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A REVIEW OF THE SEC'S ENFORCEMENT PROGRAM

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I am very pleased to have this opportunity to meet with you. As you know, I have long been convinced that these conferences contribute immeasurably to our cooperative regulatory efforts and are vital to making our dual system of Federal and State securities regulation more effective. Over the years, the Securities and Exchange Commission has developed a deep feeling of indebtedness for the ready assistance it has received from the State regulatory agencies. It is my firm belief that cooperation between us in the past has produced resolutions to many difficult problems, and I look forward to continued cooperation in the future.

In my talk today, I would like to discuss briefly the SEC's enforcement program which I consider to be one of the Commission's most valuable assets. I have chosen this subject because I believe that it is in the enforcement context that we find one of the best examples of the benefits which can be derived from the cooperative efforts of which I have just spoken.

The Commission's enforcement program, as many of you are probably aware, has been expanding significantly over the past several years. Since 1968, the number of actions -- administrative, civil and criminal -- has jumped by almost 140%. More specifically, for fiscal year 1973, the Commission has instituted 178 administrative proceedings as compared to only 36 in fiscal 1968. In fiscal 1973, 145 injunctions were obtained and 654 defendants were ultimately enjoined as compared to 98 injunctions obtained and 384 defendants enjoined for fiscal 1968. These figures for 1973 are especially impressive in my mind when one takes into account the facts that our cases have greatly increased in complexity and that our expanded enforcement effort has been accomplished with a relatively small increase in staff over the last five years.

Aside from the complexity and the number of our cases, one of the toughest challenges the enforcement program has faced is the fairly recent emergence of investment vehicles unlike the typical securities offered at your local broker's office. I am specifically referring to whiskey warehouse receipts, pyramid promotions, commodities options and other similar investments. I know that many of you in the audience are familiar with these developments because it was the States that first brought most of them to the Commission's attention. Progress in this area has not been easy; we are, however, receiving strong support from several courts for our assertions of the applicability of the Federal securities laws.

In the recent case of SEC v. M. A. Lundy Associates, for example, we obtained an opinion finding that whiskey warehouse receipts are securities. Whiskey warehouse receipts, as most of you probably know, are a method of financing liquor during its aging period. The court, in its decision, adopted a position which we consistently advocate -- that substance and not form should prevail in questions regarding the existence of a security.

In the Rimar Scotch Whiskey case, a second Federal court similarly found investment interests in aging liquor to be securities despite the unusual form of the transactions in issue. This court held that the Securities Act of 1933 covers "any novel, uncommon or irregular device, whatever it appears to be, if it is proved as a matter of fact that it was widely offered or dealt in under terms or courses of dealing which established its character in commerce as an investment contract or as an interest or instrument commonly known as a security."

With regard to pyramid schemes, the Commission has also been making some headway. Within the last few years, several injunctive actions have been

filed against various entities engaged in the sales of these programs, including Holiday Magic, the modern originator of the multi-level pyramid promotion. In 1973, we received a favorable decision from the Court of Appeals in the Ninth Circuit in the Dare to be Great case, upholding a district court decision which ruled that the pyramid plan involved there was a security and was subject to our jurisdiction. We were not as successful in the Koscot case in that we have thus far been unable to obtain the relief we are seeking. That lower court's adverse ruling is, however, being appealed. Holiday Magic, having just been filed within the last few months, is still pending.

We believe these pyramid schemes must be pursued on all fronts as investors' losses from these activities have already exceeded $1 billion. In this connection, you may find of some interest the recent activity in Congress with respect to these multi-level programs. On June 4, 1973, Senator Walter Mondale introduced a bill (S. 1939) which, in essence, would outlaw pyramid promotions. This bill is currently pending before the Senate Committee on Commerce chaired by Senator Warren Magnuson.

Still another unusual investment vehicle, which has become increasingly popular over the last several years, is the commodity option. This type of option is a right to buy or sell a futures contract in commodities at a set price during a specified time. Serious problems have arisen in the context of the way in which some of these options have been offered to the public. Of particular concern has been the so-called "naked" option in which the promoter does not purchase a futures contract to cover the option he has sold. In such situations, we have generally argued that these options purport to be options on commodity

futures in form only. In substance, they are investment contracts within the jurisdiction of the Federal securities laws. The funds committed by investors to such options are subjected to the risks of the seller's business and the pay-out, if any, will depend upon the success of the seller's enterprise. While we were not successful in obtaining preliminary relief in our suit against Goldstein, Samuelson, a firm deeply involved in the sales of naked options, we have been successful in putting a stop to this operation. Mr. Goldstein has been indicted and has pled guilty to three counts of mail fraud.

As evidenced by the three investment mediums I have just discussed, the securities scene is a changing one. This situation challenges us to use our resources more creatively and efficiently. We must be constantly alert to detect and oversee these new developments. In this battle to stay current with new investment techniques, the front line is often manned by the States. Their efforts have been most helpful to us at the Federal level, particularly in the context of the early detection of new elements in the securities field.

I would like to turn now to the more traditional aspects of the securities business and discuss briefly some recent developments in this area in terms of enforcement. A good starting point is the municipal bond industry. As you all know, municipal bonds and municipal bond dealers have enjoyed time-honored exemptions from the registration provisions of the Federal securities laws. Unfortunately, it is becoming increasingly clear that unscrupulous operators in this field have used the exemptive provisions to perpetrate a number of fraudulent practices on the investing public.

The Commission's current program in the municipal bond area began in the fall of 1971 when the broad impact of these emerging problems became

apparent. The Commission authorized a wide-ranging investigation which, during the past 18 months, has resulted in court actions against some 50 defendants, including 10 firms. The practices reflected in these cases were nationwide in scope and our complaints have alleged classic boiler room and bucket shop operations. These illicit practices, however, are not generic to all municipal bond traders. There are many fine institutions involved in this important sector of the securities industry and, accordingly, I cannot be too strong in urging that everyone having an interest should join in seeking legislation which provides for much needed regulation to supplement the existing anti-fraud provisions which are now applicable to participants in the municipal bond industry. We must not permit the dishonest and marginal operators to drive out the reputable municipal bond brokers and dealers.

In this connection, I should add that Congress would appear to have a definite interest in sponsoring legislation to provide tighter regulation of the municipal bond industry. Just last month, Senator Harrison Williams introduced a bill (S. 2474) which would subject the industry to general SEC regulatory oversight. This legislation would affect both municipal bond dealers and the municipal bond departments of commercial banks which are probably the most significant force in this industry.

Another aspect of the securities business which has been particularly troublesome over the past several years has been that of the spin-off distribution, which often involves shell companies. I am pleased to report that our enforcement efforts in this area have yielded significant successes, highlighted by the recent Fourth Circuit Court of Appeals' decision in the Datronics case. There, the court held that a spin-off distribution, effected for the purpose of

creating trading markets in the spun-off stock, must be registered under the Securities Act. Additionally, the court found Exchange Act Rule 10b-5 violations where the defendants disseminated false and misleading information in connection with the spin-offs. Datronics, in conjunction with SEC v. Harwyn Industries Corp., should assist all of us in our efforts to eliminate the illegal spin-off and shell practices which have plagued us for many years. This, of course, is one of the principal areas in which the Commission is indebted to the States for their continuing assistance and encouragement.

Few practices have as devastating an effect upon the integrity of the market place as the misuse of inside information. I would be remiss, therefore, in any review of our enforcement program if I did not mention the progress of the Commission in this area.

Several recent cases of note have been brought relating to the use and misuse of inside information. Of particular importance are our actions involving Lums, Harvey Stores and Bausch & Lomb. In the Lums case, the Commission's complaint alleged that Investors Diversified Services, a major institutional investor, had transmitted and used material inside information concerning Lums' quarterly earnings in connection with the sale of a large block of Lums' stock. Our Harvey Stores case concerned the alleged misuse of inside information by persons who obtained material non-public information relating to the existence of and progress of merger negotiations as a result of their positions as finders and through their friendship with corporate officers. In Bausch & Lomb, the Commission alleged that various securities analysts, investment advisers and brokers sold and recommended sales of Bausch & Lomb stock based on adverse, material inside information concerning the failure to meet sales projections for

a new soft contact lens. The public can be assured that the Commission will continue to exert an all-out effort to curb securities violations emanating from misuse of inside information.

In concluding my discussion of recent enforcement cases involving the more traditional forms of securities, I must not fail to mention the Commission's cases against Equity Funding, IOS Ltd. and Everest Management. Each of these involved massive frauds resulting in large investor losses. Obviously, they were most disturbing to all members of the regulatory agencies responsible for overseeing the securities industry. Unless blatant schemes such as these are stopped cold, confidence in the market place will be seriously undermined.

The IOS and Everest Management cases reflect practices about which I am particularly concerned because they involve large scale breaches of fiduciary obligations by persons who manage the funds and property of others. I consider no conduct more reprehensible than the abuse of such obligations by these managers. We must assure the investment community that vigorous measures are being taken to stamp out these practices. We at the Commission have urged our Enforcement Division to give high priority to such cases involving breaches of fiduciary obligations. I would urge each of you to do likewise.

As illustrated by the preceding discussion, the Commission has been very active in bringing enforcement actions against a variety of kinds of securities law violators and against a variety of types of securities law problems. The filing of such suits is, however, only a part of the SEC's fight to provide better protection for investors. To obtain even broader protection for the investing public, the Commission is continuing its policy of seeking more comprehensive and effective relief in its law suits. Where appropriate, it is

structuring new types of decrees in an effort to be more responsive to the victims, both individual and corporate, of the activites of securities law violators.

In this regard, I should like to call your attention to our actions against International Controls, Clinton Oil and Coastal States. In each of these cases, the Commission obtained, with the consent of the defendants, court-appointed directors to operate the companies. In some of these instances, executive and audit committees were established in an effort to get the companies back on their feet. Thus far, this type of relief, in lieu of receivership, has proven to be effective. It is also interesting to note that this concept has been followed by at least one State regulatory agency -- the Texas Railway Commission. In its action against Lo-Vaca, Inc., a subsidiary of Coastal States, the Texas Commission obtained the designation of an independent board for Lo-Vaca and a special operating officer to run its affairs.

The Commission is also continuing its policy of seeking disgorgement by defendants of the fruits of their violative activities. In this regard, we have sought and obtained court decrees requiring, in various forms, pay-backs of such funds in several of our cases, including Harvey Stores, Butcher & Sherrerd and American Agronomics.

In Harvey Stores, an insider trading case which I mentioned earlier, the court directed the defendants to pay over all profits derived from their unlawful trading, as well as the difference between the market price of Harvey stock on the day the merger information was publicly disclosed and their purchase price if they retained the purchased stock after public disclosure.

Butcher & Sherrerd was an administrative proceeding which focused upon the dissemination by a broker of a change in its investment recommendation concerning the collapsing Penn Central Company. Butcher & Sherrerd had been continuously recommending Penn Central as a buy. It changed the recommendation to sell, but it selectively disseminated information on the change so as to give preferential treatment to the accounts of its partners and certain customers. The Commission accepted an offer of settlement worked out by the staff whereby the respondents, among other things, agreed to establish a $350,000 fund for the benefit of the non-preferred customers.

In American Agronomics, a case in which the Commission alleged the unregistered and fraudulent sales of interests in orange groves, a court-appointed special counsel is in the process of determining whether the interests were suitable investments for the individual purchasers. If he determines the investment was not suitable, the investor will have the option of rescission or an equitable adjustment of his contract.

Still another example of this expansion of our traditional remedies is our experimentation with decrees calling for the adoption and implementation by various defendants in our cases of procedures which, hopefully, will reduce the opportunities for further violative conduct. In the previously mentioned Lums case, for example, IDS consented to a court decree ordering it to implement a policy designed to prevent the misuse of non-public information by any of its personnel. The procedure formulated in the statement of policy requires that all employees who receive material information about a company, which they know or have reason to believe is directly attributable to such company, determine that the information is "public" before utilizing it. The statement sets out a

definition of inside information, creates presumptions on materiality and establishes a system of checks for prevention of the use of material non-public information.

As can be seen from the enforcement actions I have touched on today, the Commission has been relatively successful in confronting a variety of challenges which have surfaced from within the securities industry. I must, however, emphasize again that much of this success would not have been possible without the cooperation received from other regulatory authorities. Accordingly, I would like to conclude my remarks with a brief summary of some of the more significant examples of this much needed cooperation and coordination of enforcement resources.

One of the most productive cooperative efforts undertaken to date has been the SEC-NASD Task Force which was created, in part, because of problems associated with the renewed emergence of "hot issues" in the latter part of 1972. The task force consists of joint teams of Commission and NASD personnel who conduct extensive examinations and investigations of selected broker-dealers to determine whether their activity is in accordance with the Federal securities laws' requirements. These inspections have uncovered a substantial number of serious violations. Where violative activity is uncovered, appropriate enforcement actions have been instituted. I would hope that some thought might be given to expanding the task force concept to include the States and, therefore, I would urge any of you who are interested in participating to contact Stan Sporkin at your earliest convenience.

Another "cooperative" project which has yielded significant returns, and which is of particular interest to me personally, is the SEC's program of

regional enforcement conferences. Since its inception in 1966, this program has been so well received that conferences have now become annual occurrences in each of the Commission's nine regions. The participants include representatives of the stock exchanges, the securities bar, the NASD, the accounting profession, State Securities Commissions and other governmental agencies engaged in enforcing securities laws. Although all of these conferences were initially hosted by the Commission's regional offices, several State agencies are now serving as sponsors.

I would consider these seminars a success if they did no more than introduce the State regulatory staffs to their counterparts within the Commission. But the record shows that much more has been accomplished. Among the many valuable by-products have been the comprehensive exchange of views and information concerning current enforcement problems and methods of cooperation and the establishment of programs for joint investigation.

The fight against organized crime and its movement into legitimate business has provided another prime area in which cooperation and coordination among regulatory agencies have been particularly necessary and fruitful. As I am sure most of you are aware, investigations into organized crime have their own special set of problems which are superimposed upon the normal difficulties of bringing clever and resourceful securities law violators to justice. Frequently, we must cope with "fronts" and foreign bank secrecy laws through which organized crime attempts to conceal its activities. Witnesses, otherwise cooperative, tend to become reluctant because of threats of or fear of physical harm. Books, records and other documentary evidence essential for successful prosecution may be destroyed or non-existent.

At the request of the Attorney General, we have set up in our Division of Enforcement a group of professionals whose primary function is to deal with organized crime activities which involve the Federal securities laws. This unit has worked closely with the Justice Department and the Internal Revenue Service. It has also maintained a liaison with the "organized crime strike forces" which are an amalgamation of personnel from various law enforcement agencies. Thus far, in actions involving persons allegedly associated with organized crime, our enforcement efforts have generated injunctive actions filed against 525 persons and produced 167 indictments and 63 convictions.

A final area in which cooperative enforcement is becoming a necessity -- but which has not yet really been developed in the context of securities law violations -- is the international scene. The IOS case points up rather dramatically the significance which must be attributed to the internationalization of the securities markets and to the emergence of the international promoter. Unfortunately, regulation of this activity is virtually non-existent. Progress is, however, being made. The IOS-Vesco case provides a good example. When we tackled that massive case, we quickly learned that the SEC could not do it alone and we sent out an urgent plea for international assistance. The response we received was excellent and exceeded our expectations. I must single out for particular commendation Robert Demers of the Quebec Securities Commission, Ted Royce, Harry Bray and Bryan Johnston of the Ontario Securities Commission, Fred Sparling of Canada's Federal Government and, from Luxembourg, Albert Dondelinger, Chairman of their Banking Commission.

The Commission has recently embarked on a program with these gentlemen to amass the assets of the far-flung IOS empire and to distribute them to their

rightful owners throughout the world. This is a unique experience in international securities regulation and one which we at the Commission are backing to the fullest possible extent. We hope that the knowledge we obtain from this endeavor will assist in forming a blueprint for establishing a more permanent structure for the future handling of international securities matters.

In closing, let me say again how pleased I am to be here with my former colleagues. This is my fourteenth consecutive meeting with you and I appreciate your inviting me to participate in your deliberations. I purposely have focused on our enforcement program because I have always had a firm commitment to its continued vitality and want to enlist your efforts in making this program even more responsive to the public's needs. A great deal has been accomplished; more must be done. I would encourage you, therefore, to develop further lines of communication and cooperation with our staff. Such efforts, I know, will be mutually rewarding.