 1974	March 8, 1974
Bankers Trust[5]	S D Ind	Oct 7, 1966	Nov 1, 1966
Bankers Trust Co [2]	S D Miss	Dec 16, 1976	April 5, 1977
Beck Industries, Inc	S D N Y	May 27, 1971	July 30, 1971
Bermec Corp	S D N Y	April 16, 1971	April 10, 1971
Beverly Hills Bancorp	C D Cal	April 11, 1974	May 14, 1974
Bubble Up Delaware, Inc	C D Cal	Aug 31, 1970	Oct 19, 1970
BXP Construction Corp	S D N Y	Jan 15, 1974	June 10, 1974
C I P Corp	S D Ohio	May 23, 1975	June 26, 1975
Calvin Christian Retirement Home, Inc [3]	W D Mich	Aug 8, 1974	Nov 4, 1974
Carolina Caribbean Corp	W D N C	Feb 28, 1975	April 17, 1975
Coast Investors, Inc [5]	W D Wash	April 1, 1964	June 10, 1964
Coffeyville Loan & Investment[5]	D Kans	July 17, 1959	Aug 10, 1959
Combined Metals Reduction Co	D Nev	Sept 30, 1970	Sept 7, 1972
Commonwealth Corp	N D Fla	June 28, 1974	July 17, 1974
Commonwealth Financial Corp [5]	E D Pa	Dec 4, 1967	Dec 13, 1967
Community Business Services, Inc	E D Cal	June 8, 1972	April 30, 1973
Continental Mortgage Investors	D Mass	Oct 21, 1976	Oct 21, 1976
Continental Vending Machine Corp	E D N Y	July 10, 1963	Aug 7, 1963
Cosmo Capital Inc [5]	N D Ill	July 22, 1963	April 22, 1963
Davenport Hotel, Inc	E D Wash	Dec 20, 1972	Jan 26, 1973
Detroit Port Development Corp [2]	E D Mich	Sept 14, 1976	Nov 17, 1976
Diversified Equity Corp [2]	S D Ind	Jan 24, 1977	Feb 17, 1977
Diversified Mountaineer Corp	S D W Va	Feb 8, 1974	April 24, 1974
Dumont-Airplane & Marine[5]	S D N Y	Oct 22, 1958	Nov 10, 1958
Duplan Corp [2]	S D N Y	Oct 5, 1976	Oct 5, 1976
E T &T Leasing, Inc	D Md	Dec 20, 1974	June 5, 1975
Educational Computer Systems, Inc	D Ariz	April 26, 1972	Nov 3, 1972
Eichler Corp [5]	N D Cal	Oct 11, 1967	Oct 11, 1967
Equitable Mortgage Investment Corp	S D Iowa	July 10, 1975	July 10, 1975
Equitable Plan Co [5]	S D Cal	March 17, 1958	March 24, 1958
Equity Funding Corp of America	C D Cal	April 5, 1973	April 9, 1973
Farrington Manufacturing Co	E D Va	Dec 22, 1970	Jan 14, 1971
First Baptist Church, Inc of Margate, Fla	S D Fla	Sept 10, 1973	Oct 1, 1973
First Home Investment Corp of Kansas, Inc	D Kan	April 24, 1973	April 24, 1973
First Research Corp	S D Fla	March 2, 1970	April 14, 1970
GAC Corp [1]	S D Fla	May 19, 1976	June 14, 1976
GEBCO Investment Corp [2]	W D Pa	Feb 8, 1977	March 24, 1977
Wm Gluckin Co , Ltd	S D N Y	Feb 22, 1973	March 6, 1973
Gro-Plant Industries, Inc [5]	N D Fla	Aug 30, 1972	Sept 13, 1972
Gulfco Investment Corp	W D Okla	March 22, 1974	March 28, 1974
Gulf Union Corp	M D La	Aug 29, 1974	Nov 5, 1974
Harmony Loan, Inc	E D Ky	Jan 31, 1973	Jan 31, 1973
Hawaii Corp [2]	D Hawaii	March 17, 1977	March 17, 1977
Hawkeye Land, Ltd	S D Iowa	Dec 19, 1973	Jan 21, 1974
R Hoe & Co , Inc	S D N Y	July 7, 1969	July 14, 1969
Home-Stake Production Co	N D Okla	Sept 20, 1973	Oct 2, 1973
Houston Educational Foundation, Inc	S D Tex	Feb 16, 1971	March 2, 1971
Human Relations Research Foundation[5]	S D Cal	Jan 31, 1964	Feb 14, 1964
Imperial-American Resources Fund, Inc	D Colo	Feb 25, 1972	March 6, 1972
Imperial '400' National, Inc	D N J	Feb 18, 1966	Feb 23, 1966
Indiana Business & Investment Trust	S D Ind	Oct 10, 1966	Feb 4, 1966
Interstate Stores, Inc	S D N Y	June 13, 1974	June 13, 1974
Investors Associated, Inc [5]	W D Wash	March 3, 1965	March 17, 1965
Investors Funding Corp of New York	S D N Y	Oct 21, 1974	Oct 22, 1974
Jade Oil & Gas Co [5]	C D Cal	June 28, 1967	Aug 16, 1967
J D Jewell, Inc	N D Ga	Oct 20, 1972	Nov 7, 1972

See footnotes at end of table

Table 37

REORGANIZATION PROCEEDINGS UNDER CHAPTER X OF THE BANKRUPTCY ACT IN WHICH THE COMMISSION PARTICIPATED—Continued

Fiscal Year 1977

Debtor	District Court	Petition Filed	SEC Notice of Appearance Filed
King Resources Co	D Colo	Aug 16, 1971	Oct 19, 1971
Kirchofer & Arnold[4]	E D N C	Nov 9, 1959	Nov 12, 1959
Lake Winnebago Development Co, Inc	W D Mo	Oct 14, 1970	Oct 26, 1970
Little Missouri Minerals Assn, Inc [4]	D N D	July 18, 1966	Jan 29, 1968
Los Angeles Land & Investments, Ltd	D Hawaii	Oct 24, 1967	Nov 28, 1967
Louisiana Loan & Thrift, Inc	E D La	Oct 8, 1968	Oct 8, 1968
Lusk Corp	D Ariz	Oct 28, 1965	Nov 15, 1965
Lyntex Corp	S D N Y	April 15, 1974	Jan. 28, 1974
Dolly Madison Industries, Inc	E D Pa	June 23, 1970	July 6, 1970
Magnolia Funds, Inc [4]	E D La	Nov 18, 1968	May 26, 1969
Manufacturer's Credit Corp [5]	D N J	Aug 1, 1967	July 30, 1968
Maryvale Community Hospital[3]	D Ariz	Aug 1, 1963	Sept 11, 1963
Mid-City Baptist Church	E D La	July 30, 1968	Oct 23, 1968
Morehead City Shipbuilding[4]	E D N C	Nov. 9, 1959	Nov. 12, 1959
Mount Everest Corp [5]	E D Pa	May 29, 1974	June 28, 1974
National Telephone Co, Inc	D Conn	July 10, 1975	May 27, 1976
Nevada Industrial Guaranty Co	D Nev	May 7, 1963	July 2, 1963
North American Acceptance Corp	N D Ga	March 5, 1974	March 28, 1974
North Western Mortgage Investors Corp	W D Wash	Dec 12, 1973	Dec. 12, 1973
Omega-Alpha, Inc	N D Tex	Jan 10, 1975	Jan 10, 1975
Pan American Financial Corp	D Hawaii	Oct 2, 1972	Jan 9, 1973
Parkview Gem, Inc	W D Mo	Dec 18, 1973	Dec 28, 1973
Pinehurst Mortgage & Loan Corp [2,4]	M D N C	April 16, 1976	Sept 14, 1976
Pocono Downs, Inc	M D Pa	Aug 20, 1975	Aug 20, 1975
RIC International Industries, Inc [4]	N D Tex	Sept 16, 1970	Sept 23, 1970
John Rich Enterprises, Inc [5]	D Utah	Jan 16, 1970	Feb 6, 1970
Reliance Industries, Inc [1]	D Hawaii	May 24, 1976	Aug 10, 1976
Riker Delaware Corp [5]	D N J	April 21, 1967	May 23, 1967
Royal Inns of America, Inc	S D Cal	April 24, 1975	June 24, 1975
Scranton Corp [5]	M D Pa	April 3, 1959	April 15, 1959
Sequoyah Industries, Inc [4]	W D Okla	Jan 21, 1974	Jan 30, 1974
Edward N Siegler & Co [5]	N D Ohio	May 23, 1966	June 7, 1966
Sierra Trading Corp [5]	D Colo.	July 7, 1970	July 22, 1970
Sound Mortgage Co, Inc [5]	W D Wash	July 27, 1965	Aug 31, 1965
Southern Land Title Corp	E D La	Dec 7, 1966	Dec 31, 1966
Stanndco Developers, Inc	W D N Y	Feb 5, 1974	March 7, 1974
Stirling Homex Corp	W D N Y	July 11, 1972	July 24, 1972
Sunset International Petroleum Corp [5]	N D Tex	May 27, 1970	June 10, 1970
TMT Trailer Ferry, Inc [5]	S D Fla	June 27, 1957	Nov 22, 1957
Texas Independent Coffee Organization[4]	S D Tex	Jan 5, 1965	Jan 13, 1965
Tilco, Inc	D Kans	Feb 7, 1973	Feb 22, 1973
Tower Credit Corp [5]	M D Fla	April 13, 1966	Sept 6, 1966
Traders Compress Co	W D Okla	May 12, 1972	June 6, 1972
Trans-East Air Inc [4]	D Me	Aug 29, 1972	Feb 22, 1973
Trans-International Computer Investment	N D Cal	March 22, 1971	July 26, 1971
Trustors' Corp [5]	C D Cal	Sept 13, 1961	Oct 9, 1961
"U" District Building Corp	W D Wash	Dec 9, 1974	Dec 9, 1974
U S Financial, Inc	S D Cal	Sept 23, 1975	Nov 3, 1975
Viatron Computer Systems Corp	D Mass	April 29, 1971	April 29, 1971
Virgin Island Properties, Inc [5]	D V I	Oct 22, 1971	April 11, 1972
Vinco Corp [5]	E D Mich	March 29, 1963	April 9, 1963
Waltham Industries Corp	C D Cal	July 14, 1971	Aug 19, 1971
Washington Group, Inc [2]	M D N.C	June 20, 1977	July 25, 1977
Webb & Knapp, Inc [5]	S D N Y	May 7, 1965	May 11, 1965
H R Weissberg Corp [5]	N D Ill	March 5, 1968	April 3, 1968
Westec Corp [4]	S D Tex	Sept 26, 1966	Oct 4, 1966
Western Growth Capital Corp.	D Ariz	Feb 10, 1967	May 16, 1968
Western National Investment Corp [5]	D Utah	Jan 4, 1968	March 11, 1968
Westgate-California Corp	S.D Cal	Feb. 26, 1974	March 8, 1974
Wonderbowl, Inc	C D Cal	March 10, 1967	June 7, 1967
Yale Express System, Inc [5]	S D N Y	May 24, 1965	May 28, 1965

[1] Commission filed notices of appearance in transitional quarter, July 1 to Sept 30, 1976
[2] Commission filed notices of appearance in fiscal year 1977
[3] Reorganization proceedings closed during transitional quarter, July 1 to Sept 30, 1976
[4] Reorganization pjroceedings closed during fiscal year 1977
[5] Plan has been substantially consummated but no final decree has been entered because of pending matters

SEC OPERATIONS

Net Cost

Total estimated fees collected by the Commission in fiscal 1977 represented 56 percent of funds appropriated by the Congress for Commission operations. The Commission is required by law to collect fees for (1) registration of securities issued; (2) qualification of trust indentures; (3) registration of exchanges; (4) registration of brokers and dealers who are registered with the Commission but are not members of the NASD; and (5) certification of documents filed with the Commission. In addition, by fee schedule, the Commission imposes fees for certain filings and services such as the filing of annual reports and proxy material.

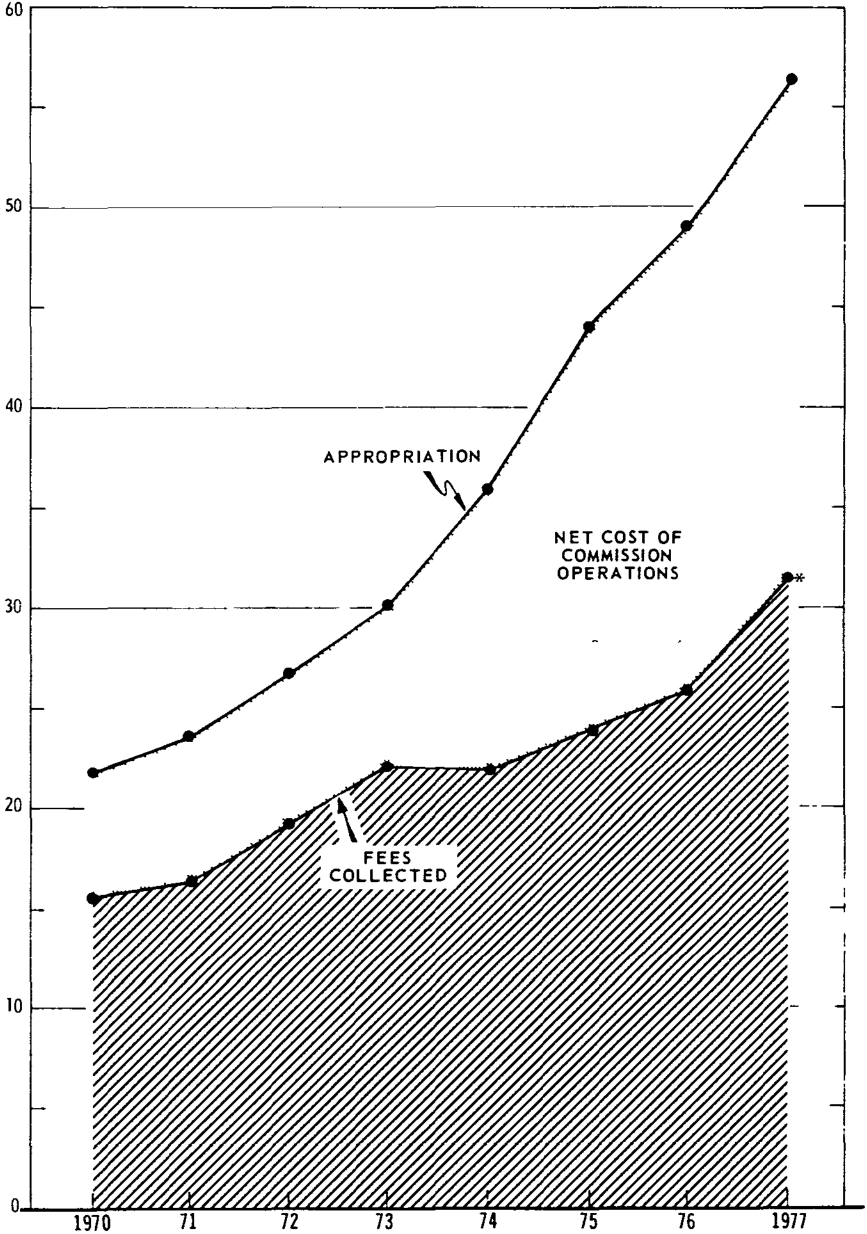

APPROPRIATED FUNDS vs FEES COLLECTED
Dollars Millions
60
50
40
30
20
10
0
APPROPRIATION
NET COST OF COMMISSION OPERATIONS
FEES COLLECTED
1970
71
72
73
74
75
76
1977
*Estimated

Table 38

BUDGET ESTIMSTES AND APPROPRIATION

Action	Fiscal 1973		Fiscal 1974		Fiscal 1975		Fiscal 1976		Transitional Quarter		Fiscal 1977		Fiscal 1978	
	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money	Positions	Money
Estimate submitted to the Office of Management and Budget	1,939	$33,691,000	1,919	$34,027,000	2,219	$43,674,000	2,294	$54,577,000	2,081	$12,500,000	2,400	$54,822,000	2,133	$59,000,000
Action by the Office of Management and Budget	−313	−2,411,000	−283	−3,930,000	−204	−2,817,000	−225	−1,543,000			−283	−3,064,000	−41	−710,000
Amount allowed by the Office of Management and Budget	1,656	29,761,000	1,715	31,210,000	1,994	42,131,000	2,018	47,187,000	2,081	12,500,000	2,117	53,098,000	2,092	58,290,000
Action by the House of Representatives			+204	+2,817,000	+150	+946,000		−302,000		−75,000		−98,000		
Sub-total	1,656	29,761,000	1,919	34,027,000	2,144	43,077,000	2,018	46,885,000	2,081	12,425,000	2,117	53,000,000	2,097	58,290,000
Action by the Senate							+126	+2,000,000		+250,000				
Sub-total	1,656	29,761,000	1,919	34,027,000	2,144	43,077,000	2,144	48,885,000	2,081	12,675,000	2,117	53,000,000	2,092	58,290,000
Action by conferees							−63	−1,000,000						
Annual appropriation	1,656	29,761,000	1,919	34,027,000	2,144	43,077,000	2,081	47,885,000	2,081	12,675,000	2,117	53,000,000	2,092	58,290,000
Supplemental appropriation		532,000		2,200,000		1,350,000		1,406,000		502,000		3,270,000		
Total appropriation	1,656	30,293,000	1,919	36,227,000	2,144	44,427,000	2,081	49,291,000	2,081	13,177,000	2,117	56,270,000		

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