ANNUAL REPORT
of the
SECURITIES AND EXCHANGE COMMISSION
for the fiscal year ended
June 30, 1975

SECURITIES AND EXCHANGE COMMISSION

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

COMMISSIONERS

RODERICK M. HILLS, Chairman
PHILIP A. LOOMIS, JR.
JOHN R. EVANS
A. A. SOMMER, JR. [Commissioner Sommer resigned from the Commission, effective April 2, 1976.]
IRVING M. POLLACK

GEORGE A. FITZSIMMONS, Secretary

LETTER OF TRANSMITTAL

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

Sirs: On behalf of the Securities and Exchange Commission, I have the honor to transmit to you the Forty-First Annual Report of the Commission covering the fiscal year July 1,1974 to June 30, 1975, in accordance with the provisions of Section 23(b) of the Securities Exchange Act of 1934, as amended; Section 23 of the Public Utility Holding Company Act of 1935; Section 46(a) of the Investment Company Act of 1940; Section 216 of the Investment Advisers Act of 1940; Section 3 of the Act of June 29, 1949 amending the Bretton Woods Agreement Act; Section 11(b) of the Inter-American Development Bank Act; and Section 11(b) of the Asian Development Bank Act.

Respectfully,

RODERICK M. HILLS
Chairman

THE PRESIDENT OF THE SENATE
THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D.C.

COMMISSIONERS AND PRINCIPAL STAFF OFFICERS

COMMISSIONERS

RODERICK M. HILLS of Calif., Chairman – Term expires June 5, 1977
PHILIP A. LOOMIS, JR., of Calif. – Term expires June 5, 1979
JOHN R. EVANS, of Utah – Term expires June 5, 1978
A. A. SOMMER, JR., of Ohio – Term expires June 5, 1976
IRVING M. POLLACK of New York– Term expires June 5, 1980

Secretary: GEORGE A. FITZSIMMONS

Executive Assistant to the Chairman: DAVID R. BOYD ROBERT H. CRAFT JR. RALPH C. FERRARA

PRINCIPAL STAFF OFFICERS

PETER H. SHIPMAN, Executive Director

RICHARD H. ROWE, Director, Division of Corporation Finance
NEAL S. McCOY, Associate Director
WILLIAM C. WOOD, Associate Director
MARY E.T. BEACH, Associate Director

STANLEY SPORKIN, Director, Division of Enforcement
IRWIN M. BOROWSKI, Associate Director
WALLACE L. TIMMENY, Associate Director

THEODORE SONDE, Associate Director

LEE A. PICKARD, Director, Division of Market Regulation
SHELDON RAPPAPORT, Associate Director
FRANCIS R. SNODGRASS, Associate Director
DANIEL J. PILIERO, II, Associate Director
ANDREW M. KLEIN, Associate Director

ANNE P. JONES, Director, Division of Investment Management Regulation
SYDNEY H. MENDELSOHN, Associate Director
JEAN W. GLEASON, 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

S. JAMES ROSENFELD, Director, Office of Public Information

CHILES T. A. LARSON, Assistant Director

JOHN C. BURTON, Chief Accountant
A. CLARENCE SAMPSON, Associate Chief Accountant

J. RICHARD ZECHER, Director of Economic and Policy Research

GENE L. FINN, Chief Economist, Office of Economic Research

BERNARD WEXLER, Director, Office of Opinions and Review
WILLIAM S. STERN, Associate Director
HERBERT V. EFRON, Associate Director

WARREN E. BLAIR, Chief Administrative Law Judge

FRANK J. DONATY, Comptroller

RICHARD J. KANYAN, Service Officer

ALBERT FONTES, Director, Office of Personnel

JAMES C. FOSTER, Director, Office of Reports and Information Services
FRANKLIN E. STULTZ, Associate Director

RALPH L. BELL, 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. – Floyd H. Gilbert, 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 1708, Everett McKinley Dirksen Bldg., 219 S. Dearborn St., Chicago, Illinois 60604.

Region 5. Oklahoma, Arkansas, Texas, part of Louisiana, Kansas (except Kansas City). – Robert F. Watson, 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, Room 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 44199. – Room 899 Federal Office Bldg., 1240 E. 9th at Lakeside.

Detroit, Michigan 48226. – 1044 Federal Bldg.

Houston, Texas 77002. – Room 5615, Federal Office & Courts Bldg., 515 Rusk Ave.

Miami, Florida 33131. – Suite 701 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. – Room 6004, Federal Reserve Bank Bldg., 120 South State St.

San Francisco, California 94102. – 450 Golden Gate Ave., Box 36042.

COMMISSIONERS

RODERICK M. HILLS, Chairman

Chairman Hills was born on March 9, 1931, in Seattle, Washington. In 1952 he received his BA degree from Stanford University and he received his LL.B. in 1955 also from Stanford. In law school he was named to the Order of the Coif. During the period 1955-1957, Mr. Hills served as law clerk to Mr. Justice Stanley F. Reed, Supreme Court of the U.S., and during 1969-1970 he was a visiting Professor at the Harvard Law School. Mr. Hills was a founding partner of the law firm of Munger, Tolles, Hills and Rickershauser, Los Angeles, California. Between 1971 and 1975 he was on leave from the firm to serve as Chairman of the Board of Republic Corporation. From April 1, 1975, until being named Chairman, Mr. Hills served as Counsel to the President of the United States. Mr. Hills was co-chairman of the Domestic Council Task Force on Regulatory Reform for the President. Mr. Hills was sworn in as Chairman of the Securities and Exchange Commission on October 28, 1975, for a term expiring on June 5, 1977.

PHILIP A. LOOMIS, JR.

Commissioner Loomis 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, except for the period from 1942 to 1944, when he served as an attorney with the Office of Price Administration, and the period from 1944 to 1946, when he was Associate Counsel to Northrop Aircraft, Inc. 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, the American Law Institute, the Federal Bar Association, the State Bar of California, and the Los Angeles Bar Association. 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 a member of the Professional Staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs, serving as minority staff director. He took office as a member of the Securities and Exchange Commission on March 3, 1973, for the term expiring June 5, 1978.

A. A. SOMMER, JR.

Commissioner Sommer was born in Portsmouth, Ohio on April 7, 1924. He received his B.A. degree from the University of Notre Dame in 1948 and his LL.B. degree from Harvard Law School in 1950. At the time he was appointed to the Commission, he was a partner in the Cleveland law firm of Calfee, Halter, Calfee, Griswold & Sommer. Mr. Sommer was formerly Chairman of the American Bar Association's Federal Regulation of Securities Committee and a member of the Committee on Corporate Laws and Committee on Stock Certificates. He was also a member of the Board of Governors of the National

Association of Securities Dealers, a lecturer on securities law at Case-Western Reserve Law School and a lecturer at various institutes and programs dealing with securities law, corporation law and accounting matters. Commissioner Sommer was formerly a member and Past-Chairman of the Corporation Law Committee of the Ohio State Bar Association. He has authored articles dealing with corporate reorganization, conglomerate disclosure and other securities and accounting topics. He took office as a member of the Securities and Exchange Commission on August 6, 1973, for the term of office expiring June 5, 1976.

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.

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PART 1
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MARKET REGULATION

During the past year, the Commission undertook several actions of far-reaching importance to the securities industry, the securities markets and the investing public. At the same time, the Congress passed

legislation enhancing and clarifying the Commission's authority over the securities markets and the securities industry.

Perhaps the most significant action taken by the Commission was its adoption of Securities Exchange Act Rule 19b-3 on January 23, 1975. That rule required the elimination of fixed commission rates on exchange transactions as of May 1, 1975 – ending a practice which had existed for over 175 years on the nation's securities exchanges. The decision to adopt Rule 19b-3 came after nearly a decade of study by the Commission, the Congress and many others. In adopting Rule 19b-3, the Commission became the first federal regulatory agency to substitute competitive pricing for a previously sanctioned system of price fixing within an industry.

Among other things, the system of fixed commission rates was seen as hindering progress toward the implementation of a national market system. The Commission has continued its efforts toward the development of such a system, including progress toward the introduction of a consolidated tape for reporting securities transactions and a composite quotation system.

The Commission and the Congress have been acting together to take all necessary and appropriate steps to assure that securities transactions are effected fairly and efficiently at the best available price, that competition is enhanced within the securities industry, and that information with respect to quotations and transactions be made more fully available to brokers, dealers and investors. Much of the Commission's work over the past year has been directed toward the realization of those goals.

The Securities Acts Amendments of 1975

The Securities Acts Amendments of 1975[1], enacted June 4, 1975, significantly revise and expand the Securities Exchange Act of 1934. Among other things, the Commission is directed to facilitate the establishment of a national market system for securities and a nationwide system for the clearance and settlement of securities transactions, clarify and strengthen the Commission's oversight role

with respect to self-regulatory organizations, and provide for broad regulation of brokers, dealers, and banks trading in municipal securities. The 1975 Amendments further contain new provisions relating to fixed commission rates, trading on national securities exchanges, the payment for research services with brokerage commissions, and registration and regulation of brokers and dealers.[2]

The National Market System. The Commission is directed to facilitate the establishment of a national market system for securities in accordance with the findings and objectives stated in Section 11A(a)(1). The heart of the national market system will be communication systems that disseminate last sale and quotation information for securities qualified for trading in the national market system. These communication systems, which will link all markets for qualified securities, are to be designed to foster efficiency, enhance competition, increase the information available to brokers, dealers and investors, facilitate the offsetting of investors' orders and contribute to best execution of such orders. To achieve those objectives, the Commission is granted jurisdiction over persons who, by direct or indirect use of the mails or any other instrumentality of interstate commerce/' are engaged in the various stages of collecting, processing, distributing or publishing, on a current and continuing basis, information about transactions in or quotations for any security (other than an exempted security). Those persons, who are termed securities information processors, and their activities are subject to registration and regulation by the Commission. The Commission also may prescribe rules and regulations relating to securities processing activities by self-regulatory organizations, members thereof, brokers or dealers which utilize any means of interstate commerce.

Certain new provisions require the elimination of restrictive rules and practices which either prevent brokers from obtaining the best price for their customers or hinder market-making activities within the national market system. Such provisions as Sections 6(b), 11A(c), 15A(b), 19(b), 19(c), 19(e), and 23(a) seek to prevent any unnecessary or inappropriate regulatory burden on competition and to balance the anti-competitive implications of any action by any self-regulatory organization or by the Commission with the purposes and

considerations of the Exchange Act. Furthermore, the 1975 Amendments expand the Commission's authority to regulate market makers, specialists, and other dealers (including the authority to prohibit a firm from acting both as a dealer and as a broker in a security) to promote fair competition among such persons and equal protection of all markets for qualified securities and of all exchange members, brokers and dealers.

The Commission is directed to review any and all rules of national securities exchanges which limit or condition the ability of members to effect transactions in securities otherwise than on such exchanges and to report its conclusions to Congress. Institution of proceedings is required where any such rule imposes a burden upon competition not necessary or appropriate in furtherance of the Exchange Act.

The 1975 Amendments also contain certain powers which may be exercised with respect to trading in listed securities in the over-the-counter markets. Additionally, the national securities exchanges are permitted to commence trading in securities not otherwise listed by the issuer on such exchanges after Commission review and approval.

Section 11A(d) requires the establishment of a National Market Advisory Board. It is to advise the Commission on what steps are appropriate to facilitate establishment of a national market system and on significant regulatory proposals made by the Commission or any self-regulatory organization. It is also directed to study the possible need for a new self-regulatory body, the National Market Regulatory Board, which would administer the national market system, and to report its conclusions to Congress.

Regulation of Clearing Agencies and Transfer Agents. The 1975 Amendments (Section 17A) establish a system of regulation extending to all facets of the securities handling process, designed to promote prompt and accurate clearance and settlement of securities transactions. Clearing agencies must register with and report to the Commission, which will review the rules of such clearing agencies to determine whether they comply with the statute's objectives. The primary enforcement and inspection responsibilities over clearing

agencies that are banks is assigned to whichever bank regulatory agency is the appropriate regulatory agency. Rulemaking authority concerning the safeguarding of funds and securities by bank clearing agencies is shared by the Commission and the appropriate bank regulatory agency.[4]

The Securities Exchange Act is further amended to require transfer agents, other than banks, to register with the Commission. Bank transfer agents must register with the appropriate bank regulatory agency. The Commission is granted broad rulemaking power over all the aspects of a transfer agent's activities. Nevertheless, as with clearing agencies, where a transfer agent is a bank, inspection and enforcement responsibilities are vested in the appropriate bank regulatory agency and rulemaking authority concerning the safeguarding of funds and securities by bank transfer agents is shared by the Commission and the appropriate bank regulatory agency.

Section 17A(e) requires the Commission to eliminate the physical movement of securities certificates during the settlement process. In addition, the Commission is directed, in Section 12(m), to study the practice of registering securities in “street name,” i.e., in a name other than that of the beneficial owner, and to report to Congress its conclusions.

Municipal Securities. New Section 15B initiates a comprehensive pattern for the registration and regulation of brokers, dealers and banks that buy, sell, or effect transactions in municipal securities as part of their regular business in other than a fiduciary capacity. Issuers of municipal securities continue to be exempt from the registration provisions of the federal securities acts.

A Municipal Securities Rulemaking Board is created to prescribe rules regulating the activities of brokers, dealers and municipal securities dealers relating to transactions in municipal securities. Its scope of authority and responsibility is defined in terms of enumerated purposes and standards. Section 15B(b)(2)(K), for example, sets forth the requirement that the Board establish the terms and conditions under which any municipal securities dealer may sell any part of a new issue

of municipal securities to a municipal securities investment portfolio during the underwriting period. The Commission is required to take affirmative action on rules proposed by the Board and is authorized to abrogate, add to, or delete from any Board rule. The Commission may directly regulate fraudulent, manipulative, and deceptive acts and practices pursuant to Sections 10(b) and 15(c) of the Exchange Act.

The Board will be comprised of representatives of broker-dealers, banks and the public, including issuers of and investors in municipal securities. (Sec. 15B(b)(1).) The procedures to be followed in the nomination and election of members of the Board are designed to assure fair administration of the Board and fair representation of all segments of the municipal securities industry (Sec. 15B(b)(2)(B). The Board is authorized to hire appropriate staff and to assess municipal securities dealers to cover reasonable expenses (Sees. 15B(b)(2)-(I) and (J).

The Board's rulemaking powers are extensive (Sec. 15B(b)(2)(A)-(K).) The purposes for which the Board can exercise its rulemaking authority include: prevention of fraudulent and manipulative acts and practices; promotion of just and equitable principles of trade; establishment of standards for entry into the municipal securities business; regulation of selling and underwriting practices; procedures for arbitration of intra-industry disputes; and determination of the frequency and scope of inspections of municipal securities dealers by the bank regulatory authorities with respect to banks and the NASD with respect to securities firms.

The Board does not have any power to conduct inspections or to enforce its rules. Instead, the Securities Exchange Act assigns these responsibilities to the NASD for securities firms which are members of the NASD (Sees. 15A(b)(7) and 15B(c)(7). Similarly, such responsibilities are assigned to the bank regulatory agencies for municipal securities dealers which are banks (Sees. 15B(c)(5) and 17(b).

As of June 30, 1975, the Commission had taken initial steps to implement the statutory goals of Section 15B. On June 12, 1975, the

Commission announced the solicitation of recommendations of individuals for appointment to the Municipal Securities Rulemaking Board.[5] The Commission plans to continue to work toward the creation of a registration process for securities firms and banks engaged in the municipal securities industry as well as the establishment of cooperative efforts with appropriate bank regulatory agencies.

Brokers and dealers that buy, sell, or effect transactions in municipal securities and banks that buy and sell such securities as a part of a regular business other than in a fiduciary capacity are required to register with the Commission (Sec. 15B(a)(1). If a bank engages in the business of trading municipal securities through a separately identifiable department or division, that department or division rather than the entire bank can register with the Commission (Secs. 3(a)(30) and 15B(b)(2)(11). Brokers and dealers already registered with the Commission by reason of their general securities business are not required to re-register. No person is permitted to engage in the business of trading in municipal securities unless registered with the Commission and the Commission has the authority, in accordance with specified procedures, to revoke the registration of any person found to be in violation of the Securities Exchange Act, or any rule of the Commission or the Board (Sec. 15B(c)(2).)

Commission Rates. The 1975 Amendments prohibit the imposition of any schedule or fixing of rates of commissions, allowances, discounts, or other fees by a national securities exchange to be charged by its members for effecting exchange transactions. A temporary exemption postpones such prohibition for odd-lot dealers or for a member acting as broker on the floor of a national securities exchange for another member. The Commission may permit a national securities exchange to impose reasonable fixed commissions (1) prior to November 1, 1976, if such fixed rates are found to be in the public interest, and (2) after November 1, 1976, if the Commission institutes a proceeding and makes certain determinations, as set forth in Section 6(e). Additional provisions, such as Section 6(f) and Section HA(c), grant authority to the Commission to remedy problems affecting the orderliness of trading on exchanges.

The elimination of fixed rates raised questions for investment managers who may be required to pay a broker for related research services. To protect an investment manager against a claim of breach of fiduciary obligation if he paid more than the lowest available price for execution and research services, Section 28(e) permits him to pay a commission for executing a transaction above the lowest available price if he determines in good faith that it was reasonable considering the value of the brokerage and research services provided. The legislative history of that provision makes it clear that Section 28(e) applies only to payments made by a money manager to a member of a national securities exchange, broker, or dealer for services rendered by that particular member, broker or dealer, and that it has no application whatsoever to a situation in which payment is made by an investment manager to one broker or dealer for services rendered by another broker or dealer.[6]

Brokers and Dealers. A significant amendment to Section 11(a) of the Exchange Act prohibits, with certain exceptions, any member of a national securities exchange from effecting any transaction on such exchange for its own account, the account of an associated person, or an account over which it or an associated person thereof exercises investment discretion. For members of a national securities exchange as of May 1, 1975, the proscriptions do not apply until May 1, 1978. The Commission is authorized to regulate transactions executed off an exchange or otherwise not prohibited.

The 1975 Amendments expand the scope of the Commission's authority under Section 15(a) to include the registration and regulation of brokers and dealers who trade exclusively on a national securities exchange. With respect to new registrations of all brokers and dealers, the Commission is required within 45 days either to issue an order granting such registration or institute a proceeding to determine whether registration should be denied. Among other sections amended, Section 15(b) authorizes the Commission to adopt uniform standards for persons engaged in the securities industry.

Accounts and Records. Section 17 of the Exchange Act has been expanded to provide for record-keeping and reporting requirements of

the various new regulated entities and that certified financial statements of brokers and dealers be filed with the Commission and sent to their customers. Section 17(e)(2) permits the adoption of rules prescribing the form and content of financial statements filed pursuant to the Exchange Act and the accounting principles and standards employed in their preparation. Section 17(f) requires, in part, (1) the implementation of a system of reporting information about missing, lost, counterfeit, or stolen securities and (2) the fingerprinting of the partners, directors, officers, and employees of every member of a national securities exchange, broker, dealer, registered transfer agent, and registered clearing agency.

Commission Rates

As noted above, the Commission, before passage of the 1975 Amendments, adopted Rule 19b-3,[7] eliminating fixed commissions on exchange transactions as of May 1, 1975. The Commission made a preliminary announcement on August 27, 1974,[8] of its plan to eliminate fixed commission rates. In September the Commission formally requested each national securities exchange to effect necessary changes in its constitution, rules and practices so as to eliminate those elements which required exchange members to charge any person any fixed rate of commission.[9] Only one national securities exchange indicated that it would comply with the Commission's request; other national securities exchanges indicated that they would not comply voluntarily with the Commission's request. Consequently, the Commission proposed Rules 19b-3 and 10b-22 under the Exchange Act for comment and held hearings to receive views, data and arguments from interested persons on both the proposed rules and the proposed effective date of May 1, 1975.

As a result of the hearings, the Commission adopted Rule 19b-3 with modifications from the form first published for comment. Specifically, the required elimination of “floor brokerage” rates was delayed until May 1, 1976. The Commission determined not to adopt proposed Rule 10b-22, which related to agreements among exchange members for the setting of brokerage rates. The Commission's administrative action

has been legislatively affirmed in Section 6(e) of the 1975 Amendments.

After careful consideration of all the arguments advanced in the hearings on Rule 19b-3, of the numerous studies made concerning commission rates, and of the recent experience of both the Commission and the securities industry with fixed rates, the Commission set forth as its basic reason for the adoption of Rule 19b-3 the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which would better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the public interest than any system of price fixing which can reasonably be devised.[10]

In March 1975, the Commission announced a program to monitor the impact of its decision to eliminate fixed rates of commission.[11] The program is designed to determine what effect the absence of any schedule or fixed rates of commissions may have on the public interest, protection of investors, and maintenance of fair and orderly markets. The program, as announced, included publication for comment of a proposed rule under the Exchange Act requiring certain broker-dealers to file with the Commission revenue and expense data and related financial and other information and notification of changes in membership interests in national securities exchanges.

The monitoring program has been analyzing a sampling of firms to develop information on effective commission rates being paid by individual and institutional customers to different types of broker-dealer firms; reviewing volume reports from national securities exchanges and third market firms to determine the distribution of trading among the various market places; compiling additional information about revenue sources and expenses of national securities exchanges and registered national securities associations; and studying the income, expenses, assets and liabilities of specialists and the activity of certain stocks.

On May 2, 1975, the Commission announced the adoption of Rule 17a-20 and related Form X-17A-20, the approval of two plans submitted pursuant to paragraph(a)(3) of Rule 17a-20, and the implementation of other aspects of the program to monitor the impact of the elimination of fixed commission rates on exchange transactions.[12]

For the months of May and June, New York Stock Exchange (NYSE) broker-dealers incurred a revenue loss from commission rate discounts of approximately $42 million. This revenue loss was approximately 7.6 percent of total securities commission revenue and 4 percent of total revenue during this period. Individual customers paid slightly more on small size orders and slightly less on large orders. The net effect in June was a decline averaging 1.5 to 2 percent in the commission rate charged on all individual orders. Institutional customers, on the other hand, received discounts in all order size categories and received an average discount of 19.5 percent in the month of June. The experience with competitive rates for non-NYSE firms during the May and June period was similar to that of NYSE member firms.

Based upon the preliminary and incomplete evidence of two months' experience (May-June, 1975) with competitive rates during a period of rising trading volume, historical trading patterns among exchanges and over-the-counter markets appear not to have altered. Similarly, the financial condition of self-regulatory organizations does not appear to have been materially affected.

Development of the National Market System

Advisory Committee on the Implementation of a Central Market System. As described in last year's Annual Report,[13] the Commission established an Advisory Committee on the Implementation of a Central Market System to assist it in connection with its proposals for a central market system and to ensure that such a system would meet the needs of the nation's capital markets in the future, consistent with the public interest and the protection of investors.

Specifically, the Committee was asked to study and to submit recommendations to the Commission on such matters as:

a. The appropriate structure for regulatory supervision of the central market system;

b. The nature and scope of the Commission's role during the process of implementing the central market system;

c. The ways in which a central market system should be structured in order effectively to meet the needs of our capital markets, the public interest, the protection of investors and the maintenance of fair and orderly markets for securities;

d. The needs and perspectives of users of a central market system, including issuers of and investors in securities, as well as securities professionals; and

e. The appropriate resolution of fundamental policy issues relating to the central market system's operations. The Committee, composed of twelve persons, eight of whom are from the securities industry, was assisted by members of the Commission's staff. The staff attempted to identify for the Committee a number of unresolved issues which the

Committee might consider, including

(1) the registration requirements and capital standards appropriate for market-makers granted access to the system; (2) the responsibilities of market-makers when acting as agents in the system; and (3) the responsibilities of market-makers acting as dealers in the system.

Certain structural questions were also raised: Whether limit orders for public customers should be held in a consolidated limit order book and, if so, who should be permitted access to the book; whether specialists or market-makers should be prohibited from dealing directly with public customers; and how the role of transactions between customers would be effected without the use of brokers or specialists in the central market system. In addition, the staff suggested that the

Committee consider rules on auction trading and priorities for public customers' orders in the new central market system.

In a preliminary statement issued December 11, 1974,[14] the Committee noted that its suggestions would be made without regard to whether it was feasible to utilize existing technology to implement its suggestions and that although not unanimous its preliminary views did reflect the sense of the Committee as a whole. Particular emphasis was placed on auction-market principles in a central market system, which were considered the most effective means of encouraging competition among buyers and sellers. The preliminary statement of the Committee set forth specific conclusions with respect to specialists' net capital, market continuity and public preference obligations, outlined the manner in which limit orders entered with specialists should be treated, and described possible trading limitations to be imposed on specialists. Stressing the importance of preserving the dealer function of brokers, the Committee recognized the importance of the role played by over-the-counter dealers in the markets and the necessity of providing an adequate opportunity and incentive for their continued participation in a central market system.

On July 15, 1975, the Committee submitted to the Commission, in preliminary form, a Summary Report of its final conclusions. The Summary Report re-emphasized that the views enunciated were not unanimous or endorsed by all members without reservation.

The Summary Report defined the objectives of the central market system as follows:

a. To provide all investors with the maximum opportunity to buy and sell securities at the best possible price;

b. To provide the depth and liquidity necessary to facilitate the raising of capital by issuers; and

c. To provide a mechanism for the consummation of transactions at a reasonable cost.

To accomplish these objectives, the Summary Report envisioned that the central market system must include all transactions in securities listed on exchanges and permit access to all specialists, qualified market-makers and qualified broker-dealers.

The Committee emphasized that auction-market principles, including preference for all public orders, would be essential to the central market system. The system's rules, according to the Summary Report, should provide that all orders entered for the account of persons other than brokers or dealers would have preference over orders entered by professionals. Among system professionals, however, the orders of specialists and market-makers would be permitted to displace orders of other broker-dealers dealing for their own account.

An important role was recommended for specialists on the various stock exchanges. The Committee also recommended that the system permit participation of all market-makers, including those now dealing in the third market (i.e., over-the-counter trading in securities listed on exchanges). The report spelled out in some detail responsibilities of specialists and market-makers entering quotations in the system, including their minimum net capital. The Summary Report indicated that there should be trading and competition among specialists and market-makers dealing in the same securities.

The Summary Report stated that both specialists and market-makers should be required to maintain continuous, fair and orderly markets in those securities in which they are registered to deal. The Committee, however, drew an important distinction between the two: specialists would be assigned to deal in particular securities, so that at least one specialist would be responsible for maintaining a market in every listed security; registered market-makers would be permitted to select the securities in which they dealt. Market-makers would also be permitted to deal with all types of customers, while specialists would be prohibited from dealing directly with institutional customers and with insiders, officers and directors of the issuers of the securities in which they made markets.

This restriction on specialists' dealings was seen to be directly related to their role as agents for the limit orders of public customers. The Committee envisioned that limit orders would be guaranteed exposure to all transactions in system securities only if they were placed with specialists. Although market-makers would be permitted to hold and execute limit orders, they would guarantee exposure of such orders to all system transactions only by using a specialist. The Summary Report recognized “best execution” as the primary duty of brokers in the system, detailing certain aspects of that duty in the context of an operational central market system. The Summary Report also indicated that the system should maximize the opportunities for brokers to execute orders for their customers without a specialist or other qualified market-maker participating in the transaction.

A central self-regulatory authority, with the responsibility and authority to impose rules and regulations on all specialists, market-makers and broker-dealers trading in listed securities was deemed important by the Committee. Early in its consideration, the Committee had recommended that such a body be established as soon as possible, in view of the operation of the consolidated tape, the dissemination of quotations in listed securities and the unfixing of commission rates. Subsequently, however, the Committee recognized that creation of such a board would be inappropriate so long as the National Market Advisory Board, called for by the Securities Acts Amendments of 1975, was assigned responsibility to study the governance of the central market system. Therefore, it urged that the Board and the Commission monitor the events taking place toward the development of a central market system to insure the existence of an appropriate regulatory framework.

The Committee believed the most efficient and effective structure for governing the central market system would be provided by the merger of presently existing exchanges dealing in securities to be included in the system. The Committee pointed out, however, that while a true central market system involves some form of centralized control, a merger of the exchanges would not be a prerequisite.

The Committee concluded its summary report with a series of recommendations for Commission action. Included were recommendations, made early in the Committee's deliberations, for imposition of rules dealing with short-selling and minimum capital requirements for specialists and market-makers. The Commission has already taken action on these matters. In addition, the Committee recommended that all specialists and market-makers be required to maintain *bona fide*, continuous and competitive two-sided quotations for each security in which they make a market and that such quotations bear a reasonable relationship to the last sale in those securities.

The Committee recognized as particularly important its recommendation that the New York Stock Exchange and the American Stock Exchange be permitted to retain their present rules causing members to bring all trades in securities on those exchanges to the respective trading floors. The Committee recognized that such rules pertaining to specific market centers will be inappropriate in the central market system but concluded that they should not be eliminated until such time as a similar rule can be imposed for the system as a whole. A system-wide rule was thought to be appropriate when a composite quotation system was in operation, facilitating members' efforts to achieve best execution, and when a consolidated limit order book was established, making possible the execution of public orders in all market places.

The Commission expects to receive a final report, with dissenting views, from the Committee in the fall of 1975. It is anticipated that the work of the Committee will constitute a beginning point for deliberations by the new National Market System Advisory Board called for by the Securities Acts Amendments of 1975.[15]

Consolidated Tape

As previously reported,[16] a plan for the consolidated reporting of price and volume data, filed jointly by the American, Midwest, Pacific, PBW and New York Stock Exchanges and the National Association of Securities Dealers, Inc. (“NASD”), was declared effective by the

Commission as of May 17, 1974.[17] The joint industry plan (the "Plan") provided for a tape consisting of two separate ticker "networks," displayed concurrently. Network A would report transactions in stocks listed on the New York Stock Exchange ("NYSE") and Network B, transactions in stocks listed on the American Stock Exchange ("Amex") and certain stocks listed only on the participating regional exchanges. Both networks would report all trades in their respective stocks, regardless of whether they took place on an exchange or in the so-called "third market." In addition, Information disseminated over Networks A and B would also be available through interrogation devices, enabling investors and market professionals to obtain the most recent last sale price for any stock covered by the system regardless of the market of execution. The system was designed to be compatible with equipment presently found in most brokerage offices.

The Plan contemplated that the consolidated tape would be put into operation in two phases beginning within 20 weeks after Commission approval of the Plan. The pilot phrase was to be a 20-week period of experimental operation covering a limited number of stocks, after which full operation of the consolidated tape would begin, by reporting and disseminating last sale data of eligible securities to be included in Networks A and B by means of a high-speed line. This would permit reception of reported information on a current basis, regardless of any delay in the dissemination of the information over Networks A and B caused by the servicing of interrogation devices.

Actual implementation of the consolidated tape lagged behind the 40-week time period contemplated by the Plan, principally because the original estimate was overly optimistic and failed to anticipate the technical problems inherent in the development of the new computer system that was required. Also, both the sponsors and the Commission believed that certain regulatory problems should be addressed before the implementation of the consolidated tape.

Phase I of the consolidated tape system was originally scheduled to commence on October 4, 1974. It was deferred for a two-week period by the Commission, in response to a request by the NYSE, to permit resolution of certain mechanical problems the NYSE believed would

have arisen as a result of the Commission's amendments to its short sale rules – Securities Exchange Act Rules 3b-3, 10a-1, and 10a-2.[18] The amendments to the short sale rules had the effect of prohibiting short sales of a security listed on an exchange at a price below the last prior sale (a “minus tick”), or at the last sale price if the proceeding different sale price had been at a higher price (a “zero minus tick”), as reported on the consolidated system. The amendments applied the Commission's short sale regulation, for the first time, in a uniform manner to all markets in which transactions in listed securities occurred, and were part of the Commission's efforts to resolve certain regulatory problems before the implementation of the consolidated tape. But after reviewing the problems created by the uniform short sale rule, the Commission determined to suspend the operation of the amendments, and the pilot phase of the consolidated system began operation as rescheduled on October 18, 1974.

Although full operation of the consolidated tape system was originally scheduled for February 21, 1975, it became obvious to all the Plan participants by mid-January that the February 21 deadline could not be met. On February 19, 1975, the Consolidated Tape Association (“CTA”), the governing body for the consolidated system, informed the Commission that, because of testing delays and recent problems with the Market Data System of the NYSE, the CTA expected to be able to implement only certain elements on or before June 16, 1975.[19] Specifically, it expected that on or before June 16, 1975: (1) last sale data regarding transactions in all eligible securities required to be included in Network A of the consolidated system would be reported in accordance with the Plan by all Plan participants (other than the Amex) and by four other “reporting parties” (i.e., the Boston Stock Exchange, the Cincinnati Stock Exchange, the Detroit Stock Exchange, and the Institutional Network Corporation (“Instinet”)) to the Securities Industry Automation Corporation (“SIAC”), the Plan processor, and (2) such last reports would be transmitted by SIAC to vendors of market information on a low-speed basis. The CTA's letter indicated that maximum effort was being expended on making Network A operational as soon as possible, and that SIAC was continuing to program for the requirements of Network B and the high-speed line.

On March 3, 1975, after indicating that it would not object to the delay, the Commission stated that it was disappointed by the delay but that it understood that certain of the reasons for the delay were beyond ,the control of the CTA. The Commission also stated that the staff would be making inquiry of the CTA as to the reasons for the delay and the future plans of the CTA with respect to the full implementation of the Plan. The CTA response of March 26, 1975, to staff inquiries regarding the delay, which detailed descriptions of the reasons for testing delays, was released by the Commission on May 1, 1975.[20] The Commission issued an interpretative release specifying the requirements regarding displays on interrogation systems,[21] which helped resolve questions concerning application of Rule 17a-15 to vendors and problems cited by the CTA in its March 26 letter.[22]

Between February and June 1975, the Plan participants conducted an extensive test program to insure the accuracy, reliability and integrity of programming for Network A. Personnel from the various exchanges, SIAC and the vendors subjected the system to a broad range of simulated market conditions. All the tests proved successful, and the CTA was able to fully implement Network A reporting on a low-speed basis on June 16, 1975. The CTA is currently continuing work on the remaining elements of the consolidated system – Network B and the high-speed line. A final date, however, has not yet been set for full implementation of all elements of the consolidated system. Implementation of Network A of the consolidated tape, while not constituting full implementation of the Plan, is a major step toward the eventual achievement of a central market system. Transactions executed in markets other than on the floor of the NYSE are now appearing on moving tickers for the first time. Such transactions are indicated on the tape by an ampersand following the symbol for the NYSE-listed stock. The ampersand, in turn, is followed by a letter that identifies the specific market place.

Those letters are: M for Midwest; P for Pacific; X for PBW; C for Cincinnati; T for NASD (i.e., the third market); and O for Instinet. The Boston Stock Exchange – identified by the letter B – was added to the consolidated tape on July 14, 1975, and the Detroit Stock Exchange –

identified by the letter D – is expected to be added to the system sometime in late summer or early fall, 1975.

The inclusion of NYSE, regional and third market transactions on a single consolidated tape, even on the limited scale currently in place, enables investors to make more informed judgments regarding which market centers offer the most advantageous price at a particular time. Even though the information presented on the consolidated tape is essentially historical information, i.e., prices at which transactions were effected in the past rather than prices at which future transactions may be effected, such information should be useful to investors in indicating general trends and temporary price disparities between market centers.

In addition to its benefits to investors, the consolidated tape represents a significant technological achievement in the processing of securities information. The consolidated tape is not just a mechanical merger of existing ticker networks but a completely new computer system tying together all the nation's market centers. Sophisticated and complex programs had to be developed to insure that the different equipment and programs of various exchanges and the NASD could be accommodated, and, perhaps more important, to insure that all last sale reports would be reported on the consolidated tape in the proper sequence. All the complex programming changes were accomplished successfully, and the CTA and the Commission are presently looking forward to implementation of the high-speed line, which for the first time will provide investors with last sale reports on a current basis, even in the event of delays in ticker dissemination due to mechanical limitations.

Composite Quotation System

When the Commission issued its first proposed rule on composite transaction reporting in March 1972, it also proposed a companion rule – Securities Exchange Act Rule 17a-14 – governing the development of a composite quotation system.[23] Rule 17a-14, as originally proposed, would have required all national securities exchanges to make quotations of their registered specialists

available on a current and continuing basis to vendors of market information. Similarly, the NASD would have been required to make available to such vendors on a current and continuing basis quotations of market makers with respect to over-the-counter quotations in securities listed or traded on exchanges.

On August 14, 1974, the Commission released for public comment a substantial revision to proposed Rule 17a-14[24] as a result of the many comments which had been received, the recommendations of the Commission's Advisory Committee on Market Disclosure regarding a composite quotation system, and the Commission's experience with implementation of a consolidated transaction reporting system under Rule 17a-15.

The major change in Rule 17a-14 from the original proposal was that the revised rule required the reporting of quotations pursuant to a plan similar to that required by Rule 17a-15. Accordingly, Rule 17a-14, as revised, would have required every national securities exchange and the NASD to report to the Commission quotations of their market makers or specialists in listed securities. The quotations were to be available on a real-time, current and continuing basis.

The Commission received many public comments with respect to its August 1974 proposal. After considering all of the public comments, the Commission determined to adopt a new approach designed to increase the availability of quotation information without potentially burdensome federal regulation. On March 11, 1975, the Commission announced that it had requested all national securities exchanges to effect changes in their rules and practices to be effective on or before May 1, 1975, to eliminate those which restricted, or had the effect of restricting, access to or use of quotation information disseminated by such exchanges to any quotation vendor.[25] At the same time, the Commission announced that it was deferring further consideration of proposed Rule 17a-14 until it had had an opportunity to observe the effects of eliminating restrictions on quotation dissemination.

In announcing its new approach, the Commission reiterated its view that quotation information, such as that currently provided by some exchanges to their members, is essential to broker-dealers, whether members or not, in discharging their duty of reasonable diligence in the execution of customers' orders.[26] By requesting the elimination of exchange restrictions on quotation dissemination, the Commission intended that as a result of competitive forces a composite quotation system would develop with a minimum of federal regulation^

On May 7, 1975, the Commission announced that it had received responses (to its March 11, 1975 request) from all national securities exchanges and that all exchanges either had taken the action requested by the Commission or had informed the Commission that they did not have any rules or practices which restricted access to, or use of, such information.[27] In making its announcement, the Commission added that, in its view, the actions taken by the various exchanges would facilitate the establishment of a central market system, as contemplated by the Market Structure Statement[28] and the Policy Statement,[29] by making possible the composite display of quotation information for multiply traded securities.

Short Sale Regulation

On March 6, 1974, the Commission proposed amendments to Securities Exchange Act Rules 3b-3, 10a-1 and 10a-2 in order to establish uniform short sale rules, which were considered to be a necessary element of the consolidated reporting system.[30] After analyzing the comments received on the proposed amendments and concluding that no serious objections had been raised, the Commission announced their adoption to be effective October 4, 1974 (the “October Amendments”).[31] In a letter to the Commission, dated October 11, 1974, the New York Stock Exchange asserted that the October Amendments would create insurmountable technical, operational and regulatory problems.

In view of the problems noted by the NYSE, the Commission temporarily suspended the effectiveness of the October Amendments to Rules 10a-1 and 10a-2.[32] The effect of that suspension was to leave

the regulation of short sales on exchange markets as it had existed before adoption of the October Amendments, while the Commission continued to study the most efficient, effective and fair manner to achieve uniform short sale regulation in a central market system.

On March 5, 1975, the Commission published for comment additional proposed amendments to Rule 10a-1, (the “March Proposals”).[33] The Commission noted that many persons believed that short selling should not be regulated at all, except to the extent it is used as a manipulative device.[34] Consideration of such arguments, however, had been hampered by a lack of current statistical studies of the pattern of short selling in today's markets, particularly on regional securities exchanges and in the third market. In any event, the Commission thought it would be premature to consider elimination of short sale regulation (altogether or for any class of short sellers) before additional progress was made toward the establishment of a central market system. Nevertheless, the Commission specifically encouraged comments on the feasibility and probable effects of exempting from regulation short sales by persons other than brokers and dealers, or of eliminating short sale regulation entirely.

The Commission acknowledged in the announcement of the March Proposals that use of the proposed rules in the consolidated system might pose certain operational problems for those exchange markets which regularly experienced a high volume in reported securities but had not yet modernized their facilities so that access to information reported in a consolidated system was not immediately available on the floor of the exchange. For that reason, the March Proposals provided, as an alternative to the Commission's general rule, that any national securities exchange, by rule, might prohibit short sales of reported securities in its own market (i) below the last sale price on that exchange, or (ii) at the last sale price, unless that price was above the next preceding different sale price. The March Proposals also provided that short sales of reported securities effected on any exchange having such a rule would have to comply with that exchange's rule and that such compliance would constitute compliance with paragraph (a) of Rule 10a-1, as amended.

Network A of the consolidated system commenced operation on June 16, 1975. In order to ensure comparable short sale regulation of all transactions in reported securities in alt markets reporting transactions to that system, the Commission announced on June 12, 1975, the adoption of amendments to Rules 10a-1 and 10a-2 (effective June 16, 1975), which were identical, in all material respects, to the March Proposals.[35]

Paragraph(a) of Rule 10a-1 will not apply to short sales of any reported security until last sale information on that security is made available to vendors of market information on a real-time basis. When such information becomes available on a real-time basis, paragraph(a) of Rule 10a-1 will govern short sales in all markets (including transactions effected on national securities exchanges and in the over-the-counter market). Additionally, national securities exchanges will have an option either to adopt their own short sale rules, subject to the Commission's power under Section 19 of the Securities Exchange Act, or be governed by paragraph(b) of Rule 10a-1, the traditional form of the rule, which applies only to short sales effected on national securities exchanges.

Option Market Regulation

By the end of fiscal year 1975, the Chicago Board Options Exchange, Inc. (“CBOE”), whose option plan were approved by the Commission in the preceding fiscal year, had 1,025 members and listed call options on 67 stocks.[36] The average daily volume of options traded on CBOE reached approximately 53,000 contracts, representing 5,300,000 shares of the underlying stocks.[37]

During the past fiscal year, the Commission declared effective option plans of two other exchanges, the American Stock Exchange (Amex) and the PBW Stock Exchange, Inc. (“PBW”). The Commission declared the Amex option plan effective in December 1974,[38] and that exchange began trading call options on January 7, 1975. By the end of the fiscal year, the Amex listed options on 40 stocks, and had an average daily volume of 17,016 contracts, representing 1,701,600 shares of underlying stock.

In May 1975, the Commission declared PBW's option plan effective and that exchange began trading options on June 27, 1975.[39]

In addition to the three exchanges with effective option plans, the Pacific Stock Exchange ("Pacific") announced its intention to initiate options trading and held several discussions with the Commission's staff regarding its preliminary work on a plan for such a program.

During the fiscal year, the CBOE, with Commission approval, made numerous changes in its option plan under Rule 9b-1. For example, in response to Commission and CBOE concern about emerging trading patterns in options where the exercise price had fallen substantially below the market price, the CBOE restricted opening transactions in such options.[40] At the same time, the CBOE prohibited market makers from quoting spreads in such options greater than ¼ of $1.[41] It also adopted provisions to facilitate more orderly openings of trading and to eliminate market-makers' ability to gain priority over public orders. The CBOE also strengthened its net capital and margin rules.

The Amex option plan, like that of the CBOE, calls for trading in options on stocks with a substantial number of shares outstanding, widely held and actively traded. Members of the Amex, at the time its option plans were declared effective, automatically obtained option trading privileges on that exchange. In general, the Amex applied contract standardization methods substantially identical to those used by the CBOE – that is, options were made fungible by limiting the contract variables such as expiration months and the exercise, or "striking", prices.

The Amex options generally are traded in a manner very similar to that for other securities traded on that exchange. A major difference between the Amex's program and the CBOE's is that the Amex uses, with certain modifications, a single specialist both to make a market and to handle agency limit orders in its options, while the CBOE splits the specialists functions between a market-maker (dealer) and a board broker, performing the agency function.[42] One modification Amex made in its floor trading procedure is that its registered floor traders

who trade options are required to trade in a way that assists the specialist in maintaining a fair and orderly market in options, and may be called upon by either a floor official or floor broker to make competitive quotations in the market.

The PBW's program is similar to that of Amex and CBOE in such areas as the characteristics of underlying stocks for its options, clearing principles, and contract term standardization for its options. Like the Amex, the PBW utilizes its existing specialists for market making in its options and requires its registered floor traders to assist the specialists. PBW's plan, however, involves for the first time options traded on the same exchange as the one on which the underlying securities are traded. Because of this distinctive characteristic, the PBW has separated its option floor from the rest of its trading floor to prevent visual and direct auditory communication between the two trading areas. The PBW also prohibits its floor members who have learned of certain large transactions about to be executed in an option or an underlying security of an option class traded on the PBW from initiating orders in the same option until two minutes after the transaction has been printed on the transaction tape.[43] These measures were designed primarily to bar possible misuse in PBW's option market of information obtained by floor members relating to activity in an underlying stock or in a block of options before the information has been publicly disseminated.

As previously reported,[44] on the basis of conclusions reached following the Commission's hearings in early 1974 on multiple-exchange options trading and options trading in general, the staff had suggested subject matters to be addressed by all exchanges concerned before the initiation of multiple-exchange options trading or the expansion of the CBOE (which was the only exchange then trading options). One such recommendation called for a common national clearing system. In declaring the Amex option plan effective, which authorized the initiation of multiple-exchange option trading, the Commission noted and approved the joint establishment by the Amex and the CBOE of the Options Clearing Corporation (“OCC”) to implement a national clearing system for all exchange-listed options.[45] All exchange-traded options were thereafter issued, guaranteed and registered by the OCC

in compliance with federal securities laws. Moreover, the OCC currently clears and settles all option transactions effected in exchange traded options, now also including those on the PBW, and it will perform the same functions for those exchanges which may later initiate options programs and become participants in OCC.

Another recommended prerequisite to multiple-exchange trading of options was the achievement of a common tape for reporting transactions in all listed options. In response, the exchanges concerned set up a policy-making body, the Options Price Reporting Authority ("OPRA"), to coordinate the establishment and ongoing administration of a separate common options tape on the floor of exchanges trading options and after a trial period, if economical, to offer access to the tape to subscribers. OPRA also administers dissemination of last sales data concerning options from the participating exchanges to vendors of automated interrogation devices.[46] Furthermore, in response to Commission staff recommendations, all the participating exchanges have agreed to make option quotations available through the vendors to qualified non-members as well as to their own members and have reached general agreement regarding standardization of terms of exchange-traded options. These actions have all been approved by the Commission.[47]

Uniform Net Capital Rule

On June 26, 1975,[48] the Commission announced the adoption of a uniform net capital rule, Securities Exchange Act Rule 15c3-1, effective September 1, 1975, subject to transitional provisions which delay the effective date of certain provisions until January 1, 1976. The adoption of the rule followed consideration of comments received in response to a release in which the proposed rule had been re-published for comment.[49]

The new rule discontinues the exemption previously embodied in the net capital rule for members of designated national securities exchanges (other than certain specialists), required to comply with net capital rules of such exchanges. In order to ease the transition to a uniform net capital rule, the Commission incorporated provisions from

superseded capital rules of national securities exchanges. These include the concepts of secured demand note capital and a modified flow-through of capital from subsidiaries.

The rule, as adopted, continues the basic net capital concept under which the securities industry has operated for many years and, in addition, introduces an alternative concept to measure the capital adequacy of broker-dealers. The approaches to capital adequacy and financial responsibility embodied in the rule are designed to balance the need for flexible and efficient use of the financial resources of the securities industry.

Development of a Uniform Broker-Dealer Reporting System

Recognizing the need to eliminate duplicative and otherwise unnecessary reporting and regulatory requirements for broker-dealers, the Commission has been working on the development of a uniform reporting and regulatory system to achieve that goal. The Commission began its study of the problem in September of 1972, when it created an Advisory Committee on Broker-Dealer Reports and Registration Requirements to review the existing reporting and regulatory requirements of the brokerage industry and to identify those requirements that were unnecessary, duplicative or unduly burdensome.

After a Commission Staff Task Force reviewed the recommendations of the Advisory Committee, the Commission issued a release in January 1974 announcing a program to implement virtually all the proposals contained in the Advisory Committee's Report.[50]

The Commission's program, as announced by the January 1974 release, included the following measures:

Key Regulatory Report. The Commission undertook to devise a key regulatory report, a uniform reporting form unifying and simplifying the reporting requirements. The Commission anticipated that the report would be the foundation of the reporting system and would incorporate the concept of layering, whereby greater increments of detail are

required as the scope and complexity of a broker-dealer's operations increase.

Proposed Rule 17a-18. In order to formulate methods of simplifying the reporting requirements and to develop the key regulatory report, the Commission thought it essential to have in its possession and subject to its review all reports, forms, questionnaires and similar reporting documents required of broker-dealers. The self-regulatory organizations agreed to supply all reports, forms and questionnaires then in use, many of which had already been supplied to the Commission. In order to provide a formal structure for the submission of new forms, reports and questionnaires or substantive modifications of existing ones thereafter proposed, the Commission published proposed Rule 17a-18. Proposed Rule 17a-18 would require every national securities exchange and every registered national securities association to file with the Commission each proposed new form, report, questionnaire, or similar document or any substantive amendment to or substantive modification of an existing form which it requires of its members or any class of members, whether on a regular, one-time, or “for-cause” basis.

Rule 17a-19. The Commission has proposed Securities Exchange Act Rule 17a-19 and related Form X-17A-19 in order to eliminate duplicative examination of and reporting by broker-dealers about their financial responsibility and related recordkeeping where they change their membership status thereby affecting the relationship with their designated examining authority or any other self-regulatory organization. The proposed rule would require each national securities exchange and each registered national securities association promptly upon the happening of certain changes in the membership status of any of its members or upon learning that such changes would occur to file Form X-17A-19 with the Commission and the Securities Investor Protection Corporation (“SIPC”).

Formation of the Report Coordinating Group. The Commission intended to submit the filings received pursuant to Rule 17a-18, if adopted, and other forms and reports to a Report Coordinating Group organized under the Federal Advisory Committee Act.[51] The Report

Coordinating Group, formed in May 1974,[52] divided their responsibilities into four work areas: uniform financial/operational forms, uniform trading forms, uniform assessment forms and uniform registration forms. The function of this Group was to review such forms, reports and questionnaires, and to provide expert advice to the Commission on such matters as uniformity of definitions and reporting formats, the extent of the anticipated administrative burden to be caused by any new form, and such other matters as might be appropriate to a program designed to streamline, unify and improve the quality of the reporting system. The Group was to advise the Commission as to areas where unnecessary or duplicative reports could appropriately be eliminated. In addition, the Group was to advise the Commission on the development of a uniform state, federal, and industry form for the registration of broker-dealers and a uniform registration form for principals and agents. The Group was also to be asked at a later date to assist in development of the proposed key regulatory report.

In August 1974, the Commission announced its approval of a preliminary outline of a Financial and Operational Combined Uniform Single Report (FOCUS Report) and issued it for public comment. It also announced the adoption of Rule 17a-18, Rule 17a-19 and Form X-17A-19.[53]

The Group issued for public comment a Discussion Paper in October 1974, containing the principles and an outline of the contents of a FOCUS Report.[54] In December, the Group presented to the Commission its Interim Report, containing several interim recommendations from each of the four working subcommittees.[55] Public comments were received on the December Report and were reviewed by the Group. The Group's First Annual Report to the Commission in June, 1975[56] was issued for public comment.[57] Several recommendations of the Group, set forth in its First Annual Report, were summarized in the June 1975 release as follows:

Financial and Operational Reports. The Report made specific recommendations for the adoption of a FOCUS Report of financial and operational information.

Assessment Forms and Procedures. In the area of assessment forms, the Group recommended, among other things, that each regulatory organization study the possibility of eliminating assessment forms based on net commission revenue and consider collecting assessments based on data captured at the source through the clearing mechanism of each respective exchange. An Assessments Form Task Force has been created.

Registration Forms. The Group's recommendation that Form U-3, the uniform broker-dealer registration form, and Form U-4, the uniform agent registration form, be adopted has been largely implemented. Forty-five states, the Commission, and the NASD have adopted the recommended uniform broker-dealer registration form; and forty-eight states, the Commission, all registered national securities exchanges, the NASD, and certain commodity exchanges have adopted the recommended uniform agent registration form.

Trading Forms. The Group has ascertained that there are 104 existing trading forms which could be reduced to 29 such forms.

The Commission believes that significant progress has been made in developing a uniform, efficient, streamlined and thorough reporting system.

Broker-Dealer Model Compliance Guide

In October 1972 the Commission established the Broker-Dealer Model Compliance Program Advisory Committee to advise the Commission concerning the development of a model compliance program to serve as an industry guide for the broker-dealer community.[58]

The Committee completed the first draft of its report in the form of a Guide to Broker-Dealer Compliance in January 1974. Approximately 2,500 copies of the draft were distributed to the public and comments were solicited. The Committee reviewed all comments received, considered the recommendations contained therein and completed the final revised draft in October 1974.

The Committee submitted the final draft of the Guide to the Commission in November 1974.[59] The Commission distributed over 1,400 copies of this draft for the purpose of soliciting public comment. The Committee's charter expired on December 31, 1974.

In its recommendations to the Commission, the Committee emphasized the benefits of the industry-regulator dialogue which took place in the development of the Guide. The Committee supported and urged the continuation and expansion of its cooperative efforts in order to provide the industry with a better understanding of the Commission's views and the Commission with a better understanding of the industry's problems. The Committee also stressed the need for the Guide to be updated on a fairly frequent basis in order for it to retain its usefulness. To that end, the Committee recommended that the Commission appoint a standing committee which would be responsible for regular and periodic updating of the Guide.[60]

In response to the Commission's directive that the aim of the Committee's recommendations should be “to educate broker-dealers as to existing requirements and how they may comply with them,” the Guide has been designed to inform management and supervisory personnel in the securities industry of applicable regulatory requirements, to identify special compliance problems, and to suggest procedures for achieving compliance.

The public comments, on balance, concluded that the Guide fulfills its general purpose. Favorable comments have also been received from members of the Congress. In other submissions, one accounting firm and two law firms wrote to express their opinion that the Guide is an extremely useful tool for the brokerage community.

DISCLOSURE RELATED MATTERS

Beneficial Ownership and Tender Offers

On September 9, 1974, the Commission announced that it had ordered public hearings to ascertain facts, conditions, practices and other matters relating to beneficial ownership, takeovers and acquisitions by foreign and domestic persons in light of the statutory purposes underlying the Securities Act and the Exchange Act, particularly certain amendments to the Exchange Act which were enacted in 1968 and 1970 ("the Williams Act"). The purpose of the inquiry was to develop a factual basis for determining whether it was necessary or appropriate in the public interest or for the protection of investors to adopt or amend rules or to recommend further legislation to the Congress with respect to these areas.

The Division of Corporation Finance conducted the month-long hearings during which testimony was received from 49 witnesses, including representatives from the securities industry, the academic community, the legal profession and publicly held corporations. In addition, letters of comment from approximately 75 interested persons were received and made part of the public record.

The following specific topics, among others, were examined during the course of the proceeding: scope of the term "beneficial owner" for purposes of the reporting and disclosure requirements of the Securities Act and the Exchange Act (except for purposes of Section 16 of the Exchange Act); scope of the terms "tender offer" "group" and "acquisition" for purposes of Sections 13(d) and 14(d) of the Exchange Act; adequacy of the disclosure requirements of Schedules 13D and 14D; necessity for disclosure requirements when issuers make tender offers for their own securities, including when issuers attempt to "go private"; adequacy of the publication, notice and dissemination requirements with respect to tender offers; necessity for rules facilitating communications between issuers and the beneficial owners of their securities; and the necessity for additional legislation relating to any of the above.

As a result of this proceeding, the staff of the Division of Corporation Finance is currently preparing rule and form changes which will be published for comment.

Annual Reports to Security Holders

Based in part on the Industrial Issuers Advisory Report,[62] 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 Forms 10-K or 12-K.[63] The Commission received 165 letters of comment from interested persons regarding these proposals.

On October 31, 1974, the Commission amended Rules 14a-3 and 14c-3 under the Securities Exchange Act of 1934[64] 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 or 12-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 or 12-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.

Projections

On April 28, 1975 the Commission published for comment a series of rule and form proposals intended to implement the “Statement by the Commission on the Disclosure of Projections of Future Economic Peformance”.[65] The proposals would require the filing of Form 8-K to disclose changes in control of a registrant and certain projections within 10 days of such events.[66] The proposed rules would define a “projection” under both Acts to be a statement made by an issuer regarding material future revenues, sales, net income or earnings per share of such issuer, expressed as a specific amount, range of amounts or percentage variation from a specific amount, or a confirmation by an issuer of any such statement made by another person. Proposed rules would require a filing of a report on Form 8-K within 10 days of the time a registrant has furnished a projection to any person, with certain exceptions including private financing, preliminary negotiations with underwriters, business combinations and government agencies which have afforded non-public treatment to the projections. A report on Form 8-K would also be required when the registrant has reason to believe its public projections no longer have a reasonable basis, or the registrant has ceased disclosing or revising projections. A report on Form 8-K could also be filed, at the registrant's option, if the registrant disassociated itself from another person's projections. However, the registrant would not be required by any of the proposals to disassociate itself from a projection made by another person.

Proposed amendments to Form 10-K under the Exchange Act and Forms S-1, S-7, S-8, S-9 and S-14 under the Securities Act would require the registrant to furnish in the report or registration statement those projections previously filed or required to be filed with the Commission covering the year-end results for the registrant's last fiscal year, together with comparisons with corresponding historical results.

The registration statements would also include any projections for the registrant's current fiscal year and/or future periods if they had been filed or were required to have been filed. Any registrant that had made projections for its last or current fiscal year or for any future period, which were filed or were required to be filed, would be required to include in its annual report on Form 10-K projections for at least the first six months of the current fiscal year, or for the full fiscal year, or to explain why it had determined to cease disclosing projections. The proposals would permit a registrant to commence disclosing projections in the annual report or registration statement only if (1) the registrant had a history of filing under the Exchange Act and budgeting experience for at least three years, and (2) the projections and related disclosures met certain standards.

To alleviate the concerns of registrants over the possible liability for disclosing projections, proposals under both Acts would define the criteria under which a projection shall be deemed not to be an untrue or misleading statement of a material fact or a manipulative, deceptive or fraudulent device, contrivance, act or practice as those terms are used in the various liability provisions of the federal securities laws. In general, these proposed rules would establish certain criteria for the issuer of securities to which the projection pertains and to the projection itself. The issuer criteria relate to reporting and budgeting experience and the projection criteria relate generally to its preparation, form and manner of disclosure, and possible review by persons other than officers, directors or employees of the issuer.

Proposed amendments to Rules 14a-3 and 14c-3 under the Exchange Act would require that all projection information, other than exhibits, contained in the registrant's report on Form 10-K be included in the registrant's annual report to security holders. Finally, a proposed amendment to the note to Rule 14a-9 under the Exchange Act would delete the word “earnings” from paragraph(a) of the note which presently refers to predictions of earnings as possibly misleading in certain situations.

The Rule 140 Series

In the Commission's 1969 Disclosure Policy Study[67] a number of recommendations were made to improve the overall disclosure process and promote objectivity in the operation, administration and enforcement of certain provisions of the Securities Act. The principal recommendations of the Study are embodied in a series of Commission rules known as the “Rule 140 Series”, comprised of Rules 144, 145, 146 and 147, adopted pursuant to the Securities Act. Rules 144 and 145 were adopted in 1972 and 1973, respectively;[68] and Rules 146 and 147 were adopted in 1974.[69]

Rule 144

Rule 144, “Persons Deemed Not to be Engaged in a Distribution and Therefore Not Underwriters,” provides a method of resale of securities acquired in private placements and for securities held by affiliates. During the fiscal year, the Commission's staff has monitored the application of the rule. Also, an amendment to Rule 144 was adopted to specify that securities sold pursuant to new Rule 240 would be deemed to be “restricted securities” for the purpose of Rule 144 and could, therefore, be resold pursuant to its provisions.[70] Rule 240 provides exemptions from registration of securities involving certain limited offers and sales by closely held issuers.

Rule 145

Rule 145, generally, provides that an “offer” or “sale” of securities Is deemed to be Involved when there is submitted for the vote or consent of security holders a plan or agreement for(1) reclassifications other than stock splits and changes in par value; (2) mergers, consolidations and similar plans of acquisition except where the sole purpose of such a transaction is to change an issuer's domicile; and (3) certain transfers of assets for securities where there is a subsequent distribution of such securities to those voting on the transfer of assets. On July 2, 1974, the Commission published a second interpretive release regarding the registration procedures applicable to open-end investment companies issuing securities in business combination transactions subject to Rule134.[71]

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.[72]

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 interpretative 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 June 1975, the Commission amended Rule 146 to clarify, and in some instances to modify, paragraph (c) of the rule, “Limitations on Manner of Offering;” paragraph (e) of the rule, “Access to or Furnishing of Information” for non-reporting companies; paragraph (f) of the rule, “Business Combinations,” and paragraph (g) of the rule, “Number of Purchasers.” The purpose of the amendments is to decrease burdens on issuers in complying with the rule, consistent with Section 4(2) of the Act and the protection of investors.

Rule 147

Section 3(a)(11) of the Securities Act, the intrastate offering exemption, which exempts from registration securities that are part of an issue offered and sold only to persons resident in a specific state by an issuer that is also resident and doing business in that state, has been widely relied upon, but has also been the source of inquiry, misunderstanding, and uncertainty over the years. On January 7, 1974, the Commission adopted Rule 147 under the Securities Act which defines certain terms in, and clarifies certain conditions

of, the intrastate offering exemption.[73] The rule provides some objective standards for determining when a person is considered a resident within a state and whether an issuer is “doing business within” a state for purposes of the exemption. The rule does not define which offers and sales constitute “part of an issue” but relies instead on the traditional understanding of when offers and sales will be integrated; it does, however, provide a “safe harbor” as to certain offers and sales. The rule benefits only issuers. Since the adoption of Rule 147, the staff of the Commission has ceased responding to requests for no-action letters under Section 3(a)(11) except in the most compelling circumstances; but the staff does provide interpretative guidance as to the use of the Rule.

Adoption of Rule 240

On January 24, 1975, the Commission adopted Rule 240 (and related Form 240), “Exemption of Certain Limited Offers and Sales by Closely Held Issuers,” which exempts from registration under the Securities

Act limited offers and sales of small dollar amounts of securities by an issuer, that, after the transactions pursuant to the rule, would continue to have a small number of beneficial owners of its securities.[74] The rule was adopted pursuant to Section 3(b) of the Act. The Rule is not available for resales.

In general, the rule exempts transactions by an issuer (other than an investment company) where (a) there is no general advertising or solicitation; (b) no commission or similar remuneration is paid for soliciting prospective buyers or in connection with the sales; (c) the aggregate sales price of unregistered securities of the issuer sold by the issuer is not more than $100,000 in the preceding twelve months; (d) the securities of the issuer are beneficially owned, before and after the transaction, by 100 or fewer persons; and (e) the issuer informs the purchasers of restrictions on resale. In addition, the issuer is required to file a notice of sales on Form 240. However, the exemption provided by the rule would be available for up to $100,000 of securities sold in transactions complying with all the conditions of the rule other than the notice requirement. In connection with the rule, the Commission adopted an amendment to Rule 144 that makes that rule available for securities acquired in a Rule 240 transaction.

Disclosure of Oil and Gas Reserves

On May 30, 1975, the Commission published for comment proposed amendments to Forms S-1 and S-7 under the Securities Act and to Forms 10 and 10-K under the Exchange Act to require the disclosure of oil and gas reserves and to provide definitions and classifications of the term “reserves.”[75] In general, these proposals would make explicit the disclosures with respect to oil and gas reserves already required under Forms S-1, S-7 and 10 and, for the first time, require such disclosures to be made on an annual basis in a report on Form 10-K. In connection with the proposed amendment to Form 10-K, Guide 2 under the Exchange Act which relates to disclosure of natural gas reserves would also be amended to make it applicable to reserves disclosed in a report on Form 10-K. The staff is now considering the comments received on these proposals.

Coordination with the Federal Power Commission on Filings Which Include Natural Gas Reserve Estimates

In early 1974, the Commission announced that it will request registrants to explain differences between natural gas reserve estimates contained in filings with this Commission and estimates reported to any other regulatory authority within one year prior to the filing. In addition, copies of prospectuses filed by registrants subject to the Federal Power Commission would be submitted to that agency for comments and, generally, appropriate technical personnel from the FPC would be invited to attend conferences where supplemental natural gas reserve information submitted by a registrant is reviewed.[76]

The Commission refined the above procedures in announcing new steps to be taken for coordination by the Division of Corporation Finance with the FPC in connection with the review of filings which include natural gas reserve estimates. The Commission stated that the Division had been authorized to provide copies of letters of comments on filings, which include natural gas reserve estimates, and any written responses and communications in connection therewith to the FPC, with the understanding that they will remain non-public unless the Commission determines otherwise.[77]

Gold Purchasing and Investing

On December 31, 1974, the restrictions on the purchase, sale and ownership of gold by American citizens imposed in 1933 by the Federal government were lifted. In response thereto, the Commission took two steps designed to guide the activities of both purchasers and sellers of gold and gold-related securities in this new investment area. First, because investment in and the purchase of gold is a potentially fertile area for unscrupulous promoters and fraudulent schemes, the Commission together with the President's Special Assistant for Consumer Affairs, the Department of Justice, the Federal Trade Commission and the U.S. Postal Inspection Service suggested certain guidelines to be followed in purchasing or investing in gold.[78] These guidelines stressed caution in purchasing gold and care in selection of seller, and advised potential investors of the information they should

seek concerning the program through which the gold was being offered in order to assure themselves of all facts necessary to make a reasoned investment decision.

Secondly, the Commission announced the adoption by the Division of Corporation Finance of a no-action position with respect to the applicability of the registration provisions of the Securities Act of 1933 to gold investment programs meeting certain criteria.[79]

It was indicated that the Division would take a no-action position where (1) it did not appear that the economic benefits to the purchaser were derived from the managerial efforts of the seller, promoter or a third party, and (2) where those services being offered in connection with the gold program did not appear to rise to the level of being the essential managerial efforts upon which the purchaser must rely in order to make a profit from his purchase. The release indicated that among the facts considered in concluding that the services provided did not rise to the level of being the essential managerial efforts were that the purchaser pay full value in cash and not purchase on margin; that any depository arrangement be limited to the storage of the gold with a reputable facility, insurance against loss or theft from the storage facility, and the issuance of a document which would evidence the right of the purchaser or his successors and assigns to take possession of the gold; and that the seller have no obligation to repurchase the gold or ownership documents from the purchaser, nor to sell such gold or ownership for the purchaser's account.

Possible Disclosure of Environmental and Other Socially Significant Matters

On February 11, 1975, the Commission announced a public proceeding, including public hearings, concerning possible disclosure in registration statements and other documents filed with the Commission or furnished to investors of information bearing on corporate environmental practices or other matters of primarily social rather than financial concern.[80] The primary objective of this proceeding was to permit the Commission to determine, with the benefit of comment from interested persons, what, if any, modifications

in the Commission's disclosure requirements are appropriate in light of the provisions of the National Environmental Policy Act (NEPA).[81] In addition, the Commission sought to determine the desirability of amending its disclosure requirements with regard to corporate equal employment practices and any other matters of social significance.

This proceeding was initiated pursuant to the order and opinion of Judge Charles R. Richey in *Natural Resources Defense Council, Inc. v. Securities and Exchange Commission*.[82] That action arose from the Commission's denial of a rulemaking petition submitted by Natural Resources Defense Council (NRDC) which would have required reporting companies to file with the Commission information concerning the effects of corporate activities on the environment, and statistics reflecting equal employment practices. The Commission subsequently proposed[83] and issued[84] more limited environmental disclosure rules which, NRDC alleged, failed to fulfill the Commission's responsibilities under NEPA. Plaintiffs also alleged that the Commission, in denying the petition and promulgating its own disclosure requirements, had not complied with the requirements of the Administrative Procedure Act (APA).

The court held that the Commission had inadequately informed the public that its proposed regulations were intended to satisfy fully the Commission's mandate under NEPA and that it had not provided a proper statement of the basis and purpose for its rulemaking action. Further, the court held that the Commission failed to articulate adequately the reasons for denial of the equal employment portion of the NRDC petition. Accordingly, Judge Richey remanded the matter to the Commission for further rulemaking action, and expressly ordered the Commission to determine the extent of “ethical investor” interest in environmental and equal employment information, and the avenues of action which such investors may pursue to eliminate corporate practices inimical to the environment and equal employment.[85]

While the Commission did not agree with Judge Richey that it had failed to satisfy the procedural requirements of the APA, it has attempted to comply fully with his order. In response to the notice

announcing the proceeding, the Commission received over 350 written comments.

In addition, at the public hearings conducted during April and May, 1975, testimony was received from 54 witnesses. The documents compiled in the proceeding exceed 10,000 pages. The participants included public corporations, institutional and individual investors, special interest groups, state and federal legislators, representatives of the accounting and legal professions, and others. The public proceeding closed on May 14, 1975, and the Commission subsequently proposed rules regarding disclosure of environmental matters and declining to promulgate rules requiring specific disclosure of other social matters.[86]

MUTUAL FUND DISTRIBUTION

In November 1974, the Commission announced a comprehensive program to revise the laws and regulations affecting mutual fund distribution.[87] Its program was based upon a report of the Division of Investment Management Regulation on “Mutual Fund Distribution and Section 22(6) of the Investment Company Act of 1940” (“Staff Report”). In transmitting the Staff Report, the Commission stated that its program was “intended to reduce or eliminate many of the inequities and inefficiencies of the present fund distribution system while, at the same time, avoiding the dangers of a sudden abolition of retail price maintenance.” The Commission added that its plan was to “lay the groundwork for the gradual and orderly introduction of retail price competition into the mutual fund distribution system.”[88]

The Commission's three-fold program involved: (1) increased use of its existing administrative powers to permit greater price flexibility and improved communication with investors; (2) a recommendation that Congress enact legislation to expand the Commission's authority to select from a broad variety of long-range options to remove inhibitions on competition in the future; and (3) the adoption of proposed rules by the NASD to prevent excessive sales loads, as a regulatory safeguard.

The Commission's program utilizes its existing administrative authority to encourage(a) improved communication with investors through expanded fund advertising and more informative portrayal of fund investment results and (b) voluntary price competition by permitting greater opportunities for mass-merchandising and more price variations in the current sales load structure.

1. Improved Communication With Investors

The Commission adopted amendments to Rule 134 under the Securities Act of 1933,[89] which expand the scope of material permitted in investment company advertisements and which also emphasize the importance of the prospectus to potential investors. As amended, Rule 134 permits registered investment companies to include in their advertisements a description of their investment objectives, policies, services, and method of operation; pictorial illustrations which are appropriate for inclusion in the company's prospectus and not involving performance figures; and descriptive material relating to economic conditions, or to retirement plans, or other goals to which an investment in the company could be directed, but not directly or indirectly relating to past performance or implying achievement of investment objectives. However, a legend calling attention to the company's prospectus must be included in advertisements containing such newly permitted information. The liberalized rule should foster more interesting and informative fund advertisements and may encourage investment companies to devote more of their promotional budgets to mass media.

These amendments are the fourth in a series of Commission efforts designed to allow a wider degree of advertising by investment companies which issue redeemable securities. Rule 134 adopted in 1955[90] was amended in 1972 [91] to permit a general description of an investment company. At the same time the Commission adopted Rule 135A[92] expanding investment company generic advertising and Rule 434(a) to permit investment companies to use a summary prospectus.

The Commission also published for comment a proposed amendment to the Statement of Policy under the Securities Act of 1933[93] which, if

adopted, would permit use of four new types of performance charts thereby giving mutual funds and variable annuities the opportunity to portray past investment results in terms of compound rates of total return (assuming dividends and capital gains are reinvested). These charts would also incorporate such features as standard comparisons with the Standard & Poor's 500, semi-logarithmic presentations, and the illustration of the investment results from market highs to market lows. The proposed charts are designed to help investors to understand better the returns, risks and expenses of mutual fund and variable annuity investments and to make comparisons among the various funds and-annuities offered. At year end, the comments on the proposal were being analyzed by the staff.

2. Price Competition at the Underwriter Level

The Commission adopted amendments to Rule 22d-1[94] which permit funds, at their option, to provide the benefit of sales load discounts to certain additional groups of persons. To be eligible under one of the amendments, a group must have been in existence for at least six months, have a purpose other than purchasing mutual fund shares at a discount, and must satisfy other criteria selected by the fund relating to the realization by the fund of economies of scale in sales effort and sales related expense. These amendments enable funds and their underwriters to introduce mass-marketing techniques and to pass on to investors economies of scale and cost savings from group sales.

As part of the program, the Commission published for comment proposed Rule 22d-4, an exemptive rule which would permit a fund and its underwriter to utilize “open seasons” during which persons who have held shares of the fund for a specified period of time could purchase specified amounts of additional shares at a reduced sales load or at no load.[95] This was designed to enable cost savings to be passed on to qualifying fund shareholders who make additional investments.

The Commission also encouraged applications for exemption from Section 22(d) to permit sales load reductions to persons who have previously or contemporaneously purchased another investment

product or an insurance product, distributed by the same underwriter. Such exemptions would permit funds to pass on to investors the cost savings from marketing several financial products during one sales effort, and would also permit underwriters to experiment with varied financial packages.

Shortly after the close of the fiscal year, the Commission adopted Rule 22d-3,[96] which provides a conditional exemption from Section 22(d) to permit variations of the sales load and certain other deductions from purchase payments for variable annuities, based upon differences in costs or services. Such price variations would be subject to the conditions that the prospectus disclose the amount of the variations and the circumstances in which such variations are available, or describe the basis for such variations and the manner in which entitlement shall be determined, and that any variations reflect differences in costs or services and do not unfairly discriminate against any person.

3. Price Competition at the Retail Level

The Commission has also authorized its staff, on an experimental basis, to view favorably interpretive requests with respect to proposals that brokers which act independently of funds and their underwriters be permitted, under certain circumstances, to charge reasonable fees for services rendered in connection with the purchase of shares of "no-load" funds. The staff has taken a "no-action" position based upon the following safeguards being met in connection with the imposition of such a service fee:

(1) the broker must not be an affiliated person of the fund, its investment adviser or principal underwriter and have no formal or informal agreement with the fund, its investment adviser or principal underwriter to distribute its shares;

(2) the fund must not encourage brokers to make such a charge or give any special treatment to orders received through brokers;

(3) the fact that such a charge may be made must be disclosed in the fund's prospectus;

(4) the prospectus must make clear that if the shares are purchased directly from the fund without the intervention of a broker, there will be no charge; and

(5) any broker who makes such a charge must inform his customer, in writing, that the shares could be purchased directly from the fund at no load.

Interpretations are being issued as requests are received.

Though the restrictions of Section 22(d) do not apply to sales of fund shares by one person to another through a broker, no secondary brokerage market in mutual funds has developed. Provisions contained in uniform sales agreements between underwriters and broker-dealers effectively prohibit such activity.

The Commission has asked the NASD to amend its Rules of Fair Practice to prohibit contractual restrictions which would prevent broker-dealers from engaging in brokered transactions in fund shares.[97] If necessary, the Commission will also consider the adoption of its own rules pursuant to Section 22(f) under the Investment Company Act to prevent funds from restricting the transferability of their shares in a secondary brokered market. Broker-dealers would not be required to set up special procedures to match orders for fund shares, and it is not anticipated that' such a market will become so significant as to disrupt the primary distribution system. However, it will introduce some retail price variations in the industry and provide some insight into whether a secondary dealer market could function effectively.

Variable Life Insurance

In February 1975, the Commission announced withdrawal of its proposed amendments to Rule 3c-4 under the Investment Company Act and Rule 202-1 under the Advisers Act[98] both of which concerned regulation of variable life insurance. The Commission also announced

its intention to propose a rule under Section 6(e) of the Investment Company Act[99] which would conditionally exempt certain variable life insurance separate accounts from particular sections of the Investment Company Act and the rules thereunder while requiring full compliance with all other provisions of this Act and rules. A short time thereafter the Commission rescinded Rules 3c-1 and 202-1, effective July 30, 1975.[100] The rescission of these exemptive rules will result in the application of the Investment Company Act and Investment Advisers Act to variable life insurance contracts, their issuers and related persons until a new rule is adopted or other relief is granted.

Status of Broker-Dealers as Investment Advisers

As a result of the elimination of fixed commission rates on exchange transactions on May 1, 1975, some broker-dealers may elect to charge separately for investment advisory services which they had previously provided solely incidentally to their business and without special compensation. The change to charging separately for investment advice would cause such broker-dealers to become “investment advisers” within the meaning of the Investment Advisers Act.

Temporary Rule 206A-1(T), adopted by the Commission prior to May 1, temporarily exempted broker-dealers registered under the Securities Exchange Act of 1934 (except broker-dealers already registered as investment advisers on May 1, 1975) from the provisions of the Advisers Act and the rules and regulations thereunder from May 1, 1975, until August 31, 1975.[101] The exemption provided by the Rule was intended to enable broker-dealers to furnish research and other investment advice for a separate fee for a period of four months without the need to comply with the provisions of the Advisers Act.

A result of charging separately for investment advice was that such brokers and dealers would be subject to Section 206(3) of the Advisers Act, which makes it unlawful for an investment adviser, if he is acting as such in relation to a particular transaction, to effect the transaction with or for his client under circumstances where the adviser acts either as principal, or as broker for a person other than his client, unless the adviser furnishes his client with prior written disclosure of the capacity

in which the adviser is acting and obtains the client's consent to the transaction.

On March 31, 1975, the Commission proposed the adoption of new Rule 206(3)-1 under the Act[102] to exempt investment advisers who are also registered with the Commission as broker-dealers from the disclosure and consent requirements of Section 206(3) of the Act with respect to certain investment advisory services if such advisers comply with the conditions set forth in the proposed rule. This rule was adopted substantially unchanged after the close of the fiscal year.

Institutional Disclosure

Under the Securities Acts Amendments of 1975, a new Section 13(f) was added to the Exchange Act, which provides the Commission with authority to require disclosure and reporting of securities holdings and transactions from all types of institutional investors. As such, the amendment implements a recommendation which the Commission had made in its letter transmitting the Institutional Investor Study to the Congress in 1971.[103]

The new section gives the Commission broad rulemaking authority to determine, *inter alia*, the size of the institutions which will be required to file reports, the format and frequency of the reporting requirements, and the information to be disclosed in each report. The Commission is also directed to provide for public dissemination of the information collected, subject to confidential treatment in appropriate cases, and is empowered to exempt any institutional investment manager or security from any or all of the provisions of the section.

The reports will provide the Commission with a continual flow of information, thereby creating a uniform, centralized data base with respect to the investment activity of large institutions. Among other things, the Commission and the public can consider “parallel” institutional trading and related price impacts, block trading and direct trading between institutions, the impact of institutional trading on brokerage services and functions, different techniques of valuation of

large securities holdings, and managers' practice in the allocation of investment opportunities among their different types of accounts.

Investment Companies – Sale of Investment Adviser

The Securities Acts Amendments of 1975 amended the Investment Company Act, in part, to clarify the ambiguity created by the decision of the Court of Appeals for the Second Circuit in Rosenfeld v. Black.[104] In that case, the court held that the general principle that a fiduciary cannot sell his office for personal gain is impliedly incorporated into Section 15(a) of the Act, which requires shareholder approval of any new investment advisory contract. Consequently, a retiring investment adviser of an investment company violates the Act by receiving compensation which reflects either (1) a payment contingent upon the use of influence to secure approval of a new adviser or (2) an assurance of profits for the successor adviser under a new advisory contract and renewals. The sweep of the court's language cast doubt, however, on whether an investment adviser, without incurring liability to the company or its shareholders, could profit when it sold its business by selling its assets.

SIGNIFICANT CASES INVOLVING SECURITIES ACTS

Gordon v. New York Stock Exchange[105] In this case the Supreme Court affirmed a decision of the Court of Appeals for the Second Circuit which had upheld the dismissal of a private antitrust damage action challenging the fixed commission rate structures of the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) as violative of the Sherman Act. The Court of Appeals had concluded that exchange rules and practices which prescribe fixed rates fell within the exclusive supervisory jurisdiction of the Commission, and were thus immune from antitrust attack.[106]

The Commission filed a brief *amicus curiae* with the Supreme Court in which it expressed the view that it would be impossible for the Commission to exercise the broad discretionary jurisdiction granted to it under the Securities Exchange Act to regulate rules and practices of

national securities exchanges in the public interest, if its decisions, and exchange activities within its jurisdiction, could be subjected to simultaneous antitrust attack in federal district courts. The Commission emphasized that it must and does consider competitive factors, together with other purposes and policies of the Act, in exercising its authority under the Act. In this context, the Commission pointed to its regulation of the exchanges' commission rate structure as an example of the complex and technical matters which Congress saw fit to entrust to its expertise under the Act.

United Housing Foundation v. Forman[107]

The Supreme Court, in a 6-3 decision, reversed the decision of the Court of Appeals for the Second Circuit in *Forman v. Community Services, Inc.*[108] which had held that shares of stock in a non-profit, state-supported, cooperative housing corporation were securities within the meaning of the federal securities laws.

The Commission first participated *amicus curiae* in this case in the Supreme Court. The Court summarily rejected the argument that the shares were securities by virtue of their denomination as “stock” since, in the Court's view, they lacked certain of the common features of stock, such as the right to receive dividends contingent upon an apportionment of profits and the ability to be negotiated, pledged or hypothecated. The Court, thus, reaffirmed the doctrine that whether a “security” exists will not turn upon the label that an instrument is given, but on the economic realities of the situation.

Regarding the economic reality of the situation, the Court was heavily influenced by what it believed to be the sole motivation of shareholders in purchasing their shares; namely, the prospect of acquiring a place to live and not the financial returns on their investment. In this connection, the Court concluded that the various ways by which investors might save on their expenses were not the kinds of profits traditionally associated with securities. According to the Court, those types of profits which would be relevant to determine whether a security exists would include profit “derived from the income yielded by an investment as well as from capital appreciation.” Since the shares

of stock could not be resold at a price higher than that which they were bought, there could be no capital appreciation. Although the commercial tenants generated income to the corporation, that income was found to be too speculative and insubstantial to bring the entire transaction within the federal securities laws.

In *Blue Chip Stamps v. Manor Drug Stores*,[109] the Supreme Court, three justices dissenting, upheld the so-called *Birnbaum* rule[110] that a person who neither purchased nor sold securities has no standing to seek damages for injuries caused by a violation of Section 10(b) of the Securities Exchange Act and Rule 10b-5. The Commission, *amicus curiae*, had urged that the rule was arbitrary, since a victim of a violation should be able to recover damages, whether he was induced to purchase shares or induced not to. Pursuant to an antitrust decree, plaintiffs in this case had been offered stock allegedly at a bargain price but failed to purchase it because of an allegedly misleading prospectus overstating the risks involved.

United States v. National Association of Securities Dealers, Inc.[111]

In this civil injunctive action, the Justice Department challenged, as violative of the antitrust laws, the activities of various mutual funds, fund underwriters and broker-dealer distributors of the funds' shares, which allegedly inhibited the development of a secondary brokerage market in the funds' shares. Specifically, the Department of Justice alleged (1) that the funds, underwriters, and dealers contracted among themselves to prohibit the dealers and underwriters from engaging in secondary brokerage transactions in the funds' shares at other than the public offering price of those shares prevailing in the primary market, and (2) that the funds, underwriters, dealers, and the National Association of Securities Dealers (NASD) engaged in a conspiracy to restrain the development of a secondary brokerage market in fund shares. The district court granted defendants' motions for summary judgment and dismissed the complaint. The Department of Justice then appealed to the Supreme Court under the Expediting Act.

While the Commission did not participate in the district court proceeding, it filed a brief, *amicus curiae*, in the Supreme Court. In that

brief, the Commission urged that the contractual restrictions challenged by the Department of Justice, although not mandated by Section 22(d) of the Investment Company Act, were shielded from anti-trust attack because of the jurisdiction granted the Commission in Section 22(f) of that Act to supervise industry imposed restrictions on the transferability and negotiability of their shares. The Commission took no position with respect to the alleged conspiratorial activities of the funds, underwriters, dealers, and NASD.

In affirming the district court's dismissal of the complaints, the Supreme Court, in accord with the Commission's position, held that the contractual provision challenged in the complaint was immune from antitrust attack, since it was subject to the supervisory jurisdiction granted the Commission in Section 22(f). The Court also held that the alleged conspiratorial activity in the complaint was in fact legitimate conduct aimed at the furtherance of the policies underlying Sections 22(d) and 22(f) of the Investment Company Act and subject to the pervasive exercise of Commission regulation under the Investment Company Act and the Securities Exchange Act.

In *Securities Investor Protection Corp. v. Barbour, et al*.,[112] the Supreme Court reversed a lower court ruling and agreed with the Commission and SIPC that the Commission's statutory right to bring an action under the Securities Investor Protection Act of 1970, to require SIPC to discharge its duties is exclusive and that customers have no similar implied right of action. The Court also recognized, but left open, the Commission's suggestion that its decision not to institute proceedings against SIPC in a particular matter might be reviewable for abuse of discretion.

The case involved an attempt by the receiver for a broker-dealer, who was appointed in a Commission enforcement proceeding, to compel SIPC to assume and complete the liquidation of the broker-dealer and thereby to make available to its customers the protections of the Act. As previously described, the Court of Appeals for the Sixth Circuit had held that the protections of the Act were available where a broker-dealer, although insolvent prior to the effective date of the Act, continued to transact a substantial business in securities after the Act

had become effective, and that the receiver had standing to bring an action on behalf of customers of the broker-dealer to compel SIPC to initiate liquidation proceedings under the Act.[113]

Securities and Exchange Commission v. First Securities Co. of Chicago[114]

The Commission instituted this equity receivership action immediately after it learned of a suicide note left by the president of the defendant broker-dealer, First Securities Co. of Chicago, in which he stated, among other things, that he had misappropriated the funds of those First Securities customers whom he had induced to invest in a special "escrow account" that he operated as a personal venture apart from the firm. The Court of Appeals had held in an earlier opinion (463 F.2d at 985-988) that First Securities was liable to the escrow investors for the president's fraud both because, as the firm's president, he had acted with apparent authority of First Securities in advising the investors to liquidate their accounts at the firm and invest in the escrow, and because the firm aided and abetted the president's violation of Rule 10b-5. Accordingly, the escrow investors had a valid claim against the estate of First Securities.

In this latest appeal, the Court of Appeals held, in accordance with the position urged by the Commission, that Section 60(e) of the Bankruptcy Act, which governs the distribution of a broker-dealer's assets in a bankruptcy proceeding, was properly applied by the district court by analogy in this receivership proceeding because "the same reasons for the Section 60(e) treatment exist in the instant stockbroker liquidation as Congress must have considered in choosing to provide specially for stockbroker bankruptcies." Section 60(e), the Court observed, "was intended to protect, and secure equality of treatment for, 'the public customer who has entrusted securities to a broker-dealer for some purpose connected with participation in the securities markets,' " and the Court noted that "a considerable portion of the [First Securities] assets on hand represents cash or the proceeds of securities entrusted to First Securities by customers" for such a purpose. In support of the application of Section 60(e), the Court also relied upon the "interest in uniformity of treatment of insolvent

brokerage houses," the Court noting that the Securities Investor Protection Act of 1970, enacted after First Securities' failure, adopted to a large degree the provisions of Section 60(e).

In affirming the lower court's ruling that the escrow investors fell into the category of general creditors rather than the higher category of "customers," who are defined in Section 60(e) to include persons who have claims on account of securities received, acquired or held by the stockbroker for the account of such persons, the Court of Appeals noted that the investors' transactions with respect to the escrow account were "on their face directly with Nay [the president], personally, and were neither in fact nor understood to be a deposit of funds with First Securities." Equity Funding Corporation of America

During 1975, criminal proceedings against those involved in the fraud at Equity Funding Corporation of America (Equity Funding) were successfully completed with the conviction and sentencing of all 22 persons indicted.[115] Equity Funding, which has been termed by commentators as the largest financial fraud in history, pioneered and sold a package investment involving life insurance and mutual funds. Over the years it had sold hundreds of millions of dollars of its securities to the public and had expanded through life insurance company and other acquisitions in exchange for its securities.

The government alleged a colossal securities fraud which lasted and expanded throughout almost the entire ten-year history of the company. In early 1973, investigation by the staff led to a trading suspension by the S.E.C. and a S.E.C. complaint seeking an injunction and receiver. Shortly thereafter, the company went into Chapter X proceedings. Further investigation revealed that the company inflated its earnings by recording non-existent receivables. This continued on an increasing scale until the fraud was discovered. The company also borrowed millions of dollars without recording the amounts borrowed as liabilities on its books. The company repaid these obligations by further undisclosed borrowings. The company structured complicated, sham, foreign transactions to record bogus income and assets.

Beginning in 1969, the company began the insurance phase of the fraud by reinsuring insurance policies of questionable value with other insurance companies. This generated badly needed cash for the company and helped it increase its reported sales and insurance-in-force figures. In 1970, the company started the outright creation of bogus insurance policies and the reinsurance of these policies. This practice continued and increased until the company collapsed. Under the company's reinsurance agreements, the company received a significant cash payment from its reinsurers at the time the policies were reinsured. In succeeding years, however, the company was required to pay to reinsurers the renewal premiums it received from policyholders. In the case of the bogus policies, there were no policyholders and the company had to pay these renewal premiums itself. The company paid these renewal premiums by reinsuring more bogus policies. Thus, the company's cash flow and liabilities problems increased in geometric proportions. In 1972, the company recorded at least $14,667,000 in fictitious premium income. The company's last annual report was for its year ended December 31, 1972. The company's balance sheet at that time reported $737,511,000 in assets of which approximately one-third was fictitious.

In November 1973, as a result of a coordinated investigation by the United States Attorney in Los Angeles, the S.E.C., the United States Postal Service, the Federal Bureau of Investigation, the Federal Reserve Board, and the insurance departments of the States of California and Illinois, 19 former Equity Funding officers and employees and three members of the auditing firm that certified these false financials were indicted on charges of conspiracy, securities fraud, making false filings with the S.E.C. and the New York Stock Exchange, mail fraud, bank fraud, and other charges. Eighteen Equity Funding conspirators pleaded guilty before trial. Stanley Goldblum, Chairman of the Board, and President of Equity Funding, entered a guilty plea after five days of his trial.

The three members of the auditing firm that certified these false financial statements were convicted by a jury after a four-month trial of various charges of securities fraud. The court instructed the jury that reckless, deliberate, indifference to, or disregard for, truth or falsity on

the part of the auditors, when considered in the light of all other evidence relating to intent, might lead to an inference that the auditors acted willfully and knowingly. The jury also was instructed that the auditors could be found to have acted in such fashion if they deliberately closed their eyes to the obvious, or to facts that certainly would have been observed in the course of their accounting work, or, if they recklessly stated as facts matters of which they knew they were ignorant.

Stanley Goldblum was sentenced to eight years imprisonment and fined $20,000. The other Equity Funding conspirators received various prison terms. Each of the auditors received two-year sentences suspended on the condition they serve three months imprisonment, four years probation, and perform 2,000 hours of community service work. The auditors have filed notices of appeal.

Securities and Exchange Commission v. Emanuel Fields.[116]

Emanuel Fields, an attorney, was enjoined by the United States District Court for the Southern District of New York from further violation of the Commission's Rule 2(e), which provides for disqualification of an attorney from appearing or practicing before the Commission. The Commission had disqualified Fields by order issued June 18, 1973.

In consenting to the Final Judgment, Fields admitted that he had appeared and practiced before the Commission in contravention of Rule 2(e) and the Commission's order, but he asserted that, at the time he engaged in the conduct alleged, he did not believe the acts alleged to be in violation of either Rule 2(e) or the Commission order.

The Final Judgment prohibits Fields (1) from representing or advising any person in any Commission proceeding, whether investigatory or administrative, in any informal inquiry conducted by the staff, in any conference, discussion or communication with the Commission or its staff, and in any proceeding, investigation or hearing conducted by a national securities exchange or a national securities association; (2) from preparing on behalf of any person, or advising any person in

connection with the preparation of, any document to be filed with the Commission under the federal securities laws; and (3) from representing or advising, in connection with any matter arising under or relating to the federal securities laws.

Exceptions are provided with respect to all of the foregoing, however, to permit Fields to represent persons, including the regulated entities enumerated above, in court litigation or in proceedings before other government agencies.

In addition, the Final Judgment orders disgorgement of any and all fees, compensation or other consideration Fields may have received, or as to which he may have a claim, not only for the services alleged in the complaint, but also for all services rendered by him since June 18, 1973, that are encompassed within the conduct described in the preceding paragraph. The Final Judgment also directs Fields to inform any issuer or other person who seeks to, or in fact does, employ him in connection with any matter arising under or relating to the federal securities laws of the fact that he has been permanently disqualified from appearing or practicing before the Commission and further requires him to provide such issuer or other person with a copy of the Commission's order of June 18, 1973 that permanently disqualified him from appearing or practicing before the Commission.

Silver and Gold Investments

During the year the Commission filed several injunctive cases concerning the sale of investments in coins, silver and silver futures.

On December 12, 1974 the Commission filed a lawsuit against Monex International Ltd., d/b/a Pacific Coast Coin Exchange based upon alleged violations of the securities registration and anti-fraud provisions of the Federal securities laws in connection with margin sales of bulk silver coins. The Commission alleged that the defendants had made false and misleading statements concerning nonexistent purchases, fees for non-existent services, investments prospects, and the firm's comparability with other exchanges. The defendants have consented to a Temporary Restraining Order.

In its first major lawsuit involving gold sales the Commission obtained a temporary restraining order against Brent Fields, Daniels & Martin, Ltd. (an Atlanta-based firm incorporated in England) and United States Bullion, a wholly-owned subsidiary, based upon violations of the securities registration and anti-fraud provisions of the Federal securities laws. The defendants had offered for sale 6,000 ounces of gold worth more than one million dollars when in fact they only had 200 ounces.

With respect to rare coins, a preliminary injunction against Federal Coin Reserve was issued on February 10, 1975, based on violations of the securities registration provisions in connection with the sale of rare coin portfolios.[117] The court noted that, although the portfolios were advertised by the defendants as investments in publications of a general (vs. numismatic) nature, the defendants offered a number of services, the most significant of which was the selection of the coins by the sellers, which gave rise to an investment contract, under the meaning of Section 2(1) of the Securities Act of 1933. The opinion states that “the dependence of the investor on the expertise of the seller to produce the expected profit” was sufficient to meet the *Howey* tests for investment contracts. The court rejected the notion that possession of the coin portfolios reconverted an investment contract into a commodity. The fact that investors were not required to avail themselves of the proffered services was declared irrelevant inasmuch as the terms of the offer, not the acceptance, determine whether any particular investment vehicle is a security within the meaning of the Federal securities laws. Defendant's proposition that none of its services affected the value of the coins and therefore securities were not involved, was also rejected by the court.

On April 21, 1975 the Commodity Futures Trading Commission came into existence. The new Commission, in addition to regulating commodity futures, has exclusive jurisdiction over margin and leveraged sales of silver and gold; however, Congress specifically mandated that pending proceedings will be unaffected by the new Commodity Act.

On November 20, 1974, the United States Attorney for the Middle District of Florida filed a one-count criminal information against James E. Tolleson and Exciting Life, Inc., charging them with wilfully, and without just cause, failing and refusing to attend and testify and produce certain records in obedience to a subpoena duces tecum issued by a Commission officer in the course of an investigation.[118] This is only the second such action instituted in recent years, and only the third such case in Commission history. Upon conviction, the defendants are subject to a maximum fine of $1,000.00 and up to one year imprisonment.

On March 26, 1975, Exciting Life, Inc., pleaded guilty to the violation as charged in the information and was fined $1,000.00. On March 11, 1975, the Court entered an order dismissing the information as to James E. Tolleson for lack of proper service. That order has been appealed by the Government to the Court of Appeals for the Fifth Circuit and a decision on the appeal is expected during fiscal year 1976.

Commission Litigation

SEC v. Stirling Homex Corporation – the Commission filed a Complaint in the United States District Court for the District of Columbia[119] seeking an injunction and certain ancillary relief against Stirling Homex Corp., six of its officers and directors and Merrill Lynch, Pierce, Fenner & Smith, Inc. (“Merrill Lynch”), a New York broker-dealer. The Commission's complaint alleged that from 1970 through 1972, the financial statements of Stirling Homex Corp., a company which was engaged in the manufacturing and installing of multi-family modular units ready for occupancy, were materially falsified by the fraudulent recording and reporting of fabricated or fictitious sales and application of inappropriate accounting principles. In addition, it was alleged that as part of the fraudulent scheme in which some of the defendants participated, illegal political contributions were made, illegal electronic surveillance equipment was used, and corporate funds were used for the personal benefit of some of the management of Stirling Homex.

With respect to defendant Merrill Lynch, it was alleged that they were involved, directly and indirectly, in the filing with the Commission and the dissemination to the public of a false Stirling Homex registration statement and they knew or should have known of material facts which were not disclosed in the registration statement and that the inquiry made by Merrill Lynch with respect to the registration statement was inadequate. Also alleged were violations of the Federal securities laws in the dissemination by Merrill Lynch to its customers of inaccurate or misleading research reports, wire flashes and opinions, earnings and price predictions and statements concerning Stirling Homex and its securities.

Simultaneously with the filing of the complaint, the six officers and directors of Stirling Homex, without admitting or denying the allegations, consented to permanent injunctions enjoining them from violations of the reporting and anti-fraud provisions of the Federal securities laws with respect to the securities of Stirling Homex or any other issuer. In addition to the injunction the court ordered three of the officers and directors not to be associated with any corporation whose securities are publicly held without prior Commission approval and to forebear from receiving any assets, properties or monies of Stirling Homex in any distribution which they would be entitled to participate in as a security holder or creditor of Stirling Homex. Further the court ordered the former Comptroller and Vice President of Stirling Homex not to be associated with any corporation whose securities are publicly owned as a chief financial officer for two years without prior Commission approval. In addition, the former Director, General Counsel and Executive Vice President undertook not to practice before the Commission as defined by Rule 2(e) of the Commission's Rules of Practice without prior Commission approval.

Also, Merrill Lynch consented, without admitting or denying the allegations, to a permanent injunction enjoining them from violations of the anti-fraud provisions of the Federal securities laws and to an order of the court requiring them to adopt within 60 days, implement and maintain policies and procedures relating to its underwriting, research and retailing activities, which are reasonably calculated to prevent the recurrence of the matters alleged in the Complaint.

After the final disposition of the civil actions now pending with respect to the securities of Stirling Homex in which Merrill Lynch is a defendant, the Commission may apply to the court for a determination of the profits earned by Merrill Lynch as a result of the activities complained of in the Commission's complaint. Upon a determination by the court of such profits, Merrill Lynch shall disgorge such profits pursuant to an order and plan to be determined by the court plus interest thereon at 6% per annum from the date of entry of said order and plan, provided however, that the court limit the amount of such disgorgement or not require any disgorgement based on a consideration of the findings in such civil actions with respect to the matters complained of in the Commission's complaint, including actions wherein determinations favorable to Merrill Lynch have been rendered, and after giving effect to all settlements and money judgments which may have been entered and satisfied by Merrill Lynch.

The Commission also issued a Report of Investigation relating to the activities of the Board of Directors of Stirling Homex Corporation ("Report") which dealt in particular with the role of Stirling Homex's two outside directors, Theodore W. Kheel and John W. Castellucci.[120] The Report was issued pursuant to Section 21(a) of the Securities Exchange Act of 1934 which allows the Commission to publish at its discretion information gathered during an investigation concerning "any facts, conditions, practices or matters which it may deem necessary or proper" in fulfilling its responsibilities. Solely for the purpose of the Report, Kheel and Castellucci consented to its issuance, without admitting or denying the findings set forth therein.

The Report outlines the background of Stirling Homex, details the composition and functions of its Board of Directors and comments on the role of Kheel and Castellucci as outside directors.

SEC v United Brands Company – On April 9, 1975, the Commission filed a Complaint in the United States District Court for the District of Columbia seeking an injunction and other relief against United Brands Company alleging violations of Sections 10(b) and 13(a) of the

Securities Exchange Act of 1934 and Rule 10b-5, 12b-20, 13a-1, 13a-11 and 13a-13 thereunder in connection with United Brands failure to disclose substantial payments to officials of foreign governments in order to secure favorable treatment in connection with its business operations in those countries.[121] United Brands contested the Commission's right to proceed with this action during the pendency of a criminal investigation being conducted by the United States Attorney for the Southern District of New York and on July 18, 1975, the United States Court for the District of Columbia held that the criminal investigation was no bar to the Commission's civil suit. The Commission is now pursuing pre-trial discovery in this matter.

S.E.C. v. Phillips Petroleum Company – On March 6, 1975 the Commission filed a complaint against Phillips Petroleum Company, William F. Martin, its present chairman, W. W. Keeler, a former chairman, John M. Houchin, one of its directors, and Carstens Slack, the vice-president in charge of its Washington, DC office.[122]

The Commission's complaint alleged that the defendants violated Section 13(a) and 14(a) of the Securities Exchange Act and certain rules promulgated thereunder by filing with the Commission annual reports and soliciting proxies from shareholders of Phillips Petroleum Company which failed to disclose that the defendants and others had created a secret fund of corporate monies which was used for unlawful political contributions and other purposes, and, additionally, that Phillips Petroleum Company financial statements filed with the Commission falsely stated the income and expenses of the Company and understated its assets.

The complaint further alleged that the defendants and others, by means of false entries on the books and records of Phillips Petroleum Company had caused to be disbursed in excess of $2.8 million in corporation funds into two Swiss bearer-stock repository corporations and that, after this sum was converted into cash, in excess of $1.3 million of this fund was returned to the United States with approximately $600,000 being expended on political contributions and related expenses, a substantial portion of which were unlawful. The

complaint also alleged that the balance of the funds channeled into the Swiss corporations was distributed overseas in cash.

The order of permanent injunction enjoins Phillips Petroleum Company from further violations of Sections 13(a) and 14(a) of the Exchange Act. The order also restrains Phillips Petroleum Company from use of corporate funds for unlawful political contributions or similar unlawful purposes, from making false or fictitious entries in its books and records and from establishing or maintaining any secret or unrecorded fund or corporation monies or assets or making payments of disbursements therefrom.

The orders entered against the individual defendants restrain them from identical practices with respect to Phillips Petroleum Company or any other company.

As part of the order entered against it, Phillips Petroleum Company undertook to prepare promptly and file, with the Commission and with the court, a report describing the investigations it has made of this matter, the results thereof and the actions taken with respect thereto. Phillips Petroleum Company also undertook to make appropriate disclosure to its shareholders of the matters involved in the report and that the Company's Board of Directors shall independently review the report and take such further action as it deems necessary and proper based on the report.

The Commission reserved the right to seek such further relief as may be necessary or appropriate if it is not fully satisfied that Phillips Petroleum Company has complied with and implemented its undertaking.

S.E.C. v. Allegheny Beverage Corporation – On January 8, 1975, Chief U.S. District Judge for the District of Columbia, George L. Hart, Jr., entered a consent order granting injunctive, mandatory and ancillary relief against Allegheny, Valu Vend, Inc. (“VV”), Valu Vend Credit Corporation (“VVCC”), and Morton M. Lapides, chief executive officer of the defendant corporations for violations of the anti-fraud, reporting, registration and proxy provisions of the Federal securities

laws. Besides enjoining future misconduct, the order (1) directed Lapides to disgorge $70,000 in unlawful gains resulting from insider sales and personal use of corporate funds, (2) provided for the appointment of a special agent to con-.firm the return to Allegheny by Lapides of $540,000 of corporate funds, (3) provided for the appointment of a special audit committee to select an independent certified public accountant for and monitor relations between the accountant and Allegheny management, and (4) directed Allegheny to file amended reports in accordance with the allegations of the amended complaint. The amended complaint included charges of misappropriation of corporate funds, the issuance of false financial reports, and the perpetration of a fraudulent public offering of debentures in 1971 and 1972.

As previously reported, the Commission instituted an injunctive action against Allegheny and 24 other defendants in 1973 alleging violations of reporting, anti-fraud and registration provisions of the securities acts.[123] The complaint was amended in January 1975 to charge proxy violations and a misappropriation of corporate funds by the chief executive officer of Allegheny. In addition to Allegheny, the defendants included two of its subsidiaries, four officers, the company's auditors, the underwriter of a subsidiary's public offering, counsel for the underwriter, counsel for the issuer, the escrow agent for the public offering and several others.

On July 1, 1975, the Commission went to trial against defendants C. Gordon Haines, Wright, Robertson & Dowell (“WRD”), A. Jeffry Robinson and Mc-Laughlin & Stern, Ballen and Miller (“MSBM”). After the trial began, settlement was reached with these four defendants, bringing to a successful conclusion all litigation instituted against the 25 defendants. As a result of the settlements, WRD, which represented the issuer in the public offering of debentures, and Haines, the partner responsible for that firm's representation of the issuer, were ordered to make adequate inquiry to insure full and accurate disclosure in securities offerings in the future, were required to adopt new procedures to prevent the recurrence of fraud, and were required to refrain from taking any new business involving practice before the Commission for 60 days.

MSBM, which represented the underwriter for the offering, consented to an order pursuant to Rule 2(e) of the Commission's rules of practice directing it to undertake internal procedures to prevent the recurrence of fraud, and censuring it for its failure to supervise an associate adequately and for the failure of the associate to make adequate inquiry concerning the facts of a closing with respect to the offering. The amended complaint charged that the terms of the offering required the issuer, VVCC, to sell $10 million in debentures within a specified time, or return the proceeds to investors and terminate the offering. It alleged that at a closing on January 3, 1972, the defendants engaged in a series of sham sales transactions designed to create the appearance that $10 million in debentures had been sold, when in fact only $525,000 in debentures had been sold, in order to continue the offering and retain the proceeds.

The following additional defendants settled prior to trial: Allegheny officers Harry J. Conn, Anthony Joseph Hering, and William Kane, First Duso Securities Corporation, Miles Bahl, Benjamin Botwinick & Company, Alvin L. Mindes, David S. Klein, Barry L. Dahne, Klein & Dahne, Southern Capital Corporation, Claude Leroy Dixon, Paken Enterprises, Inc., Kenneth Denson, W.F.S., Inc., Walter F. Sparks, and Suburban Trust Company.

SEC v. Penn Central Co., et al.[124] On May 2, 1974, the Commission filed a civil injunctive complaint alleging violations of the federal securities laws in connection with events relating to the financial collapse of the Penn Central railroad in 1970. The action named Penn Central Company, Penn Central Transportation Co., two subsidiaries, several officers of the companies, three non-officer directors, several other individuals and the independent auditing firm for these companies. The complaint was based on an investigation which was previously the subject of a report entitled “The Financial Collapse of the Penn Central Co. – Staff Report of the SEC to the Special Subcommittee on Investigations of the House Committee on Interstate and Foreign Commerce.”[125]

The complaint alleged that the anti-fraud provisions and periodic filing requirements were violated in that during the period prior to the filing of a petition for reorganization under the bankruptcy laws in June 1970 by Penn Central Transportation Co., the financial results and condition of the companies were misrepresented and the extent of the deterioration in the affairs of the companies was not disclosed. It was also alleged that as a part of the fraudulent conduct some of the officers of a subsidiary improperly received payments based on the inflated earnings of the subsidiary and that an officer of the Transportation Co. sold Penn Central stock on inside information. It was also alleged that certain railroad funds had been improperly diverted to a small European country. In its complaint, the Commission sought injunctions against further violations and the disgorgement of monies improperly received.

Since the filing of the action, one officer, the two subsidiary companies and the independent auditing firm have consented to permanent injunctions without admitting or denying the allegations. The settlement with the independent auditing firm, Peat, Marwick, Mitchell & Co., was part of a combined settlement arrangement involving other actions and related remedies which is described elsewhere in this report.

In *SEC v. Goldman, Sachs & Co.*,[126] an action related to the Penn Central action, the Commission alleged in a complaint filed in the Southern District of New York on May 2, 1974 that Goldman, Sachs & Co., Penn Central's commercial paper dealer, violated the anti-fraud provisions in connection with the sale of Penn Central Transportation Co. commercial paper prior to the filing of the petition for reorganization. Simultaneously with the filing of the action, Goldman Sachs consented to a injunction without admitting or denying the allegations of the complaint and undertook, as part of the relief, to implement certain procedures relating to the collection of information about issuers of commercial paper and the dissemination of such information to its customers who purchase the commercial paper.

SEC v. National Student Marketing Corporation, Cortes W. Randell, the former president of National Student Marketing Corporation, Bernard J. Kurek, its former chief financial officer, John G. Davies, its

former general counsel and Robert C. Bushnell and Dennis M. Kelly former sales executives of National were convicted of conspiracy to violate mail fraud statutes and filing provisions of the Securities Exchange Act in connection with the issuance in 1968 of false and misleading financial statements and reports concerning the assets and earnings of National.

Also convicted were Anthony M. Natelli, then a partner in the firm of Peat, Marwick, Mitchell & Co., outside auditors for National, and Joseph Scansaroli, a former employee of that firm, Randell, Bushnell, Kelly and Kurek with making false and misleading statements with the Commission in mid-1969.

NOTES TO PART 1

[1]Pub. L. No. 94-29 (1975) [hereinafter referred to as the "1975 Amendments"].

[2]Not discussed in this section of the Annual Report are the provisions of the 1975 Amendments concerning uniform criminal penalties under the federal securities laws, Commission enforcement and investigative powers, the alteration of Commission administrative powers with respect to those who are not securities professionals, judicial review of orders and rules of the Commission, consolidation of Commission actions for equitable relief pursuant to Section 1407(a) of Title 28, United States Code, the cessation of Commission authority to suspend trading in the securities of bank holding companies, annual reports to Congress, transaction fees paid by national securities exchanges, arbitration proceedings between self-regulatory organizations and their participants, members, or persons dealing with members or participants, institutional disclosure, and amendments to the Securities Act of 1933, Securities Investor Protection Act of 1970, Investment Company Act of 1940, Investment Advisers Act of 1940, Act of August 20, 1962, Public Utility Holding Company Act of 1935, and Trust Indenture Act of 1939.

[3]The 1975 Amendments changed the definition of "interstate commerce" in Section 3(a)(17) of the Securities Exchange Act to

include intrastate use of (A) any facility of a national securities exchange or of a telephone or other interstate means of communication and (B) any other interstate instrumentality.

[4]The 1975 Amendments allocate certain rulemaking, enforcement and other responsibilities between the Commission and bank regulatory agencies. This is accomplished by introducing a new term, "appropriate regulatory agency," whose definition delineates which agency has authority over which persons or transactions. Other provisions seek to promote cooperation between and efficiency among the several regulatory agencies concerned with municipal securities dealers and the activities of transfer agents and clearing agencies.

[5]Securities Exchange Act Release No. 11469 (June 12, 1975), 7 SEC Docket 157.

[6]Securities Acts Amendments of 1975, Conference Report to Accompany S.249, Joint Explanatory Statement of the Comm. of Conference, H.R. Rep. No. 229, 94th Cong., 1st Sess. 108 (1975).

[7]Securities Exchange Act Release No. 11203 (January 23, 1975), 6 SEC Docket 147. See also, 40th Annual Report, p. 5.

[8]Securities Exchange Act Release No. 10986 (August 27, 1974), 5 SEC Docket 64.

[9]Securities Exchange Act Release No. 11019 (September 19, 1974), 5 SEC Docket 156.

[10]When the Commission commenced its inquiry into the commission rate structures at the time of the Special Study, fixed commission rates were assumed by everyone, including the Commission, to be a normal and necessary feature of the exchange markets. It only became clear in light of later experience and thorough study that this was not the case. While the virtues of the traditional system were at first staunchly defended, by the time of the hearings on Rule 19b-3 the existing system had few defenders. Those who opposed Rule 19b-3 largely confined themselves to either asking for delay, or suggesting that the

initiation of competitive commission rates should await a more prosperous period, or be deferred pending the taking of certain further steps toward a central market system, or the adoption of certain proposed safeguards for the auction market process. A few witnesses suggested that some vaguely outlined better system of fixed commission rates should be developed. No one who testified at the hearings on Rule 19b-3 supported any extended continuation of the status quo, at least with respect to public rates.

[11]Securities Exchange Act Release No. 11293 (March 13, 1975), 6 SEC Docket 431.

[12]Securities Exchange Act Release No. 11395 (May 2, 1975), 6 SEC Docket 841.

[13]40th Annual Report, p. 4.

[14]Securities Exchange Act Release No. 11131 (December 11, 1974) 5 SEC Docket 672.

[15]Securities Exchange Act Release No. 11505 (June 30, 1975), 7 SEC Docket 287.

[16]40th Annual Report, p. 7; 39th Annual Report, p. 9.

[17]Securities Exchange Act Release No. 10787 (May 10, 1974), 4 SEC Docket 271.

[18]Securities Exchange Act Release No. 11036 (October 3, 1974), 5 SEC Docket 213. Amendments to the short sale rules were announced in Securities Exchange Act Release No. 11030 (September 27, 1974), 5 SEC Docket 189.

[19]Securities Exchange Act Release No. 11273 (March 3, 1975), 6 SEC Docket 375.

[20]Securities Exchange Act Release No. 11389 (May 1, 1975), 6 SEC Docket 787.

[21]Securities Exchange Act Release No. 11317 (March 28, 1975), 6 SEC Docket 544.

[22]During the year, the Commission adopted an amendment to Securities Exchange Act Rule 17a-15 (See 39th Annual Report, p. 9) to establish procedures for appeal to the Commission from certain actions which may be taken pursuant to the joint industry plan, (Securities Exchange Act Release No. 11097 (November 13, 1974). 5 SEC Docket 471) declared effective plans filed under the Rule by the Boston, Cincinnati, and Detroit Stock Exchanges and Instinet, and granted an exemption to the Intermountain Stock Exchange from the reporting requirements of the Rule (Securities Exchange Act Release No. 11385 (April 30, 1975) 6 SEC Docket 782). The Intermountain Stock Exchange is required, by the terms of its exemption, to report to the Commission on a weekly basis details of its transactions (if any) in securities which would otherwise be required to be reported pursuant to Rule 17a-15.

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

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

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

[26]*Id.* at 2.

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

[28]Securities and Exchange Commission, Statement on the Future Structure of the Securities Markets (February 2, 1972), 37 Fed. Reg. 5286 (1972).

[29]Securities and Exchange Commission, Policy Statement on the Structure of a Central Market System (March 29, 1973).

[30]Securities Exchange Act Release No. 10668 (March 6, 1974), 3 SEC Docket 650.

[31]Securities Exchange Act Release No. 11030 (September 27, 1974), 5 SEC Docket 189.

[32]Securities Exchange Act Release No. 11056 (October 7, 1974), 5 SEC Docket 286.

[33]Securities Exchange Act Release No. 11276 (March 5, 1975), 6 SEC Docket 378.

[34]See, Lorie, Public Policy for American Capital Markets 10 (Department of the Treasury, Feb. 7, 1974); Letter from Weeden and Co. to Lee A. Pickard, Director of Division of Market Regulation, Securities and Exchange Commission, November 15, 1974 (File No. S7-515).

[35]Securities Exchange Act Release No. 11468 (June 12, 1975), 7 SEC Docket 150.

[36]Securities Exchange Act Rule 9b-1 provides that a national securities exchange whose facilities are to be used to effect transactions in options must first file with the Commission a plan which contains those rules or requirements of the exchange that relate solely or significantly to transactions in options on the exchange. Under that rule, the plan must be declared effective by the Commission before any transaction in options can take place on that exchange. At the end of fiscal year 1975, the Commission's staff was working on a proposal for a new rule under Section 19 of the Act, as amended by the 1975 Amendments, which, if adopted would result in rescission in its entirety of Rule 9b-1. Amended Section 19 and the new rule would provide procedures for submission for Commission approval of proposed exchange rules generally, and since these would be essentially the same as those of Rule 9b-1, that rule would be rescinded.

[37]See 40th Annual Report, P. 8.

[38]Securities Exchange Act Release No. 11144 (December 19, 1974), 5 SEC Docket 734.

[39]Securities Exchange Act Release No. 11423 (May 15, 1975), 6 SEC Docket 894.

[40]As defined by CBOE, these options are those selling for below $.50 where the underlying security is 5 points or more below the exercise price (CBOE Rule 4.17). There was evidence of increased uncovered writing activity in such options which raised regulatory questions of suitability, financial responsibility and excessive speculation. The Amex and PBW have adopted similar restrictions as part of their option plans (Amex Rule 910 and PBW Rule 1052).

[41]The PBW and the Amex subsequently adopted similar restrictions.

[42]See 40th Annual Report, p. 8; n. 40, p. 21.

[43]PBW Rule 1016.

[44]See 40th Annual Report, p. 9.

[45]Securities Exchange Act Release No. 11144 (December 19, 1974), 5 SEC Docket 734.

[46]*Id.*

[47]See Securities Exchange Act Release No. 10981 (August 22, 1974), 5 SEC Docket 224.

[48]Securities Exchange Act Release No. 11497 (June 26, 1975), 7 SEC Docket 241.

[49]Securities Exchange Act Release No. 11094 (November 11, 1974), 5 SEC Docket 448. The rule had previously been published for comment in Securities Exchange Act Release No. 9891 (December 5, 1972) and

Securities Exchange Act Release No. 10525 (November 29, 1973), 3 SEC Docket 103.

[50]Securities Exchange Act Release No. 10612 (January 24, 1974), 3 SEC Docket 423.

[51]5 U.S.C. App. I.

[52]See Securities Exchange Act Release No. 10808 (May 16, 1974), 4 SEC Docket 304.

[53]See Securities Exchange Act Release No. 10959 (August 9, 1974), 4 SEC Docket 304.

[54]FOCUS Report (prepared by Staff Work Group of the Informal FOCUS Report Subcommittee of the Report Coordinating Group (October 15, 1974).

[55]Interim Report of the Report Coordinating Group to the Securities and Exchange Commission (December 16, 1974).

[56]Report Coordinating Group First Annual Report to the Securities and Exchange Commission (June 16, 1975).

[57]See Securities Exchange Act Release No. 11499 (June 26, 1975), 7 SEC Docket 282.

[58]Securities Exchange Act Release No. 9835 (October 25, 1972).

[59]Securities Exchange Act Release No. 11098 (November 13, 1974), 5 SEC Docket 472.

[60]The necessity to update the Guide was repeated in many letters from the public and the Congress. Both Congressman John E. Moss and Congressman Lionel Van Deerlin wrote to the Chairman expressing the necessity to keep the Guide current. In a letter dated May 22, 1975 to the Chairman, Congressman Van Deerlin wrote:

The House and Senate have approved the conference report on S.249, the Securities Acts Amendments of 1975, and we anticipate that the President will sign it promptly. The changes in the law made by that bill makes inaccurate certain parts of the Broker-Dealer Compliance Guide. . . . There has been considerable discussion between this Subcommittee and the Commission concerning the need to keep that Compliance Guide up-to-date. I trust that you will take the occasion of the passage of this legislation to arrange to maintain the Compliance Guide current.

[61]Securities Act Release No. 5526 (September 9, 1974), 5 SEC Docket 115.

[62]See 39th Annual Report, pp. 16-17

[63]Securities Exchange Act Release No. 10591 (January 10, 1974), 3 SEC Docket 359. See 40th Annual Report, pp. 15-16.

[64]Securities Exchange Act Release No. 11079 (October 31, 1974), 5 SEC Docket 356.

[65]Securities Act Release No. 5362, February 2, 1973.

[66]Securities Act Release No. 5581, April 28, 1975.

[67]See 35th Annual Report, p. 21.

[68]See 38th Annual Report, p. 12; 39th Annual Report, p. 15.

[69]See 40th Annual Report, p. 13.

[70]Securities Act Release No. 5560 (January 24, 1975), 6 SEC Docket 132.

[71]Securities Act Release No. 5510 (July 3, 1974), 4 SEC Docket 524.

[72]Securities Act Release No. 5487 (April 23, 1974), 4 SEC Docket 154.

[73]Securities Act Release No. 5450 (January 7, 1974), 3 SEC Docket 349.

[74]Securities Act Release No. 5560 (January 24, 1975), 6 SEC Docket 132.

[75]Securities Act Release No. 5588 (May 30, 1975), 7 SEC Docket 62.

[76]Securities Act Release No. 5504 (June 14, 1974), 4 SEC Docket 417; See 40th Annual Report, p. 15.

[77]Securities Act Release No. 5564 (January 31, 1975), 6 SEC Docket 210.

[78]Securities Exchange Act Release No. 11125 (December 9, 1974), 5 SEC Docket 667.

[79]Securities Act Release No. 5552 (December 26, 1974), 6 SEC Docket 2.

[80]Securities Act Release No. 5569 (February 11,1975), 6 SEC Docket 257.

[81]42 U.S.C. 4321 *et seq*.

[82]389 F. Supp. 689 (D.D.C., 1974).

[83]Securities Act Release No. 5235 (February 16, 1972).

[84]Securities Act Release No. 5386 (April 20, 1973), 1 SEC Docket No. 12, p. 1.

[85]389 F. Supp. at 701.

[86]Securities Act Release No. 5627 (October 14, 1975), 8 SEC Docket 41.

[87]Investment Company Act Rel. No. 8570 (November 4, 1974), 5 SEC Docket 423.

[88]Letter transmitting Staff Report to the U.S. Senate Committee on Banking, Housing and Urban Affairs, November 4, 1974.

[89]Investment Company Act Rel. No. 8568, (November 4, 1974) 5 SEC Docket 388; Investment Company Act Rel. No. 8824, (June 16, 1975) 7 SEC Docket 187.

[90]Securities Act Rel. No. 3568, (August 29, 1955).

[91]Securities Act Rel. No. 5248, (May 9, 1972).

[92]*Id.*

[93]Investment Company 8571 (November 4, 1974), 390.

[94]Investment Company 8569 (November 4, 1974), 5 SEC 420.

[95]Investment Company Act Rel. 8894 (August 19, 1975), 7 SEC Docket 639.

[96]Investment Company Act Rel. No. 8878, (August 7, 1975) 7 SEC 528.

[97]Letter to Gordon Macklin, President, NASD, November 22, 1974. 74-75 Decisions, CCH Fed. Sec. L.R. para. 80,019.

[98]Investment Company Act Rel. No. 8690, Investment Advisers Act Rel. No. 439 (February 27, 1975), 6 SEC Docket 362.

[99]Investment Company Act Rel. 8826, Investment Advisers Act Rel. 463 (June 18, 1975), 7 SEC Docket 221

[100]Investment Company Act Rel. 8691, Investment Advisers Act Rel

[101]Investment Advisers Act Rel. No. 455 (April 23, 1975), 6 SEC Docket 726.

[102]Investment Advisers Act Rel. No. 448 (April 2, 1975), 6 SEC Docket 549.

[103]SEC, Institutional Investor Study Report, H.R. Doc. 64, 92d Gong., 1st Sess. Vol. 1 at X, XI (March 10, 1971).

[104]445 F 2d 1337 (1971).

[105]95 S.Ct. 1598 (1975).

[106]Gordon v. New York Stock Exchange, Inc., 498 F.2d 1303 (C.A. 2, 1974).

[107]Sup. Ct. Nos. 74-157 and 74-647 (June 16, 1975).

[108]500 F.2d 1246 (C.A. 2, 1974).

[109]Supreme Court, October Term, 1974, No. 74-124.

[110]Based on Birnbaum v. Newport Steel Corp., 193 F. 2d 461 (C.A. 2, 1952).

[111]95 S. Ct. 2427 (1975).

[112]421 U.S. 412 (1975).

[113]40th Annual Report, p. 65.

[114]507 F.2d 417 (C.A. 7, 1974).

[115]U.S. v Stanley Goldblum, et al., U.S.D.C. (C.D. Calif.) Crim 70 13390; see also SEC v Equity Funding Corp. of America, U.S.D.C. (C.D. Calif), Civil Action 73-714.

[116]S.D.N.Y., No. 75 Civ. 1299 (LPG).

[117]SEC v. Brigadoon Scotch Distributors, Ltd., Docket No. 74-5422, SONY.

[118]U.S. v. James E. Tolleson, Litigation Release No. 6598 (November 22, 1974), 5 SEC Docket 686.

[119]See Litigation Release No. 6960 (July 2, 1975), 7 SEC Docket 370.

[120]Securities Exchange Act Release No. 11516 (July 2, 1975), 7 SEC Docket 298.

[121]See Litigation Release No. 6827 (April 9, 1975), 6 SEC Docket 635.

[122]Litigation Release No. 6770 (March 6, 1975), 6 SEC Docket 419.

[123]39th Annual Report, p. 76. See also 40th Annual Report, p. 84.

[124]Litigation Release No. 6349 (May 2, 1974), E.D. Pa. Civil Action No. 74-1125.

[125]U.S. Government Printing Office, Washington, 1972

[126]Litigation Release No. 6349 (May 2, 1974), S.D.N.Y. 74 Civ. 1916.

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 stockholders' 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 Securities 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. The Commission has proposed amendments to this form designed to reduce the cost and burden of registration to issuers consistent with the protection of investors by increasing the availability of the form to more types of employee plans, particularly certain option plans which may not receive special tax treatment under the Internal Revenue Code. The relaxed standards may be used by issuers pending final action on the proposals.[1] Comments on the proposals are presently being reviewed by the staff.

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.[2] 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 1975 fiscal year, 2,781 registration statements became effective. Of these, 266 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 2,515 statements, the median number of calendar days between the date of the original filing and the effective date was 33.

Financial Analysis and Examination

During the fiscal year, the Office of the Chief Financial Analyst of the Division of Corporation Finance reviewed electric and gas utilities; the bank holding companies industry; and the fire and casualty insurance industry.

Three new dimensions were added during the fiscal year to the periodic reviews of specific industries. First, the input was enlarged by incorporating views of federal and state agencies and regulatory commissions, academicians, trade associations, research analysts and industry specialists. Secondly, the Office of the Chief Financial Analyst provided the Division's examining staff with ratios, averages and standards for each industry under review. Thirdly, certain statistical disclosure formats were redesigned to reflect the impact on financial reporting of dynamic changes in the current economic climate.

Office of Oil and Gas

The Division's Office of Oil and Gas has processing responsibility for all oil and gas drilling program filings, as well as filings covering fractional undivided interests in oil and gas rights. Seventy-two registration statements were filed during fiscal 1975 for oil and gas drilling programs, totaling $638,282,035. And fifteen registration statements covering fractional undivided interests in oil and gas rights were filed aggregating $9.098,000.

In addition to the direct processing of those filings, the Office of Oil and Gas is responsible for reviewing the disclosure relating to oil and gas business and properties, including data on production and reserves, contained in other filings directly processed by the several branches of the Division. In fiscal 1975, such other filings consisted of 198 registration statements under the Securities Act and 17 offering circulars pursuant to the Regulation A exemption thereunder, as well as registration statements and proxy statements under the Exchange Act.

Additional information regarding offerings of fractional undivided interests is contained under Regulation B in this Part.

Tax Shelters

During the year, a significant number of registration statements relating to real estate limited partnerships and other tax shelter offerings were filed with the Commission. All registration statements relating to real estate limited partnerships were processed by one branch within the Division of Corporation Finance, while registration statements relating to other non-oil and gas types of tax shelters, such as cattle feeding and breeding, agri-business and leasing, as well as condominium offerings, were processed in a separate branch. A third branch, the Office of Oil and Gas, has processing responsibility for tax shelters relating to oil and gas.

In all of these types of offerings, the disclosure generally emphasized has included the compensation paid to the program sponsors, the conflicts of interest inherent in many such offerings, the record in prior offerings of the sponsors of the offering, and the tax ramifications of the offering.

Dividend Reinvestment Plans

In recent years, an increasing number of issuers provide a means by which security holders might automatically reinvest dividends in additional securities of the issuer. In response to this increased interest in dividend reinvestment plans, the Commission 'in August 1974, announced a revised interpretative position of its Division of Corporation Finance concerning securities offered and sold without registration under the Securities Act pursuant to dividend reinvestment and similar plans.[3] The release states that until further notice, the Division will take the position that the issuer or its affiliates may perform bookkeeping and similar administrative functions in operating such plans and that these activities, in and of themselves, will not cause the participation of the issuer or its affiliates to exceed the limitations set forth in Securities Act Release No. 4790. The revised interpretation requires that the agent not be affiliated with the issuer, and that securities acquired on behalf of the plan be acquired through such agent.

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; 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 1975 fiscal year, 265 notifications were filed under Regulation A, covering proposed offerings of $91,287,-296, compared with 438 notifications covering proposed offerings of $147 million in the prior year. A total of 675 reports of sales were filed reporting aggregate sales of $49,369,171. Such reports must be filed every six months

while an offering is in progress and upon its termination. Sales reported during 1974 had totaled $69 million. Various features of Regulation A offerings over the past three years are presented in the statistical section of this report.

In fiscal 1975, the Commission temporarily suspended 9 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 17 cases pending at the beginning of the fiscal year, this resulted in a total of 26 cases for disposition. Of these, the temporary suspension order became permanent in 18 cases: in 7 by lapse of time, in 2 cases after hearings, and in 8 by acceptance of an offer of settlement. One temporary suspension order was vacated. Eight cases were pending at the end of the fiscal year.

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 material information of such offering must be filed with the Commission. Copies of the final offering sheet 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 1975 fiscal year, 625 offering sheets and 672 amendments thereto were filed pursuant to Regulation B and were examined by the Office of Oil and Gas of the Division of Corporation Finance. Sales during 1975 under these offerings aggregated $35.4 million. During the 1974 fiscal year, 625 offering sheets and 751 amendments were filed covering aggregate sales of $29.1 million. For the fiscal year 1973,

725 offering sheets were filed with 1,020 amendments thereto, covering aggregate sales of $19.9 million. In fiscal 1975, the Commission temporarily suspended the Regulation B exemption for one offeror where it had evidence that the offeror had failed to comply with certain requirements. At year end, the suspension had not yet become permanent. In the prior fiscal year, there was one temporary suspension of the Regulation B exemption which became permanent when the offeror withdrew its request for a hearing.

Regulation E

Under Section 3(c) of the Securities Act, the Commission is authorized to adopt rules and regulations exempting securities issued by a small business investment company under the Small Business Investment Act. Pursuant to that section, the Commission has adopted Regulation E, which conditionally exempts such securities issued by companies registered under the Investment Company Act of 1940 up to a maximum offering price of $500,000. The regulation is substantially similar to Regulation A, described above. No notifications were filed under Regulation E for the two preceding fiscal years.

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 1975 fiscal year, 15 notifications were filed under Regulation F, covering assessments of stock of $380,318, compared with 12 notifications covering assessments of $408,652 in 1974.

CONTINUING DISCLOSURE: THE SECURITIES EXCHANGE ACT

The Securities Exchange Act of 1934 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.

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 fiscal year 1975, a total of 114 issuers listed and registered securities on a national securities exchange for the first time and a total of 575 registration applications were filed. The registrations of all securities of 192 issuers were terminated. Detailed statistics regarding securities traded on exchanges may be found in the statistical section of this report.

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 ex-emptive 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 fiscal year, 372 registration statements were filed under Section 12(g). Of these, 144 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 are companies which succeeded to the businesses of reporting companies, and thereby became subject to the reporting requirements.

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.

At the beginning of the year, 10 exemption applications were pending, and 44 applications were filed during the year. Of these 54 applications, 15 were withdrawn, 18 were granted, and 4 denied. The remaining 17 applications were pending at the end of the fiscal year.

Periodic Reports

Section 13 of the Securities 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.

In 1975, 54,640 reports – annual, quarterly and current – were filed.

In December 1974, the Commission rescinded the requirement that registrants furnish an EDP attachment as an exhibit.[4] The EDP

attachment, which was required in certain reports on Forms 10-K and 10-Q, had been used by the Commission to gather information generally reflected in the report to which it was an exhibit. The Commission determined the functional justification for the attachment did not warrant its continued use and accordingly rescinded any requirement that it be furnished.

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 1975 fiscal year, 6,826 proxy statements in definitive form were filed, 6,801 by management and 25 by nonmanagement groups or individual stockholders. In addition, 127 information statements were filed. The proxy and information statements related to 6,762 companies, and pertained to 6,685 meetings for the election of directors, 216 special meetings not involving the election of directors, and 27 assents and authorizations.

Aside from the election of directors, the votes of security holders were solicited with respect to a variety of matters, including merger, consolidations, acquisitions, sales of assets and dissolution of companies (191); authorizations of new or additional securities, modifications of existing securities, and recapitalization plans (474); employee pension and retirement plans (65); bonus or profit-sharing plans and deferred compensation arrangements (217); stock option plans (705); approval of selection by management of independent auditors (3,366) and miscellaneous amendments to charters and by-laws, and other matters (1,868).

During the 1975 fiscal year, 370 proposals submitted by 68 stockholders for action at stockholders' meetings were included in the proxy statements of 198 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, the sending of a post meeting report to all stockholders, and limitations on charitable contributions.

A total of 185 proposals submitted by 87 stockholders were omitted from the proxy statements of 90 companies in accordance with the provisions of the rule governing such proposals. The most common grounds for omission were that proposals were not submitted on time or were not proper subjects for stockholders' action under the applicable state law.

In fiscal 1975, 25 companies were involved in proxy contests for the election of directors which bring special requirements into play. In

these contests, 303 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 20 instances. In 10 of these, management retained control. Of the remainder, three were settled by negotiation, one was won by non-management persons, and six were pending at year end. In the other five cases, representation on the board of directors was involved. Management retained all places on the board in three contests, opposition candidates won places on the board in two cases.

Takeover Bids, Large Acquisitions

Sections 13(d) and (e), and 14(d),(e) and (f) of the Securities Exchange Act, enacted in 1968 and amended in 1970, provide for full disclosure in cash tender offers and other stock acquisitions involving 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 1975 fiscal year, 1,165 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 thirteen Schedule 13D reports were filed by persons or groups making tender offers (including 24 tender offers filed with the Commission by foreign nationals), which, if successful, would result in more than five percent ownership. In addition, 73 Schedule 14D reports were filed on solicitations or recommendations in a tender offer by a person other than the maker of the offer. Twelve statements were filed for the replacement of a majority of the board of directors otherwise than by stockholder vote. Six statements were 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.

During the fiscal year, the Commission delegated to the Director of the Division of Corporation Finance authority to permit management recommendations to be made within less than the ten-day period of Rule 14d-2(f).[5] This procedure was adopted to expedite the Commission's handling such requests because they usually need prompt action.

Insider Reporting

Section 16 of the Securities 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 investment companies are contained in the Holding Company and Investment Company Acts.

In fiscal 1975, 91,298 ownership reports were filed. These included 11,953 initial statements of ownership on Form 3, 74,303 statements

of changes in ownership on Form 4, and 5,042 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 11,500 subscribers.

ACCOUNTING

The securities acts 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, reporting and auditing standards applicable to the financial statements and to assure that high standards of professional conduct are maintained by the public accountants who examine the statements. The primary responsibility for this program rests with the Chief Accountant of the Commission.

Under the Commission's broad rule-making 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 in compliance with the securities laws. The Commission has also formulated rules on accounting for and auditing of broker-dealers and prescribed uniform systems of accounts for mutual and subsidiary service companies related to holding companies subject to the Public Utility Holding Company Act of 1935. The accounting rules and opinions of the Commission, and its decisions in particular cases, have contributed to clarification and wider acceptance of the accounting principles and practices and auditing standards developed by the profession and generally followed in the preparation of financial statements.

However, the accounting and financial reporting rules and regulations – except for the uniform systems of accounts which are regulatory reports – prescribe accounting principles to be followed only in certain limited areas. In the large area of financial reporting not covered by its rules, the Commission's principal means of protecting investors from inadequate or improper financial reporting is by requiring a report of an independent public accountant, based on an audit performed in accordance with generally accepted auditing standards, which expresses an opinion whether the financial statements are presented fairly in conformity with accounting principles and practices that are recognized as sound and have attained general acceptance. The requirement that the opinion be rendered by an independent accountant, which was initially established under the Securities Act of 1933, is designed to secure for the benefit of public investors the detached objectivity and the skill of a knowledgeable professional person not connected with management.

The accounting staff reviews the financial statements filed with the Commission to insure that the required standards are observed and that the accounting and auditing procedures 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, the combining of old businesses, the use of more sophisticated securities, and other innovations create accounting problems which require a constant reappraisal of the procedures.

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 this 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 of accountancy groups from twenty-seven countries, was established to promulgate international accounting standards. This committee has adopted one standard, has proposed a number of other standards and is developing additional proposals. The Commission will 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.

Accounting and Auditing Standards

The FASB supplanted the Accounting Principles Board of the AICPA, which ceased operations on June 30, 1973, as the organization which establishes standards of financial accounting and presentation for the guidance of issuers and public accountants. The new organization was established on the basis of recommendations by a committee appointed by the AICPA in early 1971 to explore ways of improving this function. A financial accounting foundation, sponsored by the AICPA and consisting of representatives of leading professional organizations, appoints the seven “members of the FASB who serve on a salaried, full-time basis, and the members of an advisory council to the Board who serve on a voluntary basis. The Commission endorsed[6] the FASB, which it believes will provide operational efficiencies and insure an impartial viewpoint in the development of

accounting standards on a timely basis, and stated that the FASB's statements and interpretations would be considered as being substantial authoritative support for an accounting practice or procedure.

As of June 30, 1975, the FASB had issued seven Statements of Financial Accounting Standards and six Interpretations relating to accounting opinions or standards. In addition, it had under active consideration a heavy agenda of technical projects which included: financial reporting for segments of a business enterprise; accounting for leases; criteria for determining materiality; conceptual framework for accounting and reporting; accounting for translation of foreign currency transactions and foreign currency financial statements; financial reporting in units of general purchasing power; business combinations and purchased intangibles; accounting for interest costs; accounting and reporting for employee benefit plans; accounting for the cost of pension plans; and accounting for income taxes – oil and gas producing companies. It had held public hearings on five of the projects and had issued exposure drafts of three proposed statements of standards.

The FASB recently 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 updates its rules and regulations to conform to the improved standards, in accordance with its stated policy. Such amendments have been proposed[7] to effect conformity with the standards established in FASB Statement Nos. 2 and 7, “Accounting for Research and Development Costs” and “Accounting and Reporting by Development Stage Enterprises.”

The AICPA appointed another committee in early 1971 to study and refine the objectives of financial statements. It studied the basic questions of who needs financial statements, what information should be provided, how it should be communicated, and how much of it can

be provided through the accounting process. The committee's report on the objectives of financial statements, which was published in October 1973, is being utilized by the FASB as the basis of its study of the conceptual framework for accounting and reporting.

More recently the AICPA established a Commission on Auditors' Responsibilities chaired by former SEC Chairman Manuel Cohen which will determine whether a gap exists between what the public expects of auditors and what auditors can reasonably be expected to accomplish. Specific questions to which this Commission seeks answers include: Should auditors monitor all financial information released to the public and, if so, what should be the extent of their responsibilities? Should the auditor's standard report, particularly the phrase “present fairly,” be changed to express better the responsibilities of auditors? Is the mechanism for developing auditing standards adequate?

The Chief Accountant also maintains liaison with other senior committees of the AICPA on projects of mutual interest, principally, proposed audit guides and standards of the Auditing Standards Executive Committee and the proposed statements of position of the Accounting Standards Executive Committee. Regular meetings are held with the Committee on SEC Regulations to provide information and guidance to the profession concerning the interpretation of and compliance with the Commission's accounting and auditing requirements applicable to registrants and their independent accountants.

Other Developments

The Commission has developed a new publication series entitled “Staff Accounting Bulletins” to provide information to the public regarding informal and administrative practices and guidelines developed by the accounting staff with respect to specific accounting and auditing problems considered in the review of financial data filed.[8]

During the fiscal year, the Commission issued 16 Accounting Series Releases to provide interpretations or guidelines on matters of

accounting principles and auditing standards, to require improved disclosure of financial information by amendment of reporting forms or Regulation S-X, or to announce decisions in disciplinary proceedings under Rule 2(e) of the Commission's Rules of Practice concerning accountants appearing before it.

Four interpretative or advisory releases dealt with requirements for financial statements of limited partnerships in annual reports filed with the Commission,[9] disclosure of unusual risks and uncertainties in financial reporting,[10] financial disclosure problems relating to the adoption of the LIFO inventory method,[11] and amendments of guidelines pertaining to classification of short-term obligations expected to be refinanced.[12]

Three releases were issued in which amendments to Regulation S-X were adopted to effect improved disclosures in specific areas of financial statements: one release[13] dealt with the capitalization of interest by non-utility companies, including imposition of a moratorium on capitalization by such companies which had not previously followed that policy; another release[14] dealt with the components of accounts receivable and inventories relating to defense and other long-term contract activities; and a third release[15] with the relationships between registrants and their independent accountants. This latter release also contained amendments to a report form and rules under the Exchange Act regarding those relationships.

In conjunction with the Division of Corporation Finance, a release was issued adopting guides for the textual analysis of the summary of earnings or operations in the preparation of registration statements and reports under the Securities Act and the Exchange Act. In conjunction with the Division of Corporate Regulation, a release[17] was issued rescinding the uniform system of accounts for registered holding companies under the Holding Company Act, in order to facilitate adjustment of their accounts to generally accepted accounting standards. In lieu of the uniform system of accounts, the requirements of Regulation S-X for the form and content of financial statements were made applicable.

Shortly after the end of the fiscal year, an amendment to Article 4 of Regulation S-X was adopted[18] relating to the requirements for consolidated and combined financial statements in filings with the Commission. Also after the end of the fiscal year, amendments to Regulation S-X and filing forms were adopted[19] which require increased disclosure of interim financial data. Condensed financial statements and a narrative analysis of the results of operations are to be included in quarterly reports filed and summary data regarding the quarterly results in a fiscal year are to be included in a note to the financial statements filed for a fiscal year. These requirements were adopted after public consideration of proposals[20] and subsequent alternative proposals[21] and public hearings regarding increased disclosure of interim results by registrants and review of such data by independent accountants. In connection with the adoption of these requirements, the Commission issued[23] for public comment revised proposed standards and procedures to be applicable to the review of the interim financial data by the independent accountants in the absence of adequate standards and procedures promulgated by the accounting profession.

During the fiscal year, other proposals were issued for public comment, one[24] of which would effect a general revision of Article 7 of Regulation S-X, pertaining to the form and content of financial statements of title insurance and mortgage guarantee insurance companies, to reflect developments in accounting practice, including the requirements that the financial statements be prepared in accordance with generally accepted accounting principles. Another proposal[25] would effect minor amendments in various sections of Regulation S-X regarding disclosures of leases, compensating balances and short-term borrowing arrangements, and income tax expense.

The Commission issued opinions in seven proceedings under Rule 2(e) of its Rules of Practice during the fiscal year. Under that rule, the Commission may disqualify an attorney or accountant from practicing before it, either temporarily or permanently, or it may censure him on grounds specified in the rule. In one proceeding[26] an accounting firm was censured for failing fully to disclose to the Commission and the

public the facts relating to a settlement negotiated between the firm and a client regarding an audit of certain inventories that were misstated in the financial statements of the client filed with the Commission.

In three proceedings[27], accountants were permanently suspended from appearing or practicing before the Commission. In each case the accountant had been permanently enjoined by a Federal court in a Commission injunctive action from violating antifraud provisions of the Federal securities laws. In one instance the accountant was given the right to apply for reinstatement after September 20, 1976.

In another proceeding,[28] an accounting firm, which had been permanently enjoined by a Federal court from violating antifraud provisions of the Federal securities laws, was censured and remedial sanctions were imposed. The firm was required to employ a consultant for one year, who will be available for special consulting requests, will review approximately 15 percent of the firm's audits during the year of publicly held companies, report to the Commission regarding the adequacy of the audit work performed in such audits, and require the firm to adopt auditing procedures to determine whether its clients have entered into material transactions with related parties. In the event the firm should merge with another firm at least twice as large the above requirements would terminate and the combined firm would be required to apply its quality control standards to the audits of the financial statements of the publicly held former clients of the original firm and to render progress reports on such application to the Commission.

In a proceeding[29] pertaining to an accounting firm which had failed to comply with generally accepted auditing standards and the Commission's instructions in Form X-17A-5 in the audit of a broker-dealer's financial statement, the firm and a partner of the firm were suspended from appearing or practicing before the Commission for 18 months. They were required to request a review of their auditing procedures under the quality review program of the American Institute of Certified Public Accountants and to correct any deficiencies reported. The firm was also required to give notice in writing of these

findings to any client who requests auditing services for the purpose of registration with or reporting to the Commission.

In another proceeding sanctions were imposed[30] against an accounting firm and a partner of the firm on the basis of a consent injunction involving violations of the antifraud provisions of the Exchange Act. The firm was required to request the AICPA to designate persons satisfactory to the Commission's Chief Accountant to review audit work papers, personnel and other records of the firm to determine whether audit and professional procedures are adequate. The firm was prohibited from accepting engagements for a period of 10 months with new clients involving auditing or accounting services in connection with filing of financial statements with, or submissions or certifications to, the Commission. In addition, the firm was ordered to require, for a five-year period, each of its partners to attend courses or seminars in subjects relating to public accounting or auditing to the extent of at least 40 hours per year. The enjoined partner was prohibited from practicing before the Commission for a period of 10 months as an accountant other than as an employee or consultant under supervision, and in no case to act as or be a partner of the accounting firm. He was also required to complete a program of continuing professional education by attending at least 100 hours of acceptable courses or seminars in public accounting and auditing subjects within a period of 10 months.

Shortly after the close of the fiscal year, three opinions were issued in proceedings instituted against accounting firms pursuant to Rule 2(e). One proceeding involved a major accounting firm, against which the Commission had filed four civil injunctive complaints concerning the firm's examinations of financial statements of four companies and questions raised in an investigation regarding the firm's audit of the financial statements of another company.[31] The firm was required to have an investigation made of its audit practices with respect to the financial statements of client-registrants of the Commission and to promptly adopt and implement any recommended corrective actions. The firm was also required to conduct a study of the percentage of completion method of accounting and establish guidelines to be applied in the conduct of future audits. For a period of six months, the

firm was not permitted to accept engagements from new clients (with certain exceptions) to examine financial statements to be filed with the Commission. In addition the firm is required to have reviews conducted in 1976 and 1977 in conformity with the AICPA's program for the review of quality control procedures of multi-office firms to determine whether the firm has adopted and implemented procedures agreed upon in the proceedings and any corrective actions recommended in the prior investigation.

The other proceedings were instituted on the basis of investigations in which the Commission found that accounting firms did not perform the audits of financial statements of registrants filed with the Commission in accordance with generally accepted auditing standards. In one proceeding[32] the accounting firm was censured by the Commission. In the second proceeding[33] the accounting firm was ordered to employ consultants to review and evaluate its auditing procedures and professional practice in connection with the audits of publicly held companies with a report of conclusions to be made to the Commission, and the firm was ordered not to accept engagements to examine new clients' financial statements to be filed with the Commission until one month after the report of the consultants is submitted to the Commission.

EXEMPTIONS FOR INTERNATIONAL BANKS

Section 15 of the Bretton Woods Agreements 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. The following summary of the Bank's activities reflects information obtained from the Bank. Except where otherwise indicated, all amounts are expressed in U.S. dollar equivalents as of June 30, 1975.

Net income for the year was $275 million, compared with $216 million the previous year. Of the $275 million net income, the Executive Directors allocated $165 million to the Supplemental Reserve Against Losses on Loans and from Currency Devaluations and recommended to the Board of Governors that an amount of $110 million be transferred by way of grant to an affiliate of the Bank, the International Development Association.

Repayments of principal on loans received by the Bank during the year amounted to $569 million, and a further $80 million was repaid to purchasers of portions of loans. Total principal repayments by borrowers through June 30, 1975, aggregated $6.5 billion, including $4.3 billion repaid to the Bank and $2.2 billion repaid to purchasers of borrowers' obligations sold by the Bank.

Outstanding borrowings of the Bank were $12.3 billion at June 30, 1975. During the year, the Bank borrowed $440 million through the issuance of 2-year U.S. dollar bonds to central banks and other governmental agencies in some 65 countries; $500 million in the United States; DM 1,228.3 million (U.S. $512.2 million) in Germany; 35.9 billion yen (U.S. $122 million) in Japan; U.S. $150 million in Iran; U.S. $240 million in Nigeria; SRCs 500 million (U.S. $140.8 million) and U.S. $750 million in Saudi Arabia; Bs 430 million (U.S. $100 million) and U.S. $400 million in Venezuela; and the equivalent of U.S. $35 million in other countries outside the United States. The above U.S. dollar equivalents are based on official exchange rates at the times of the respective borrowings.

These borrowings, in part, refunded maturing issues amounting to the equivalent of $959 million. After retirement of $68 million equivalent of obligations through sinking fund and purchase fund operations, the Bank's outstanding borrowings showed a net increase of $2,637 million from the previous year after adding $275 million representing

adjustment of borrowings as a result of currency devaluations and revaluations 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 reflects information submitted by the Bank to the Commission.

On June 30, 1975 the outstanding funded debt of the Ordinary Capital resources of the Bank was the equivalent of $1.606 billion, reflecting a net increase in the past year of the equivalent of $290 million. During the year, the funded debt was increased through two public offerings in the United States totaling $225 million as well as private placements in Italy, Trinidad and Tobago for the equivalent of $17 million. In addition, there were drawings totaling $20.8 million under arrangements entered into during previous years with Finland, Japan and Spain. Additionally, $55.6 million of two-year and five-year bonds were sold to Latin America and Caribbean Central Banks, essentially representing a roll-over of a maturing borrowing of $53.4 million. The funded debt increased by approximately $78.2 million due to upward adjustment of the U.S. dollar equivalent of borrowings denominated in non-member currencies. The funded debt was decreased through the retirement of approximately $53.2 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 41 members with subscriptions totaling $3.08 billion.

Through June 30, 1975, the Bank's borrowings totaled the equivalent of $567 million. In 1975 the Bank issued obligations of the equivalent of $103.6 million in Japan, $14.4 million in Saudi Arabia and $70 million to various Central Banks. In 1975. borrowing in the United States was $75 million at 8.5 percent. Before selling securities in a country, the Bank must obtain the country's approval.

As of June 30, 1975, 12 countries had contributed or pledged a total of $270 million to the Bank's concessionary loans fund. A total of $57.4 million from Ordinary Capital resources have been set aside by the Board of Governors for concessionary loan purposes. In addition Congress has authorized a further $50 million contribution and is considering the appropriation of these funds in fiscal 1976.

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 fiscal year 1975, 528 trust indentures relating to securities in the aggregate amount of $34.9 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[34] 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 the 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)[35] 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 provides 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 interpretative letters received after December 31, 1970, and responses thereto (17 CFR 200.81). 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 Information 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.

Most of the administrative appeals decided by the Commission from the effective date of the amendments to the close of the fiscal year were 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.[36] 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.[37] 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,[38] except where a demonstration of particularized need for access to the records sufficient to outweigh considerations of personal privacy has been made.[39]

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 Securities 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 1975 fiscal year, 19,186 persons examined material on file in Washington; several thousand others examined files in New York, Chicago, Los Angeles, and other regional offices. More than 47,282 searches were made for information requested by individuals, and approximately 4,949 letters were written on information requested.

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 15 cents per page for pages not exceeding 8½” x 14” in size, with a $2 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” x 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-printers 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 12 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 *Wolfson v. S.E.C.*,[40] plaintiff requested access to the contents of two investigatory files compiled in the early 1950's. Following the enactment of the amendment to the Freedom of Information Act relating to the exemption for investigatory records, the Commission reconsidered its earlier denial of access to the requested records, and

granted plaintiff's request with respect to all investigatory records in its possession, with the exception of inter- and intra-agency memoranda contained in the file, which in the Commission's view were exempt by virtue of the fifth exemption of the Freedom of Information Act. The court thereupon allowed plaintiff a period of time to amend his complaint, and upon his failure to do so, the action was dismissed.

In *First Mid America v. S.E.C.*,[41] the Commission was named in a suit seeking an injunction to prohibit the disclosure of certain investigatory records it had previously determined to produce to a third party who had requested access pursuant to the Freedom of Information Act. In its complaint, plaintiff claimed that the records the Commission proposed to disclose were protected by the attorney-client privilege and that disclosure would be an unwarranted invasion of personal privacy. After stipulating that it would not disclose the records pending resolution by the court of the issues raised by the complaint, the Commission filed an Answer and Counterclaim for Interpleader seeking to bring into the suit as the real party in interest the person seeking the records under the Freedom of Information Act. Before the Commission's motion to add the requester as a party had been acted upon, however, plaintiff withdrew its claim and the parties stipulated to the dismissal of the action.

At the close of the fiscal year, suits brought pursuant to the Freedom of Information Act were pending against the Commission in *American Institute Counselors, Inc., et al. v. S.E.C.*[42] and *Sahley v. Federal Bureau of Investigation, et al.*[43] In both of these cases, subjects of Commission investigations are seeking access to the contents of active investigatory files concerning them.

NOTES FOR PART 2

[1]Securities Act Release No. 5530 (October 3, 1974), 5 SEC Docket 208.

[2]Securities Act Release No. 5231 (February 3, 1972).

[3]Securities Act Release No. 5515 (July 22, 1974), 4 SEC Docket 623.

[4]Securities Exchange Act Release No. 11124 (December 6, 1974), 5 SEC Docket 626.

[5]Securities Exchange Act Release No. 11419 (May 14, 1975), 6 SEC Docket 893.

[6]Accounting Series Release No. 150 (December 20, 1973), 3 SEC Docket 275.

[7]Securities Act Release Nos. 5541 (November 21, 1974), 5 SEC Docket 499, and 5601 (July 31, 1975), 7 SEC Docket 457.

[8]Accounting Series Release No. 180 (November 4, 1975) and Staff Accounting Bulletin No. 1 (November 4, 1975).

[9]Accounting Series Release No. 162 (September 27, 1974), 5 SEC Docket 181 and 387.

[10]Accounting Series Release No. 166 (December 23, 1974), 5 SEC Docket 772.

[11]Accounting Series Release No. 169 (January 23, 1975), 6 SEC Docket 130.

[12]Accounting Series Release No. 172 (June 13, 1975), 7 SEC Docket 143.

[13]Accounting Series Release No. 163 (November 14, 1974), 5 SEC Docket 436.

[14]Accounting Series Release No. 164 (November 21, 1974), 5 SEC Docket 500.

[15]Accounting Series Release No. 165 (December 20, 1974), 5 SEC Docket 767.

[16]Accounting Series Release No. 159 (August 14, 1974), 5 SEC Docket 1.

[17]Accounting Series Release No. 171 (May 1, 1975), 6 SEC Docket 801.

[18]Accounting Series Release No. 175 (July 10, 1975), 7 SEC Docket 339.

[19]Accounting Series Release No. 177 (September 10, 1975), 7 SEC Docket 816.

[20]Securities Act Release No. 5549 (December 19, 1974), 5 SEC Docket 727.

[21]Securities Act Release No. 5579 (April 17, 1975), 6 SEC Docket 670.

[22]Securities Exchange Act Release No. 11354 (April 17, 1975), 6 SEC Docket 682.

[23]Securities Act Release No. 5612 (September 10, 1975), 7 SEC Docket 825.

[24]Securities Act Release No. 5513 (July 11, 1974), 4 SEC Docket 551.

[25]Securities Act Release No. 5587 (May 27, 1975), 7 SEC Docket 58.

[26]17 C.F.R. 201.2(e) Accounting Series Release No. 157 (July 8, 1974), 4 SEC Docket 547.

[27]Accounting Series Release No. 158 (July 19, 1974), 4 SEC Docket 591; No. 161 (August 29, 1974), 5 SEC Docket 61; and No. 170 (January 27, 1975) 6 SEC Docket 188.

[28]Accounting Series Release No. 167 (December 24, 1974), 5 SEC Docket 780.

[29]Accounting Series Release No. 160 (August 27, 1974), 5 SEC Docket 89.

[30]Accounting Series Release No. 168 (January 13, 1975), 6 SEC Docket 76.

[31]Accounting Series Release No. 173 (July 2, 1975), 7 SEC Docket 301.

[32]Accounting Series Release No. 174 (July 2, 1975), 7 SEC Docket 293.

[33]Accounting Series Release No. 176 (July 22, 1975), 7 SEC Docket 432.

[34]Pub. L. No. 93-502.

[35]See Securities Act Release No. 5571 (February 21, 1975), 6 SEC Docket 286.

[36]See, e.g., In the Matter of Request of I. Walton Bader, FOIA Rel. No. 1, (April 3, 1975) 6 SEC Docket 541; In the Matter of Request of Jeffrey B. Albert, FOIA Rel. No. 10 (June 11, 1975), 7 SEC Docket 138.

[37]Securities Act Rel. No. 5571 (February 21, 1975), 6 SEC Docket at 288. In the Matter of Request of John A. Jenkins, FOIA Rel. No. 11 (June 11, 1975), 7 SEC Docket 139.

[38]In the Matter of Request of John A. Jenkins, FOIA Rel. No. 11, (June 11, 1975), 7 SEC Docket 139.

[39]In the Matter of Request of Jung Ja Malandris, FOIA Rel. No. 8, (May 29, 1975), 7 SEC Docket 58.

[40]D.D.C., No. 74-1372.

[41]D.D.C., No. 75-0314.

[42]D. Mass., No. 75-1578-F. For the Commission's disposition of the administrative appeal in this matter, see In the Matter of Request of American Institute Counselors, FOIA Rel. No. 3 (April 24, 1975), 6 SEC Docket 718.

[43]E.D. La., No. 75-1831. For the Commission's disposition of the administrative appeal in this case, see In the Matter of Request of Lloyd William Sahley, FOIA Rel. No. 4 (April 24, 1975), 6 SEC Docket 719.

PART 3
REGULATION OF SECURITIES MARKETS

In addition to the disclosure provisions discussed in the preceding chapter, the Securities Exchange Act assigns to the Commission broad regulatory responsibilities for securities markets and persons in the securities business. That Act, among other things, requires securities exchanges to register with the Commission, provides for Commission supervision of the self-regulatory responsibilities of registered exchanges, and permits registration of associations of brokers or dealers exercising self-regulatory functions under Commission supervision. The Act requires registration and regulation of brokers and dealers doing a business in securities. It also contains provisions designed to prevent fraudulent, deceptive and manipulative acts and practices on the exchanges and in the over-the-counter markets.

The Securities Acts Amendments of 1975 (the “1975 Amendments”)[1] establish a new self-regulatory organization, the Municipal Securities Rulemaking Board, to formulate rules for the municipal securities industry subject to the oversight of the Commission. The amendments also authorize a national system for the clearance and settlement of securities transactions and require municipal securities dealers, certain

securities information processors, clearing agencies and transfer agents to register, keep records, and file reports with the Commission. These recent developments concerning regulation of the securities markets are discussed in Part I.

REGULATION OF EXCHANGES

Registration

The Securities Exchange Act generally requires a securities exchange to register with the Commission as a national securities exchange unless the Commission exempts it from registration because of the limited volume of its transactions.[2] As of June 30, 1975, the following 13 securities exchanges were registered with the Commission:

American Stock Exchange, Inc.
Board of Trade of the City of Chicago
Boston Stock Exchange
Chicago Board Options Exchange, Incorporated
Cincinnati Stock Exchange
Detroit Stock Exchange
Midwest Stock Exchange, Inc.
National Stock Exchange
New York Stock Exchange, Inc.
Pacific Stock Exchange, Inc.
PBW Stock Exchange, Inc.
Intermountain Stock Exchange
Spokane Stock Exchange

On January 31, 1975 the National Stock Exchange ceased operations and has since been proceeding with the necessary steps under New York State law for corporate dissolution. That exchange is also in the process of seeking delisting of its listed securities and will then withdraw its registration as a national securities exchange.

In March 1975 the Executive Committee of the Board of Trade of the City of Chicago adopted a resolution to close the Board's securities

market. The Commission's staff has been informed that the Board is now prepared to file a written notice of withdrawal from registration.

Delisting

Pursuant to Section 12(d) of the Exchange Act, securities may be stricken from listing and registration upon application to the Commission by an exchange, or withdrawn from listing and registration upon application by an issuer, in accordance with the rules of the exchange and upon such terms as the Commission may impose for the protection of investors. It is the Commission's view that in evaluating delisting applications, it is not generally the Commission's function to substitute its judgment for that of an exchange, and that where there has been full compliance with the rules of an exchange with respect to delisting, the Commission is required to grant a delisting application. The authority of the Commission in such cases is limited to the imposition of terms deemed necessary for the protection of investors.[3]

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 an 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 criteria for earnings or financial condition; or (4) required reports have not been filed with the exchange.

During fiscal year 1975, the Commission granted exchange applications for the delisting of 125 stock issues and 14 bond issues. The largest number of applications came from the American Stock Exchange, 41 stocks and 4 bonds. The number of applications granted other exchanges were: New York, 24 stocks and 8 bonds; Pacific, 16 stocks and 1 bond; National, 15 stocks; PBW, 14 stocks; Midwest, 9 stocks;. Boston, 4 stocks; Cincinnati, 1 bond; Detroit and Intermountain, 1 stock each.

Exchange Disciplinary Actions

The 1975 Amendments adds a new Section 19(d) to the Securities Exchange Act requiring exchanges to report to the Commission, and authorizing the Commission to review, any final disciplinary sanction imposed by an exchange that (i) denies membership or participation to any applicant, (ii) prohibits or limits any person access to services offered by an exchange or member thereof, or (iii) imposes final disciplinary sanctions on any person associated with a member or bars any person from becoming associated with a member. Before the Amendments, the Securities Exchange Act did not explicitly authorize the Commission to review exchange disciplinary actions, although each national securities exchange did report voluntarily to the Commission disciplinary action taken against members and member firms and their associated persons.

During the fiscal year, five exchanges reported a total of 107 separate disciplinary actions, including the imposition in 81 cases of fines ranging from $25.00 to $20,000; the expulsion of 6 individuals; the suspension from membership (for periods of 3 to 36 months) of 5 member organizations and 8 individual members; and the censure of 20 member organizations.

EXCHANGE RULES

The Commission's staff continually reviews the rules and practices of the national securities exchanges to determine the adequacy and effectiveness of the self-regulatory scheme. To facilitate Commission oversight, each national securities exchange has been required to file with the Commission a report of any proposed change in rules or practices not less than three weeks (or such shorter period as the Commission may authorize) before implementing a change. These filings have been available for public inspection.

Under the 1975 Amendments, national securities exchanges are now required to file with the Commission any proposed change in exchange rules accompanied by a concise general statement of the basis and purpose of such proposed rule change. In general, the

Commission must then publish notice of the proposed rule change together with the terms of such change or a description of the subjects and issues involved and give interested parties an opportunity to submit their views concerning such proposed rule change. No proposed rule change may take effect unless approved by the Commission or otherwise permitted by the Securities Exchange Act.

During the fiscal year, the Commission received 153 letters from exchanges proposing amendments involving over 500 rules and stated practices. The following were among the more significant:

1. All the registered exchanges adopted rule amendments which provide for competitive commission rates on public transactions, and several exchanges adopted rule amendments which provide for competitive commission rates on intra-member transactions. For further discussion of competitive commission rates, see Part I.

2. The American Stock Exchange (“Amex”) and the PBW Stock Exchange adopted rule changes which allowed the establishment of odd-lot markets in U.S. government debt obligations on the respective exchanges.

3. The New York Stock Exchange (“NYSE”) adopted rule changes which increased fees for persons who elected to utilize the NYSE's arbitration facilities and also modified certain arbitration procedures.

4. Most of the national stock exchanges adopted rule amendments which extended their trading hours from 3:30 P.M. to 4:00 P.M. EST.

5. The NYSE, the Amex, the Midwest and Pacific Stock Exchanges adopted rule changes which increased the original and annual maintenance listing fees paid to the respective exchanges by companies which have securities listed on those exchanges.

6. The NYSE, the Amex, and their affiliated clearing corporations submitted for Commission review rule changes designed to implement continuous net settlement systems for the clearing of exchange-listed

securities. For a further discussion of the development and operation of continuous settlement systems, see Part I.

7. The NYSE, the Amex and the Chicago Board Options Exchange adopted minimum margin maintenance requirements for options carried by broker-dealers for their customers, as well as for market makers, specialists or registered traders for whom such broker-dealer clear transactions on an exchange. The rules of each of the three exchanges dealt with margining uncovered options and various spread or hedged option positions.

EXCHANGE INSPECTIONS

NYSE Specialist Inspection

On June 19, 1974, the Commission's staff wrote a letter to the NYSE to inform it of the findings of an inspection of that exchange's specialist surveillance and stock allocation programs which was begun with a visit to the NYSE on May 29, 1973.[4]

The letter summarized the Division's conclusions with respect to (1) the NYSE's use of the “New Measures of Specialist Performance” (“New Measures”), (2) the basis for judging specialist performance developed by the New Measures, (3) the use of sampling techniques, (4) the use of disciplinary action in cases of poor performance, (5) the allocation of securities to specialists and (6) the need for more complete minutes of NYSE Floor Committee meetings.

On June 16 and 17, 1975, the Commission's staff conducted a further on-site inspection to review procedures adopted by the NYSE in response to the staff letter of June 19, 1974. In a June 26, 1975 letter to the NYSE, the Commission staff, after noting that only preliminary results from the inspection were then available, expressed concern that the NYSE apparently did not implement procedures to provide for more detailed and informative NYSE Floor Committee minutes until long after the staff made the request in the June 19, 1974 letter. In addition, the staff noted that the initial exchange efforts to maintain

more extensive records still did not reflect sufficient information about stock allocation decisions. The staff stated that until questions relating to the specialist system were resolved satisfactorily, a number of procedures should be adopted to better enable the NYSE Board of Directors to insure that the current system of allocating stocks to a particular specialist unit was administered adequately.

More specifically, the Commission's staff suggested that a transcript be kept of those portions of NYSE Floor Committee meetings which related to the allocation or reallocation of stocks to or from specialist units or to proposed mergers of such units. It was also suggested that the entire record, including copies of all memoranda and reports considered by the Floor Committee regarding such matters, be made available to the NYSE Board of Directors along with the Floor Committee's recommendations, and that those recommendations be supported by a statement of the factors the Floor Committee considered in concluding that a particular unit, as opposed to any other units, should have stocks allocated to it. The Division also urged again that minority views be reflected. The Division further requested an early status report regarding this interim action.

Chicago Board Options Exchange Inspection

From August 19-22, 1974, members of the Commission's staff inspected various aspects of the Chicago Board Options Exchange (“CBOE”) options pilot program. The purpose of the inspection was to gain a general familiarity with the operation of the CBOE's floor, including tracing the handling of an order from the time of receipt on the floor through its being filled and printed on the transaction tape. The Commission's staff noted the crowded conditions of the CBOE floor and reviewed with CBOE officials their plans for a new trading floor. In accordance with those plans, the CBOE moved during the fiscal year to a new, greatly enlarged floor which opened for options trading on December 2, 1974.

The Commission's staff also took note of problems relating to the reporting of options transactions and the inability of investors to obtain quotations and last sale data with respect to options transactions.

Following the Commission's inspection, the CBOE installed high speed lines for reporting transactional data and, along with the Amex, engaged the Securities Industry Automation Corporation as a central processor for that data. As a result of the CBOE's corrective measures, significant progress has been made toward resolving the problems relating to the reporting of transactional information and obtaining quotations and last sales data.

The Commission's staff also inspected CBOE's floor surveillance program. During that inspection, the staff observed the CBOE's innovative system of using “post coordinators” to monitor the performance of market makers. Under the CBOE's monitoring system, post coordinators stand at each trading post located on the floor of the exchange to insure that bids and offers are properly recorded and to detect and report possible violations of exchange rules in the trading crowd. The Commission's inspection group informally recommended expansion of the post coordinator function; because of staff problems, however, the CBOE substantially eliminated the surveillance role of these individuals. At the end of the fiscal year, the Commission's staff planned to hold further discussions with officials of the CBOE about reinstating the post coordinator inspection system. In connection with the CBOE's floor surveillance, the Commission's staff recommended, and the CBOE instituted, a floor members' disciplinary action bulletin to describe action taken by the Business Conduct Committee of the CBOE for violations of floor practice rules and to keep its floor members abreast of the conduct proscribed by the CBOE.

American Stock Exchange Options Program Inspection

On April 1 and 2, 1975, members of the Commission's staff conducted an inspection of certain aspects of the Amex pilot program for listing and trading call options. Special emphasis was given to an examination of the Amex's market surveillance of options trading, its surveillance of registered options traders and options specialists, and observation of options trading as conducted on the exchange floor. The Commission's staff also examined the Amex's methods for conducting inquiries into such matters as unusual trading activity and/or violations (if any) of exchange rules of policy.

Partly as a result of this inspection, the Commission's staff recommended that the Amex elaborate upon the responsibilities of floor members in assisting the specialist in his options market-making capacity. The Amex responded that it would again inform all parties, i.e., registered traders, specialists, and floor brokers, of their obligations in that regard.[5] Furthermore, through a special exchange bulletin on this subject sent to its floor members, the Amex outlined its policies concerning the responsibilities of those members.[6]

Preliminary Inspection of Contemplated PBW Option Pilot

On June 23 and 24, 1975, the Commission's staff conducted a preliminary inspection of the PBW Stock Exchange, Inc. (“PBW”) pilot program for trading call options. The inspection was conducted during the PBW's test simulation program, before the actual initiation of trading. The staff paid particular attention to the adequacy of exchange facilities and market surveillance systems. The Commission's staff found two possible impediments to future expansion of the PBW's option pilot. The first was that the use of a manual floor display of market quotations on a chalkboard rather than on a cathode ray tube might prove to be inefficient in a period of heavy trading. Secondly, the staff questioned whether presently available floor space could accommodate additional option classes beyond the 10 initially authorized NYSE-listed common stocks. These matters were to be discussed with PBW officials early in the next fiscal year.

SUPERVISION OF NASD

The Securities Exchange Act provides that any association of brokers or 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 the Act. The 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 must have rules designed to protect investors and the public interest, to promote just

and equitable principles of trade and to meet other statutory requirements. Registered national securities associations operate under the Commission's general supervisory authority, which includes the power to review disciplinary actions taken by an association, to disapprove changes in association rules and to alter or supplement rules relating to specified matters. The National Association of Securities Dealers, Inc. (“NASD”), is the only association registered with the Commission under the Act.

In adopting legislation to permit the formation and registration of national securities associations, Congress provided an incentive to membership by permitting such associations to adopt rules which preclude any member from dealing with a nonmember broker or dealer except on the same terms and conditions and at the same prices as the member deals with the general public. The NASD has adopted such rules. As a practical matter, therefore, membership is necessary for profitable participation in many underwritings, since members properly may grant only to other members price concessions, discounts and similar allowances not granted to the general public.

By the close of the fiscal year, the number of NASD firms had declined by almost 11 percent from the previous year, leaving 2,991 members, a net loss of 327 members during the year. This loss reflects the net result of 158 admissions to and 485 terminations of membership. The number of members' branch offices decreased by 224, to 5,924 as a result of the opening of 834 new offices and the closing of 1,058. The reduction in the number of members and branch offices and the consolidation of others resulted generally in larger and better capitalized organizations. During the fiscal year, the number of registered representatives and principals (these categories include all partners, officers, traders, salesmen and other persons employed by or affiliated with member firms in capacities which require registration) decreased by 9,393 to 197,702 as of June 30, 1975. This decrease reflects the net result of 14,011 initial registrations, 19,527 re-registrations and 42,931 terminations of registration during the year.

During the fiscal year, the NASD administered 40,576 qualification examinations of which 21,799 were for NASD qualification, 3,052 for

the Commission's SECO program[7] and the balance for other agencies, including major exchanges and various states.

NASD Rules

Under the Securities Exchange Act, as in effect before the enactment of the 1975 Amendments, the NASD was required to file for Commission review copies of proposed rules or rule amendments 30 days prior to their proposed effectiveness.[8] Any rule changes or additions may be disapproved by the Commission if it finds them to be inconsistent with the requirements of the Act. Generally, the Commission also reviews, in advance of publication, general policy statements, directives and interpretations to be issued by the Board of Governors pursuant to the Board's power to administer and interpret NASD rules.

During the fiscal year, numerous changes in or additions to NASD rules were submitted to the Commission for its consideration. Among the major filings which were not disapproved by the Commission were:

1. Amendments to Schedule D of the NASD's By-laws relating to the initial standards for inclusion of securities in the NASDAQ system. The minimum number of shareholders was reduced from 500 to 300. It had become increasingly difficult for new issues to meet the higher 500 shareholder test because of the emphasis within the industry on the practice of holding securities in “street name.” At the same time the price of the security was eliminated as a criterion for inclusion in NASDAQ. This major liberalization of the requirements was made because it was felt that the- safeguards that are imposed by other applicable NASDAQ criteria, such as the Section 12(g)(1) registration[9] and the assets and net worth standards, as well as the NASD's continuing and improved market surveillance programs, are sufficient to prevent the various abuses at which the price criterion was aimed.

2. Amendments to Schedule D of the NASD's By-laws to provide for the elimination of the minimum bid quotation requirements for issues on the National Lists for over-the-counter securities published in newspapers and other media. The principal effect of this amendment

was to allow the NASD, in face of lower market prices during the past two years, to continue to utilize available newspaper space for the National Lists.

3. Amendments to Schedule C of the NASD's By-laws providing for the establishment of new NASD qualification examinations for representatives engaging in general securities activities. In order to upgrade the qualification standards for securities industry personnel and to develop tests suited to specific categories of persons, the NASD, along with the NYSE, developed a new comprehensive examination for general securities representatives. The examination consists of two 125 question parts and is given in separate three-hour sessions. The examination is divided into four subject matter areas: Industry Regulation and Brokerage Office Procedures, Product Knowledge, Financial and Security Analysis, and the Servicing of Accounts. In addition, the NASD is developing separate examinations, which would be given in lieu of the new general securities examination to individuals selling only special types of securities such as mutual funds, variable life and annuity contracts, or limited partnership interests.

4. Amendments to Schedule A of the NASD's By-laws providing for an increase in the gross income assessment rate for member firms, and for a special service charge for qualification examinations administered by the NASD in its foreign test centers. The gross income assessment levy is a means used by the NASD to provide for the equitable allocation of dues among its members to defray reasonable expenses of administration. The service charge for foreign test centers was imposed to cover the additional expenses involved in administering such a program.

5. Amendments to Schedule G of the By-laws governing the reporting by members of over-the-counter transactions in listed securities to the consolidated tape, and amendments to the By-laws, Operating Rules and Interim Rules of the National Clearing Corporation were adopted to facilitate reporting.[10]

NASD Inspections

During the fiscal year, the Commission's staff inspected the NASD's district offices in Philadelphia and Chicago, and commenced an inspection of the operations of its NASDAQ and Market Surveillance Departments located in its Washington headquarters office. Those inspections were conducted as a part of the Commission's oversight responsibilities to assure that the NASD is properly carrying out its self-regulatory functions, and to coordinate with the NASD in regulating and enforcing activities in the over-the-counter markets.

The district office inspections involved a review of (1) the composition and effectiveness of the District Committees, the District Business Conduct Committees, examination subcommittees, nominating committees and quotations committees; (2) the functioning of the district staffs, especially their working relationships with the various committees; (3) the district staffs' coordination and cooperation with the Commission's regional offices, exchanges and other interested regulatory bodies; (4) the effectiveness of disciplinary procedures; and (5) the need, if any, for new rules or amendments to existing rules, policies or interpretations. The inspection of the operations of NASDAQ and Market Surveillance Departments involved a review of similar areas of concern, with particular concentration on the effectiveness of the NASDAQ regulatory procedures necessary to protect and promote a fair and orderly marketplace.

The inspection of the NASD's Philadelphia district office revealed several areas of concern which the staff felt merited further discussion with representatives from the NASD's headquarters office. Specifically, the staff noted problems in the following areas: (1) delays in the preparation and subsequent processing of formal complaint actions against firms and individuals; (2) the adequacy of follow-up inquiries based on notices received Jay the NASD of registered representative terminations of employment with member firms; and (3) a lack of communications with the Commission concerning possible securities acts violations.

These matters were discussed with representatives of the NASD. In response to the problem of timely processing of formal complaint

actions, the NASD has made personnel changes in the Philadelphia district and added an attorney to the district staff to help in reducing backlogs. In response to the other problems, the NASD has indicated to the Commission's staff that greater depth would be sought in the future with respect to the handling of registered representative termination notices and matters for referral to the Commission concerning possible securities acts violations.

An inspection of the NASD's Chicago district office also revealed certain areas of concern warranting discussion with the NASD's headquarters office. Specifically, the staff noted problems in the following areas: (1) possible over-representation of exchange-oriented firms on the District Committee; (2) some delays in the preparation of formal complaint actions and in the writing of District Business Conduct Committee (“DBCC”) decisions against firms and individuals; (3) imposition by the DBCC of apparently insufficient sanctions in certain cases; (4) delays by the staff in presentation of disciplinary matters to the DBCC in several instances; (5) a continuing reluctance on the part of the District to utilize the Letters of Admission, Waiver and Consent[11] procedure in appropriate cases in accordance with headquarters policy; and (6) a possible need for more frequent DBCC meetings in order to provide for more efficient disposition of its disciplinary caseload.

While a report on these findings has been prepared and the Commission's staff sent a preliminary letter to the NASD, these matters have not yet been discussed in detail with NASD representatives. A meeting with the NASD will be scheduled for early in the next fiscal year.

NASD Disciplinary Actions

The Commission receives from the NASD copies of its decisions in all cases where disciplinary action is taken against members and persons associated with members. Generally, such actions are based on allegations that the respondents violated specified provisions of the NASD's Rules of Fair Practice. Where violations by a member are found, the NASD may impose such penalties as expulsion,

suspension, fine, or censure. If the violator is an individual, his registration with the NASD may be suspended or revoked, he may be suspended or barred from being associated with any member or he may be fined and/or censured.

During the past fiscal year, the NASD reported to the Commission its final disposition of 486 disciplinary complaints in which 330 members and 553 individuals were named as respondents. Complaints against 23 members and 53 individuals were dismissed for failure to establish the alleged violations. Forty-six members were expelled from membership and 24 members were suspended for periods ranging from one day to one year. In many of these cases, a fine also was imposed. In 210 cases, members were fined amounts ranging from $25 to $50,000 and in 27 cases members were censured. In disciplinary sanctions imposed on individuals associated with member firms, 142 persons were barred or had their registrations revoked and 91 had their registrations suspended for periods ranging from one day to eight years. In addition, 243 other individuals were censured and/or fined in amounts ranging from $100 to $50,000.

Review of NASD Disciplinary Actions

Disciplinary action taken by the NASD is subject to review of the Commission on its own motion or on the timely application of any aggrieved person. In those cases reviewed by the Commission before the enactment of the 1975 Amendments, the effectiveness of any penalty imposed by the NASD was automatically stayed pending Commission review, unless the Commission otherwise ordered after the notice and opportunity for hearing.[12] If the Commission found that the disciplined party committed the acts found by the NASD and that such acts violated the specified rules, the Commission was required to sustain the NASD's action unless it found that the penalties imposed were excessive or oppressive, in which case it was required to reduce them or set them aside.

At the beginning of the fiscal year, 26 proceedings to review NASD disciplinary decisions were pending before the Commission and, during the year, 16 additional cases were brought up for review. The

Commission disposed of 11 cases. In six cases the Commission affirmed the NASD's action and in two other cases dismissed the appeal because of respondent's failure to file a brief. In two cases, the NASD's findings and/or penalties were modified and in one case the NASD's action was set aside. At the close of the fiscal year, 31 cases were pending.

In *Thomas E. Jackson*,[13] the Commission, affirming the NASD, held that a registered representative can be disciplined for conduct not arising directly out of securities activities. Jackson was charged with violating the requirement of the NASD's Rules of Fair Practice that members and associated persons adhere to “high standards of commercial honor and just and equitable principles of trade”,[14] because he forged the signatures on applications for insurance in order to obtain commissions to which he was not entitled. The Commission held that Jackson's conduct obviously did not meet such standards.

The Commission cited the 1938 Maloney Act amendment to the Securities Exchange Act, which provided for the voluntary registration of self-regulatory associations of securities brokers and dealers and sought to eliminate abuses and up-grade standards of conduct in the over-the-counter markets by setting up a system of self-regulation. Such associations were to provide rules designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and in general, to protect investors and the public interest. The Commission saw no reason why the NASD should be precluded from, carrying out its mandate to protect its members and their customers against a repetition of the kind of conduct in which Jackson engaged. In addition, the Commission noted that although Jackson's wrong-doing in this instance did not involve securities activities, the NASD could justifiably conclude that on another occasion it might.

In *Livada Securities Co.*,[15] the Commission affirmed the NASD's findings that the respondent violated the net capital rule and failed to prepare and maintain proper books and records. It sustained the fine

imposed by the NASD despite the respondent's contention that the penal-

ties were excessive in light of various mitigating circumstances, i.e., the violations were inadvertent and attributable in part to respondent's inexperience and there were no customer losses. The Commission observed that the issue before it was not whether it would have imposed the same sanctions as the NASD, but whether the penalties imposed were excessive or oppressive, having due regard for the public interest. The Commission stated that it was in full accord with the NASD's stress on the importance of a firm's compliance with the net capital and recordkeeping requirements. The Commission emphasized, furthermore, that the net capital rule, which was designed to assure financial responsibility of brokers and dealers, has been described as “one of the most important weapons in the Commission's arsenal to protect investors,”[16] and that accurate and current records are essential to enable a broker-dealer to determine compliance with net capital and other requirements.

Review of NASD Membership Action

Before the enactment of the 1975 Amendments, the Securities Exchange Act and NASD By-laws provided that, unless approved by the Commission, no broker or dealer could become or continue to be an NASD member if it or any person associated with it was subject to specified disabilities.[17] Commission action to approve or direct the admission of a person to membership in the NASD, or the continuance of membership of any person, is generally sought after an initial petition to the NASD is made by the member or applicant for membership. The NASD in its discretion may then file an application with the Commission on behalf of the petitioner. If the NASD refuses to sponsor the application, the broker or dealer may apply directly to the Commission for an order directing the NASD to admit it to, or to continue it in, membership. At the beginning of the fiscal year, four applications were pending before the Commission. During the year, seven applications were filed, five were approved and two were withdrawn, leaving four applications pending at the end of the year. All of the applications were filed by the NASD.

NASDAQ Issuer Removal

On March 13, 1975, the Commission issued an order dismissing review proceedings on an application for review by *Tassaway, Inc.*,[18] a publicly held company whose common stock was removed from the NASD's automated quotation system ("NASDAQ"),[19] because the issuer failed to maintain at least $250,000 in capital plus surplus, as required by NASD rules. Tassaway's application under Securities Exchange Act Rule 15AJ-2 for review of its removal from NASDAQ was the first ever made to the Commission by a NASDAQ issuer. Tassaway conceded its failure to meet NASDAQ's numerical qualitative test[20] but argued that a proposed acquisition would, when consummated, give it more than enough capital to meet NASDAQ's capital test. In view of the fact that the acquisition agreement was rescinded during the pendency of the appeal, the Commission ordered that the proceeding be dismissed.

Since this was the Commission's first such appeal, however, it took the opportunity to state the basic standards by which it would be guided when asked to review the NASD's actions with respect to access to NASDAQ. The Commission expressed the view that the NASD's role in NASDAQ is, in essence, the same as that of exchanges with respect to the listing and delisting of securities and, citing prior decisions on the latter subject, the Commission concluded that the governing legal standards should be the same, i.e., (1) though exclusion from the system may hurt existing investors, primary emphasis must be placed on the interest of prospective future investors[21]; (2) the Commission's review function is solely that of determining whether "the specific grounds on which the action of the self-regulatory organization is based exist in fact and are in accord with the applicable rules of the association"; and (3) to the extent that discretion enters into the matter, the Commission is not at liberty to substitute its discretion for that of the NASD.

EXPENSES AND OPERATIONS OF SELF-REGULATORY ORGANIZATIONS

The year 1974 was a poor one for the securities markets in general, and the major self-regulatory organizations suffered financially as a result.[22] The high national rate of inflation seems to have been a primary influence on the markets during the year.

In an inflationary period, it can normally be expected that expenses, such as wages and salaries, will rise in accord with the general inflation rate; and during 1974 this was the case with the NYSE and the NASD, whose expenses are heavily weighted with personnel costs, as might be expected of a regulatory body. Many industries, however, pass on these increased costs through higher prices for the goods and services they market. The securities industry, however, is almost totally a service industry and must finance its self-regulatory effort very largely through fees and assessments levied on persons engaged in the business. Its revenues, in turn, depend upon, and fluctuate with, the price and volume levels of the securities being marketed. The self-regulatory organizations, whose revenues must depend, in the final analysis, on the profitability of their member firms were caught in the middle. Their revenues declined while their expenses were increasing in line with the high rate of inflation.

Cost-cutting measures were introduced by most self-regulatory organizations to meet this problem; nevertheless, particularly in the case of the NYSE and the NASD, those measures were not fully adequate because of their need to meet on-going and increasing regulatory and surveillance responsibilities.

Total share volume of securities traded on all national securities exchanges and over-the-counter continued to decline in 1974, amounting to approximately 6.0 billion shares in 1974 as compared with 7.4 and 8.5 billion shares in 1973 and 1972, respectively. As a group, the self-regulatory organizations' combined total revenues declined to $173 million in 1974 from $180 million in 1972, as a result mostly of the decrease in trading volume. Communication fees, however, rose from $19 million to $21 million, and revenue from depository fees increased by $3 million primarily because of the activity of a newly formed Midwest Stock Exchange subsidiary, the

Midwest Stock Trust Company. Changes in various other revenue components were as follows:

Revenues on transactions fees declined to $24 million from $29 million;

Revenues on listing fees declined to $25 million from $26 million;

Revenues from clearing fees declined to $30 million from $36 million;

Revenues from tabulating services declined to $11 million from $12 million; and

Revenues from all “other” sources increased to $39 million from $38 million because of an increase in membership dues.[23]

Thus, the self-regulatory organizations as a group suffered a net loss of $1.1 million (before taxes) in 1974 as opposed to net income of $2.2 million and $18.9 million in 1973 and 1972, respectively. In the first six months of 1975, however, the situation improved in line with the increased market activity, resulting in net income before taxes of $12.1 million.

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 is filed pursuant to Section 15A of the Securities Exchange Act, which requires the NASD to have an equitable allocation of dues among its members to defray reasonable expenses of administration.

The NASD's statement of financial results for its fiscal year ended September 30, 1974, revealed that the NASD's equity declined to $7.8 million from $8.4 million the year before. The decline in equity resulted from lower net operating earnings and a larger loss incurred by the

National Clearing Corporation, the NASD's wholly-owned clearing subsidiary, which was charged to NASD earnings.

Operating revenues of the NASD declined by $0.5 million to $12.2 million, a decline of 4%. This reduction in income was brought about by two major factors. First, a major source of revenue, fees charged for administering qualification examinations given principally to individuals entering the business, declined 25%, to $3.1 million in fiscal year 1974, versus $4.1 million in fiscal year 1973. The number of examinees declined from 72,598 in fiscal year 1973 to 47,212 in fiscal year 1974. Secondly, because of poor market conditions, the number of firms having public offerings declined significantly. The total dollar value of public offerings in which NASD members participated fell to $8.65 billion from $14.1 billion in fiscal year 1973, a 53% decline. This decline caused a drop in NASD fees for underwriting arrangements filed with it for review during the NASD's fiscal year. Other NASD revenues were stable, except for a new revenue source that went into effect on June 1, 1974 – the NASDAQ issuer fee, which brought in $0.7 million.

Operating expenses of the NASD dropped by $0.2 million (to $12.1 million in the NASD's 1974 fiscal year from $12.3 million in its 1973 fiscal year) largely as a result of various cost-cutting measures taken by it. Thus, the decreases in operating revenues and expenses resulted in net operating income of $0.1 million as opposed to $0.4 million in the prior year, down but still positive, until the net NCC loss of $0.7 million ($0.3 million in the NASD's 1973 fiscal year) is taken into account.[24] This additional expense put the NASD in a net loss position of $0.6 million in its 1974 fiscal year as opposed to a profit of $0.1 million in fiscal year 1973.

More recently, the high trading volume for the first six months of 1975 resulted in higher gross revenues and net income for the NASD. Over that six-month period, both revenues and net income before taxes gradually increased, providing a January-to-June gross revenue in excess of $10 million. Expenses, on the other hand, remained relatively stable during this period, resulting in net income of $0.6 million for the period.

NASD Budget

The review of the NASD budget is conducted as a part of the Commission's regulatory oversight responsibilities, and during the past two years the Commission has been concerned very largely with the program for examination of member broker-dealers to assure that the NASD has a sufficient examiner staff to carry out its enforcement and surveillance responsibilities.

In addition to its usual budget submission, in September 1974, the NASD submitted a “Personnel Budget Study”, which outlined the NASD's projected staff requirements for its fiscal year ending September 30, 1975. That study concluded that a total of 168 field examiners, not including those needed to staff such departments and sections as Internal Review and Anti-Fraud, were needed to complete the 1975 examination program. Selective reductions of certain professional and clerical positions, as recommended in that study, were made to reduce the total authorized field staff from 349 in the NASD's 1974 fiscal year to 285 in its 1975 fiscal year. That was a net budgeted decline of 64 positions (47 professional and 17 clerical). With respect to field staff then on board, however, the study had recommended a reduction in force of only 34 positions (22 professional and 12 clerical).

The recommended reduction was a marked change from a 1973 NASD personnel budget study, which had indicated that the examination program for 1974 would require 213,373 examiner man-hours for completion. The 1974 study concluded that the fiscal year 1975 examination program would require only 156,058 man-hours for completion. Several factors accounted for that projected decrease in staff. First, the number of firms in the association's highest priority category, i.e., member firms doing a general securities business whose only affiliation with a self-regulatory organization is the NASD, dropped appreciably during the year (from 1,208 in 1973 to 1,010, or a decrease of 198 firms). That decline resulted in a “saving” of 15,246 examination man-hours, or 26.6% of the total 1973-1974 difference.

Secondly, the reduction in required man-hours for 1974 was partially the outgrowth of positive enforcement programs in being since 1973, which resulted in a decrease in the number of firms on special surveillance,[25] i.e., a decrease from 90 firms in April 1973 to 48 in April 1974. That resulted in a saving of slightly under 7,000 man-hours, or approximately 12% of the 1973-1974 difference.

Additionally, since the Commission's adoption of a rule about control of customers' securities (Securities Exchange Act Rule 15c3-3) in January 1973, the staff of the NASD has encouraged members to operate pursuant to exemptions afforded by that rule. The NASD estimates that over 200 firms availed themselves of such exemptions, which permitted a reduction in man-hours required for examination of such firms of approximately 8,500 hours, or 15% of the 1973-1974 difference. Also, the NASD eliminated the three-year routine examination frequency cycle for mutual-fund retailers, which reduced the workload by approximately 8,938 examiner man-hours, or 15% of the difference.

Finally, estimates as to the required amount of time for examination of different categories of members were revised in the 1974 study. Those revisions were based on actual experience gained over the most recent eight-month period through the use of the NASD's new time-recording system. That resulted in a decrease of approximately 17,839 man-hours, or 31.3% of the 57,315 man-hour difference in the two studies.

Financial Results of the NYSE

In 1974, the NYSE had net operating revenues of $0.66 million, on total revenues of $72.6 million, as compared with net operating revenues of $3.7 million on gross revenues of $78.0 million in 1973. In addition, the NYSE had a tax credit of $221,000, equity in net revenues of the Depository Trust Company of $552,000, and a credit to capital of $990,000 from initiation fees, for a total of $1.7 million, resulting in an increase in equity to $62.8 million from $61.0 million in 1973. In the prior year, the NYSE's equity had increased by $4.5 million.

As in the case of the NASD, declining revenues as a result of poor market conditions for members in 1974 was the primary reason for significantly lower operating revenues, which decreased by $5.3 million from the previous year to $72.7 million, a decline of nearly 7%. A decline in revenue from two sources made up the bulk of this decrease. First, charges on commissions declined by $2.0 million, to $17.0 million from $19.0 million the previous year. This was a direct result of reduced trading activity on the NYSE – i.e., average daily volume fell from a daily average of 16.1 million shares in 1973 to 13.9 million shares in 1974, a decline of 14%. Secondly, initial listing fees declined by $3.2 million, from $10.8 million in 1973 to $7.6 million in 1974. There were only 48 new listings in 1974 as against 98 in 1973 (which was also a poor year for new listings). This loss in initial listing fee revenue was offset in part by an increase in continuous listing fee revenue of $0.8 million. Thus, there was a net decline of $2.4 million in total listing fee revenue in 1974, to $18.9 million from $21.3 million in 1973. The NYSE's other revenue sources, including communications charges and clearing services, also yielded less in the aggregate, declining by a total of $0.7 million.

Partly as a result of decreased activity on the exchange and partly because of cost-cutting measures, the NYSE reduced its operating expenses by $1.7 million (2.3%). The NYSE reduced expenditures significantly in the following areas:

1. Reduction in leased facilities and equipment expenses by $1.6 million;

2. Elimination of the block automation system, saving $2.2 million;

3. Reduction in legal expenses by $2.3 million;

4. Elimination of the NYSE's national advertising program, saving $1.5 million;

5. Reduction of staff[26] by a total of 280 people, saving $4.5 million; and

6. Reduction of other expenses by $1.0 million.

These savings were offset partially by an salary increases of $2.2 million.

During the first six months of 1975 the NYSE experienced an increase in total revenues as share volume increased from 388 million shares traded in January to 479 million shares traded in June. Expenses during this period were held to $48 million, producing a pre-tax net income of $8.4 million for the six months.

Boston Stock Exchange, Chicago Board Options Exchange, and Midwest Stock Exchange[27]

In contrast to the NYSE and the NASD, the Boston Stock Exchange ("BSE"), the Chicago Board Options Exchange ("CBOE"), and the Midwest Stock Exchange ("MSE") experienced increases in revenues between 1973 and 1974. The MSE increase was caused primarily by expansion of services offered to its members. The CBOE increase was generated mainly from commission charges on increased volume in listed option trading. The BSE increase was the result of a general rise in all sources of revenue. Expenses also increased during this period, resulting in a decline in net income before taxes between 1973 and 1974, except in the case of the CBOE, which reduced its losses in 1974 relative to 1973. Revenue information for the MSE for the first five months of 1975 showed an increase, dipping only slightly in June. Expenses for the MSE during these six months were relatively stable. MSE net income from operations for the first six months, which fluctuated to some degree, totaled $0.8 million. Likewise, CBOE and BSE experienced greater revenues in the first six months of 1975. Expenses for BSE remained stable while those for the CBOE rose because of higher salary costs.

Net income for the first six months of 1975 was $0.2 million for the BSE and $0.8 million for the CBOE.

American Stock Exchange, Detroit Stock Exchange, PBW Stock Exchange and Spokane Stock Exchange

The Amex, the Detroit Stock Exchange (“DSE”), the PBW Stock Exchange (“PBW”), and the Spokane Stock Exchange (“SSE”) all experienced a decline in revenues and expenses between 1973 and 1974, primarily because of low exchange volume and generally unfavorable market conditions. Nevertheless, the first six months of 1975 showed a reversal of the downward trend for these exchanges. Only the PBW showing renewed signs of decline in May and June. Both the DSE and the SSE showed steadily declining expenses during the first half of 1975, while PBW and Amex expenses experienced an overall upswing. Of those four exchanges, only the SSE showed a loss for the first six months of 1975. The Amex, DSE and the PBW had net incomes of $0.5 million, $4,000 and $0.3 million, respectively.

Cincinnati Stock Exchange, Intermountain Stock Exchange, and Pacific Stock Exchange

The Cincinnati Stock Exchange (“CSE”), Intermountain Stock Exchange (“ISE”), and the Pacific Stock Exchange (“PSE”) all increased their revenues and decreased their expenses between 1973 and 1974. The revenue increase for CSE came primarily from listing fees and floor usage revenues. The slight rise in revenues for the ISE came entirely from rental income. The rise in revenues for the PSE was due to increases in member dues, listing fees, and earnings from investments. The rise in revenues for those exchanges caused all three to experience increases in net income between 1973 and 1974.

During the first six months of 1975, the CSE revenues and expenses varied considerably, resulting in a net loss for two of the six months. The ISE experienced declining revenues during the first six months of 1975. This, combined with fluctuating expenses, resulted in losses for four of the six months. The PSE on the other hand, experienced an upward movement in total revenues during the first six months of 1975. Expenses for the PSE also increased, but the increases did not prevent the PSE from operating at a profit for the first half of 1975.

The combined revenues and expenses of all the exchanges and the NASD for the years 1972, 1973 and 1974, and for the months of

January through June, 1975, are presented in tables in part 9. Revenue and expenses for each exchange and for the NASD for. 1974 and for the period January through June, 1975 are also shown in Part 9.

BROKER-DEALER REGULATION

Registration

Brokers and dealers who use the mails or a means of interstate commerce in the conduct of an interstate over-the-counter securities business are required to register with the Commission.[28]

As of June 30, 1975, there were 3,546 broker-dealers registered, compared with 3,982 a year earlier. This represents a decrease of 436, or 10.9 percent, since June 30, 1974. During the year, 709 registrations were terminated, of which 576, or 81.2 percent, were withdrawn by the broker-dealer and 133, or 18.8 percent, were revoked or cancelled by the Commission. During the year, 274 new applications became effective, while 235 new applications were either withdrawn, returned, or denied.

On May 16, 1975,[29] the Commission announced the adoption of Form U-3, a uniform application for registration as a broker-dealer under Section 15(b) of the Securities Exchange Act and for the amendment of that registration. Form U-3 replaced Form BD, but the designation “Form BD” has been retained. The Commission also announced adoption of Form U-4, a uniform application for registration of associated persons, which will replace Form SECO-2.[30]

In addition, Securities Exchange Act Rule 15b3-1 was amended to provide that each registered broker-dealer be required to file new Form BD (that is, Form U-3 as adopted) furnishing all required information at such time as the broker-dealer's registration presently on file requires amendment. In any case, a new Form BD would be required to be filed within 120 days after the effective date of the amendment to Rule 15b3-1.

Paragraph(a)(3) of Securities Exchange Act Rule 15b8-1 was amended to require that any broker or dealer whose Form SECO-2 becomes inaccurate or incomplete for any reason file a Form U-4. Form U-4 would not have to be filed for associated persons within any specified time.

On July 10, 1975, the Commission postponed the effective date of the new forms and the amendments to the related rules until October 1, 1975, and made certain changes in the forms and rules, including changes in Form BD required by the 1975 Act Amendments.[31]

Recordkeeping

On May 7, 1975,[32] the Commission proposed amendments to a portion of Securities Exchange Act Rule 17a-3. Rule 17a-3(a)(12)(A)(8) presently requires brokers and dealers to obtain for each associated person a record of any arrests, indictments, or convictions for any felony or misdemeanor, except minor traffic offenses. The Commission proposed to amend Rule 17a-3(a)(12)(A)(8) to limit the reference to arrests or indictments for crimes whi.ch were related to the safe operation of the securities industry. The rule will continue to require employers in the securities industry to maintain records of all convictions other than minor traffic offenses of their associated persons.

Financial Responsibility

On January 23, 1975,[33] the Commission announced that it had under consideration a proposal to amend Securities Exchange Act Rule 15c3-2. Presently Rule 15c3-2 prohibits a broker or dealer from using customer free credit balances in his business, unless the customer is given notice at least once every three months informing him of the sum due and that such funds: (1) are not segregated; (2) may be used in the operation of the broker-dealer's business; and (3) are payable upon demand. With the adoption of Securities Exchange Act Rule 15c3-3,34 which limits the extent to which a broker-dealer can use customer funds or securities in the operation of his business, the

disclosures required by Rule 15c3-2 are no longer appropriate. Rule 15c3-3 permits the use of customer funds only in limited areas of the broker-dealer's business relating to the rendering of services to customers. Funds not used in those limited areas are required to be deposited in a “Special Reserve Bank Account for the Exclusive Benefit of Customers.”

The proposal to amend Rule 15c3-2 would require any broker or dealer subject to the Rule to send to its customers a quarterly statement of account reflecting any money balances held for the customer's account, securities positions and securities transactions in the customer's account. The proposed amendments would further require a broker or dealer to disclose, among other things, that customers' free credit balances and fully-paid securities are available to customers in the normal course of business operations following demand and that the broker or dealer may use any customers' free credit balances left with it in the business of such broker or dealer except as limited by Rule 15c3-3. The Commission is presently considering the comments received on the proposed rule.

Broker-Dealer Examinations

During the past few years the Commission has continued to emphasize the importance of a strong regulatory program aimed at improving and raising the regulatory standards in the industry, informing all registered broker-dealers of their responsibilities and, where appropriate, detecting infractions and deviations from the regulatory rules and standards which have been established to protect the investing public. The Commission is aided in its efforts by examiners who are employed by the various self-regulatory organizations and who carry out examinations, inspections and related functions. A result of that effort has been a substantial decrease in the annual incidence of losses of funds or securities to the customers of failing brokerage firms requiring the assistance of the Securities Investor Protection Corporation (“SIPC”), while more and more firms which find it necessary to leave the securities business are liquidating in an orderly fashion without loss to customers or creditors.[35]

The Commission's Office of Broker-Dealer Examination Program, recently redesignated as the Office of Broker-Dealer Compliance and Examination, in the Division of Market Regulation, is charged with carrying out the Commission's program to insure compliance by broker-dealers with applicable rules relating to supervision, sales practices, trading practices, suitability, books and records, financial responsibility and other related activities. During the past fiscal year, the Office of Broker-Dealer Compliance and Examination has expanded its efforts to insure that the securities industry has an up-to-date, comprehensive early warning and surveillance system and examination and examiner training programs.

Early Warning and Surveillance

The Commission is responsible for the financial and operational soundness of all registered broker-dealers and members of self-regulatory organizations. In this connection, pursuant to Section 5(a) of the Securities Investor Protection Act of 1970 (the “SIPA Act”), the Commission requires monthly or more frequent early-warning lists from each self-regulatory organization identifying member firms which may be in or approaching financial difficulty or which may require closer-than-normal surveillance for any reason. This information is collected on a monthly basis and sent it to the appropriate Com-

mission regional office for verification. A continuing monitoring program with respect to firms on the early-warning list is subsequently undertaken in cooperation with the self-regulatory organizations.

Other Commission early warning and surveillance tools used during the fiscal year included (1) Securities Exchange Act Rule 17a-11, which requires a broker-dealer to notify the Commission if it breaks through certain specified financial or operational parameters; (2) Securities Exchange Act Rule 17a-5(j), which requires a broker-dealer, to notify the Commission if its exemption from the Commission's net capital rule has ceased because it no longer is. a member of a national securities exchange; and (3) Securities Exchange Act Rule 17a-10, which requires a broker-dealer to file Form X-17A-10 annually with the Commission. The Commission continues to monitor these programs,

although some or all of them may eventually be incorporated into the Financial and Operational Combined Uniform Single (FOCUS) Report Program being developed for the industry by the Report coordinating Group.

The Commission periodically reviews through on-site inspections and in-house studies the early warning surveillance tools of the self-regulatory organizations to insure that they constitute sound, effective programs which will enable each organization at the earliest possible time to detect and monitor member firms which are in or approaching financial difficulty.

During the past fiscal year, the Commission's staff conducted on-site inspections of the early warning and surveillance programs of the CBOE, Boston Stock Exchange, Midwest Stock Exchange, and PBW Stock Exchange; it completed on-site inspections of the Amex, the NYSE and the Pacific Stock Exchange in the previous fiscal year. In addition, the Commission's staff reviewed the programs of the NASD, as implemented by its district offices located in Philadelphia, Cleveland, New York, Chicago, San Francisco and Atlanta.

The various self-regulatory organizations have primary responsibility for examining their members with respect to compliance with the applicable financial responsibility rules. With respect to firms not belonging to any self-regulatory organization (SECO firms), the regional office having jurisdiction is responsible in the first instance for compliance monitoring. The responsibilities of a principal examining authority, and of the Commission's regional offices in the case of SECO firms, involve routine examinations of the broker-dealers or when necessary. The regional offices, in addition, conduct oversight examinations of member firms in furtherance of the Commission's early warning and surveillance efforts.

The Commission's program for examining the self-regulatory organizations has two phases. Through the first phase, on-site inspections of the self-regulatory organizations, the Commission's staff reviews and attempts to strengthen, where necessary, their examination, early warning, surveillance and training programs, while

at the same time evaluating and defining the goals, policies, procedures, design, budget and staffing of those programs. During the past two fiscal years, the staff has conducted inspections of all eight major self-regulatory organizations and, during the past fiscal year, 13 out of the 14 district offices of the NASD in order to evaluate and, where appropriate, to recommend improvements in the scope and design of each of those programs.

While it is important for the Commission to review at a national level the system and design of the examination programs of the self-regulatory organizations and to recommend that those programs be strengthened where appropriate, the second phase of the Commission's examination program, the direct examination of the members of the self-regulatory organization, is the critical element of the examination program. Among other reasons, the proximity of the Commission's regional offices to the members being examined puts them in the best position to judge the effectiveness of the self-regulators' examination programs and to ascertain whether the stated policies and procedures of the national offices of the self-regulatory organizations are being implemented. The regional offices' oversight programs involve (1) examinations of member firms to determine whether such firms are in compliance with the federal securities laws, and (2) concurrent reviews of the reports and working papers of the latest examinations performed by the various self-regulatory organizations of their members to determine whether the self-regulators' examination programs are thorough and effective.

In addition to oversight examinations, the Commission's regional offices conduct cause examinations and SECO examinations. Cause examinations usually result from a complaint received by a customer or another broker-dealer and are usually limited to the subject matter of the complaint. The examiner may, however, enlarge the scope of the examination if he believes that the firm's operations warrant further study.

The regional offices have established a regular examination cycle in which each SECO broker-dealer is examined 30 to 60 days after it becomes registered with the Commission and on an annual basis

thereafter. Such examinations are usually routine examinations covering all aspects of a broker-dealer's operations. Other examination goals of the regional offices are to conduct oversight examinations of at least five percent of the members of each self-regulatory organization in their region.

The Commission headquarters monitors the examination activities of the regional offices, meeting with the regional office examiners on a quarterly basis to review the effectiveness of the examination program.

Of great assistance to the self-regulatory organizations, and to the Commission in the case of firms which are members of more than one such organization, has been the designation, formerly made by SIPC, but now made by the Commission as a result of amendments to Section 9(c) of the SIPC Act effected by the 1975 Amendments, of one regulatory organization in each case to serve as that firm's principal examining authority for compliance with the financial responsibility rules.

Another step toward eliminating duplication of effort has been the Commission's development of a monthly examination report which it transmits both to its regional offices and to any self-regulatory organization which requests it. The report is a compilation of all examinations of all broker-dealers conducted during the previous twelve months by either a regional office of the Commission or a self-regulatory organization. This report has aided the regional offices and the self-regulatory organizations in avoiding duplicative examinations.

In fiscal year 1975, the Commission's regional offices conducted a total of 1,071 broker-dealer examinations, which exceeded by 14% the year's total examination goal of 942. Of the 1,071 examinations conducted, 449 were oversight examinations, 426 were cause examinations and 196 were routine examinations (mostly of SECO firms).[36]

In early 1972, the Commission developed a revised and expanded broker-dealer examination report form and outlined the appropriate report procedures to be undertaken by an examiner in the conduct of

his duties. These procedures were revised a number of times and have been updated in order to reflect the current rules and regulations applicable to broker-dealers. A special procedure outline was prepared for firms which engage in specialized types of business in addition to those covered under the general procedural outline.

A manual of instruction which amplifies the outline for the securities compliance examiner in connection with the conduct of an examination of a broker-dealer was greatly expanded and improved in 1972 and again in 1974 and 1975. In addition, the self-regulatory organizations have been requested to formulate, update and/or revise appropriate procedural outlines for use by their employees engaged in the examination of member firms. The Commission's staff has also requested that examination manuals and other instructional materials be prepared by each self-regulatory organization.

The Commission's staff prepares and transmits to the regional offices a monthly status report of current broker-dealer regulatory developments to insure greater control over and more timely coordination with the Commission's examination program. In addition, quarterly meetings are held with the regional office employees who are responsible for each office's examination programs for the purpose of insuring greater cooperation and control over the Commission's regulatory program.

Training Program

The Commission believes very strongly in the need for comprehensive training programs for securities compliance examiners, both those on the Commission staff and those on the staffs of the various self-regulatory organizations. Such training efforts, by continually updating the skills and knowledge of the examiners, contribute substantially to the effectiveness and efficiency of the examination programs conducted by the Commission and the self-regulatory organizations. Accordingly, the Commission has utilized in the past fiscal year a series of training courses, some directed toward only Commission examiners and others toward both Commission examiners and the self-regulatory organizations' examiners. The training program is

divided into two categories training provided by outside institutions and training provided by internal SEC programs.

The Commission encouraged its own securities compliance examiners to improve their skills through correspondence courses, seminars and/or college courses and has paid tuition for such study, where appropriate. The Commission has also instituted a program whereby examiners are encouraged to take a self-taught training course prepared by an outside agency and has provided each examiner with the course materials. Furthermore, the Commission is presently assisting in the development of a course specifically designed to provide examiners with the skills necessary to examine a firm having computerized books and records.

The internal SEC training program for securities compliance examiners consists of four parts:

1. Periodic, two-day training seminars in the regional offices on the subject of Commission's oversight examinations to which the self-regulators are invited. Such seminars review the results of oversight examinations, discuss any new and important developments or techniques with regard to these examinations, and provide an opportunity for the regional offices to discuss with the self-regulators ways in which they can further the principles and effectiveness of cooperative regulation.

2. Two-day seminars held twice each year in each regional office for experienced securities compliance examiners on the subject of examination techniques. Such seminars are not only refresher courses, but also focus on significant new developments and serious recent problems in the industry and the particular examination techniques that might be used to deal with such developments or problems.

3. Two four-day training seminars held at the Commission's headquarters. These seminars increasingly employ audio-visual instruction and provide examiners from the Commission, the self-regulatory organizations and state securities commissions with

information on the basic examination techniques and the various rules, regulations and regulatory programs of the Commission which pertain to broker-dealer financial and operational compliance.

4. Regional office continuing examiner training program involving biweekly, one-hour training sessions in the regional offices. These sessions focus on new developments, problems, rules and examination techniques within the regional offices on an informal, continuing basis. To insure a coordinated training effort, the Commission has adopted a program in which the regional office chief examiners meet every three months to discuss new training techniques, areas where additional training is required, and the strengths and weaknesses of the current program.

In addition to incorporating the self-regulators' examiners into the Commission's training programs, the Commission has also emphasized the need for the self-regulators to improve their own training programs. Consequently, the Commission periodically reviews the training efforts of the self-regulators and has encouraged each self-regulator to hold informal, bi-monthly training programs and more formal annual training sessions.

Regulation of Broker-Dealer Trading in Gold

As of December 31, 1974, the federal restrictions upon the ownership of gold bullion by United States citizens were eliminated. It was apparent that some broker-dealers were planning to engage in transactions involving gold bullion and that such activity might present many new problems. The Commission issued a release calling some of them to the attention of broker-dealers and investors and suggesting several guidelines for purchasing or investing in gold.[37] The Commission emphasized the extreme importance of exercising caution in such dealings and of becoming entirely familiar with the business reputation and credentials of those selling gold.

The Commission was concerned that a number of broker-dealers might participate in a variety of marketing arrangements for interests in gold requiring registration under the Securities Act of 1933 without

such broker-dealers realizing this. In view of the uncertainty as to the market for gold which would evolve and of the risks inherent in purchasing gold, the Commission proposed to adopt Securities Exchange Act Rule 15c3-5 designed to assure that broker-dealers who effected transactions for the accounts of customers would not undertake imprudent financial risks when settling such transactions.[38] In addition, proposed Rule 15c3-5 would establish certain minimum standards for broker-dealers with respect to the custody and safekeeping of gold held for customers. The Commission's concern was based, in part, on the substantial volatility of the price of gold.

The Commission considered it important, moreover, for each self-regulatory organization to be certain that member firms were familiar with the applicable financial responsibility rules and regulations, including the recently proposed Rule 15c3-5, pertaining to transactions in gold. In that connection, the Commission thought it useful to review the regulatory program of each of the self-regulators in order to insure a coordinated and effective program of industry-wide regulation for broker-dealers engaging in transactions in gold for the accounts of customers. Accordingly, the staff held a meeting with representatives from seven national securities exchanges, the NASD and SIPC on January 21, 1975. The meeting considered such issues as the Commission's approach to certain interests in gold involving securities, its views on financial responsibility rules and regulations pertaining to transactions in gold (including the proposed Rule 15c3-5), appropriate suitability standards and procedures for supervision of sales practices, and examination and surveillance procedures for broker-dealers trading in gold.

The Commission continues to monitor the self-regulatory organizations' efforts to insure proper regulation of their member firms transactions in gold. Specifically, the Commission has been monitoring self-regulatory procedures for requiring member firms to submit a plan describing their proposed manner of trading in gold, and for the subsequent examination and surveillance of such firms.

In much the same way, the Commission has coordinated the efforts of its regional offices in surveying SECO broker-dealers with regard to

their intentions to trade in gold and in developing a program for the examination and surveillance of such firms. That program involved the development of a special examination checklist for SECO broker-dealers trading in gold. Finally, the Commission has coordinated many of its efforts in this area with the bank regulatory agencies.

Regulatory Burdens on the Small Broker-Dealer

The Commission has analyzed the effects its rules and regulations are having on the viability of small brokers and dealers and is aware of the need to identify and eliminate any unnecessary reporting or regulatory burdens upon the small broker-dealer firm, without compromising any needed protections afforded the public. In that connection, and in order to help to assure the continued participation of small brokers and dealers in the United States securities markets, the Commission has addressed itself to the problems of the small broker-dealer.

Beyond the Commission's continued review of its financial and operational responsibility rules, perhaps the most visible demonstration of the Commission's concern for eliminating unnecessary or duplicative reporting burdens, particularly for small broker-dealers, has been its active participation in the work of the Report Coordinating Group. That group's progress is summarized in Part 1 of this report.

Consideration of the regulatory burden on the small broker-dealer has generally been part of a broader regulatory effort by the Commission and the self-regulatory organizations to eliminate duplicative, unnecessary and unduly burdensome elements. Actions already taken by the Commission in this area include:

1. Review of the Commission's financial and operational responsibility rules, all other rules and regulations, and related reporting requirements for broker-dealers;

2. Formation of the SEC Advisory Committee on Broker-Dealer Reports and Registration Requirements-Report Coordinating Group (Advisory);

3. Formation of the SEC Broker-Dealer Model Compliance Program Advisory Committee;

4. Formation of the SEC Advisory Committee on the Implementation of a Central Market System; and

5. Consideration of additional securities legislation.

CLEARANCE AND SETTLEMENT

A number of clearing entities[39] and depositories[40] affiliated with national securities exchanges or the NASD are currently in operation. During fiscal year 1975, numerous changes and additions to the rules and practices of these clearing and depository entities were submitted to the Commission for review and consideration under various provisions of the Act. The following are among the significant items on which the Commission acted favorably:

1. Pursuant to Securities Exchange Act Rule 9b-1, the Amex and the CBOE proposed the establishment of the Options Clearing Corporation, which was intended to act as a single clearing and settlement entity for transactions in exchange-traded options. The submission by the two exchanges was the result of Commission urging that they direct their efforts toward the establishment of a central option market system, for which common clearing facility was one of the essential elements,

2. The NYSE proposed that its wholly owned subsidiaries, the Stock Clearing Corporation (“SCC”) and the Depository Trust Company (“DTC”), establish and operate a Continuous Net Settlement (“CNS”) System. The CNS System reduces, through netting, the number of trades which a participant in SCC must settle and makes possible, through a link between SCC and DTC, automatic book entry settlements through clearing participants' accounts in DTC.

3. The Amex proposed that its wholly-owned subsidiary, American Stock Exchange Clearing Corporation, establish a CNS System which is comparable to SCC's system and has a similar link with DTC.

4. The Boston Stock Exchange, the Midwest Stock Exchange, Inc., the PBW Stock Exchange, Inc. and TAD Depository Corporation (“TAD”) proposed that TAD establish a transfer agent depository as a facility of those exchanges. As a transfer agent depository, TAD accepts from participating broker-dealers deposits of those securities for which the transfer agents have entered into an expediting relationship. TAD holds the securities as a custodian and, pursuant to withdrawal instructions, re-delivers the securities to its participants or to customers of its participants on an expedited basis. TAD's services include dividend protection and proxy handling with respect to securities held in custody.

5. Following favorable action by the Commission with respect to the TAD transfer agent depository, TAD and the National Clearing Corporation (“NCC”), a wholly-owned subsidiary of the NASD, proposed to establish an interface between TAD and NCC. As proposed, the interface would enable broker-dealer participants in either or both TAD and NCC to effect delivery of securities to other broker-dealers in TAD or NCC by bookkeeping entry.

6. The NCC proposed to establish a National Envelope Settlement System (“NESS”). NESS would expand NCC's existing Envelope Settlement System in New York to provide for inter-city deliveries of securities and settlement of trades not qualified for clearance and settlement through NCC's CNS system. NCC's goal was to lower the cost of inter-city settlements to its participants through the use of NCC's existing network of regional service centers, communications and couriers. In reviewing these matters, the Commission acted with a view toward facilitating the development of a national system for the prompt and accurate clearance and settlement of securities transactions, including the elimination of the use of securities certificates by broker-dealers in connection with the settlement of securities transactions.

SECURITIES INVESTOR PROTECTION CORPORATION

SIPC was established to provide certain protections to customers of SIPC members. It is a non-profit membership corporation, the members of which are registered brokers and dealers and members of national securities exchanges. While SIPC is funded primarily through assessments on its members, under certain conditions it may borrow up to $1 billion from the United States Treasury.

During the summer of 1974, a Special Task Force organized by the Chairman of SIPC made its report and recommendations for changes in the SIPC Act to the SIPC Board of Directors.[41] During fiscal year 1975, the SIPC Board approved essentially all of the report and in late 1974 presented it to Congress. The legislative proposal was introduced into both Houses of Congress in late 1974[42] and was reintroduced in the first half of 1975.43 The major recommendations of that proposal are: (1) to amend existing procedures which require court-appointed trustees in all SIPC liquidations to permit SIPC to make direct payments to customers in small cases; (2) to permit customer accounts to be transferred in bulk to other brokers in appropriate cases rather than to be liquidated account by account; and (3) to raise the dollar limits of protection to correspond to the limits of protection afforded depositors by the Federal Deposit Insurance Corporation.

Litigation Related to SIPC

In *SEC v. Guaranty Bond and Securities Corp*.,[44] the United States Court of Appeals for the Sixth Circuit held, among other things, that the receiver of a broker-dealer appointed by the district court had standing to bring an action on behalf of customers of the broker-dealer to compel SIPC to initiate liquidation proceedings under the SIPC Act. In response to SIPC's petition, which the Commission supported,[45] the Supreme Court agreed to review this decision. On May 19, 1975, the Supreme Court reversed the decision of the Sixth Circuit and held that the

Commission's statutory right to bring an action to require SIPC to discharge its duties is exclusive and that customers have no similar implied right of action.[46] That decision affirms the Commission's position that only it may seek judicial review of a discretionary determination by SIPC not to initiate proceedings.

Commission Rule Changes Relating to SIPC

On October 8, 1974, the Commission announced the adoption of Securities Exchange Act Rule 15b5-1 and the amendments of Securities Exchange Act Rule 15b6-1 and related Form BDW.[47] The rules and .forms provided that where the Commission revokes or cancels the registration of a broker-dealer, or a broker-dealer withdraws its registration, the effectiveness of such revocation, cancellation, or withdrawal would be delayed for six months for purposes of the SIPC Act. Thus, during that period, the protection of the SIPC Act would be available to the customers of the broker-dealer whose claims arose prior to the effective date of revocation, cancellation, or withdrawal.

SECO BROKER-DEALERS

Under the Securities Exchange Act, the Commission is responsible for establishing and administering rules on qualification standards and business conduct of broker-dealers who are not members of the NASD (referred to as SECO broker-dealers) in order to provide regulation of such broker-dealers comparable to that provided by the NASD for its members.

At the close of the fiscal year, the number of nonmember broker-dealers registered with the Commission totaled 302 and the number of associated persons of such firms (i.e., partners, officers, directors and employees not engaged in merely clerical or ministerial functions) totaled 21,122.

On May 1, 1975, the Commission announced adoption of Securities Exchange Act Rule 15b10-11, which establishes fidelity bonding

requirements for SECO broker-dealers.[48] A similar rule had been adopted by the NASD, as described in the Commission's 40th Annual Report.[49] The primary purpose of the bonding rules is to prevent the unwarranted exposure of SIPC funds to certain special kinds of losses, such as misappropriation of firm assets through employee theft and dishonesty.

Securities Exchange Act Rule 15b10-11 requires that SECO broker-dealers carry a fidelity bond in the form, amount and type of coverage prescribed by the Rule. The bond is required to contain agreements covering at least the following areas:

1. A “Fidelity” insuring clause to indemnify the insured broker-dealer against loss of property through any dishonest or fraudulent acts of employees, (this clause also generally covers losses due to “Fraudulent Trading” by employees);

2. An “On Premises” agreement insuring against losses resulting from common law and statutory crimes such as burglary and theft and including a “Misplacement” clause specifically covering misplacement and “mysterious, unexplainable disappearances” of property of the insured (no matter where located);

3. An “In Transit” clause indemnifying against losses occurring while property is in transit;

4. A “Forgery and Alteration” agreement insuring against loss due to forgery or alteration of various kinds of negotiable instruments (including checks); and

5. A “Securities Loss” clause protecting the insured against losses incurred through forgery and alteration of securities, or written documents relating to securities, ownership, or conveyance.

In addition, Rule 15b10-11 requires SECO broker-dealers to obtain certain minimum coverages similar to the coverages set forth in the NASD's bonding rule.

Securities Exchange Act Rule 15b9-2

imposes an annual assessment to be paid by SECO broker-dealers to defray the cost of their regulation by the Commission. During the fiscal year, the Commission increased the fee for each associated person of a SECO member from $12 to $15.[50] Additionally, the Form SECO-2 filing fee imposed pursuant to Securities Exchange Act Rule 15b9-1, was increased from $35 to $50. These increases were made necessary by increased costs of the SECO program.

EXEMPTIONS

During fiscal year 1975, the Commission or its staff, acting pursuant to delegated authority, granted the following exemptions to statutory provisions or rules adopted under the Securities Exchange Act.

1. Of 487 requests for exemption under paragraph(f) of Securities Exchange Act Rule 10b-6, 347 were granted because the transactions did not constitute a manipulative or deceptive device or contrivance within the meaning of the rule. Rule 10b-6 places certain prohibitions upon trading in securities by persons interested in a distribution of such securities.

2. One request for an exemption from the broker-dealer registration requirements was received and granted pursuant to Section 15(a)(2) as necessary and appropriate in the public interest and for the protection of investors.[51]

3. Ten requests for exemptions under Rule 17a-20 were received by the Commission. Rule 17a-20 was adopted as part of the Commission's monitoring of the effects of the introduction of competitive commission rates and requires certain brokers and dealers to submit to the Commission information relating to revenues and expenses and other matters. Two exemptions were granted (8 were pending as of June 30, 1975) because the applicant did no business for which a negotiated commission was charged.

OTHER COMMISSION RULE CHANGES AND DEVELOPMENTS

Mortgage Market Exemptions

As previously reported,[52] the Commission had been working with the Federal Home Loan Mortgage Corporation (FHLMC) to clarify the applicability of the federal securities laws to Amminet, Inc., which was established under FHLMC sponsorship to operate an automated trading information system to promote a more liquid secondary market for residential mortgages. FHLMC and the Commission developed proposed legislation on that subject, which resulted in the 1975 Amendments adding an exemption for certain mortgage-related securities to Section 4(5) of the Securities Act of 1933.

Under the new exemption, transactions involving (i) offers or sales of certain mortgage-related securities, or (ii) non-assignable contracts to buy or sell such securities which are to be completed within two years may be conducted, under the conditions and manner specified, without compliance with the registration and prospectus requirements of Section 5 of the Securities Act. The exemption is available only with respect to promissory notes directly secured by a first mortgage on a single parcel of real estate upon which is located a residential or commercial structure, and participation interests in such notes. For offers or sales of such mortgage-related securities to qualify for the exemptions, three conditions of sale must be satisfied: the minimum aggregate sales price per purchaser must be not less than $250,000, the purchaser must pay cash either at the time of sale or within sixty days thereof, and each purchaser must buy for his own account. Furthermore, for the transaction to qualify for the exemption, only designated types of institutions may originate the mortgage-related securities, and in certain instances, only designated institutions may purchase such securities. Finally, the exemption does not apply to resales of securities acquired pursuant to that exemption unless each of the conditions of sale is satisfied.

Regulatory Problems Posed by “Going Private”

On February 6, 1975, the Commission announced that it was ordering a public investigatory and rulemaking proceeding relating to so-called "going private" transactions by public companies or their affiliates.[53] The Commission invited both oral and written comments from interested persons regarding rules it was proposing and various specific inquiries related to such transactions.

The Commission noted that the two rules it was proposing were designed to provide an opportunity for public comment, but that it had not at that time reached any conclusions with respect to the proposed rules. The Commission also noted that the announced proceeding and proposed rules should not in any way be owned subsidiary, American Stock Exchange Clearing Corporation, estab-to such transactions. [*sic*]

The first of the two proposed rules (Securities Exchange Act Rule 13e – 3(A) was designed to protect investors, particularly the interests of minority security holders, in "going private" transactions. The Rule would make unlawful certain purchases of an issuer's securities, and certain related solicitations of proxies, by the issuer or its affiliates, as defined, unless the issuer or its affiliate complied with specific disclosure and substantive provisions.

As an alternative to certain of the provisions of proposed Rule 13e-3(A), the Commission at the same time also published for comment proposed Rule 13e-3(B). That Rule would require that, when the purchase of an equity security by the issuer or an affiliate would result or was intended to result in any of the enumerated consequences, terms of the transaction, including any consideration to be paid to any security holder, be fair and, in transactions by the issuer, that a valid business purpose for the transaction exist. Proposed Rule 13e – 3(B), which would also include some or all of the disclosure and tender offer requirements set forth in proposed Rule 13e-3(A), was intended to provide the Commission with sufficient flexibility to deal with any type of transaction by an issuer or its affiliates having the same consequences.

The Commission received a substantial number of written comments, which are being reviewed and analyzed. The Commission noted that,

after the proceeding, it might adopt or propose for comment one or more rules under the Securities Exchange Act and/or recommend legislation to the Congress.

Foreign Access to United States Securities Markets

On February 8, 1974, the Commission solicited public comment on issues affecting foreign professional access to the United States securities markets.[54] The Commission received a number of comments, which are being studied by the staff together with the provisions of the 1975 Amendments as they may relate to the issue of foreign access. The Commission expects to complete its study of this matter in the near future.

Real Estate Investment Contract Securities

On January 31, 1975, the Commission adopted Rule 3a12-5 and amendments to Rule 15c2-5,[55] which served to exempt certain investment contract securities involving the direct ownership of specified residential real property from the Exchange Act's credit arrangement provisions when offered by broker-dealers, subject to certain conditions. The Commission stated that the unique characteristics of these investment contract securities make the existence of the concerns about credit arrangements in Sections 7(c) and 11(d)(1) of the Exchange Act unlikely. The Commission considered the lack of a secondary trading market a significant factor in support of the proposed exemption.

Confirmation Requirements for Periodic Transactions

On September 24, 1974, the Commission adopted an amendment to Rule

15c1-4 under the Exchange Act relating to purchases of redeemable securities issued by registered investment companies and unit investment trusts.[56] The Commission had published notice of a proposal to adopt these amendments on March 15, 1974.[57]

Before the adoption of the amendment, Rule 15c1-4 required brokers and dealers to give or send to their customers written confirmations of securities transactions effected with or for the account of such customers at or before the completion of each such transaction. Representatives of the mutual fund industry sought the amendment to make it more economical for registered open-end investment companies to sell shares to participants in group plans and tax qualified pension plans which might involve small and frequent purchases. They noted that the need for this amendment was especially important in view of the recently enacted Employee Retirement Income Security Act of 1974,58 which permits the use of mutual funds as investment media for certain tax qualified individual and group pension plans.

The amendments relaxed the requirements of Rule 15c1-4 with respect to certain purchases of shares of open-end investment companies and unit investment trusts by permitting a broker-dealer to confirm on a quarterly basis, rather than immediately, purchases of securities of such issuers pursuant to(a) individual retirement or pension plans under the Internal Revenue Code, or(b) group plans whether or not qualified under the IRC.

The Commission did not relax the confirmation requirements for purchases of equity securities made pursuant to certain systematic accumulation plans administered by broker-dealers. The Commission indicated that the various policy issues and technical problems relating to a further relaxation of Rule 15c1-4 in this area would continue to receive staff study.

Short Selling into Secondary Offerings

On April 2, 1975, the Commission published for comment revisions of proposed Rules 10b-20 and 10b-21 under the Exchange Act and proposed amendments to Rules 17a-3(a)(6) and 17a-3(a)(7).[59] Those rules were first proposed on February 11, 1974,[60] and relate to certain practices which were brought to the Commission's intention, partly as a result of an investigation by the Commission's staff.[61]

Proposed Rule 10b-20 would prohibit underwriters and dealers participating in a securities distribution from requiring a purchaser, in order to receive an allocation of securities from the underwriter or dealer, to pay consideration in addition to the amount indicated in the prospectus or to perform any other act such as purchasing an additional security in an unrelated offering (so-called “tie-in” arrangements). Proposed Rule 10b-21 would impose certain limitations on purchases to cover short sales where such short sales were effected before the commencement of an offering involving securities of the same class.

Under the proposed amendments to Rule 17a-3, broker-dealers would be required to ask customers, or note if the sale was for the broker-dealer's own account, whether the sale was “long” or “short.” These recordkeeping changes are intended to assist broker-dealers in complying with provisions relating to short sales under the securities laws, and most notably Regulation T (broker-dealer margin provision) promulgated by the Board of Governors of the Federal Reserve System. Furthermore, the amendments would aid the Commission's enforcement of the margin provisions.

NOTES FOR PART 3

[1]Pub. L. No. 94-29 (June 4, 1975).

[2]The Honolulu Stock Exchange is the only securities exchange presently exempted from registration.

[3]See In the Matter of Ecological Science Corporation, Securities Exchange Act Release No. 10217 (June 13, 1973), 1 SEC Docket No. 20, p. 5, and cases cited therein. During fiscal 1975, the Commission took a similar position in its first decision concerning the removal of a security from NASDAQ, the automated quotation system for trading over-the-counter securities sponsored by the National Association of Securities Dealers, Inc. See In the Matter of Tassaway, Inc., Securities Exchange Act Release No. 11291 (March 13, 1975), 6 SEC Docket 427. See discussion of the Tassaway case at p. 74.

[4]For a summary and the conclusion of that inspection visit, see 40th Annual Report, pp. 49-50.

[5]Amex letter to Division of Market Regulation dated May 2, 1975.

[6]American Stock Exchange, Inc., Special Bulletin to Floor Members dated June 2, 1975. See also Amex Rule 958.

[7]Those registered broker-dealers which are not NASD members are referred to as SECO (SEC Only) broker-dealers. See p. 86, infra.

[8]The 1975 Amendments amended Section 19 of the Securities Exchange Act to provide that proposed rules of a self-regulatory organization may not take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of that Section.

[9]Section 12(g)(1) of the Securities Exchange Act generally requires the registration of equity securities with the Commission if, at the close of any fiscal year of the issuer, the class of securities is held of record by 500 or more persons and the issuer has $1,000,000 or more in assets. Such registration causes the reporting and other requirements of Section 13, the proxy requirements of Section 14, and the insider trading provisions of Section 16 to apply to the issuer to the same degree they apply to issuers of exchange-listed securities. Registration under Section 12(g) is permitted to be terminated if the number of record holders of the class of securities registered falls below 300.

[10]See part 1 page 11.

[11]This procedure is employed in disciplinary cases where the respondents, in lieu of institution of complaint proceedings, admit the findings made by the DBCC, waive their right of review of the DBCC's action by the NASD Board of Governors, the Commission and the Courts, and consent to the penalties imposed by the DBCC. The respondents submit a letter to this effect which must be accepted by both the DBCC and the National Business Conduct Committee before the matter is closed.

[12]Under Section 19(d)(2) of the Securities Exchange Act, as amended, an application for review or the institution of a review by the Commission no longer operates as a stay unless the Commission otherwise orders.

[13]Securities Exchange Act Release No. 11476 (June 16, 1975), 7 SEC Docket 193.

[14]Article III, Section I.

[15]Securities Exchange Act Release No. 10894 (July 2, 1974), 4 SEC Docket 529.

[16]Blaise D. Antoni & Associates, Inc. v. S.E.C., 289 F.2d 276, 277 (C.A. 5, 1961).

[17]The 1975 Amendments have altered this procedure by adding Section 15A(g)(2), under which a registered securities association need only file notice with the Commission of its intention to admit a member or any person associated with it subject to a statutory disqualification. Such notice must be filed not less than thirty days prior to admission of such member or person.

[18]Securities Exchange Act Release No. 11291 (Mar. 13, 1975), 6 SEC Docket 427.

[19]Article XVI of the NASD's By-laws (which became effective on December 16, 1968) describes the system and sets forth rules with respect to it.

[20]Tassaway, Inc.'s annual report on Form 10K filed with the Commission showed that by April 30, 1973, it not only lacked the required $250,000, but had a capital deficit of over $3.4 million.

[21]Compare Exchange Buffet Corporation v. New York Stock Exchange, 244 F. 2d 507, 510 (C.A. 2, 1957), affirming Atlas Tack Corporation 37 SEC 362 (1956); Polarad Electronics Corporation,

Securities Exchange Act Release No. 9419 (December 15, 1971); Langley Corporation, Securities Exchange Act Release No. 9729 (August 16, 1972).

[22]Section 23(b) of the Securities Exchange Act, as amended by the 1975 Amendments, 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, for which purpose data pertaining to such expenses and operations shall be made available by such organization to the Commission at its request.” The discussion in this section is in response to that requirement. This section of the annual report is necessarily less detailed than the Commission anticipates will be the case in future years since the Commission did not, prior to the 1975 Amendments, require self-regulatory organizations to compile or furnish to the Commission the data which the Commission will include in future annual reports. The staff is engaged in a study with respect to financial reporting of expenses and revenues of the self-regulatory organizations to determine what additional information is needed to accommodate the needs expressed by the Congress. Because of the complexity of the revenue studies needed, it may not be possible to collect and analyze the data in time for the Commission's annual report for 1976. We anticipate that the staff's study and its implementation will be completed in time for inclusion in the Commission's annual report for fiscal year 1977. The data included in this annual report were compiled from the annual reports submitted to the Commission by the self-regulatory organizations and the “Survey of Self-Regulatory Organizations and Subsidiaries,” which was conducted in connection with the Commission's program for monitoring the effects of competitive brokerage commission rates on the securities industry.

[23]It should be noted that other revenue sources include revenues which are not related to exchange business and self-regulatory activities (e.g., real estate).

[24]The selection of Bradford Computer & Systems, Inc. as the NCC facilities management contractor precludes further losses in this area. NASD 1974 Annual Report, p. 1.

[25]Personnel Budget Study 19.

[26]Including staff reductions at SIAC.

[27]These exchanges are grouped according to trends in revenues and expenses.

[28]Section 15(a) of the Securities Exchange Act, as amended by the 1975 Amendments, now requires the registration by December 1, 1975, of brokers and dealers who were previously exempt from registration because they confined their securities business to an exchange. Brokers and dealers who confine their activities to exempted securities, as defined in Section 3(a)(12) of the Securities Exchange Act, continue to be exempt from the registration requirement. Effective December 1, 1975, municipal securities are no longer defined as exempted securities for purposes of the registration requirement applicable to brokers and dealers.

[29]Securities Exchange Act Release No. 11424 (May 16, 1975), 7 SEC Docket 2.

[30]New Form BD will be used by approximately 45 states and the NASD. Form U-4 will likewise be used by approximately 45 states, as well as the NASD and the exchanges.

[31]Securities Exchange Act Release No. 11530 (July 10, 1975), 7 SEC Docket 343.

[32]Securities Exchange Act Release No. 11402 (May 7, 1975), 6 SEC Docket 856.

[33]Securities Exchange Act Release No. 11196 (January 23, 1975), 6 SEC Docket 144.

[34]39th Annual Report, pp. 59-60. Securities Exchange Act Release No. 9856 (November 10, 1972).

[35]In the past few years, while SIPC's assistance has been necessary in more than 100 cases of firms failing and causing losses of funds or securities, more than 1,000 firms have left the securities industry without the assistance of SIPC and without losses to customers or creditors.

[36]Few routine examinations are now conducted of firms other than SECO firms, as all examinations of member firms of self-regulatory organizations must now be oversight examinations, which go one step further than routine examinations by their evaluation of the self-regulatory organizations' reports of examinations.

[37]See Securities Exchange Act Release No. 11125 (Dec. 9, 1974), 5 SEC Docket 667.

[38]See Securities Exchange Act Release No. 11158 (Dec. 31, 1974), 6 SEC Docket 6.

[39]Clearing entities clear and settle transactions between participating broker-dealers. Offsetting transactions between broker-dealers are netted out and settlement and delivery are effected only as to the balance under the traditional balance-order system. Under the more recent and now almost universally utilized continuous net settlement system, balances may be carried forward and netted against future settling trades.

[40]Depositories hold securities certificates and effect delivery between participants by book entry.

[41]See 40th Annual Report p. 64.

[42]S.4255, 93d Cong., 2d Sess. (1974); H.R. 17684, 93d Cong., 2d Sess. (1974).

[43]S. 1231, 94th Cong., 1st Sess. (1975); H.R. 8064, 94th Cong., 1st Sess. (1975).

[44]496 F.2d 145 (C.A. 61974).

[45]40th Annual Report, p. 65.

[46]Securities Investor Protection Corp, v. Barbour, 421 U.S. 412 (1975).

[47]Securities Exchange Act Release No. 11042 (October 8, 1974), 5 SEC Docket 247.

[48]Securities Exchange Act Release No. 11388 (May 1, 1975), 6 SEC Docket 784.

[49]40th Annual Report, p. 53.

[50]Securities Exchange Act Release No. 11425 (May 16, 1975), 7 SEC Docket 21.

[51]See Securities Exchange Act Release No. 11355 (Apr. 17, 1975), 6 SEC Docket 683.

[52]40th Annual Report, p. 66.

[53]Securities Exchange Act Release No. 11231 (Feb. 6, 1975), 6 SEC Docket 261.

[54]Securities Exchange No. 10634 (February 8, Docket 507.

[55]Securities Exchange No. 11220 (Jan. 31, 1975), 6 SEC Docket 342. See 40th Annual Report, p. 66.

[56]Securities Exchange Act Release No. 11025 (Sep. 24, 1974), 5 SEC Docket 184.

[57]Securities Exchange Act Release No. 10681 (Mar. 15, 1974), 3 SEC Docket 691. See 40th Annual Report, p. 67.

[58]Pub. L. No. 93-406 (1974).

[59]Securities Exchange Act Release No. 11328 (Apr. 2, 1975), 6 SEC Docket 552.

[60]Securities Exchange Act Release No. 10636 (Feb. 11, 1974), 3 SEC Docket 540.

[61]In the Matter of A.P. Montgomery & Co., Inc., Securities Exchange Act Release No. 10637 (Feb. 11, 1974), 3 SEC Docket 542.

PART 4
ENFORCEMENT

The Commission's enforcement activities, which are designed to combat securities fraud and other illegal activities, continued, at a high level during the past year. These activities encompass civil and criminal court actions, as well as administrative proceedings conducted internally. 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 light 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 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, some 4,000 complaints against broker-dealers were received, analyzed and answered. Most of the above mentioned 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 some 5,500 complaints received concerning investment advisers, issuers, banks, transfer agents and mutual funds.

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 have authority to arbitrate private disputes between brokerage firms and investors or directly to assist investors in the legal assertion of their personal rights, 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

To enable the Commission to carry out surveillance of the securities markets, its staff has devised procedures to identify possible violative activities. These include surveillance of listed securities, which is coordinated with the market surveillance operations of the New York, American and regional stock exchanges.

The Commission's market surveillance staff maintains a continuous watch of transactions on the New York and American Stock Exchanges and the Chicago Board Options Exchange and reviews reports of large block transactions to detect any unusual price and volume variations. Also the financial news tickers, financial publications and statistical services are closely followed. In addition, the staff has supplemented its regular reviews of daily and periodic market surveillance reports, which provide a more in-depth analysis of the information developed by the exchanges.

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 staff, 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. This data, combined with other available information, is analyzed for possible further inquiry and enforcement action.

In addition, recognizing that the computer provides the most expeditious method of reviewing and analyzing the voluminous trading data generated by the securities markets, the Commission has developed a program which provides an analysis of the bid listings for each security by summarizing specified types of activity by each broker-dealer firm submitting price quotations for that particular security.

The staff oversees tender offers, exchange offers, proxy contests and other activities involving efforts to change control of public corporations. Such oversight involves not only review of trading markets in the securities involved, but also filings with the Commission of required schedules, prospectuses, proxy material and other information.

INVESTIGATIONS

Each of the acts administered by the Commission authorizes investigations by it to determine if violations have occurred. Most of these are conducted by the Commission's regional offices. Investigations are 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 fiscal year 1975, a total of 490 investigations were opened, as against 382 in the preceding year.

LITIGATION INVOLVING COMMISSION INVESTIGATIONS

In *White v. Jaegerman*,[1] the plaintiffs had filed suit against the Commission's Chief Investigative Counsel, seven other present or former Commission employees and others alleging that the Chief Investigative Counsel had maliciously harassed them by, among other things, leaking to the New York Times confidential information acquired during an investigation of the plaintiffs. The plaintiffs also alleged that the Chief Investigative Counsel conspired with the other defendants to cause the accounting firm for the corporate plaintiff to withdraw a favorable financial report concerning it, to cause the Commission to suspend over-the-counter trading of the stock of the corporate plaintiff, and to cause another company controlled by the individual defendant to be placed on the Commission's Foreign Restricted List.

On October 9, 1969, United States District Judge McLean dismissed the complaint against each of the former and present Commission employees, with the exception of the Chief Investigative Counsel, on the ground that the activities alleged in the complaint were within the scope of their official duties and they therefore were immune from suit. In Judge McLean's view, however, the alleged leaking by the Chief Investigative Counsel of information obtained by him during a confidential investigation, which information the plaintiffs alleged was false, would have been outside the scope of his employment. Judge McLean indicated that the plaintiffs should have the opportunity to

present proof as to these allegations and that their complaint should not be disposed of by motion for summary judgment.

On October 2 and 3, 1974, the case was tried before Judge Bonsai sitting without a jury. After the trial, Judge Bonsai dismissed the complaint against the Chief Investigative Counsel, who was the only remaining defendant, on the ground that the plaintiffs had failed to prove that he acted outside the scope of his employment or that he intimidated them or otherwise engaged in improper conduct. In order to sustain their claims against the Chief Investigative Counsel, the court held that the plaintiffs had to show "that he acted outside the limits of the broad investigative responsibilities with which he was charged."[2]

Furthermore, the court held that the plaintiffs would not be entitled to damages in any event since, among other things, the truth of the information published in the New York Times had been established in the Commission's injunctive action against the plaintiffs.[3]

S.E.C. v. Csapo[4] involves the application of the Commission's sequestration rule in a nonpublic investigation. The district court conditioned the enforcement of a Commission investigative subpoena directed to Mr. Csapo upon his being permitted to be accompanied and represented by certain attorneys who also represented various other persons involved in the investigation. The Commission appealed from the portion of the enforcement order imposing this condition, and the matter is pending in the court of appeals.

In *S.E.C. v. Republic National Life Insurance Co., et al.*,[5] one of the defendants, Peat, Marwick, Mitchell and Co. filed a counterclaim against the Commission seeking, in effect, an order requiring the Commission, whenever it uncovers information that might be material to an independent public accountant's examination of financial statements that are to be filed with the Commission, to disclose that information to the accountant. On October 18, 1974, the district court dismissed the counterclaim finding that it was within the Commission's discretion to deny Peat Marwick access to investigative materials and that the exercise of discretion was not reviewable.

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 or applicable Commission rules. In injunctive actions the Commission has frequently sought to obtain ancillary 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 has often requested the court to appoint a receiver for a broker-dealer or other business where investors were likely to be harmed by continuance of the existing management. It has also requested, among other things, court orders restricting future activities of the defendants, requiring that rescission be offered to securities purchasers, or requiring disgorgement of the defendants' ill-gotten gains.

The SEC'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, the Commission may file criminal contempt proceedings, 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. Most commonly, 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 for 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 summarily to suspend trading in a security when the public interest requires.

Proceedings are frequently completed without hearings where respondents waive their right to a hearing and submit settlement offers consenting to remedial action which the Commission accepts as an appropriate disposition of the proceedings. The Commission tries to gear its sanctions in both contested and settlement cases to fit the circumstances of the particular case. For example, it may limit the sanction to a particular branch office of a broker-dealer rather than sanction the entire firm, prohibit only certain kinds of activity by the broker-dealer during a period of suspension or only prohibit an individual from engaging in supervisory activities.

A chart listing the various types of enforcement proceedings, as well as statistics on such proceedings are located in the statistical section.

ADMINISTRATIVE PROCEEDINGS

Summarized below are some of the many administrative proceedings pending or disposed of in fiscal 1975.

Financial Programs, Inc.[6] – The Commission instituted administrative proceedings against Financial Programs, Inc., a Denver-based mutual

fund manager and five of its former officers. Pursuant to offers of settlement submitted by Financial Programs and two of the individual respondents in which they neither admitted or denied the charges, the Commission found that respondents violated the antifraud provisions of the Securities, Securities Exchange, Investment Company and Investment Advisers Acts. Specifically, it was found that Financial Programs and the two former officers committed over $21 million of the assets of the four funds, for which Financial Programs served as investment adviser, to several over-the-counter securities that were speculative, unseasoned and in limited supply. This was done on the basis of recommendations made by a single salesman and without adequate independent study.

The Commission found that the funds' prospectuses and periodic reports disseminated to the public were false and misleading because the stated investment policies were disregarded. There was no disclosure about the practices described above or their effect on the net asset values of the funds, or about the funds' inability to dispose of these securities at prices that their own trading had created.

The Commission also found that Financial Programs violated certain provisions of the Federal securities laws by causing the funds it managed to maintain excessive cash balances with a certain bank which considered those balances in lending money to persons affiliated with Financial Programs.

The Commission further found that the two officers of Financial Programs referred to above received compensation from the salesman who had arranged the sales of the thinly traded over-the-counter securities to the funds and that such compensation was obtained in violation of the Investment Company Act.

The Commission ordered Financial Programs to comply with its undertaking to, among other things, offer the four funds $2.5 million in settlement of claims against it and refrain for 180 days from performing any investment advisory function for any new client. The Commission barred one of the former officers, and barred in certain respects and

suspended in other respects the other former officer from engaging in certain activities in the securities industry.

In a subsequent order, the Commission found, pursuant to an offer of settlement submitted by Financial Programs's former president, that he failed to adopt adequate supervisory procedures, misrepresented to shareholders that the funds would be properly managed, and caused the funds to maintain excessive cash balances. He was suspended for a 60-day period from engaging in certain activities in the securities industry. The Commission noted his undertaking to pay $15,000 to two of the funds.[7]

The proceedings against the two remaining respondents were still pending at the end of the fiscal year.

Chase Investment Services of Boston, Inc.[8] – The Commission simultaneously instituted administrative proceedings against Chase Investment Services of Boston, Inc. (CIS), John P. Chase, Inc. (JPC), CIS's parent, and certain individuals, and issued an order imposing remedial sanctions against respondents, based upon offers of settlement in which respondents, without admitting or denying the charges against them, consented to certain findings and sanctions. Pursuant to these offers, the Commission found

that (a) CIS, certain officers of CIS and JPC and others violated the antifraud provisions of the securities laws; and (b) JPC and the chairman of JPC's board of directors failed reasonably to supervise with a view toward preventing such violations.

The Commission found that advertisements were distributed and oral sales presentations made to CIS clients which contained untrue and misleading statements relating to, among other things, the similarity between CIS's advisory service to the kind of service furnished by JPC and other investment counsel firms to wealthy investors, the past performance of CIS accounts, and the risks involved in CIS's investment methods. The Commission also found that investment decisions for CIS clients were made without regard to their suitability for the particular client; clients accounts were not promptly reviewed

when material changes occurred in CIS's research positions about securities in such accounts; inducements were offered to broker-dealers to recommend that their customers become clients of CIS, including a share of the advisory fees paid by such clients and the likelihood of substantial brokerage income; and that the foregoing facts were not disclosed to clients or prospective clients of CIS.

The Commission's order: (1) Suspended both CIS and JPC for 180 days from soliciting or accepting new clients for or on behalf of CIS; (2) Required CIS to serve its existing clients at cost during the aforementioned 180-day suspension period; (3) Suspended the chairman of JPC's board of directors from association with an investment adviser for 30 days; (4) Suspended the investment adviser registration of JPC's former executive vice-president and his right to associate himself with any other investment adviser for 30 days; and (5) Precluded CIS's former president from associating himself with an investment adviser, a broker, or a dealer without the Commission's prior approval. The Commission's order noted that CIS and JPC have undertaken to institute certain remedial steps for the conduct of CIS's advisory business and that JPC's former executive vice-president has made a similar undertaking with respect to his investment advisory business.

Intersearch Technology, Inc. – The decision of an administrative law judge revoking the investment adviser registrations of Intersearch Technology, Inc., and Intersearch Publications, Inc. and barring Jesse B. Reid, who controlled both firms, from being associated with an investment adviser became the final decision of the Commission.

It was found that during 1970 and early 1971 respondents had violated the anti-fraud provisions of the Investment Advisers Act by using false and misleading statements in subscriptions to the investment advisory publication InterScan and failing to disclose the firms' insolvency to subscribers or potential subscribers to their publications.

Third National Corporation[9] – Administrative proceedings were instituted against Third National Corporation, a registered bank holding company, to determine whether certain of its filings with the

Commission under the Securities Exchange Act were deficient. Third National consented, without admitting or denying the charges, to findings that its filings were deficient in several material respects. The Commission ordered Third National to correct its filings to disclose: (1) that key management of Third National's principal subsidiary, Third National Bank, had a significant undisclosed interest in certain acquisitions effected by Third National, and (2) that Third National Bank, in connection with its correspondent banking activities, had a practice of making loans to persons in positions of control or influence at correspondent banks, which loans were on terms more favorable than those available to comparable borrowers not in a position to influence Third National Bank's correspondents.

As part of its settlement offer, Third National undertook to inform its shareholders fully of these matters and to offer rescission to offerees of a current exchange offer.

Laidlaw & Co., Inc. – Public administrative proceedings were ordered against 21 respondents based on charges of violations of various provisions of the Federal securities laws, primarily in connection with an unsuccessful public offering of 200,000 shares of SaCom common stock on October 31, 1972. Named as respondents were the managing underwriter, Laidlaw & Co., Inc. (now known as LAC, Inc.) and Rollin F. Perry, the former head of Laidlaw's corporate finance division; two market makers in SaCom stock, A.P. Montgomery and Torpie & Saltzman, Inc.; eight of the participating underwriters in the SaCom offering and the legal counsel for Laidlaw. The Commission also named NDF Securities, Inc. and seven individuals in connection with trading activities in SaCom.

It was alleged that Laidlaw and Perry, in the SaCom offering, engaged in manipulative activities to facilitate the distribution of the SaCom offering and create the false impression that the offering had been successfully distributed to the public. In this regard it was alleged that members of the underwriting syndicate sent false “all-sold” wires to the manager of the syndicate. It was further alleged that there were undisclosed pre-effective date arrangements between underwriters whereby certain underwriters would not have to accept unsold stock.

Laidlaw, Perry and others also were alleged to have violated the Federal securities laws in connection with trading activities in the common stock of Manchester Life & Casualty Management Corp. and Dyna-lectron Corporation.

Nineteen of the respondents have consented to the entry of various sanctions against them.[10] A public hearing on the charges against the two remaining respondents is scheduled for October, 1975.

Steadman Security Corporation (SSC) – This is an administrative proceeding against SSC, a registered investment adviser, and its president, board chairman, and controlling shareholder. He is also president and board chairman of four registered investment companies (Steadman Funds) managed by the registered investment adviser. Also named as respondents were certain affiliated registered broker-dealers.

An administrative law judge found that respondents committed violations of the antifraud and other provisions of the federal securities laws. Specifically, respondents were found to have, among other things, (a) caused the Steadman Funds to maintain at or to transfer to certain banks their custodian accounts to enable respondents to get loans and brokerage commission business from such banks instead of obtaining for the Steadman Funds the best available custodian services at terms most advantageous to such Funds, (b) caused securities transactions between the Funds and an off-shore fund controlled by respondents to be effected without obtaining approval from the Commission as required by the Investment Company Act of 1940, (c) failed to see to it that the funds filed reports required by the federal securities laws on time and (d) failed to disclose the above described conduct.

The administrative law judge concluded that the investment adviser registration of SSC should be revoked and its president be barred from association with any investment adviser or registered investment company and suspended for one year from association with any broker-dealer. At the end of the fiscal year, the case was pending before the Commission on review of the initial decision.

Samuel H. Sloan[11] – The Commission barred Samuel H. Sloan from association with any broker-dealer and revoked the broker-dealer registration of his firm. The Commission's action was based on Sloan's persistent violations of the Exchange Act's recordkeeping, net capital, and reporting provisions and on injunctive decrees restraining him from further violations of the recordkeeping and net capital provisions. The Commission concluded that: “Sloan's violations are neither trivial nor technical. They involve flagrant and long-continued breaches of significant duties imposed on persons in the securities business.”

APPLICATIONS FOR RELIEF FROM DISQUALIFICATION

On February 26, 1975, the Commission issued a release announcing the various factors which are considered when it entertains an application for readmission to the securities business by individuals or firms which previously have been barred from participation in the securities business or some aspect thereof.[12] The Commission noted that situations may exist where, in view of changed circumstances and after the passage of a period of time, it may appear appropriate to the Commission, in its discretion, to lift the disqualification if the applicant is able to demonstrate to the Commission's satisfaction that removal of the disqualification would be consistent with the public interest.

The Commission enumerated the following factors, among others, which it generally considers in exercising its discretion in the review of applications for relief: the period of time which has elapsed since entry of the disqualification order, the nature of the findings that resulted in the disqualification, the applicant's attempts to undo any injury resulting from his prior misconduct, the applicant's overall conduct since the entry of the disqualification order, the type and nature of the applicant's prospective duties, and any other factors which the Commission may deem pertinent. In addition, the Commission noted that it may seek additional information concerning the applicant by conducting an investigation or by obtaining the views of interested third parties.

As a final matter, the Commission specified the procedures to be followed by an applicant seeking relief from disqualification.

TRADING SUSPENSIONS

The Securities Exchange Act authorizes the Commission summarily to suspend trading in a security traded on either a national securities exchange or in the over-the-counter market for a period of up to 10 days if, in the Commission's opinion, such action is required in the public interest.

During fiscal 1975, the Commission suspended trading in the securities of 113 companies, a decrease of 59% from the 279 securities suspended in fiscal 1974 and a 35% decrease from the 174 securities suspended in fiscal 1973. The decreased number of trading suspensions reflected a significant reduction in the number of issuers which were delinquent in filing required reports with the Commission. In most instances, the suspensions were ordered either because of substantial questions as to the adequacy, accuracy or availability of public information concerning the companies' financial condition or business operations or because of transactions in the companies' securities suggesting possible manipulation or other violations.

On January 3, 1975, the Commission suspended trading in the securities of American Agronomics Corporation[13] because of questions concerning the market activity in the shares of the company.

On April 22, 1975, the Commission suspended trading in the securities of General Refractories Corporation[14] because of the unavailability of current accurate information concerning certain business transactions conducted by the company with a principal European stockholder and companies under his control, and because of questions concerning the identity of that stockholder and the extent of his holdings.

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 and other periodic and current reports required to be filed by issuers and individuals. The Delinquent Reports Program is designed to identify required reports which have not been timely filed and, when appropriate, to recommend remedial enforcement action. Such enforcement action entails alerting the public to the lack of current and accurate information and, where necessary, seeking a court order requiring the filing of the delinquent reports coupled with an injunction against further violations of the Exchange Act's reporting provisions.

The statutory framework within which this program operates is primarily Sections 13(a) and 15(d) of the Exchange Act and the rules thereunder which require companies whose securities are registered under Section 12 to file periodic and current reports in proper form; Section 12(k) of the Exchange Act which authorizes the Commission to suspend temporarily trading in the securities of issuers; and Rule 15c2-11 under the Exchange Act which requires broker-dealers making specific quotations in an inter-dealer quotation medium to have available certain information regarding the issuer of the securities quoted.

During the 1975 fiscal year, the Commission temporarily suspended trading in the securities of approximately thirty companies solely due to the lack of current and adequate information. They hadn't even filed at least a Form 10-K annual report disclosing their audited financial condition and results of operations.

During this fiscal year, the Commission brought thirteen civil injunctive actions[15] solely on the basis of the issuers' failure to comply with the reporting requirements of the Exchange Act. In some of these actions, the chief operating officer was included as a defendant for his alleged failure to cause the company to file the delinquent reports.

For example, on December 20, 1974 an action was filed against Data Lease Financial Corporation (“Data Lease”), a bank holding company, in which it was alleged that Data Lease was delinquent in filing its Annual Report on Form 10-K for its fiscal year ended June 30, 1974

and an amendment to its Form 10-K for fiscal year ended June 30, 1973. The Commission's Motion for Summary Judgment was granted by the court on February 14, 1975. Data Lease was ordered to file the delinquent reports immediately, and a permanent injunction was issued against further violations of the reporting requirements of the Exchange Act. One week later, the delinquent reports were filed with the Commission.

After an issuer has been enjoined from violating the reporting provisions of the Exchange Act, the program monitors its subsequent compliance with the court's order. If it continues to violate the reporting requirements of the Exchange Act and the court's order to file timely and proper reports, further action may be instituted. In the past fiscal year, proceedings seeking to hold three such companies and certain of their officers in civil contempt of prior injunctive orders were initiated and successfully concluded.[16]

The Commission hopes this program has succeeded in making issuers increasingly aware of the importance it attaches to the prompt filing of required reports, and the necessity of informing shareholders why such reports are not being filed on time and furnishing them with any available preliminary financial and operational information.

CIVIL PROCEEDINGS

During fiscal 1975, the Commission instituted a total of 174 injunctive actions. Some of the more noteworthy injunctive proceedings and significant developments in actions instituted in earlier years are reported below. Several of these enforcement actions were achieved through coordination between self-regulatory bodies and the Division of Enforcement.

S.E.C. v. Phillips Petroleum Company. On March 6, 1975, the Commission filed a complaint against Phillips Petroleum Company and several of its past and present officers and directors to enjoin them from further violations of Sections 12(b), 13(a) and 14(a) of the Securities Exchange Act and rules thereunder. The complaint alleged

that the defendants maintained a secret fund of corporate monies which were used for unlawful political contributions and other purposes. In particular, it was alleged that during the period from 1963 to 1975, the defendants disbursed in excess of $2.8 million in Phillips's corporate funds to two Swiss corporations by means of false entries on the books and records of Phillips. These disbursements were then converted into cash. In excess of $1.3 million of this fund were returned to the United States of which about $600,000 was expended for political contributions and related expenses, a substantial portion of which was unlawful. The balance of the funds was allegedly channeled into the Swiss corporations and distributed overseas in cash.

Each of the defendants consented, without admitting or denying the facts set forth in the complaint, to the entry of a permanent injunction prohibiting future violations of the Federal securities laws. In addition, Phillips 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 this report to its shareholders.

On April 11, 1975, the Commission filed a complaint against Accuracy in Media, Inc. (“AIM”), a non-partisan and non-profit organization devoted to promoting accuracy and correcting errors in the media, seeking to enjoin AIM from violations of the proxy provisions of the Exchange Act and rules thereunder.[17] The complaint alleged that AIM solicited proxies by means of newspaper advertisements while failing to furnish the shareholders of RCA Corporation and CBS, Inc., with written proxy statements containing certain specific information. It was also alleged that AIM failed to file with the Commission copies of preliminary proxy statements furnished to shareholders of RCA Corporation and CBS, Inc., within the time prescribed in Rule 14a-6. The complaint further alleged that AIM'S newspaper advertisements violated Rule 14a-9 in that such advertisements contained statements which, at the time and in light of the circumstances under which they were made, omitted to state material facts necessary in order to make the statements contained therein not misleading. In addition, the Commission sought to require AIM to publish corrective

advertisements and to make an offer to return all contributions received in response to AIM'S initial advertisements.

AIM consented without admitting or denying the allegations of the complaint to the entry of a final judgment of permanent injunction enjoining it from violating Section 14(a) of the Exchange Act and Rules 14a-3, 14a-6, and 14a-9 thereunder. The Court's order further provided that AIM publish the corrective advertisements and make an offer to return the contributions received in response to the initial advertisements.

In *S.E.C. v. Management Dynamics, Inc*.,[18] the court of appeals affirmed a preliminary injunction for violation of the registration provisions of the Securities Act and the antifraud provisions of Section 10(b) of the Securities Exchange Act and Rule 10b-5 by a lawyer responsible for the dissemination of almost a million unregistered shares of Management Dynamics's stock in relatively small-denomination certificates. These shares were in the name of a person who had purported to represent one or more foreign investors, but who, in fact, attempted to sell the shares within the United States.

The court also upheld a preliminary injunction against a broker-dealer firm, which had acted as market maker for Management Dynamics's stock, for violation of the antifraud provisions of the securities laws. The firm's vice-president in charge of trading continued trading the shares even though there was no logical explanation for a price rise from $0.38 to $6.00 in a period of about six months and the company had not responded to an inquiry for information sent by the broker-dealer. The court of appeals stated that it agreed with the Commission's position that Section 20(a) of the Securities Exchange Act “was not intended as the sole measure of employer liability” in an enforcement action brought by the Commission, because Section 20(a) was “enacted to expand, rather than restrict, the scope of liability under the securities laws.”

The court also explicitly held that “proof of irreparable injury or inadequacy of other remedies as in the usual suit for injunction” is not required in an injunction action brought by the Commission.

S.E.C. v. Geon Industries, Inc.,[19] involved trading on inside information about a proposed merger between Geon and Burmah Oil Co., Ltd., of Great Britain. The complaint charged violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 in connection with several purchases of Geon stock by individuals who knew about the state of the merger negotiations that was not publicly known. It also charged violations of those provisions and of Section 17(a) of the Securities Act in connection with the sale of Geon stock by persons having inside knowledge that the merger might not go through. Also, violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5 were charged against Geon's secretary-treasurer, who, when the stock exchange on which the Geon stock was trading inquired whether there was any reason for a large imbalance of sell orders, stated that he knew of none, thus resulting in the commencement of trading in Geon stock, when he knew that insiders had become aware that the merger might fail.[20]

The district court held[21] that the company's president violated the antifraud provisions by disclosing nonpublic information about the fact and progress of the proposed merger, which resulted in purchases and sales of Geon stock, and that Geon was liable for these acts of its president. The court refused to hold that a brokerage firm was liable for purchases and sales made by a registered representative on the basis of inside information, although the registered representative consented to an injunction against him. The court also refused to hold liable the secretary-treasurer of Geon for his alleged misleading statements to the stock exchange. Geon and its president have appealed, as has the Commission.

In May 1975, the Commission filed a complaint in the United States District Court for the District of Columbia seeking to enjoin General Refractories Company (“GRX”), Joseph G. Solari, its chairman, and John E. Hartshorn, its executive vice president.[22] Also named in the complaint were Hermann Mayer, a Swiss businessman, Dan Mayer, his son and a former GRX director, several Swiss and Liechtenstein companies owned or controlled by Hermann Meyer, a Swiss attorney who acted for several of such companies, and Swiss Bank

Corporation. Preliminary and permanent injunctions from further violations of Section 13(d) of the Exchange Act and the anti-fraud, financial reporting and proxy solicitation provisions of that Act were requested.

The complaint charged, among other things, that Hermann Mayer had for many years been a substantial stockholder of GRX, owning or controlling as much as 17% of GRX's outstanding common stock, and that in an effort to conceal these holdings failed to file with the Commission the required reports on Schedule 13D when he acquired in excess of 5% of GRX's outstanding stock. In addition, the complaint alleged that, with the assistance of Swiss Bank Corporation, he dispersed his GRX stockholdings to make it more difficult to trace its ownership. Mayer subsequently caused false and misleading Schedules 13D to be filed. Solari was also charged with violating Section 13(d) of the Exchange Act in connection with his purchase, as part of a group, of in excess of 5% of GRX's outstanding stock without filing the required report on Schedule 13D.

The complaint further charges that the defendants failed to disclose in filings with the Commission that Hermann Mayer and the defendant companies owned or controlled by him have engaged in extensive business transactions with GRX amounting to millions of dollars. These filings with the Commission and materials sent to stockholders also failed to disclose that Hermann Mayer was, during the period 1965-1975, represented on GRX's board of directors. They further failed to disclose that GRX had made payments to officials of foreign governments.

In addition to injunctive relief and disgorgement of illegally obtained benefits, the Commission is also seeking the appointment of a special counsel for GRX to investigate the Mayer transactions and foreign payments. The Court granted the Commission's motion for a temporary restraining order freezing Hermann Mayer's GRX stock. GRX stipulated that it would send materials to stockholders disclosing the GRX – Mayer dealings. The case is still pending.

S.E.C. v. Ambassador Church Financial Development Group, Inc. and Henry C. Atkeison, Jr.[23] This case involved a broker-dealer which engaged in the business of assisting churches to raise capital through the sale of church bonds. The Commission instituted an injunctive action alleging violations of the anti-fraud provisions of both the Securities Act and Exchange Act and requested that a receiver be appointed and a trust imposed on the assets of Atkeison, the president and sole shareholder of the firm. A permanent consent injunction was secured and a SIPC trustee appointed. On January 16, 1975 the trustee filed a petition with the court requesting that Atalbe Christian Credit Association, Inc., an affiliate of Ambassador, and Ambassador be declared alter egos of Atkeison for the purpose of liquidation under the Securities Investor Protection Act of 1970. This was done with the consent of Ambassador, Atalbe, Atkeison and SIPC and the trustee is now liquidating all three estates in this manner.

The Commission filed a civil injunctive action against James Corr III and several of his relatives and associates alleging violations of the anti-fraud, anti-manipulative, margin, stock ownership reporting and registration provisions of the securities laws and seeking ancillary relief.[24] The complaint alleged that during the latter part of 1974, the defendants participated in a scheme to manipulate upwards the price of the common stock of American Agronomics Corporation, listed on the American Stock Exchange, pursuant to which scheme Corr and his group acquired approximately 57% of American Agronomies' outstanding stock and approximately 63% of the floating supply of shares.

The complaint also charged that Clinton Youmans, former president of the Community Bank of St. Petersburg, Florida, misappropriated approximately $4 million from the bank which funds were used by Corr and his associates, in violation of the margin requirements, for manipulative purchases of American Agronomics stock. Alfred Hamilton, a friend of Corr's and a member of his undisclosed group, also effected a manipulative series of transactions and further participated in the alleged manipulation by, among other things, effecting wash sales and matched orders and sales with Corr as part of the defendants' overall scheme to create a false and misleading

appearance of active trading in American Agronomics stock. In addition, the complaint alleged that the defendants made certain false filings, which omitted to disclose sources of funds used to buy the stock and the existence of the group, and failed to make certain required filings with the Commission regarding their purchases of American Agronomics stock. The complaint further charged that certain of Hamilton's shares had been sold in violation of the registration requirements and that Corr and others, under the circumstances, were about to violate the registration provisions. The case is still pending.

On April 10, 1975, the Commission filed an injunctive action against *Sanitas Service Corporation* and five other defendants alleging violations of the anti-fraud, financial reporting and proxy solicitation provisions of the Exchange Act.[25] The complaint alleged that several of the individual defendants, who were officers and directors of Sanitas, caused Sanitas to pay in excess of $1 million to a company owned by Sanitas' executive vice-president. These funds were then converted into cash and used for political payments, bribes and kickbacks to local and state authorities and others. The complaint alleged that Sanitas and the other defendants made these payments without disclosing to Sanitas' stockholders, the public and the Commission, the true nature, purpose and amounts of

such payments. In addition, the complaint alleged that Sanitas had improperly used “pooling” accounting for an acquisition of a waste disposal company in 1971 and that it misrepresented and improperly accounted for the sale of one of its major linen laundry divisions in 1972.

Sanitas and all but two of the other defendants have consented to permanent injunctions. The court's order provided that Sanitas and its new independent auditors would take various steps to determine the ultimate recipients of the cash payments with a view to recouping such payments for the company. The consent order also provided that Sanitas would maintain its new audit and legal committees which would review accounting procedures and review potential claims which Sanitas may have against former employees and others after

reviewing investigations performed by its new counsel and auditors. Further, Sanitas was directed to file a report of its investigation of certain matters with the court and Commission and file amended reports with the Commission.

The litigation is continuing against the remaining two defendants.

S.E.C. v. Minnesota Mining and Manufacturing Co.[26] – In January 1975, the Commission filed an injunctive action in the United States District Court for the District of Minnesota against Minnesota Mining and Manufacturing Co. ("3M"), and three individuals who were officers and directors of 3M.

The complaint alleged that the defendants violated the proxy rules and reporting provisions of the Exchange Act in connection with secret funds used to make unlawful political contributions with corporate monies. The complaint alleged that these monies were falsely recorded on the books of 3M as insurance and legal expenses, and further alleged that the reports and proxy material of 3M filed since 1963 failed to disclose the facts and circumstances surrounding the operation and maintenance of the secret fund and the involvement of the individual defendants.

Without admitting or denying the allegations of the complaint, the defendants consented to a permanent injunction enjoining them from: 1) using corporate funds for unlawful political contributions or other similar purposes, 2) filing and disseminating materially false and misleading annual and other periodic reports and proxy material, and 3) making or aiding and abetting the making of materially false and fictitious entries in the books of 3M, or establishing or maintaining any secret or unrecorded funds of monies or other assets or making any disbursements therefrom.

The order also provides that the defendants arrange for the reimbursement to 3M of at least $425,000 and transmit to Shareholders a statement describing the facts and circumstances regarding the allegations of the proceeding. 3M also undertook to appoint a special agent to investigate any instances in which 3M

expenses were recorded on the books for other than their actual purposes.

On December 17, 1974, the Commission filed a civil injunctive action in the U.S. District Court for the District of Columbia charging OSEC Petroleum S.A., of Luxembourg, OSEC Petroleum A.G., of Munich, West Germany, and Jacques Sarlie, a non-resident American citizen and Interinventa Trust, Liechtenstein trust, with violations of the Exchange Act and rules thereunder.[27] All defendants, except Interinventa, have consented to the entry of a final judgment which, in part, provides for an injunction and for the payment of $150,000 to persons who sold common stock of Ulster Petroleums, Ltd. to OSEC S.A. between September 17, 1973 and January 4, 1974. Ulster is a Canadian company.

The complaint charged, among other things, that OSEC S.A., at the direction of its parent, OSEC A.G., and Sarlie, purchased over 20% of the stock of Ulster through a Canadian broker on the Toronto Stock Exchange. Ulster shares are listed on various Canadian exchanges and on the Pacific Stock Exchange. The complaint further charges that defendants did not file a timely report with the Commission when OSEC S.A. purchased more than 5% of Ulster's stock, as required by law. Violation of Section 10(b) of the Exchange Act and Rule 10b-5 was also charged because of their purchasing as a result of purchases of Ulster stock without first disclosing to sellers and to the public certain material, nonpublic information concerning OSEC's intention to acquire control of Ulster, since OSEC previously had announced the cancellation of a proposed transaction with Ulster which would have resulted in OSEC's acquisition of control of Ulster. The Commission also charged Interinventa Trust, alleged owner of approximately 11% of OSEC A.G.'s shares, with refusing to release its identity and the identity of its beneficial owner to OSEC S.A. or the Commission for inclusion in OSEC S.A.'s Schedule 13D filed with the Commission.

Under the final judgment, eligible sellers who submit claims to share in the $150,000 fund will receive, pro rata, the difference between their sale price and $1.52 per share. In addition, OSEC S.A., OSEC A.G. and Sarlie must grant a proxy covering most of OSEC's Ulster shares

to an approved proxy holder who shall independently vote the shares in nearly all matters until the fund has been paid or 14 months from the date of judgment, whichever is later. During this period, OSEC S.A.'s power to dispose of the stock, in other than ordinary brokers' transactions, is conditioned upon its disclosure in advance of certain information to the Commission concerning such transactions.

In *S.E.C. v. Capital Growth Company, S.A. (Costa Rica), et al*.[28], the Commission filed a complaint on September 3, 1974 alleging anti-fraud violations and seeking injunctive relief and the appointment of the receiver.

The complaint alleged that beginning about September 1968 and continuing to the present, Clovis W. McAlpin, Capital Growth Company, S.A. (Costa Rica)("the Capital Growth companies"), New Providence Securities, Ltd. and their predecessors, along with other persons and other defendants, including, Sanford C. Shultes, Sheffield Advisory Company, Sheffield Advisory Company, S.A. ("Sheffield") and EHG Enterprises, Inc., Ariel E. Gutierrez and Enrique H. Gutierrez ("EHG") converted and misappropriated the assets of the Capital Growth companies for their own benefit. The draining of the assets of Capital Growth companies was accomplished through a series of self-dealing transactions which included eliminating the independent trustee, the close-ending of the Capital Growth companies and the diversion of the marketable assets of the Capital Growth companies into newly-formed entities owned or controlled by certain of the defendants or their associates.

An order of preliminary injunction was entered and a receiver was appointed. Sheffield consented to a permanent injunction and a final judgment of default was entered against the remaining defendants, over the argument of EHG, who contended that telephonic notice of the temporary restraining order was inadequate and that service of the summons and complaint was not made in a timely manner. These defendants were then granted additional time to file their answer and present factual evidence why the preliminary relief granted should not stand. This was not done.

Defendants appealed from the decision of the District Court and urged the Court of Appeals for the Second Circuit to vacate the order of preliminary injunction and the appointment of a receiver. On June 2, 1975, the Court of Appeals for the Second Circuit, in an unwritten opinion affirming the lower court's decision held, among other things, that the defendants had received sufficient notice of the proceedings and were given an adequate opportunity to present their objections to the relief granted by the District Court.

SEC v. J&B Industries, Inc.[29] On September 3, 1974, the Commission filed a complaint against J&B Industries, Inc., and nine other defendants alleging that “special land rights” representing fractionalized interests in a large tract of Canadian land constituted a security in the form of an investment contract that was being offered and sold in violation of the registration and anti-fraud provisions of the Federal securities laws.

Although each purchaser received title in fee simple, the defendants retained total control over all investments by having each investor execute an “irrevocable power of attorney” and a “firm option” in favor of the defendants contemporaneously with each purchase.

On October 2, 1974 the court issued a preliminary injunction and appointed a temporary receiver.

Several of the defendants have consented to permanent injunctions without admitting or denying the allegations in the Commission's complaint.

SEC v. Bull Investment Group.[30] On December 20, 1974 the Commission filed suit in the Federal District Court for the District of Massachusetts charging Bull Investment Group, Ronald Kimball, Richard G. Grondin, Richard F. Tosti, Golden Book of Values and James Sanford with violating the registration and anti-fraud provisions of the federal securities laws. The complaint, alleging that the defendants sold investment contracts in the form of pyramid marketing plans, sought injunctive relief and the appointment of a receiver.

After an evidentiary hearing, the court noted the parallels between the Bull Investment Group case and the *SEC v. Glenn Turner Enterprises*, Inc., 474 F. 2d 476 (C.A. 9, 1973) and *SEC v. Koscot Interplanetary*, Inc., 497 F. 2d 473 (C. A. 5, 1974), indicated that the Commission would probably succeed in establishing that the defendants pyramid plan was an investment contract, and accordingly entered a preliminary injunction on March 11, 1975. The Commission's motion for default judgment was granted against the defendants Bull, Kimball, Grondin, and Tosti for their failure to comply with the Court's order compelling discovery. The matter is still pending against Golden Book and Sanford.

Noteworthy collateral matters were in issue during the course of the litigation. The Commission on February 4, 1975 moved that the defendant's answer be stricken because it was filed in bad faith in that it contained many patently false assertions. The motion was subsequently granted, but the defendants were granted leave to amend. During the course of the hearing on preliminary injunction a "clean hand" defense was raised, asserting that the Commission had violated its own rules of confidentiality by providing information gathered from the defendants to other law enforcement agencies. The court, after taking testimony on the issue, rejected the defense. Finally, the Commission, upon learning that the defendants were violating the preliminary injunction, moved to modify that order to insure that the injunction would be honored. After a hearing concerning these violations, the court entered an order which broadened the injunction's scope, and installed monitoring devices to insure compliance.

SEC v. Howard Garfinkle, et al.[31] On January 14, 1975, the Commission filed a complaint in the Southern District of New York alleging that Howard N. Garfinkle and other defendants had violated the anti-fraud and registration provisions of the securities laws in connection with the sale of limited partnership interests in apartment buildings. The complaint alleged that the offerings involved misstatements and omissions to state material facts concerning, among other things, the financial projections inserted in the offering circulars, the failure to transfer record title to the properties, the quick sale of the properties causing the limited partners to lose tax benefits

and part of their invested capital, the commingling and misappropriation of funds of the limited partnerships and the failure to distribute proportionate shares of the proceeds of sales to the limited partners.

The complaint also alleged that Bernard Tolkow, the business manager of United Welfare Fund and another defendant, caused United to provide monies to Garfinkle by purchasing participations in short-term notes collateralized by mortgages on properties sold to limited partnerships, and that Garfinkle misappropriated for his own benefit the monies he received from United. It was alleged that Garfinkle provided kickbacks to Tolkow in the form of purported returns on investments by Tolkow in limited partnerships. Disgorgement is sought of funds received by Garfinkle from investors and received by Tolkow from Garfinkle as a result of the fraud.

After a hearing, the Court granted preliminary injunctions against Tolkow and the Security Division of United Welfare Fund and ordered the Security Division to maintain specific investment procedures to limit the possibility of improper investment of welfare funds. Garfinkle had consented to a preliminary injunction prior to the hearing. All the defendants, except Garfinkle, Tolkow and the Welfare Fund, including a lawyer who had procured investors in the limited partnerships, have been permanently enjoined by consent. The action continues as to the remaining defendants.

In *SEC v. Town Enterprises Inc. et al*.,[32] the Commission alleged a massive fraudulent scheme in the offer and sale of unregistered securities in the form of “passbook certificates” and “time certificates” by Town through at least eight wholly-owned, uninsured subsidiaries operating under Morris Plan and Industrial Banking statutes of seven states. The Commission's complaint alleged, among other things, that the defendants offered and sold these securities during a period when Town and its subsidiaries were experiencing large undisclosed financial losses. Approximately $16,000,000 of such securities, held by at least 15,000 investors, were in the hands of investors at the time the complaint was filed.

All defendants, without admitting or denying the allegations of the complaint, consented to orders permanently enjoining them from further violations of the registration and anti-fraud provisions of the Federal securities laws. Town and several subsidiaries, named as defendants, have subsequently filed voluntary petitions in Bankruptcy under Chapter XI of the Federal Bankruptcy Act.

SEC v. Brigadoon Scotch Distributors, Ltd., et al.[33] On December 12, 1974, the Commission instituted an injunctive action against Brigadoon Scotch Distributors, Ltd. and 26 other defendants alleging violations of the registration and anti-fraud provisions of the Federal securities laws in connection with the offer and sale by the defendants of investment interests in scotch whisky and rare coin portfolios.

Of particular note, and a question of first impression was the charge in the Commission's complaint that the offer and sale of rare coin portfolios by the Federal Coin Reserve, Inc. (“FCR”) constituted the offer and sale of a security subject to the jurisdiction of the federal securities laws.

In this regard, the court in an opinion dated February 10, 1975, after a hearing on the Commission's motion for a preliminary injunction against FCR, its principals and key sales personnel, found that the investment interests in rare coin portfolios being offered and sold by the defendants to the investing public did, in fact, constitute the offer and sale of a security within the province of the Federal securities laws. Accordingly, the court granted the Commission's request for a preliminary injunction.

In *SEC v. Robert Dale Johnson, et al*.[34] the Commission, on June 14, 1974, filed an injunctive action alleging violations of the registration and antifraud provisions of the Federal securities laws, variously, by Robert Dale Johnson, Ridge Associates & Co. and ten other defendants in connection with a multi-million dollar industrial wine Ponzi scheme. The Commission alleged that the defendants offered and sold securities in the form of investment contracts to approximately 400 investors without compliance with the securities registration requirements. In addition, it was alleged that Johnson and

Ridge engaged in a fraudulent scheme inducing investors by falsely representing that their funds would be used to purchase European industrial wine to be resold at huge profits. In fact, Johnson and Ridge kept selling wine contract obligations, evidencing a promised return to investors of principal invested and profits ranging from 30 to 100%, which were being paid off with the funds of other investors. No wine investment program ever existed. Approximately $75 million was raised from approximately 400 investors under such promissory notes. Final Judgments of Permanent Injunction were entered against all defendants. On August 26, 1974, Johnson pleaded guilty to a criminal information charging him with one count of securities fraud and one count of mail fraud arising out of this scheme and was sentenced to a term of six years imprisonment.[35]

SEC v. North American Acceptance Corporation.[36] On February 7, 1975, the Commission filed a complaint seeking to enjoin North American Acceptance Corporation (NAAC), a Georgia corporation, and 10 other defendants alleging violations of the registration and antifraud provisions of the securities acts. The complaint alleges that NAAC and others made false and misleading statements and omitted to state material facts in the sale of its high interest unsecured corporate notes to residents of Georgia. Among other things, these statements related to the use of proceeds; that land development companies owned by NAAC were causing a negative cash flow for NAAC; that NAAC was having liquidity problems; that financial statements did not reflect substantial changes in the financial condition of NAAC; that NAAC's parent corporation, Omega-Alpha, Inc. (OA) was losing money; and that millions of dollars transferred from NAAC to OA were being utilized by OA for working capital and the retirement of debt not related to NAAC.

NAAC sold promissory notes with maturity dates of one to five years and promissory notes payable on demand. In January 1974, NAAC mailed an annual financial statement to its noteholders which contained adverse information. As the result of this information, noteholders immediately began to demand the return of their investment which NAAC was unable to repay. Thereafter, on February 6, 1974, NAAC filed a petition under Chapter XI of the Bankruptcy Act

which was later converted to a Chapter X proceeding. About 5,000 investors still hold NAAC notes aggregating $38,000,000.

In *S.E.C. v. Cambridge Capital Corporation, et al*.[37] and *S.E.C. v. Interstate Syndications, Inc., et al.*,[38] the Commission instituted injunctive actions against two Atlanta-based land syndication companies charging violations of the registration and antifraud provisions of the securities laws. Both companies were engaged in the business of selling investments in various tracts of raw land in the form of either limited partnership interests or co-tenancy interests in the real estate. The sales terms of these real estate syndication interests called initially for down payments and later for yearly payments by each investor to cover the annual mortgage, interest and real estate tax obligations relating to each tract of raw land. In order to protect the investors' interests in the real estate, a court-appointed agent was needed to administer the receipt and disbursement of the funds. In each suit, the court, at the request of the Commission, appointed a special fiscal agent to administer the various land syndications. Because these interests were frequently sold to persons who were told or led to believe that they would not have to make more than one or two of the annual payments before the land was “turned over” at a profit and because the raw land was not producing any income, the special fiscal agents encountered difficulties preserving the investors' interests. Subsequent efforts made by the court, the special fiscal agents and the Commission's staff have been directed toward minimizing investor loss in the adverse climate of a tight money market and a general recession in the market for unimproved real estate.

In *SEC v. Strathmore Distillery Co. Ltd*.[39] an order of permanent injunction was entered against Strathmore and defendant John B. R. Turner, both of Glasgow, Scotland, enjoining further violations of the securities registration, broker-dealer registration and anti-fraud provisions of the federal securities laws.

The Commission alleged in its complaint that the defendants were engaged in a nationwide campaign to sell the Scotch whisky interests and that in some cases the prices for the whisky interests sold by the defendants were 100 percent above the prevailing market prices for

such interests. The complaint further alleged that in connection with the sale of those interests in scotch whisky the defendants made untrue statements of material facts including, but not limited to, statements that investors would obtain profits of 20% per year, that overproduction of scotch whisky was an investment risk, and that there are no qualitative differences between various scotch grain whiskies. Also it was alleged that the defendants omitted to state certain facts necessary to make the statements made not misleading. Among other things, the defendants did not disclose the amount of the sales proceeds retained by the defendants, the source of market price quotations and the actual market price quotations for the scotch whisky being sold.

S.E.C. v. R. J. Allen & Associates, Inc.[40] – This case involved the use of fraudulent sales practices by a dealer of tax-exempt securities in selling Industrial Development Revenue Bonds. Neither the dealer nor the bonds were registered with the Commission. The firm, three of its principals and two sales personnel were defendants in the action which the Commission instituted in the United States District Court for the Southern District of Florida. After a trial which lasted several days and after one salesperson consented to the entry of a permanent injunction against her, the court found that the defendants had engaged in various fraudulent practices, including: misrepresentations and omissions of material facts about the bonds; the practices of "bucketing" – not filling orders for which customers had paid – and "switching" – delivering bonds to customers other than those they had ordered. Prominent among the victims were a number of returned prisoners of war from Vietnam who had invested all or part of the back pay earned while they were prisoners based upon the false promise of fully insured tax-free income.

In addition to the entry of a permanent injunction against the defendants prohibiting further violations of the anti-fraud provisions of the Securities Act and the Exchange Act, the court also appointed a receiver, required an accounting, froze the defendants' assets, and ordered the firm and its two principals to jointly disgorge to the receiver an amount equal to the total sales of all Industrial Development Revenue Bonds to all customers – approximately $4,500,000.[41] Since

the entry of the order, the Commission has continued to assist the receiver in locating assets of the defendants and to complete an accounting of the firm's books and records.

S.E.C. v. Prudential Funds, Inc.[42] – In June, 1975, in U.S. District Court for the District of Columbia, the Commission sued Prudential, its Executive Vice-President (Finance), Winston S. McAdoo, and its broker-dealer subsidiary, Prudential Ventures Corporation, charging violations by all the defendants of the anti-fraud, reporting and prospectus provisions of the federal securities laws, and the violation by Prudential of the proxy solicitation provisions.

The Commission alleged that the defendants, when offering and selling over $10 million in limited partnership interests in “leveraged” oil and gas drilling programs prospectuses, misrepresented the manner in which they would conduct the business of the drilling programs in a way materially at variance with representations to investors made in prospectuses, tax opinion letters, and selling literature, and ignored the warnings of their tax counsel as to the possible adverse tax consequences of such conduct.

The Commission alleged that the defendants engineered a series of sham transactions in late 1972 which were of doubtful validity from a tax viewpoint, and which had not been disclosed to investors. Investors were informed by Prudential as to the availability of leveraged tax deductions (in excess of their cash investment) for their 1972 tax returns, without being informed as to the nature of the transactions purportedly giving rise to the deductions or as to the tax risks associated with claiming the deductions. The defendants consented to the entry of an injunction against further violations without admitting or denying the Commission's allegations.

S.E.C. v. G. C. George Securities, Inc.[43] – On February 12, 1975, the Commission filed an injunctive action in the United States District Court for the Eastern District of Washington against eleven Spokane-based securities broker-dealers and sixteen individuals associated with the broker-dealer firms. The suit alleged that the defendants were violating the anti-fraud provisions of the Federal securities laws in

connection with the publication and nation-wide distribution of over-the-counter quotation sheets for the securities of some 80 local mining companies, which reflected quotations having little or no relationship to the prices at which concurrent transactions were being effected in such securities by the defendants.

The Commission's Motion for Preliminary Injunction has been consolidated with a hearing on the merits. No trial date has been set pending the outcome of settlement negotiations.

In *S.E.C. v. Western Pacific Gold and Silver Exchange Corporation, et al*.[44] the United States District Court for the District of Nevada held that the offer and sale of investment interests in gold and silver to investors in several states involved the offer and sale of investment contracts, evidences of indebtedness in interests and instruments commonly known as securities, in violation of the registration and antifraud provisions of the Federal securities laws.

The court found that the defendants had omitted to state, among other things, that: Western Pacific Gold and Silver Exchange Corporation was insolvent; its investment agreements were written without acquiring the corresponding gold and silver, or silver futures contract for each contract sold to investors; it paid investors by raising funds from other investors; it could not fulfill its guarantee to repurchase gold and silver from investors; investors' funds were not being used to acquire silver and gold and were being diverted and converted to the use of the defendants; silver was not stored in independent storage facilities, nor was the investors' silver segregated from the silver of another investor; and little, if any, silver presently exists in or otherwise for the accounts of investors who requested storage.

The Order of Preliminary Injunction was followed by a summary judgment[45] which prohibited the named defendants from violating the registration and anti-fraud provisions of the securities laws. The judgment also provided for certain ancillary relief. The defendants were enjoined from altering, destroying, concealing, dissipating, disclosing, transferring or moving any books, records, documents, correspondence, funds or assets of the defendants. The judgment

continued the appointment of a receiver of all assets and property of, belonging to, or in possession of the defendants which have been received as a result of the acts and practices complained of. It required the defendants to make an accounting of all funds received from investors in connection with the silver investment agreements, and to disgorge to the receiver any and all funds and silver which they received as a result of their sales and purchases of the securities described in the complaint.

In addition, in fiscal 1975, the Commission filed *S.E.C. v. Silver Mint Mortgage, Co., Ltd., et al.*,[46] *S.E.C. v. Constitution Mint, Inc., et al*.,[47] and *S.E.C. v. Douglas S. Warren, et al*.[48] Preliminary or final injunctions have been entered in the above cases.

S.E.C. v. Seaboard Corp.[49] – The Commission obtained consent injunctions against all but two of the twenty-nine defendants in this previously reported 50 case. The suit dealt essentially with the alleged mismanagement and outright looting of a complex of mutual funds ("Funds").

The complaint alleged that a portfolio manager of the Funds engaged in a practice of first purchasing thinly traded securities through nominees, then causing the Funds to purchase the same securities in large volume, thereby causing a price rise. He then allegedly sold his personal holdings either to the Funds or into the market when the Funds were buying. As a result, the Funds were alleged to have lost as much as $4,000,000.

The complaint also alleged that finders' fees in excess of $200,000 were illegally paid to affiliates of the Funds and that securities were purchased, investment advisers selected and other decisions relating to the investment funds made in order to benefit Seaboard and its affiliates to the detriment of the Funds.

In addition to enjoining the defendants from further violations of the antifraud provisions of the federal securities laws, the court has imposed other sanctions, including the payment of money to the Funds

and to special funds administered by the court for the benefit of other classes of persons who were injured through the defendants' actions.

S.E.C. v. Republic National Life Insurance Company.[51] – As previously reported,[52] the Commission instituted an injunctive action against Republic National Life Insurance Company ("Republic"), Realty Equities Corporation of New York ("Realty"), Peat, Marwick, Mitchell & Company ("PMM"), Westheimer, Fine, Berger & Co. ("Westheimer"), and eleven individuals who were employees of Republic or Realty. The Commission charged extensive violations of antifraud and reporting provisions of the Exchange Act. In essence, the complaint alleged that Republic, in trying to conceal its failing investment in Realty, put millions of dollars into Realty through certain transactions. The proceeds were usually channeled back to Republic to repay earlier Realty debt. Realty was thus enabled to retain sufficient funds through the transactions to continue in operation. Republic and Realty and each of their independent auditors were alleged to have made and issued false and misleading financial statements.

Republic, Realty, PMM, Westheimer, and eight of the eleven individual defendants consented to permanent injunctions enjoining them from future violations of various provisions of the Exchange Act. Certain of the defendants also consented to ancillary remedies designed to prevent recurrences of violative conduct. The litigation is continuing with respect to three remaining defendants.

S.E.C. v. Mattel, Inc.[53] – In two separate proceedings during 1974, Mattel, Inc., a California toy manufacturer, was enjoined on its consent from violating the antifraud and reporting provisions of the Securities Exchange Act. The allegations related to material misstatements in Mattel's financial statements during 1971 through 1973 and press releases issued during that period.

In addition to the injunctions, the court ordered that Mattel (1) appoint and maintain a majority of its directors who are unaffiliated with Mattel; (2) maintain committees of such independent directors to review financial controls and auditing procedures and also litigation; (3) appoint a special counsel to investigate the matters alleged in the

complaint, to report his findings to the court and the Commission and to initiate actions on behalf of the company against management; and (4) appoint a special auditor to examine the company's past financial statements.

S.E.C. v. Solitron Devices, Inc.[54] – In an action filed in March 1975, the Commission obtained a final order against Solitron Devices, Inc. on allegations that Solitron's 1967 through 1970 Annual Reports on Form 10-K were false and misleading because the accompanying audited financial statements materially overstated the value of its inventory, sales and accounts receivable and its pre-tax and net income. In addition, the complaint alleged that Solitron's annual and other reports from 1971 and audited financial statements failed to disclose that a substantial part of the writedown of Solitron's inventory described therein was due to, among other things, Solitron's falsification of its prior financial statements and that Solitron had a substantial contingent liability arising out of its prior falsified financial statements.

The court ordered Solitron, with its consent, to file timely complete and accurate annual and periodic reports with the Commission containing all material facts. Further, Solitron was ordered to make only such public statements as are complete and accurate in all material respects.

Moreover, the court's order directed the company to restate correctly its prior filings which were the subject of the Commission's complaint. Finally, the court directed Solitron to retain special counsel, satisfactory to the Commission, to accomplish the matters referred to in a stipulation and undertaking executed by Solitron and annexed to the court's order and to comply fully with the stipulations and undertakings contained therein.

S.E.C. v. Savoy Industries Corporation[55] – This case exemplifies how cooperative efforts of the Commission's staff and self-regulatory bodies produce effective enforcement action. On November 22, 1974, the Commission, after an investigation resulting from information received from the American Stock Exchange, instituted an injunctive action against Savoy and five other defendants alleging violations of

the reporting and anti-fraud provisions of the Federal securities laws. The complaint alleged that the defendants made numerous fraudulent misstatements of material facts and omitted to state other material facts in reports required to be filed with the Commission and the American Stock Exchange. The defendants were charged with failing to disclose the role of one of the defendants as a controlling factor in a scheme to acquire Savoy stock and that the real purpose of the acquisition was to turn Savoy into an insurance holding company.

Savoy and three other defendants, without admitting or denying the allegations, consented to permanent injunctions enjoining them from further violations of the reporting and anti-fraud provisions of the Federal securities laws. In addition, all defendants who acquired shares of Savoy common stock have agreed not to dispose of those shares for at least two years.

Three civil actions were initiated during fiscal 1974 by the Commission against Florida-based issuers of unregistered mortgage notes and the mortgage brokers selling the notes. These actions against a total of 21 defendants, were captioned S.E.C. v. Continental 'Land Management Corp.[56] *S.E.C. v. L.T.P. Properties, Inc*.[57] and *S.E.C. v. Horowitz*.[58] Each of the cases included charges of violations of registration and anti-fraud provisions by the issuers and sellers of corporate promissory notes collateralized by mortgages or assignments of installment land sales contracts. Typically, the lots purportedly mortgaged or assigned to investors were, at best, much less valuable than represented and, at worst, nonexistent. The issuer in each of these cases is currently in receivership as a result of the Commission action or in bankruptcy proceedings. Approximately 2,300 investors sustained losses on the securities issued of about $20 million.

PARTICIPATION AS *AMICUS CURIAE*

Slade v. Shearson, Hammill & Co., Inc.[59] – In this action brought pursuant to Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, an investor was seeking damages suffered when she purchased securities on the basis of the recommendations of a

salesman of the defendant made at a time when the defendant's investment banking department was in possession of adverse material non-public information about the issuer of the securities, which was also an investment banking client. Shearson asserted that its internal policies prohibited the firm from making any recommendations with respect to investment banking clients, although individual salesmen of the firm were permitted to make recommendations based on their analyses of publicly available information. Shearson contended that it was precluded from using inside information in the possession of its investment banking department for the benefit of its brokerage customers, and that this would be the case if it caused its salesmen to withdraw outstanding recommendations after receipt of the adverse non-public information. The lower court denied Shearson's motion for a partial summary judgment and certified a controlling question of law to the Second Circuit for interlocutory appeal. The Second Circuit accepted the certification.

The Commission as *amicus curiae* argued in the court of appeals that this case should not be viewed as governed solely by cases where an insider takes advantage of inside information in effecting securities transactions. In this case, the Commission noted, the broker's recommendation did not permit his customer to benefit from inside information; rather, the recommendation was that, notwithstanding material adverse information, the customer buy the securities in question. In these circumstances, another principle becomes applicable; specifically, the Commission argued, Rule 10b-5 must be interpreted to prohibit a recommendation contrary to non-public facts about the security in question known by the broker-dealer. The preservation of necessary restrictions upon the use of material inside information does not require that the broker's misrepresentations be condoned. They could be avoided with no drastic affects on a multi-function securities firm if, in addition to separating its departments and not allowing non-public information to pass from the investment banking department to the broker-dealer department, the firm would also use a device such as a restricted list, pursuant to which the firm and its salesmen would be prevented from making recommendations with respect to securities at such times as the firm may have, or is likely to obtain, material inside information. This device would enable

the firm to avoid inadvertent violations by salesmen who are unaware of inside information that may be inconsistent with the information which served as the basis for the recommendation.

On December 16, 1974, the court of appeals held that its acceptance of the certification of the question for review had been improvidently granted, and remanded the case to the district court. Noting the implications the resolution of this case had for both the securities industry and the investing public, the court decided that it would proceed further in this case only on the basis of full findings of fact and a consequent narrowing of the issues.

In *Schlick v. Penn-Dixie Cement Corporation, et al.*,[60] the United States Court of Appeals for the Second Circuit reversed a lower court ruling which had dismissed the complaint. The complaint was filed by minority shareholders of Continental Steel Corporation. It alleged violations of Sections 10(b) and 14(a) of the Securities Exchange Act and Rules 10b-5 and 14a-9 thereunder. It charged that Penn-Dixie, as the majority shareholder of Continental, engaged in a scheme to manipulate the business affairs of Continental, thereby depressing the market price of Continental stock in relation to that of Penn-Dixie, in order to effect a merger between the two companies on the basis of an exchange ratio that reflected the manipulated price, and was thus unfair to the minority shareholders of Continental. Penn-Dixie was also alleged to have failed to disclose certain facts concerning the scheme in proxy materials sent to Continental shareholders in connection with the merger.

With respect to plaintiff's claim under Rule 10b-5, the court of appeals held, in substantial agreement with the position taken by the Commission in an *amicus curiae* brief, that where a majority shareholder engages in “a scheme to defraud” minority shareholders, which includes market manipulation and a merger on preferential terms, of which alleged omissions and misrepresentations contained in proxy soliciting material are only one aspect, a plaintiff need allege only that he suffered economic harm in order to state a cause of action (i.e., that the exchange ratio arguably would have been fairer had the basis for valuation been disclosed). The plaintiff did not have to allege

that the merger transaction itself was “caused” by material omissions and misrepresentations.

The court of appeals also held, again in substantial agreement with the position of the Commission on the allegations about Rule 14a-9, that certain misstatements or omissions in the proxy materials were material and that the proxy solicitation was an essential link in effecting the merger, were sufficient to plead the element of causation in the merger transaction and, therefore, were sufficient to state a cause of action under those provisions. In this regard, the court observed, among other things, that if shareholders had been fully informed, they may have had recourse to measures other than the casting of proxies in opposing the merger, or at least, have been in a better position to protect their interests.

CRIMINAL PROCEEDINGS

As a result of investigations conducted by its staff, the Commission during the past fiscal year referred 88 cases to the Department of Justice for criminal prosecution. This represents a substantial increase over the 65 cases referred during the preceding fiscal year. As a result of these references, 53 indictments naming 199 defendants were returned, as compared to 40 indictments against a total of 169 defendants during the previous year. In addition, during the past fiscal year, the Commission authorized its staff to file 17 criminal contempt actions, and convictions were obtained against 10 defendants. During the past fiscal year, 116 defendants were convicted in the 33 criminal cases that were tried. Convictions were affirmed in 6 cases that had been appealed, and appeals were still pending in 5 other cases at the close of the period.

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 usually 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 demonstrated the great variety of fraudulent practices that have been devised and employed against members of the investing public.

After three weeks of trial,[61] J. Harlow Tucker of Spokane, Washington, pled guilty to five counts of an indictment charging securities fraud and mail fraud. The defendant defrauded in excess of 1,300 investors, residing primarily in eastern Washington, of more than $4,000,000 through the sale of common stock and subordinated convertible debentures of The Davenport Hotel, Inc. and other investment programs related thereto. Funds raised were purportedly to be used to renovate The Davenport Hotel, a landmark located in Spokane, Washington, and to build an adjacent convention center, but were in fact primarily used for other undisclosed purposes. The defendant capitalized on the area's sentimental attachment to the hotel and a promise to pay an 8% return on the debentures, which enabled Tucker to sell securities to numerous older retired persons and many others who had never previously invested in securities.

Sentencing has been delayed by the court pending a pre-sentence investigation report.

In *U.S. v. E. M. Riebold*,[62] a multi-count indictment was returned in the United States District Court for the District of New Mexico alleging violations of the wire fraud, mail fraud and interstate transportation of stolen property and misapplication of bank funds statutes by E. M. Riebold, a New Mexico businessman; Donald T. Morgan, a former New Mexico banker; Harold M. Morgan, an Albuquerque, New Mexico, attorney; E. J. Hammon, a New Mexico businessman; and Hilliard Crown, a Santa Fe, New Mexico, accountant.

The indictment alleged that the defendants obtained in excess of $5,000,000 from various victims, including banks, and the Home-Stake Production Co. of Tulsa, Oklahoma.

Harold Morgan pled guilty to an information charging him with one count of securities fraud.[63] E. J. Hammon pled guilty to an information

charging him with one count of securities fraud, and Hilliard Crown pled guilty to one count of the indictment alleging that he made a false statement to a bank in connection with a loan.[64] The case remains for trial against defendants E. M. Riebold and Donald Morgan.

Gary J. Awad was the Operations Manager for some 9 years in the Detroit branch of a large brokerage firm which was and is a member of the New York Stock Exchange. In August, 1970, Awad opened a securities trading account at the firm in a fictitious name and from that time to about October, 1973, effected numerous purchases and sales in the account. During that same period, he was able to alter the records of his employer to reflect receipt into the account of various securities, which were either nonexistent or the property of other customers of the firm. Using these securities supposedly in the account as “collateral,” Awad caused the firm to issue checks out of the account, the proceeds of which Awad converted to his own use and benefit. Since Awad had authority to sign checks drawn on the firm's bank accounts, he was able to have checks issued to the person in whose name the account was maintained, sign this name on the back of the checks, and deposit or cash the checks at banks where Awad maintained accounts in .the fictitious name. During the period the scheme was in operation, the purchases and sales in the account resulted in a loss to the firm of about $80,000. In addition, checks issued out of the account to the purported customer totaled about $124,200, compared to deposits into the account of some $42,800, or a loss to the firm of an additional $81,400.

Following a lengthy investigation by the Detroit Branch Office, an informal but detailed report was furnished to the United States Attorney in Detroit. On June 19, 1975, Awad entered a plea of guilty to a one-count Information filed that same day in Detroit federal court, for violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.[65] Sentencing was deferred until completion of the pre-sentence report. As of the date of this resume, a sentencing date has not been set.

After a five-week trial, three defendants in *U.S. v. The Technical Fund, Inc., et al*. were found guilty of violating various provisions of the

Federal securities laws.[66] The seven counts which went to the jury concerned the defendants and their relationship with a Boston based mutual fund, the Technical Fund, Inc., and a Boston and New York brokerage house, Security Planners Limited. The fund had been placed in receivership pursuant to an S.E.C. action in May of 1972, while the brokerage firm had been committed to a Securities Investor Protection Corporation trusteeship, again following Commission action, in July 1971.

Sumner H. Woodrow, who was counsel for both the investment company and the broker-dealer, was convicted of participating in the filing of a false broker-dealer registration form on its behalf and certain undisclosed principals and of employing a scheme to defraud in connection with the diversion of funds from Technical Funds to the broker-dealer. Howard P. Smolar, president of the fund, and Edward Vanasco, an undisclosed principal of the broker-dealer, were convicted of conspiracy, of the filing of false financial reports and of engaging in prohibited affiliated transactions with the fund in violation of the Investment Company Act. Smolar and Vanasco were also convicted in separate counts of participating in a course of conduct whereby Vanasco, who had been barred by the SEC from being associated with any broker-dealer, became an undisclosed controlling person of Security Planners Limited. Vanasco was sentenced to 3 years in jail; Smolar was sentenced to 2 years in jail, one month to be served and the balance suspended, and he was placed on probation for 2 years; and Woodrow was sentenced to one year in jail, sentence suspended, and he was placed on probation for one year. This case is significant as it resulted in convictions stemming from violations of sections of the Investment Company Act.

In *United States v. Acton*[67] four defendants were found guilty of conspiracy, securities fraud, mail fraud and the sale of unregistered stock in connection with the distribution of the common stock of Pioneer Development Corp. Three defendants pled guilty and charges were dismissed as to one of the defendants. The defendants were found to have acquired control of thousands of unregistered shares of Pioneer stock, created an artificial market for the stock in the over-the-counter market through manipulative devices and sold, pledged and

otherwise disposed of stock to the public. All of the defendants convicted at trial received sentences of at least two years imprisonment.

Ira Feinberg, former president of Manor Nursing Centers, Inc., was convicted after a four week jury trial of 15 counts of an indictment charging him with securities fraud, mail fraud and conspiracy. Another defendant was acquitted.[68] Previously, four other defendants, including Ivan Alan Ezrine had pled guilty to conspiracy. Ezrine also pled guilty to securities fraud, mail fraud and making false statements to the Commission. As a result of his guilty plea, Ezrine, an attorney, was disbarred. The six defendants had been indicted for their activities in connection with the 1970 public offering of the common stock of Manor Nursing Centers, Inc. A previous Commission injunctive action in this matter had resulted in a landmark securities law decision by the United States Court of Appeals for the Second Circuit.[69]

Martin D. Nass was convicted of securities fraud in connection with his activities as vice-president and resident branch office manager of Thomson & McKinnon, Auchincloss, Kohlmeyer, Inc. ("Thomson & McKinnon") a New York Stock Exchange member firm.[70] Nass pled guilty to two counts of a thirteen-count indictment charging him with removing funds and securities from numerous customer accounts at Thomson & McKinnon and converting them to his own use. Nass had engaged in this complicated fraudulent scheme to misappropriate at least $1,000,000 in customer funds and securities from these brokerage accounts.

He was sentenced to a prison term of two years and three years probation to be serve consecutively.

After a six week trial, Bernard Deutsch and Stanley DuBoff, two former registered representatives with a New York broker-dealer, and Milton Cohen, a St. Paul, Minnesota, businessman and President of Richard Packing Company, were found guilty of all four counts of an information filed by the United States Attorney's Office in the Southern District of New York.[71] Deutsch and DuBoff were sentenced to three year prison terms and Cohen received a six month sentence. The

convictions were affirmed by the United States Court of Appeals for the Second Circuit.

Deutsch and DuBoff are currently under indictment in three other cases involving violations of the conspiracy, mail fraud and Federal securities laws in connection with transactions in the securities of Acrite Industries, Inc., Frigitemp Corp., and Integrated Medical Services as well as an indictment for evasion, filing false tax returns and aiding and abetting the filing of false tax returns for the period 1968 to 1972.

As a result of the Commission's referral of part of its investigative files to the Department of Justice in the Stirling Homex Corporation matter, a 28 count indictment was returned on December 11, 1974 in the Western District of New York charging David Stirling, Jr., and Harold M. Yanowitch with violations of provisions of the Federal labor statutes in connection with their arranging for union officials to purchase Stirling Homex Corp. stock.[72] Stirling was formerly chief executive officer of Stirling Homex, and Yanowitch was formerly its executive vice president and general counsel.

The indictment alleged that Stirling arranged for seven officials of the United Brotherhood of Carpenters and Joiners of America, which represented Stirling Homex employees, to purchase Stirling Homex stock substantially below the prevailing market price and that Stirling and Yanowitch arranged the financing of those purchases. The indictment further alleges Yanowitch arranged for some of the union officials to sell their stock at $10 a share above the prevailing market price. Both Yanowitch and Stirling pled not guilty to all counts. A trial is expected in the fall of 1975.

On May 2, 1975, Charles Erb and Franklin DeBoer, both former managing partners of the defunct firm of Baerwald & DeBoer, were convicted of, among other things, violating the Federal securities laws in connection with the offer and sale of the common stock of XPrint Corporation.[73] Erb and DeBoer were convicted on ten counts and one count respectively, with each count carrying a possible prison sentence of five years. The indictment alleged that these two partners

used nominees to conceal their ownership of XPrint stock at a time when their firm was underwriting the offering, and that they caused false and misleading documents to be filed with the Commission and disseminated false and misleading prospectuses to the public.

On May 9, 1975, Charles Fischer, a money manager who specialized in purchasing and selling government and commercial paper, was sentenced to one year imprisonment and fined $1,000. The jail sentence was suspended except for one month. Fischer pled guilty to an information which charged him with making payments to an officer of the Neuwirth Fund to purchase millions of dollars worth of certificates of deposit in the banks and in the amounts designated by Fischer.[74]

On April 2, 1974, James W. White was preliminarily enjoined from further violations of the anti-fraud and registration provisions of the Federal securities laws and was prohibited from serving as an officer or director of a public corporation as a result of the Commission's action. Subsequently, the Commission sought to have White held in criminal contempt of the court's preliminary injunction because it found that White had promoted two shell corporations – North American Kemcore Inc., and Engineered Construction Industries Inc. White was arrested but was released on his own recognizance. During the interim between White's arrest and trial, the Commission discovered and reported to the court that White had violated the terms of his release and was involved in still another promotion of the corporation named the Garden Doc, Inc.

After a trial, White was convicted and sentenced to a six month sentence.[75]

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 fiscal year 1975, the organized crime program focused principally on two ends (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 last year 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 thereby benefited 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, there has been an increase in the number and importance of actions in this area. In the past year, in cases where members of organized crime were involved, the Commission filed injunctive actions naming 47 persons and contributed to the return of indictments naming 47 individuals and the conviction of 34 of them. Three persons considered to be important members of organized crime were indicted and three such members were convicted on indictments returned in prior years. The Commission presently has 54 matters under investigation involving organized crime.

As a result of an intensive Commission investigation and the efforts of the Organized Crime Strike Force in Manhattan, a Federal grand jury in the Southern District of New York on August 9, 1974 indicted 15 individuals, including John J. Santiago a/k/a Sonny Santini, nine past or present brokers and an attorney, for conspiracy to violate and substantive violations of the antifraud provisions of the securities laws, together with mail fraud in the case of *U.S. v. Baron, et al*.[76] Eight defendants pled guilty before trial and four more were convicted on March 5, 1975 after a five week jury trial. One defendant was acquitted and two remain to be tried. The case involved issuance of unregistered shares of common stock in Elinvest, Inc. and the subsequent sale of this stock to the public at artificially inflated prices.

In another significant case, Sidney Stein and 9 others were indicted in June 1974 in the Southern District of New York in connection with a widespread fraudulent distribution of Stern-Haskell, Inc. stock. They

were charged with sales of unregistered stock, securities fraud, mail fraud and conspiracy in the case of *U.S. v. Rubinson, et al*.[77]. On March 23, 1975, Stein and 6 other defendants were convicted of these charges. As a result of Stein's role in this fraud and his long history of securities violations, he was sentenced to 10 years imprisonment and fined $20,000.

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 has also 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, state and local prosecutors' offices 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. During the past several years, the Commission's Division of

Enforcement has conducted Enforcement Training Seminars to which were invited representatives of all the state securities agencies and their counterparts In the Canadian provinces. Invitations were also extended to other Federal agencies having investigative or enforcement responsibilities involving laws relating to the issuance of or transactions in securities. A shortage of funds in fiscal 1975 resulted in a determination not to conduct this seminar in the past year.

The Commission's Proceedings and Litigation Records Branch continues to provide one means for cooperation on a continuing basis with other agencies having securities enforcement responsibilities. The Branch acts as a clearinghouse for information regarding enforcement actions in securities matters that have been taken by state and Canadian authorities, other governmental and self-regulatory agencies, and the Commission itself. It answers requests for specific information and in addition publishes a periodic bulletin which is sent to contributing agencies and to other enforcement and regulatory bodies. During fiscal 1975, the branch received 2,992 letters either providing or requesting information, and sent out 2,233 communications to cooperating agencies. Records maintained by the Branch reflect a steady increase in recent years in the number of enforcement actions taken by state and Canadian authorities. The data in the SV (Securities Violations) Files, which is computerized, is useful in screening issuers and applicants for registration as securities or commodities brokers or dealers or investment advisers, as well as applicants for loans from such agencies as the Small Business Administration.

SWISS TREATY

As previously reported,[78] the United States and Switzerland signed a treaty on Mutual Assistance in Criminal Matters in May of 1973. The treaty ratified by the lower house of the Swiss Parliament in December, 1974, and by the upper house in May of 1973. The treaty was ratified by the lower house of the Swiss Parliament in passed by the two houses are expected to be resolved in the parliamentary

session starting in September, with consideration by the United States anticipated shortly thereafter.

The treaty should be of assistance to the Commission where Swiss financial institutions are utilized to engage in securities transactions in the United States, or where funds resulting from illegal activities are secreted in such institutions. A representative of the Commission has participated in the negotiations since they began early in 1969.

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 recently been, or are currently being offered for public sale in the United States in violation of the registration requirement of Section 5 of the Securities Act of 1933. 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. During the past fiscal year, the following corporations were added to the Foreign Restricted List, bringing the total number of corporations on the list to 84:

Finansbanken a/s.[79] – This is a bank in Denmark subject to supervision by Danish government bank regulatory authorities. It has been advertising in newspapers and periodicals in the United States for the purpose of publicly offering its savings accounts and its shares of stock to United States investors. These advertisements offered 8 percent interest on savings accounts of depositors not owning shares of stock of the bank and 10 percent interest to savings account depositors owning shares of its stock. The advertisements also offered 14 percent interest on savings accounts not withdrawable except on 18 months notice, if the depositor also purchases shares of stock directly from the bank.

It has been judicially recognized that the offer of a bank savings account constitutes the offer of a security as that term is defined in the Securities Act.[80] Although such accounts in United States banks are exempt from Securities Act's registration requirements, those of a foreign bank are not exempt. Since neither the savings accounts nor the shares of Finansbanken a/s are so registered, the Commission has placed them on the Foreign Restricted List.

Alan Mac Tavish, Ltd.[81] – This English corporation, has been advertising and mailing solicitations to prospective investors in the United States to induce them to invest in Scotch malt whiskey in storage in casks in warehouses in Scotland for the purpose of aging the whiskey until it becomes more valuable.

The Commission had previously obtained injunctions against similar offers because the offers included services to assist the investor in obtaining profits, thereby constituting the offer of an investment contract that is a security.[82]

These decisions sustained the position publicly announced by the Commission on November 4, 1969,[83] that the distribution of ownership interests in whiskey in this way ordinarily constitutes the offer of a security required to be registered under the Securities Act.

Since Alan Mac Tavish, Ltd. was following substantially the same procedures in offering Scotch whiskey investments and had not filed a Securities Act registration statement with the Commission covering these securities, the Commission placed Alan Mac Tavish, Ltd. on the Foreign Restricted List.

Silver Stack Mines Ltd.[84] – This Canadian company has been engaged in gold mining exploration in Quebec. In May of 1974 it offered and sold in Canada 1,000,000 new shares of its common stock at 60 cents per share. These shares were in addition to the 1,500,000 shares already outstanding. These shares were listed and traded on the Montreal Stock Exchange. Not long after the new shares were issued, an investment adviser in the United States began publishing a “Flash

Buy Recommendation" to purchase shares of this stock, and investors in the United States were found to be carrying more than 200,000 shares of the stock in their brokerage accounts at leading broker's offices.

No securities issued by Silver Stack Mines, Ltd. had ever been registered with the Commission under the provisions of the Securities Act. Due to the shortness of time following the issuance by the corporation of the 1,000,000 new shares, it appeared that the sales of shares to investors in the United States constituted a public offering of new shares that should have been registered under the Securities Act. Accordingly, the Commission placed Silver Stack Mines, Ltd. on the Foreign Restricted List.

NOTES FOR PART 4

[1]391 F.Supp. 438 (S.D.N.Y., 1975).

[2]*Id.* at 440.

[3]Securities and Exchange Commission v. North American Research and Development Corp., 280 F.Supp. 106 (S.D.N.Y., 1968), affirmed in part and vacated in part, 424 F.2d 63 (C.A. 2, 1970). Securities and Exchange Commission v. North American Research and Development Corp., 375 F.Supp. 465 (S.D.N.Y., 1974).

[4]C.A. D.C., No. 74-1947.

[5]74 Civ. 1097 (MP).

[6]Securities Exchange Act Release No. 11312 (March 24, 1975), 6 SEC Docket 503.

[7]Securities Exchange Act Release No. 11496 (June 26, 1975), 7 SEC Docket 240.

[8]Securities Exchange Act Release No. 11322 (March 28, 1975), 6 SEC Docket 587.

[9]Securities Exchange Act Release No. 11396 (May 2, 1975), 6 SEC Docket 852.

[10]Securities Exchange Act Release No. 11564 (July 31, 1975), 7 SEC Docket 472.

[11]Securities Exchange Act Release No. 11376 (April 29, 1975), 6 SEC Docket 772.

[12]Securities Exchange Act Release No. 11267 (February 26, 1975), 6 SEC Docket 346.

[13]Securities Exchange Act Release No. 11164 (Januarys, 1975), 6 SEC Docket 10.

[14]Securities Exchange Act Release No. 11366 (April 22, 1975), 6 SEC Docket 725.

[15]See Litigation Release Nos. 6522, 6552, 6576, 6592, 6749, 6750, 6832, 6864, 6880, 6909, 6917, 6932 and 6996.

[16]See Litigation Release Nos. 6732, 6819 and 6915.

[17]Litigation Release No. 6831 (April 11, 1975), 6 SEC Docket 708.

[18]575 F. 2d807 (C.A. 2, 1975).

[19]See 40th Annual Report, p. 79.

[20]The complaint also alleged violations of the margin requirements of Section 7 of the Securities Exchange Act by a registered representative of a brokerage firm and by an employee of Geon, both of whom consented to injunctive relief against them.

[21]The district court's opinion is reported at 381 F. Supp. 1063 (S.D. N.Y., 1974).

[22]Litigation Release No. 6898 (May 21, 1975), 7 SEC Docket 53.

[23]Litigation Release No. 6588 (November 15, 1974), 5 SEC Docket 496.

[24]Litigation Release No. 6794 (March 19, 1975), 6 SEC Docket 473.

[25]Civil Action No. 75-0520 (D.D.C., 1975); Litigation Release No. 6829 (April 1, 1975), 6 SEC Docket 707.

[26]Litigation Release No. 6711 (January 31, 1975), 6 SEC Docket 242.

[27]Civil Action No. 74-1844 (D.D.C., 1974); Litigation Release No. 6646 (December 19, 1974), 5 SEC Docket 765.

[28]74 Civ. 3779 (CES). Litigation Release No. 6502 (September 3, 1974) 5 SEC Docket 4.

[29](D. C. Mass. 1974), Civil Action 74-4250-M, CCH Fed. Sec. L Rep. If 94, 860, 388 F. Supp. 1294; Litigation Release Nos. 6543 (October 10, 1974) and 6587 (November 14, 1974), 5 SEC Docket 268, 495.

[30]Civil Action 74-5806-M (D. Mass), Litigation Release No. 6676 (January 10, 1975), 6 SEC Docket 70.

[31]Litigation Release No. 6687 (January 15, 1975), 6 SEC Docket 95.

[32]Litigation Release No. 6850 (April 23, 1975), 6 SEC Docket 740.

[33][Current Transfer Binder] CCH Fed. Sec. L Rep. H 94,980 (S.D.N.Y. 1975).

[34](E.D. Va., Alex. Div., Civil Action No. 336-74-A).

[35]U.S. v. Robert Dale Johnson Va., Alex. Div., Criminal No. 216-74).

[36]Litigation Release No. 6723 (February 7, 1975), 6 SEC Docket 277

[37]Litigation Release No. 6636 (December 13, 1974), 5 SEC Docket 724.

[38]Litigation Release No. 6668 (January 7, 1975), 6 SEC Docket 67.

[39]Litigation Release No. 6477 (August 13, 1974), 5 SEC Docket 33.

[40]Litigation Release No. 6675 (November 19, 1974), 5 SEC Docket 433.

[41]Litigation Release No. 6653 (December 27, 1974), 6 SEC Docket 40.

[42]Litigation Release No. 6920 (June 4, 1975), 7 SEC Docket 133.

[43]Litigation Release No. 6734 (February 13, 1975), 6 SEC Docket 281.

[44]CCH Federal Securities Law Reporter, 1 95, 064.

[45]Litigation Release No. 6903 (May 27, 1975), 7 SEC Docket 91.

[46]Litigation Release No. 6585 (November 14, 1974), 5 SEC Docket 494.

[47]Litigation Release No. 6586 (November 14, 1974), 5 SEC Docket 495.

[48]Litigation Release No. 6606 (November 26, 1974), 5 SEC Docket 588.

[49]Litigation Release No. 6821 (April 8, 1975), 6 SEC Docket 632.

[50]40th Annual Report, p. 83.

[51]Litigation Release No. 6652 (December 24, 1974), 5 SEC Docket 780, 799.

[52]40th Annual Report, p. 84.

[53]See Litigation Release No. (October 2, 1974), 5 SEC Docket 241.

[54]See Litigation Release No. (April 17, 1975), 6 SEC Docket 711.

[55]Litigation Release No. 6707 (January 31, 1975), 6 SEC Docket 241.

[56]Litigation Release No. 6339 (May 14, 1974), 4 SEC Docket 255.

[57]Litigation Release No. 6664 (January 3, 1975), 6 SEC Docket 44.

[58]Litigation Release No. 6934 (July 1, 1975), 7 SEC Docket 225.

[59]517 F.2d 398 (C.A. 2, 1974).

[60]507 F.2d 374 (C.A. 2, 1974).

[61]U.S. v. J. Harlow Tucker, Litigation Release No. 6929, (June 11, 1975), 7 SEC Docket 176.

[62]Litigation Release No. 6674 (January 10, 1974), 6 SEC Docket 69.

[63]Litigation Release No. 6948 (June 24, 1975), 7 SEC Docket 279.

[64]Litigation Release No. 6953 (June 30, 1975), 7 SEC Docket 368.

[65]U.S. v. Gary J. Awad, Litigation Release No. 6947 (June 24, 1975), 7 SEC Docket 279.

[66]Litigation Release No. 6933 (June 12, 1975), 7 SEC Docket 179.

[67]Litigation Release No. 6541 (October 10, 1974), 5 SEC Docket No. 9.

[68]See Litigation Release No. 5913 (May 30, 1973), 1 SEC Docket No. 18.

[69]SEC v. Manor Nursing Centers, Inc., 458 F. 2d 1082 (2d Cir. 1972).

[70]Litigation Release No. 6763 (February 27, 1975), 6 SEC Docket 371.

[71]U.S. v Bernard Deutsch et al, S.D.N.Y., 73 Crim. No. 1086.

[72]U.S. v David Stirling, Jr., et al., W.D.N.Y., 74 Crim. No. 318.

[73]Litigation Release No. 6874 (May 9, 1975), 6 SEC Docket 887.

[74]Litigation Release No. 6879 (May 13 1975), 6 SEC Docket 910.

[75]Litigation Release No. 6848 (April 22, 1975), 6 SEC Docket 740. 76 S.D.N.Y., 74 Cr. 1226.

[77]S.D.N.Y. 74 Cr. 573.

[78]See 39th Annual Report, p. 22 and 38th Annual Report, p. 88.

[79]Securities Act Release No. 5569 (February 6, 1975), 6 SEC Docket 257.

[80]S.E.C. v. First American Bank & Trust Co., 481 F.2d 673 (C.A. 8, 1973).

[81]Securities Act Release No. 5580 (April 25, 1975) 6 SEC Docket 721.

[82]SEC v. Glen-Arden Commodities, Inc., 493 F.2d 1027 (C.A. 2nd, 1974); SEC v. Haffendam-Rimar International, Inc., 362 F. Supp. 323 (E.D. Va., 1973); SEC vs. M.A. Lundy Associates, 362 F. Supp. 226 (D.R.I. 1973)

[83]Securities Act Release No. 5018.

[84]Securities Act Release No. 5584 (May 2, 1975), 6 Docket 829.

PART 5
INVESTMENT COMPANIES AND ADVISERS

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 Regulation.

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 advising others on their 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 performance fee contracts which do not meet certain requirements, fraudulent, deceptive or manipulative practices, and advertising which does not comply with certain restrictions.

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, and the safeguards provided by the

Investment Company and Investment Advisers Acts contribute to sustaining such confidence.

NUMBER OF REGISTRANTS

As of June 30, 1975, there were 1,301 active investment companies registered under the Investment Company Act, with assets having an aggregate market value of over $74 billion. Those figures represent an increase of 13 in the number of registered companies and an increase of nearly $12 billion in the market value of assets since June 30, 1974. Further data is presented in the statistical section of this Report. At June 30, 1975, 3,420 investment advisers were registered with the Commission, representing an increase of 406 from a year before.

During the fiscal year, the Division's staff conducted examinations of 244 investment companies and 404 investment advisers, 76 and 121, respectively, more than during fiscal 1974. It is the Commission's ultimate objective to examine all investment company registrants within the first year after registration, and to examine each registered investment company and registered investment adviser every other year. This should provide effective regulatory oversight. As a result of the Commission's examination and investigation program in 1975, numerous violations of the Investment Company Act and of the Investment Advisers Act were uncovered, and approximately $4,248,976 was returned to investment companies and their shareholders. Sixteen investment company and twenty investment adviser matters were referred to the Division of Enforcement for possible action.

LEGISLATION

Securities Acts Amendments of 1975

A recent amendment of the Investment Advisers Act now requires affirmative Commission action on an application for registration as an investment adviser, instead of the previous procedure where a

registration automatically became effective thirty days after receipt by the Commission unless a proceeding to deny registration was recommended. This new procedure conforms with that adopted for broker-dealer registrations under the Exchange Act, as amended. Section 203(c)(2) of the Advisers Act now provides that, within forty-five days from the date of filing of an application for registration (unless the applicant consents to a longer period), the Commission shall either grant registration by order or institute proceedings to determine whether registration should be denied. The types of crimes, conviction for which registration may be denied or revoked under Section 203(e)(2), were expanded under the new amendments. Section 204 was broadened to give the Commission authority to prescribe rules for the making and dissemination of such reports and records deemed necessary or appropriate in the public interest.

RULES

Amendments to Rule 17d-1

Section 17(d) of the Investment Company Act prohibits any affiliated person of or principal underwriter for a registered investment company from effecting any transaction in which the registered company, or a company controlled by it, is a participant with the affiliated person or principal underwriter, in contravention of any rule prescribed by the Commission for the purpose of limiting or preventing participation by the registered or controlled company on a basis different from or less advantageous than that of other participants. Rule 17d-1 prohibits affiliated persons of and principal underwriters for registered investment companies from effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which any such registered company, or a company controlled by such registered company, is a participant unless an application regarding such joint enterprise has been filed with, and granted by, the Commission.

In October 1974, the Commission adopted an amendment to Rule 17d-1[1] to enable certain affiliated companies and persons affiliated with such companies to participate in joint transactions with registered

investment companies and companies controlled by registered investment companies without an order of the Commission, provided certain conditions are met. The primary condition is that the principal underwriter and certain described “upstream” affiliated persons of the registered investment company would not participate or have a financial interest in the transaction. The Commission was persuaded that the conditions of the exemption are such that there is little likelihood of unfair or disadvantageous treatment to the investment company or its controlled companies. The amendment also provides that certain registered small business investment company (“SBIC”) stock option plans may become operative without an order of the Commission.

Amendment of Rule 17a-7

Section 17(a) of the Investment Company Act generally prohibits purchases or sales of securities between investment companies and affiliated persons. Exemptions are provided in Rules 17a-1 through 17a-7. Rule 17a-7 exempted from the prohibitions of Section 17(a) of the Act purchase and sale transactions between affiliated investment companies if, among other things, the security involved was traded principally on a national securities exchange and the price used in the transaction was the current market price on that exchange. In September 1974, Rule 17a-7 was amended to expand its exemptive relief to transactions in securities which are included in an interdealer quotation, system, such as NASDAQ, which is sponsored and governed by the rules of a national securities association registered pursuant to Section 15A of the Securities Exchange Act of 1934 and which displays quotations for such security on a current and continuous basis, provided (1) the transaction is effected at the average of the highest current independent bid and the lowest current independent offer for such security as quoted on such quotation system, and (2) at the time of such transaction, such quotation system carries at least two independent current bids and offers furnished or submitted by at least two brokers or dealers with respect to such security.[2]

In addition, an amendment was adopted to the annual report form of all management investment companies requiring registrants to describe all Rule 17a-7 transactions and to identify the persons involved and the nature of their affiliation with the registrant. The amendment requires the registrant to state also the reasons why it was appropriate for one investment company to purchase securities which an affiliated investment company wished to sell.

Temporary Rule 6c-2(T) and Proposed Rule 6c-2

In February 1974, the Commission adopted Temporary Rule 6c-2(T) and proposed for public comment a permanent measure, Rule 6c-2[3] to provide corporations organized pursuant to the Alaska Native Claims Settlement Act of 1971[4] ("Settlement Act corporations") blanket exemptive relief from a substantial number of provisions of the Investment Company Act.

The Settlement Act corporations, over 200 in number, were created to receive, hold, and administer the land, mineral rights and cash awarded by the United States Government to Alaska's Native Indian, Aleut and Eskimo population in settlement of their aboriginal claims to land in the State of Alaska. During the first few years of the existence of the Settlement Act corporations, only .the cash portion of the award has actually been distributed to the companies, and many of the Settlement Act companies have invested the cash in securities. Hence, a substantial number of these entities have become investment companies within the meaning of the Act, and to date thirty-five Settlement Act corporations have registered pursuant to Section 8(a) of the Act and are covered by Rule 6c-2(T).[5]

The staff analyzed the public comments received on proposed Rule 6c-2 and revised the proposal in accordance with such comments and with views expressed by other members of the staff and the Commission itself. After the close of the fiscal year, such a revised rule was published for comment.[6] The revised version would impose additional responsibilities upon the large Settlement Act corporations (i.e., those having 500 or more shareholders and total assets exceeding $1,000,000) by requiring them to comply with the proxy

solicitation, periodic reporting and financial recordkeeping provisions of the Act. On the other hand, the revised proposal would significantly decrease the burden of compliance upon all Settlement Act corporations registering under Section 8(a) by instituting certain limited exemptions from Section 17 of the Act for affiliated transactions involving Settlement Act corporations. The simpler temporary version of the rule, Rule 6c-2(T), will remain in effect until the Commission either adopts Rule 6c-2 or rescinds the temporary measure.

Investment Company Confirmation Requirements

In September 1974, the Commission amended Rule 15c1-4 under the Exchange Act to permit, subject to certain conditions, the substitution of quarterly account statements for immediate confirmations in connection with the purchase of mutual fund shares issued pursuant to tax qualified individual pension plans or any group plans.[7] The adoption of this rule amendment was significant in light of the enactment of the Employee Retirement Income Security Act of 1974, which reflects Congressional efforts to reform and extend pension benefits to retired persons and which permits the use of mutual funds as an investment media for certain tax qualified individual and group pension plans. The relaxation of the Exchange Act confirmation requirements will help make it economically feasible for mutual funds to be sold to such plans in accordance with Congressional policy.

During the fiscal year, a number of significant rules were also proposed under the Investment Advisers Act of 1940 which were designed to improve the regulation of investment advisers and to respond to changes in the market place brought about by the elimination of fixed commission rates on securities transactions.

Brochure Rule

On March 5, 1975, the Commission proposed the adoption of new Rule 206(4)-4 and new paragraph (14) of Rule 204-2(a) under the Investment Advisers Act.[8] The proposed rules are intended to assure that existing and prospective clients of an investment adviser obtain written disclosure of material information which would enable such

persons to evaluate, among other things, the adviser's qualifications, methods, services, and fees. They generally would require that investment advisers furnish a written disclosure statement to every client and prospective client (other than a registered investment company) upon entering into, extending or renewing an advisory contract with such client and that copies of each such disclosure statement be maintained by investment advisers as part of their recordkeeping obligations under the Advisers Act. The proposed written statement would include, among other things, a description of the types of services offered, length of time the investment adviser has been in such business, investment techniques, sources of information used, general standards of education and business background required of advisory personnel and the basis of fee charges. There are additional disclosure requirements for advisers providing investment supervisory services or managing investment advisory accounts. As of the end of the fiscal year, the staff was analyzing the comments received on this proposal.

Investment Adviser Record-Keeping Requirements

In order to strengthen the protections afforded by the Advisers Act to investment advisory clients, one amendment to the recordkeeping rule was made and another proposed. Rule 204-2 requires investment advisers to maintain such books and records as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. The record keeping requirements of Rule 204-2 serve as an important safeguard against fraudulent securities trading practices. Rule 204-2(a)(12) requires investment advisers to maintain records of securities transactions for certain persons connected with the investment adviser. In furtherance of this purpose, on February 21, 1975, the rule was amended[9] to include a requirement for the maintenance of such records for affiliated persons of controlling persons of investment advisers and affiliated persons of such affiliated persons. In addition, the rule was amended to provide for a similar recordkeeping requirement for investment advisers primarily engaged in non-advisory businesses.

Rule 204-2(e) requires that books and records be maintained and preserved “in an easily accessible place” and that partnership articles and corporate books and records be maintained at the investment adviser's principal office. The Commission expressed doubt as to whether certain places outside of the territorial United States are “easily accessible,” and, in order to facilitate the inspection of books and records as contemplated by Section 204, on May 30, 1975, the Commission announced that it was considering the adoption of new paragraph (j) under Rule 204-2 under the Advisers Act.[10] The proposed rule would require a non-resident investment adviser(1) to maintain and preserve copies of the required books and records at a place within the United States and to file with the Commission a written notice specifying such place, or(2) in lieu thereof, to file with the Commission an undertaking to furnish copies of such books and records upon demand by the Commission. The proposed rule is substantially similar to Rule 17a-7 under the Securities Exchange Act of 1934.

Regulatory Safeguards – The NASD Maximum Sales Load Rule

The 1970 Amendments to Section 22(b) of the Investment Company Act of 1940 gave the NASD the authority, with Commission oversight, to promulgate and enforce rules preventing sales charges which are “excessive.” Under the statute, such sales charges must allow for “reasonable” compensation for sales personnel, broker-dealers, and underwriters and for “reasonable” sales loads to investors. In 1972 the NASD submitted its proposed “full service” maximum sales load rule to the Commission. As proposed, the rule, which is designed to prevent excessive sales loads, taking into account all relevant circumstances, permits mutual funds or single payment contractual plans to charge a maximum sales load of 8.50% (declining to 6.25% for larger purchases), but conditions the right to charge the maximum on the fund's offering (1) dividend reinvestment at net asset value, (2) rights of accumulation, and (3) volume discounts, as defined in the rule. A specific reduction from the maximum is associated with the failure to provide .each of the services. The proposed rule also provides maximum sales loads ranging from 8.50% down to 6.50% on single-payment variable annuities, and a maximum of 8.50% of total

payments as of a date not later than the twelfth year after purchase for multiple payment variable annuity contracts.

The rule was adopted by the NASD's Board of Governors on January 28, 1975, and subsequently approved by the NASD membership, and was submitted to the Commission for approval under Section 15A(j) of the Securities Exchange Act of 1934 on April 28, 1975. Subsequent .to that date, the Securities Act Amendments of 1975 substituted the procedure provided by Section 15A(j) with a new procedure for Commission approval of rules promulgated by self-regulatory organizations under Section 19(b) of the 1934 Act. Therefore, at year end, the staff had requested that the NASD refile the proposed rule in accordance with the new procedure. Shortly thereafter it was published for comment.[11]

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 fiscal year, 241 applications were filed under both Acts, and final action was taken on 241 applications. As of the end of the year, 178 applications were pending under both Acts. Of the totals described, the predominant number were applications filed under the Investment Company Act. With respect to the Advisers Act, two applications were filed, final action was taken on three and three were pending at the end of the year.

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 the purposes fairly intended by the policy 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 participate in a joint arrangement with the registered company and 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.

Among the applications disposed of during the fiscal year, the following were of particular interest.

The Commission issued an opinion and order under the Investment Company Act allowing the proposed merger of Christiana Securities Company and E.I. du Pont de Nemours and Company (Du Pont).[12] As previously reported, Christiana, a closed-end investment company with assets in excess of $2.2 billion and the owner of 28 per cent of Du Font's common stock had, together with Du Pont, filed an application with respect to the merger proposal since the affiliations of the parties would preclude such a transaction without Commission approval. The Commission order, which was issued after an administrative hearing before a judge and an oral argument before the Commission in which certain objecting Du Pont shareholders participated, permits the issuance of Du Pont common stock to the Christiana common shareholders at 97.5 per cent of the net asset value of the Christiana common stock, with Du Pont the surviving corporation.

The Commission's opinion in the matter noted that “The Act's requirement that the transaction be reasonable, fair, and free from overreaching, does not mean that the benefits to the parties must be nicely balanced. Such a reading would be wholly impractical and would frustrate legitimate arrangements.”[13] As of the end of the fiscal year, the merger was not yet consummated since the objecting Du Pont shareholders who had participated in the Commission proceeding have filed an appeal of the Commission decision which is pending before the United States Court of Appeals for the Eighth Circuit.[14]

In the past fiscal year, the complex of eleven investment companies, which were advised, distributed and managed by Wellington

Management Company and which have identical boards of directors, proposed to internalize their corporate administrative functions by capitalizing and operating a service company to be known as The Vanguard Group, Inc. ("Vanguard"). No officer or employee of Vanguard could own any securities or have any interests in any external investment adviser or distributor. By organizing such a wholly-owned, independent company, the funds, headed by Wellington Fund, Inc., hoped to increase their ability to evaluate the performance of their adviser, distributor and administrative service agents. In addition, each fund hoped to decrease its expenses; and pursuant to a new advisory contract with Wellington Management Company reflecting the proposed change in responsibilities whereby Wellington Management Company would serve solely as adviser and distributor of the funds, the funds expected to realize a reduction of $300,000 to $500,000 in their aggregate expenses for the year.

Because of the affiliations among the eleven funds, an application was filed by Vanguard and Wellington Management Company seeking a Commission order pursuant to Section 17(b) of the Act and Rule 17d-1 permitting the consummation of such transactions. The Commission thereafter issued such an order.[15] On May 1, 1975, after obtaining the approval of the shareholders of each fund, now collectively known as the Vanguard Funds, Vanguard began its operations.

Subsequent to the Commission announcement of its program to revise the laws and regulations affecting mutual fund distribution, an application was filed by Putnam Investors Fund, Inc., and its principal underwriter and by two unit investment trusts and Merrill Lynch, Pierce, Fenner & Smith, Inc., their sponsor and principal underwriter. The applicants sought an order exempting them from Section 22(d) of the Act which prohibits an investment company and its principal underwriter from selling its securities to the public except at the current public offering price. Applicants proposed to offer, on a combination basis, units of the bond funds along with shares of Putnam Investors Fund, Inc. The sales charges for such combined unit represented a reduction from the sales charge applicable to the securities when offered separately. The Commission granted such exemption,[16] since the reduced charge seemed to reflect reduced costs of distribution,

and the standards of Section 6(c) of the Act were satisfied. At the close of the fiscal year, a similar application was pending.

OTHER DEVELOPMENTS

"Money Market" Funds

A recent innovation in the investment company industry is the so-called "money market" fund, an investment company whose policy is to invest primarily in short term debt securities (e.g., Treasury bills, commercial paper, certificates of deposit). Such funds seek to allow investors to take advantage of higher short term rates earned on large investments by pooling their capital to permit the purchase of larger denomination instruments than could normally be bought by the average small investor. These funds have also attracted significant investments from corporations and non-profit institutions.

Money market funds have been one of the fastest growing segments of the mutual fund industry. At June 30, 1974, only 10 money market funds, with total assets of approximately $454 million, had effective registration statements. By June 30, 1975, the number of money market funds with effective registration statements had grown to 38. As of that date total money market fund assets had climbed to almost $3.8 billion which amounted to approximately 7% of the assets of the mutual fund industry.

Money market funds, because of their short term nature and the securities in which they invest, pose unique regulatory questions. For example, these funds are sold generally on the basis of "yield", but since they have not adhered to a uniform method of valuing their assets or calculating their yields, it is difficult to make accurate yield comparisons among them. In connection with this problem, the Commission published for comment two proposed guidelines[17] designed to standardize valuation of short-term debt securities and money market fund yield quotations. At year end, comments on these proposals were still being received.

Sale of Participations in Certificates of Deposit

A number of inquiries were received during the year concerning the status of publicly solicited participations in large denomination certificates of deposit and in other money market instruments which offered relatively high interest rates. The staff took the position that the offer and sale to the public of participations in such certificates involves the offer and sale of a separate security and that the issuer of such securities may be an investment company which must register under the Act, unless some specific exception or exemption is available.

Assignments of Investment Advisory Contracts

Among the 1975 amendments, Section 15(f) of the Investment Company Act[18] permits an investment adviser, or an affiliated person of an adviser, to obtain a profit in connection with a transaction which results in an assignment of the advisory contract if certain conditions are met. These conditions are designed to prevent an investment adviser or an affiliate from receiving any payment or other benefit in connection with the sale of its business which includes any amount reflecting its assurance that the investment advisory contract will be continued.

Specifically, it is required that for the succeeding three years at least 75% of the board of directors of the investment company not be comprised of “interested persons” of the investment adviser or its predecessor and that the transaction does not impose an unfair burden on the investment company, such as an arrangement whereby an adviser or an interested person of an adviser is entitled to receive compensation from the company for brokerage, other than *bona fide* compensation as principal underwriter, or for other than *bona fide* advisory or other services.

Registration of foreign investment companies

Foreign investment companies, which generally are prohibited from selling their securities in this country, offer an opportunity for investing

in diversified pools of securities issued by companies in foreign countries. On December 2, 1974, the Commission issued a release[19] prepared by the Division of Investment Management Regulation requesting public comments on whether foreign investment companies should be permitted to register under the Investment Company Act and allowed to sell their shares in this country and, if so, under what conditions. The issues raised in this release were consistent with a recent recommendation of the Organization for Economic Co-operation and Development supported by representatives of the Commission, that member countries review their regulation of investment companies and when deciding whether to' permit a foreign investment company to operate in their country, give substantial weight to whether such company is domiciled in a country which complies with the OECD's rules on operation of investment companies. The Commission also sought comments on related issues, including whether such companies could be allowed to register and sell shares in this country without sacrificing the high level of investor protection embodied in the Act. In response to the release, the Division received approximately fifty comments, including comments from domestic and foreign investment companies, representatives of the United States and foreign government agencies, and United States investors. The Division has reviewed these comments and intends to recommend to the Commission definitive action on this issue in the next fiscal year.

NASD Anti-Reciprocal Rule

Reciprocal sales practices, allocations of portfolio brokerage business by mutual funds to broker-dealers as a reward for their sales of fund shares, have been a subject of Commission concern for more than ten years. The reciprocal use of portfolio brokerage has been viewed by the Commission as creating hidden influences behind recommendations to customers by retail sellers of fund shares, inducing improper portfolio management practices and creating undesirable anticompetitive effects.[20] In its Statement on the Future Structure of the Securities Markets the Commission announced that reciprocal sales practices must be terminated, and, effective July 15,

1973, the National Association of Securities Dealers, Inc. (“NASD”) adopted a rule prohibiting these arrangements.[21]

During the prior fiscal year, the Commission announced that public hearings would be held to consider suggested interpretations of and amendments to the NASD Anti-Reciprocal Rule.[22] Prior to the hearings, 42 letters of comment were received, and at the hearings held on September 10-12, 1974, 14 witnesses appeared. Subsequently, representatives of the NASD indicated that the NASD would submit a revised proposal to meet some of the objections raised by the Commission staff.

Under the proposal as revised, a broker-dealer would be prohibited from demanding or requiring any brokerage commissions or soliciting a promise of such commissions as a condition to the sale of fund shares. A principal underwriter would be prohibited from offering or promising any commissions to a broker-dealer for the sale of fund shares, but would be permitted to request or arrange for some (but not a specific amount or percentage of) brokerage to be paid to a broker-dealer for the sale of fund shares. The revisions would specifically allow an NASD member to sell fund shares or act as a principal underwriter for an investment company which follows a policy, described in its prospectus, of considering sales of its shares as a factor in the selection of broker-dealers to execute its portfolio transactions, when such broker-dealers are qualified to provide best execution, provided that the member complies with the specific provisions of the Rule and any published interpretation of it. At the end of the fiscal year, the staff was in the process of reviewing the NASD proposal.

Two-Tier Real Estate Companies

A two-tier real estate company is a company which invests in companies which in turn invest in real estate. The question of the applicability of the Investment Company Act to such companies has arisen .most often in connection with limited partnerships which invest, as limited partners, in limited partnerships engaged in the real estate business. Under Section 3(a) of the Investment Company Act, an

issuer is an investment company if it is, or holds itself out as being, engaged primarily in the business of investing, reinvesting or trading in securities or if it is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40% of the value of such issuer's total assets (exclusive of government securities and cash items) on an unconsolidated basis. Generally, an issuer that invests in real estate can rely upon Section 3(c)(5) of the Act which excludes from the definition of investment company persons purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

In August 1974, a release was issued[23] setting forth the position of the Division with respect to the status under the Investment Company Act of two-tier real estate companies. The staff believes that no action by the Commission is warranted if a two-tier real estate limited partnership does not register under the Investment Company Act, in reliance upon an opinion of counsel, if certain criteria are satisfied. These criteria relate to the primary business of the limited partnership, the nature of the limited partnership's investments, the rights of the limited partners in the partnership and the duties of the general partner to the partnership.

The staff further believes that certain two-tier real estate limited partnerships which do not qualify for the above “no-action” position may nevertheless, upon application to the Commission, be exempted from registration under the Investment Company Act, pursuant to Section 3(b)(2) or Section 6(c) of the Act, if (1) the partnership is, in fact, engaged in the real estate business through control of the underlying partnerships or (2) if the partnership invests in limited partnerships engaged in the development and building of housing for low and moderate income persons and certain requirements regarding investor suitability and fair dealing by the general partner are satisfied.

Variable Annuity Illustrations

The Commission adopted an amendment to the Statement of Policy under the Securities Act of 1933,[24] which permits investment

companies issuing variable annuity contracts to employ standardized illustrations based upon hypothetical investment results in sales literature and prospectuses. The amendment sets forth standards for permissible illustrations including (1) a presentation of effective rates of return which should permit an evaluation of aggregate costs (including hidden charges), and (2) uniformity of presentation to enable the investor to make accurate comparisons between issuers of such contracts. Thus the illustrations serve as a valuable disclosure device providing meaningful cost information to investors about a contract which is currently little understood. They could foster greater competition, which should encourage a more rational pricing system than presently exists in the sale of variable annuity contracts.

Shortly thereafter, the Commission published for comment proposed amendments under the Securities Act of 1933[25] which would require prospectuses of variable annuity separate accounts to include illustrations which are in accordance with the Statement of Policy as amended. At year end, comments on this proposal were being considered by the staff.

Employee Retirement Income Security Act

In connection with the implementation of the fiduciary and disclosure provisions of the Employee Retirement Income Security Act of 1974,[26] the Commission offered the technical assistance of its staff to the Department of Labor (“Labor”) and the Internal Revenue Service (“IRS”). The Division was appointed as the Commission's liaison with Labor and IRS. This became an important function, when in early 1975, the Commission was concerned that the immediate effectiveness of certain sections of the Act proscribing certain types of transactions would adversely affect the nation's securities markets. The staff of the Division offered drafting and interpretive assistance with respect to these provisions of ERISA in connection with the various applications for exemption filed by members of the securities industry in order to avoid such adverse impact.

Securities Depository System

During the past fiscal year, the Division studied the impact of participation in a securities depository by registered management companies either directly or through their custodians. Section 17(f) of the Investment Company Act defines “securities depository” as “a system for the central handling of securities established by a national securities exchange or national securities association registered with the Commission” pursuant to which securities are treated as fungible and may be transferred or pledged by bookkeeping entry without physical delivery of such securities. The Division's study has included visits to banks and securities depositories, and the Division is presently involved in formulating a questionnaire which will be sent to interested persons in order to gain additional information concerning whether rules may be necessary or appropriate in order to insure adequate investor protection. A letter issued by the Division took the position that the Act did not preclude participation in a depository by an investment company.

NOTES TO PART 5

[1]Investment Company Act Release No. 8542 (October 11, 1974), 5 SEC Docket 300.

[2]Investment Company Act Release No. 8494 (September 13, 1974), 5 SEC Docket 140.

[3]Investment Company Act Release No. 8251 (February 26, 1974), 3 SEC Docket 631.

[4]43 U.S.C. 1601, et seq.

[5]For a description of Rule 6c-2(T) and Rule 6c-2 as originally proposed, see 40th Annual Report, p. 106.

[6]Investment Company Act Release No. 8902 (August 22, 1974), 7 SEC Docket 733.

[7]Investment Company Act Release No. 8514 (September 24, 1974), 5 SEC Docket 184.

[8]Inv. Adv. Act Rel. No. 442 (March 5 1975), 6 SEC Docket 414.

[9]Inv. Adv. Act Rel. No. 436 (February 21, 1975), 6 SEC Docket 327.

[10]Inv. Adv. Act Rel. No. 460 (May 30, 1975), 7 SEC Docket 128.

[11]Securities Exchange Act Rel. No. 11593, Investment Company Act Rel. No. 8893 (August 14, 1975), 7 SEC Docket 570.

[12]Investment Company Act Release No. 8615 (December 13, 1974), 5 SEC Docket 745.

[13]5 SEC Docket at 750.

[14]Collins v. SEC No. 75-1100; Murtaugh v. SEC Nos. 75-1262, 75-1263.

[15]Investment Company Act Release No. 8676 (February 18, 1975), 6 SEC Docket 325.

[16]Investment Company Act Release No. 8741 (April 3, 1975), 6 SEC Docket 582.

[17]Investment Company Act Rel. No. 8757, (April 15, 1975), 6 SEC Docket 703 and Investment Company Act Rel. No. 8816, (June 12, 1975), 7 SEC Docket 141.

[18]Securities Acts Amendments of 1975, Section 28(1).

[19]Investment Company Act Release No. 8596 (December 2, 1974), 5 SEC Docket 640.

[20]SEC, Public Policy Implications of Investment Company Growth, H. Rep. No. 2337, 89th Cong., 2d Sess., at 172-182 (1966).

[21]Article III, Section 26(k) of the NASD Rules of Fair Practice.

[22]Investment Company Act Release No. 8393, Securities Exchange Act Rel. No. 10867 (June 20, 1974), 4 SEC Docket 474.

[23]Investment Company Act Release No. 8456 (August 9, 1974), 4 SEC Docket 721.

[24]Investment Company Act Rel. No. 8772 (April 28, 1975), 6 SEC Docket 761.

[25]Investment Company Act Rel. No. 8784 (May 9, 1975), 6 SEC Docket 832.

[26]Pub. L. No. 93-406 (September 2, 1974)(codified in 29 U.S.C. 1001 et seq. and in scattered sections of 26 U.S.C.).

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 non-utility companies which are subsidiary companies 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

At the end of calendar 1974, there were 22 holding companies registered under the Act. There were 20 registered holding companies within the 17 “active” registered holding-company systems.[1] The

remaining two registered holding companies, which are relatively small, are not included among the “active” systems.[2] In the 17 active systems, there were 71 electric and/or gas utility subsidiaries, 68 non-utility subsidiaries, and 16 inactive companies, or a total of 175 system corn-holding companies. Table 30 in Part 9 lists the active systems and their aggregate assets.

PROCEEDINGS

New England Electric System.[3] The court of appeals affirmed the Commission's approval[4] of the sale by New England Electric System (“NEES”) of Lawrence Gas Company to Bay State Gas Company and its denial of a request for hearing by the Association of Massachusetts Consumers, Inc. (“Association”).[5] The Association has filed a petition for a writ of certiorari.[6]

In a related proceeding, the Commission sought enforcement of its order approving a plan for the retirement of the minority stock interest in Lawrence Gas Company in the United States District Court for the District of Massachusetts.[7] On September 15, 1975, the court entered an order enforcing the Commission's order.

In a separate proceeding[8] the Commission denied the joint application of NEES, Eastern Utilities Associates, also a registered holding company, and Boston Edison Company, an operating electric utility not subject to the Act, for authority to form a new holding company.[9]

Union Electric Company.[10] The court of appeals affirmed without opinion[11] the Commission's order granting Union Electric Company, an

exempt holding company, permission to acquire the common stock of Missouri Utilities Company.[12] At that time the Commission declined to order divestiture of the gas properties of both companies, taking note of the adverse developments in gas supply, and reserved jurisdiction to reexamine the retainability of the gas properties.

American Electric Power Company, Inc.[13] The Commission heard oral argument on the application of American Electric Power, a registered holding company, to acquire by a tender offer the stock of Columbus and Southern Ohio Electric Company, a nonassociate electric utility company. In light of problems encountered by the electric utility industry since the record in this proceeding was closed in January 1972, the Commission, by supplemental order,[14] has requested that all parties in interest submit briefs in response to questions specified in that order.

Northeast Utilities. Northeast Utilities ("Northeast") and its Connecticut subsidiaries, The Connecticut Light & Power Company ("CL&P") and The Hartford Electric Light Company ("HELCO") have filed a joint application under Section 11(e) of the Act pursuant to which they propose to sell all of the gas properties owned by CL&P and HELCO, together with those of The Connecticut Gas Company, a subsidiary of CL&P, to the Connecticut Natural Gas Corporation ("CNG"), a nonaffiliated gas utility company, and to the Town of Wallingford, Connecticut.[15] The proposed sale is intended to bring Northeast into compliance with the integration provisions of Section 11(B)(1).

In Northeast's judgment, CNG and the Town of Wallingford were the highest bidders for the gas properties, having offered about 120-125% of the net book value of the properties as of December 31, 1972, subject to adjustment. After the close of the fiscal year, a hearing was held and several parties appeared in opposition to the plan alleging, among other things, that Northeast did not maintain competitive conditions in soliciting bids and that the sale is not in the interest of consumers. The matter is pending.

Empire State Power Resources, Inc. Consolidated Edison Company of New York, Inc., Long Island Lighting Company, New York State

Electric and Gas Corporation, Niagara Mohawk Power Corporation and Rochester Gas and Electric Corporation, five of the seven sponsors of Empire State Power Resources, Inc. ("ESPRI") have filed a joint application for the acquisition of their stock interest in ESPRI under Section 10 of the Act and for exemptions as holding companies pursuant to Section 3(a).[16]

ESPRI will be jointly owned by its sponsors. It will construct and own generating facilities throughout New York State to supply energy to its sponsors. It is proposed that ESPRI will construct 13 nuclear and 3 coal-fired baseload units with a rated capacity of 18,600 MW. Construction costs during the period 1980-1991 are estimated to be in excess of $20 billion. No action had been taken with respect to the application and no hearing had been scheduled at the close of the fiscal year.

General Public Utilities Corporation.[17] The Commission permitted Metropolitan Edison Company ("Met Ed"), a subsidiary of General Public Utilities Corporation, to make certain amendments to its first mortgage bond indenture and authorized the solicitation of proxies for bondholder consent to the amendments.[18] The Commission rejected arguments raised by a Met-Ed bondholder, Walplan and Company, who opposed the proposal and solicitation.

In a related case,[19] the court of appeals affirmed the district court order dismissing a suit for an injunction brought by Walplan of Met Ed alleging that the proxy statement was false and misleading.[20]

American Natural Gas Company. The Commission authorized American Natural Gas Company ("American Natural"), a registered holding company incorporated under Delaware law, to distribute to its stockholders all of the stock of Wisconsin Gas Company ("Wisconsin").[21] The distribution left American Natural with one gas utility subsidiary, Michigan Consolidated Gas Company, a Michigan corporation.

The same order also granted American Natural an exemption under Section 3(a)(1) of the Act to be effective upon distribution of the

Wisconsin stock and reincorporation of American Natural under Michigan law. The order of exemption became effective on June 30, 1975.

Utah Power and Light Company.[22] The Commission approved the plan of Utah Power and Light Company ("Utah"), filed under Section 11(e) of the Act, which provided for the sale by Utah of the utility assets of The Western Colorado Power Company, its only electric utility subsidiary.[23] When Utah completed the sale, the Commission issued a supplemental order declaring that Utah ceased to be a holding company and that its registration as such was terminated.[24]

John H. Ware – Penn Fuel Gas, Inc.[25] After representatives of minority stockholders of North Penn Gas Company ("North Penn") objected to the plan filed by Penn Fuel Gas, Inc. ("Penn Fuel"), pursuant to Section 11(e) of the Act, a new plan was negotiated and filed.[26] The object of the plan is the retirement of the minority stock of North Penn. Ware is the controlling stockholder of North Penn and Penn Fuel.

Under the plan, a new holding company, Penn Fuel System, Inc., ("System"), has been organized to carry out the plan. System proposes to acquire about 243,000 shares of North Penn common stock at $18.50 per share, payable $3.10 in cash and the balance of $15.40 in 10% serial installment notes on which the final payment will be due on December 31, 1979. System also will issue its common stock to Ware and members of his family in exchange for about 207,000 shares of North Penn common stock and up to 93% of the outstanding common stock of Penn Fuel owned by them. System requests an exemption pursuant to Section 3(a)(1) of the Act.

A hearing was held, and the matter was pending at the close of the fiscal year.

FINANCING

Volume

During fiscal 1975, a total of 15 active registered holding company systems issued and sold 56 issues of long-term debt and capital stock aggregating $2.79 billion pursuant to authorizations by the Commission under Sections 6 and 7 of the Act. Table 31 in Part 9 presents the amount and types of securities issued and sold by these holding company systems.

The dollar volume of these financings represents an 11 percent increase over the previous year. Bonds issued and sold decreased 24 percent, and preferred stock 11 percent. However, the amount of common stock and debentures issued and sold increased 148 percent and 78 percent, respectively.

Financing of Fuel and Gas Supplies

Due to curtailments of fuel supplies, electric and gas utilities have found it increasingly necessary to finance substantial portions of their energy requirements by capital investment in sources of supply and transportation.[27] During fiscal 1975, approval was given to 8 registered systems to invest in the aggregate over $500 million in these activities.

Competitive Bidding

The Commission's Rule 50, adopted in 1941, requires competitive bidding in the sale of securities by registered public utility holding companies and their subsidiaries.[28] A temporary suspension of the competitive bidding requirements of Rule 50 as applied to common stock of registered holding companies was authorized from November 7, 1974, to March 31, 1975.[29] This action was taken because it appeared to the Commission that, under market conditions then prevailing, competitive bidding might not assure a sufficient number of potential purchasers given the volume of common stock issues that utilities were offering for sale. A hearing also was ordered to develop information as to whether the suspension should be continued beyond March 31, 1975.

The Commission did not extend the temporary suspension beyond March 31, 1975, except that contemplated sales of common stock

publicly announced by January 31 could be sold without competitive bidding no later than April 30, 1975.[30] Based upon the record developed at the hearing and the experience with offerings of debt and equity securities of utility companies, whether sold by negotiation or competitive bidding, the Commission was persuaded that common stocks of registered holding companies again could be marketed in the manner required by Rule 50. It also noted that the exemptive provisions of the Rule provide sufficient flexibility for issuers who encounter difficulties in selling their common stock by competitive bidding.

Of the 56 issues of long-term debt and capital stock sold by registered systems referred to above, 18 were sold by negotiation. The negotiated underwritings totaled about $1.2 billion and consisted of one bond offering,[31] 3 preferred stock[32] and 14 common stock[33] issues. Nine of the common stock offerings were sold during the period of the temporary suspension. The remaining nine issues were sold pursuant to exceptions from the Rule granted by order. Table 32 in Part 9 sets forth statistical data with respect to all of these issues.

NOTES TO PART 6

[1]Three of the 20 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]These holding companies are British American Utilities Corporation and Kinzua Oil & Gas Corporation.

[3]Previously reported in 40th Annual Report, p. 115; 39th Annual Report, p. 110.

[4]Holding Company Act Release Nos. 18149 (October 31, 1973), 2 SEC Docket 680, and 18254 (January 11, 1974), 3 SEC Docket 373.

[5]Association of Massachusetts Consumers, Inc. v. Securities and Exchange Commission, 516 F. 2d 711 (C.A. D.C., 1975).

[6]No. 75-607 (October 22, 1975).

[7]Civil Action No. 74-2466-M.

[8]Previously reported in 38th Annual Report, p. 108; 37th Annual Report, p. 170; 36th Annual Report, p. 160; 35th Annual Report, p. 149; 34th Annual Report, p. 138.

[9]Holding Company Act Release No. 18801 (February 4, 1975), 6 SEC Docket 225.

[10]Previously reported in 40th Annual Report, p. 116; 39th Annual Report, p. 110; 38th Annual Report, p. 109; 37th Annual Report, pp. 172-173.

[11]City of Cape Girardeau v. Securities and Exchange Commission, No. 74 – 1590 (C.A.D.C.)(September 22, 1975).

[12]Holding Company Act Release No. 18368 (April 10, 1974), 4 SEC Docket 89.

[13]Previously reported in 39th Annual Report, p. 110; 38th Annual Report, p. 108; 37th Annual Report, p. 170; 36th Annual Report, p. 160; 35th Annual Report, p. 149; 34th Annual Report, p. 138.

[14]Holding Company Act Release No. 19145 (August 27, 1975), 7 SEC Docket 731.

[15]Holding Company Act Release No. 18874 (March 19, 1975), 6 SEC Docket 484.

[16]Holding Company Act Release No. 18994 (May 19, 1975), 7 SEC Docket 39. Only Rochester Gas and Electric and Niagara Mohawk require approval under Section 10. All five applicants seek an exemption order.

[17]Previously reported in 40th Annual Report, p. 116.

[18]Holding Company Act Release No. 18993 (May 20, 1975), 7 SEC Docket 32.

[19]Previously reported in 40th Annual Report, p. 117.

[20]Walplan and Company v. Metropolitan Edison Company, 506 F. 2d 1053 (C.A. 3, 1974).

[21]Holding Company Act Release No. 19038 (June 12, 1975), 7 SEC Docket 164.

[22]Previously reported 40th Annual Report, p. 116.

[23]Holding Company Act Release No. 18794 (January 31, 1975), 6 SEC Docket 217.

[24]Holding Company Act Release No. 19155 (September 3, 1975), 7 SEC Docket 793.

[25]Previously reported in 40th Annual Report, p. 117.

[26]Holding Company Act Release No. 18879 (March 19,1975), 6 SEC Docket 488.

[27]See, e.g., Public Service Company of Oklahoma, Holding Company Act Release No. 19090 (July 17, 1975), 7 SEC Docket 413; Indiana & Michigan Electric Company, Holding Company Act Release No. 19064 (June 26, 1975), 7 SEC Docket 346; Ohio Power Company, Holding Company Act Release No. 19036 (June 12, 1975), 7 SEC Docket 163; Appalachian Power Company, Holding Company Act Release No. 18971 (May 7, 1975), 6 SEC Docket 868, and No. 18363 (April 3, 1974), 4 SEC Docket 50; Middle South Utilities, Inc., Holding Company Act Release No. 18966 (May 2, 1975), 6 SEC Docket 806, No. 18785 (January 23, 1975), 6 SEC Docket 172, and No. 18221 (December 17, 1973), 3 SEC Docket 258; Transok Pipe Line Company, Holding

Company Act Release No. 18933 (April 14, 1975), 6 SEC Docket 691; Columbia Gas System, Inc., Holding Company Act Release No. 18749 (December 31, 1974), 6 SEC Docket 22.

The need for Commission approval of such nonutility businesses has been well established. See, e.g., Columbia Gas & Electric Corporation 17 S.E.C. 494 (1944); Appalachian Electric Power Company, 27 S.E.C. 1029 (1948); General Public Utilities Corporation, 32 S.E.C. 807 (1951); Columbia Hydrocarbon Corporation, 38 S.E.C. 149 (1957); Arkansas Power & Light Company, Holding Company Act Release No. 17400 (December 17, 1971).

[28]Holding Company Act Release No. 2676 (April 7, 1941). Previously reported in 40th Annual Report, p. 118; 7th Annual Report, pp. 98-102.

[29]Holding Company Act Release No. 18646 (November 7, 1974), 5 SEC Docket 417.

[30]Holding Company Act Release No. 18898 (March 28, 1975), 6 SEC Docket 564.

[31]Georgia Power Company.

[32]Jersey Central Power & Light Company (2); Ohio Power Company.

[33]Southern Company (2); Northeast Utilities (2); Utah Power & Light Company (2); Delmarva Power & Light Company; Middle South Utilities, Inc., Central and South West Corporation; American Natural Gas Company; General Public Utilities Corporation; American Electric Power Company, Inc.; New England Electric System; Ohio Edison Company.

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 judge, 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 judge may, if he 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 of 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 judge requests the Commission's participation.

The Commission in its Chapter X activities has divided the country into five 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 X RULES

The Advisory Committee on Rules of Practice and Procedure of the Judicial Conference of the United States proposed new Chapter X Rules. The Commission, in response to a general invitation for comment, submitted a comprehensive report generally critical of many aspects of the proposed Rules. In the Commission's view the Rules repeatedly abolished, without comment, carefully devised Congressional safeguards for public investors. Also, the Rules do not adequately reflect the differences between procedures needed to bring about the reorganization of an enterprise under Chapter X in order that it may continue as a going-concern and procedures necessary to accomplish liquidation in ordinary bankruptcy proceedings.

As a result of the Commission's comments, substantial changes were made and some rules were deleted or redrafted. Thereafter the Chapter X Rules and official forms were submitted to the Supreme Court which by order dated April 28, 1975, transmitted the Rules and Forms to Congress pursuant to Section 2075, Title 28, United States Code.

The Commission continued to disagree with a number of proposed rules and submitted a memorandum to Congress objecting to four proposed rules. They are: Rule 10-601 dealing with stay of actions against debtors and lien enforcement; Rules 10-117 and 10-308(a), dealing with the transfer of a Chapter X proceeding to Chapter XI and conversely; and Rule 10-215(c)(4), dealing with security transactions by fiduciaries. The Commission opposed these rules because they made substantial changes in existing law with little or no explanation

and if adopted, would impair the effective administration of Chapter X. The Rules became effective without amendment on August 1, 1975.

SUMMARY OF ACTIVITIES

In fiscal year 1975, the Commission entered 14 new Chapter X proceedings involving companies with aggregate stated assets of approximately $657 million and aggregate indebtedness of approximately $686 million. Including the new proceedings, the Commission was a party in a total of 129 reorganization proceedings during the fiscal year.[1] The stated assets of the companies involved in these proceedings totaled approximately $3.8 billion and their indebtedness about $3.4 billion.

During the fiscal year, 9 proceedings were closed, leaving 120 in which the Commission was a party at fiscal-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.

King Resources Company.[2] The Commission supported the trustee in urging affirmation of the district court's ruling which rejected a claim by unsecured senior creditor banks for post-petition interest from funds which would otherwise have been available to holders of subordinated debentures under terms of the subordination agreements.

Since the debtor was found insolvent, the case was governed by the general rule that interest on unsecured claims ceases to accrue as of the date the petition is filed.[3] Therefore, to establish the right of senior creditors to post-petition interest, the subordination agreement must unambiguously show that the general rule was intended to be

suspended.[4] Since no reference to payment of post-petition interest was contained in the subordination agreements, the senior creditors presumably have no right to post-petition interest. The matter was still pending as of the close of the fiscal year.

Investors Funding Corporation of New York.[5] – Voluntary Chapter X petitions filed by the company and 33 wholly-owned subsidiaries were approved and a trustee was appointed. These debtors were engaged primarily in the business of owning, operating, managing, purchasing, selling and leasing commercial and residential real estate. Consolidated assets and liabilities were reported at $380 million and $340 million, respectively. The parent company has outstanding about 1.6 million shares of stock held by over 5,000 persons and, together with IFC Collateral Corporation, a subsidiary, has outstanding over $140 million in subordinated debentures held by over 27,000 persons.

The Commission objected to the trustee's relation of a certain law firm as his general counsel on the ground that it was not disinterested under Section 158 as required by Section 157, since it was concurrently representing a separately operated non-banking division of a large bank creditor. Prior to the hearing on disinterestedness held under Section 161, the law firm advised the court that it would terminate its representation of that division, and the Commission withdrew its objection.

Calvin Christian Retirement Home, Inc. and Praire, Inc.[6] The court approved an involuntary petition for reorganization of the debtors. The debtors had sold unregistered securities in the form of promissory notes and passbook deposits to over 800 persons, on which the debtors were allegedly in default.

The attorney for the petitioning creditors was appointed as general counsel for the trustee. The Commission petitioned for his disqualification on the ground that he was not disinterested by reason of his representation of the petitioning creditors. The order finding the attorney disinterested and appointing him as general counsel to the trustee was withdrawn. However, that same lawyer was retained as special counsel to assist the trustee in performing duties that would not

conflict with the statutory proscriptions. The Commission did not object to such special appointment. Subsequently, a new general counsel to the trustee was appointed.

Dolly Madison Industries, Inc.[7] – The debtor's certificate of authority to do business in Virginia was revoked by that state's corporation commission for failure to file annual reports with the state and for failure to pay required registration fees. The reorganization court ordered the state agency to reinstate the debtor's certificate of authority. On appeal, the court of appeals reversed, holding that, while property of the debtor may have been affected by the action of the state agency, the revocation of the certificate did not constitute a "claim" -against the debtor's "property" and the reorganization court lacked summary jurisdiction to order its reinstatement.[8]

R. Hoe & Co., Inc.[9] Early in these proceedings the trustee renegotiated certain of debtor's contracts for the manufacture and sale of printing presses. The trustee, pursuant to court approval, required payment by the debtor's customers of a premium over the original contract price. A customer, who had paid the premium, filed a claim for its recovery asserting an administration claim or, alternatively, a general unsecured claim for the rejection of an executory contract. The reorganization court disallowed the claim entirely. On appeal, the court of appeals rejected the administration claim and held that the customer was entitled to a general unsecured claim in the amount of the premium it had paid.[10]

East Moline Downs, Inc.[11] The plan of reorganization, which was approved by the court during the pendency of an appeal from the court's finding that the petition was filed in "good faith", failed to receive the requisite number of acceptances from unsecured creditors and stockholders. After the hearing required by Section 236, the debtor was adjudged a bankrupt. As a result, the parties consented to the dismissal of the pending appeal as moot.[12]

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.

*Farrington Manufacturing Company, et a*l.[13] – As a result of facts uncovered during the course of his extensive investigation of the debtors, the trustee brought a plenary action in the federal court in New York to recover for Farrington Manufacturing Company ("Manufacturing") about $800,000 in profits allegedly made by a retired officer and director who sold shares while in possession of material adverse information which was not publicly disclosed or was disclosed in a misleading manner. The court held that the complaint stated a cause of action under Delaware law for common law breach of a director's fiduciary duty to a corporation to refrain from making personal profit through the use of inside corporate information, but that the trustee had no standing to sue under Section 10(b) of the Securities Exchange Act, since neither he nor the corporation was a defrauded purchaser or seller.[14]

The reorganization judge dismissed the trustee and directed the successor trustee to petition the New York court to transfer the case to the Eastern District of Virginia "for hearing and determination." Subsequently, upon joint motion of the successor trustee and the defendant, the complaint was dismissed without prejudice pursuant to Rule 41 of the Federal Rules of Civil Procedure.[15]

In his report, the trustee concluded that, *inter alia*, the offering circular used in connection with the offer and sale of $10,000,000 in Euro-dollar debentures issued by Farrington Overseas Corporation ("Overseas"), guaranteed by Manufacturing, contained false statements of material facts and failed to disclose other material information. Based upon the information developed during the investigation, a debenture holder filed an action in the federal court in New York on behalf of itself and other original purchasers against the

accountants, underwriters and officers and directors of Overseas and Manufacturing alleging violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and the Commission's rules promulgated thereunder.[16] The plaintiff joined the trustee as an involuntary plaintiff pursuant to Rule 19 of the Federal Rules of Civil Procedure, claiming he was an indispensable party because he had all of the documentary evidence and Overseas had causes of action against the defendants based on the same facts.

The reorganization judge ordered the trustee "to forthwith petition the New York court for leave to withdraw as party plaintiff. . . ." In an accompanying memorandum, the judge stated that ". . . [the trustee and his counsel] worked up the suit, developed the evidence and drafted the complaint and forwarded it to New York for filing." Upon learning of this memorandum opinion and order, the judge in the New York action requested the parties to address themselves to the issue of "whether it is a collusive action."

The Commission was prepared to argue *amicus curiae* that such an action is not collusive merely because the Chapter X trustee shares the fruits of his investigation with a party to the reorganization proceeding. This argument became unnecessary when the judge ruled at the outset of the hearing that the Euro-dollar debenture holder could remain as a party plaintiff. The purpose of a trustee's investigation is to enable him to convey to the court and all parties in interest the information he has discovered. The Supreme Court, while holding a Chapter X trustee did not have standing to assert a claim on behalf of debenture holders, stated that public investors "would be able to take advantage of any information obtained by the trustee in reorganization as a result of the investigation which the statute requires that he make."[17] For a court to hold that a trustee cannot share facts uncovered during his investigation with a representative of a class that allegedly has been injured would erode an important investor safeguard of Chapter X.

Subsequent to the withdrawal of the Overseas' trustee as a party, the district court ordered the dismissal of the debenture holders' action for lack of subject-matter jurisdiction after finding that the purchase was

“predominantly foreign” and that the antifraud provisions of the Federal securities laws were not intended to apply to such a purchase.[18] The court further found that the debenture holders that commenced the action, a Canadian corporation, was not within the group of intended or lawful offerees since the offering circular involved carried a proviso that the debentures were not to be sold to United States or Canadian nationals or residents and that the purchasers had signed a covenant to that effect.

Arlan's Department Store, Inc.[19] – Prior to the proceeding, a shareholder commenced a derivative action against the company's management.[20] About four months after the appointment of the Chapter X trustee, the court approved, over the Commission's objection, a $150,000 cash settlement of the lawsuit in exchange for general releases from the defendants, because the trustee needed the cash to operate the business.

The trustee had had little or no time to conduct the required investigation of the debtor's affairs or possible causes of action that existed against former management. The Commission urged that the investigation be made so that the trustee could present facts from which an informed judgment could be reached on the overall merits of the settlement. In the Commission's view the cash was not significant in light of the debtor's overall needs to warrant relinquishing possible claims.

About six months after the settlement was approved, the trustee ceased operations and announced his intention to propose a plan of orderly liquidation. At the close of the fiscal year, neither a plan nor the report of the trustee's investigation had been filed.

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 fiscal year the Commission published no formal advisory report, but its views on 12 plans of reorganization were presented to the courts either orally or by written memoranda.[21]

Dolly Madison Industries[22] – At the conclusion of plan hearings the court found the debtor insolvent and referred an internal plan of reorganization proposed by the trustee and a plan of orderly liquidation proposed by a major creditor to the Commission for its report. The trustee's plan provided for, among other things, the issuance of stock to creditors and warrants to shareholders. The trustee's plan appeared feasible, but the Commission was unable to determine whether it was "fair and equitable" because of the inadequacy of the record. In its report, the Commission objected to the proposed issuance of warrants,[23] pointed out that the warrants and under^ lying securities, if issued, would not be exempt from the registration provisions of the Securities Act, recommended a more simplified capital structure for the reorganized company than the one proposed,[24] and urged that provisions for the issuance of non-voting stock which violate Section 216 (12)(a) be deleted. The Commission also advised the court that the plan of orderly liquidation was premature. At the close of the fiscal year, the court had not rendered a decision regarding approval of either plan.

Diversified Mountaineer Corp., et al.[25] Four plans of reorganization were proposed for this West Virginia industrial savings and loan business which, through seven offices, had about $30 million in uninsured deposits and $6.8 million in subordinated debentures to over 20,000 persons.

Three plans were filed by outside proponents and provided for either the purchase of the debtor's assets or an acquisition of the company which contemplated the continuation of the debtor's business. The trustee proposed an internal plan calling for the debtor's reentry into the industrial loan business but without accepting savings deposits. Under the trustee's plan creditors would receive cash and securities of the reorganized company.

The trustee proposed a form of consolidation which treated the parent corporation separately from its subsidiaries. The subsidiaries' assets would be pooled and all creditors of these subsidiaries including depositors would be treated as equally entitled to the pooled assets. As a result, the parent estate was separately valued with recognition given to the subsidiaries' claims totaling almost $6 million, which represent advances to the parent.[26] The court as urged by the Commission adopted this form of consolidation.

Holders of the debtor's common stock would be excluded from participation under all plans in accordance with the court's finding of insolvency, whether treated separately or combined with its subsidiaries. Likewise the subordinated debenture holders, due to their subordination, were accorded no participation as such in the trustee's plan. The plan provides that to the extent that debenture holders can establish claims based on alleged violations of the Federal securities laws, they will participate on a parity with depositors as unsecured creditors.

The Commission suggested that the trustee's proposed claim procedure for subordinated debenture holders providing for a separate determination of each claim be consolidated for trial on a class action basis and that a lead counsel be appointed. Shortly thereafter a class action was filed on behalf of the debenture holders claiming that sales were made in violation of the antifraud provisions of Federal securities laws.

In its original memorandum, the Commission found the three outside plans either unfair and/or unfeasible and concluded that the trustee's plan was fair, equitable and feasible but indicated that the creditors would receive more in value if the estates were liquidated. The bankruptcy judge acting as special master agreed with the Commission and recommended that the trustee amend his plan to provide for the orderly liquidation of the estate. The estate was valued at about $23 million on a going-concern basis and about $32 million under an orderly liquidation.

Thereafter the trustee amended his plan to provide for the orderly liquidation of the estates continuing the form of consolidation and treatment of debentures as previously approved by the court. An outside proponent amended his previous plan to provide more consideration to the creditors in light of the $32 million liquidation value. The Commission's supplemental memorandum concluded that the orderly liquidation was fair to creditors but still found the creditor's plan to be unfair. Amendments necessary to make the proponent's plan fair having not been made, the court approved the trustee's plan of orderly liquidation. After the close of the fiscal year, the court confirmed the trustee's plan.

North Western Mortgage Investors Corp.[27] – The debtor was engaged in the business of buying and selling interests in various types of real estate. Approximately 1,700 public investors purchased about $11 million of promissory notes, secured by fractional interests in real estate mortgages and contracts.

The trustee's investigation disclosed that the selection of security for the particular investors was made in a fortuitous manner by the debtor subsequent to payment by the investor. Thus, he concluded that the actual value of the security assigned to investors varied greatly. The trustee therefore proposed an internal plan of reorganization embodying a compromise among the public creditors. Under the plan each investor would receive a non-interest bearing debenture in the principal amount equal to 50 percent of the security he holds. In addition, the investor would receive common stock of the reorganized company in exchange for the remaining portion of his claim, including the other 50 percent of the value of the claimed security. Unsecured creditors would receive the balance of the common stock except that up to 50 percent of the stock may be retained for issuance to new management. The plan excludes the two present stockholders from participation since the debtor was insolvent.

In its report the Commission pointed out that while compromises are “a normal part of the process of reorganization,”[28] the court has a duty to scrutinize the merits of the proposed compromise and apply its informed independent judgment.[29] Thus, since further hearings on

objection to the compromise were scheduled which could result in evidence that would controvert the trustee's findings, the Commission did not take a position with respect to the fairness of the compromise and urged the court to hear the objections before approving the compromise.

The plan was deficient in leaving for future determinations the maturity date of the debentures and provisions for payments into the sinking fund,[30] thus preventing the Commission from analyzing the feasibility and fairness of the trustee's plan.

The Commission also objected to the reservation of common stock for compensation to new management, noting that the Supreme Court has held that because certain persons can provide management, without more, “is no legal justification for the issuance of stock to them” under a Chapter X reorganization.[31] The Commission pointed out that stock compensation for new management is a matter more appropriate for consideration by the new board of directors of the reorganized company.

In accordance with the Commission's view, the court is conducting further hearings on the fairness of the compromise. As of the end of the fiscal year the court had not approved the plan.

Air/Industrial Research, Inc.[32] The debtor sold limited partnership interests to public investors to finance real estate acquisitions. The properties are encumbered, generating a negative cash flow, primarily from agricultural leases. The trustee's proposed plan of reorganization substantially consolidated the limited partnership's assets with those of the debtor, the general partner,[33] and offered common stock of the reorganized corporation in exchange for the limited partners' interests.[34] The plan also contemplated the sale of stock to the public to provide a source of capital to enable the reorganized company to service its secured debt and pay its operating expenses for a short time after emerging from Chapter X. The Commission objected to approval of the plan and pointed out the serious feasibility problems; it took the position that it was incumbent on the court to disapprove plans of reorganization that would perpetuate “corporate cripples”.[35] It

also noted that the sale of stock would not be within the exemption provided by Section 264a(2) from the registration provisions of the Securities Act, since it was not offered in exchange for claims against or interests in the debtor. The trustee requested the court to defer consideration of the proposed plan pending the resolution of these problems.

Pan American Financial[36] – The court, as recommended by the Commission, deferred approval of the trustee's plan of reorganization for lack of adequate financial records to support proposals to sell the debtor's subdivision lots. The trustee then filed an amended plan providing for the sale of all unsold lots in a large Hawaiian subdivision, which were encumbered by first mortgages exceeding $10 million held by 2,000 public investors.

The proponent, a local real estate broker, was to sell the remaining lots at retail and pay the mortgage principal to the investors from the sale proceeds. The Commission advised the court that there was a question whether there would be sufficient funds to complete required subdivision improvements. It characterized the broker's proposal as nothing more than a best efforts marketing program which could be abandoned at any time without recourse. In the event of default, the plan provided that the lots would be deeded to the investor-mortgagee in lieu of foreclosure or, at his option, sold on his behalf. In either case, an administrative surcharge would be assessed.

The Commission pointed out that an orderly disposition of the lots through a Chapter X plan was better for the investor-creditors than foreclosures or forced sales in straight bankruptcy.[37] While the Commission urged the court not to approve the amended plan until the feasibility problems concerning the marketing proposal were resolved, the plan was approved, accepted, and confirmed, but not consummated when the purchaser defaulted on the down payment. The agreement was terminated and the trustee proceeded to formulate the alternate deed-out program in compliance with provisions of the Interstate Land Sales Full Disclosure Act.[38]

Atlanta International Raceway, Inc.[39] – The Court of Appeals for the Fifth Circuit, as urged by the Commission, affirmed the district court's order confirming the trustee's amended plan of reorganization.[40] The district court held that the opportunity to receive cash in excess of the per share value of the stock as found by the court provided "more than 'adequate protection' pursuant to Section 216(8)" for dissenting stockholders.

The Supreme Court denied a petition for a writ of certiorari filed by a shareholder who also was a proponent of a competing plan.[41] The petitioner contended that Section 216(8) does not apply where a debtor has only one class of stockholders and that class rejects the reorganization plan. The Commission, in its brief opposing the petition, noted both that petitioner did not challenge the adequacy of the cash offer and that payment in cash "is the perfect realization of a money chose in action."[42] It urged that in the absence of reported decisions involving a cram-down to dissenting stockholders the principle of the parallel provision in Section 216(7), dealing with dissenting creditors, is equally applicable to shareholders.

Continental Vending Machine Corp.[43] The district court approved an amended plan of reorganization based on substantive consolidation of a parent corporation and its subsidiary, which provided that no secured creditor's claim shall be improved as a result of the consolidation. Since the plan treated unsecured claims as consolidated and secured claims as unconsolidated, a secured creditor appealed contending that the plan was not "fair and equitable". The court of appeals, as urged by the Commission and the trustee, affirmed the approval order and held that the secured creditor's right to specific assets pledged to it in connection with loans to the two corporations was preserved and that the Bankruptcy Act does not require consolidation to be complete for all purposes.[44]

Lyntex Corporation[45] – The trustee filed plans of reorganization contemplating the orderly liquidation of the debtor and its subsidiaries. Under the plans, costs and expenses of administration in the superseded Chapter XI proceedings were to be treated subordinate to those incurred in the Chapter X proceedings. The Commission advised

the court that the plans would be “fair and equitable” if amended to accord equal treatment for costs and expenses of administration of both proceedings. Under Section 328 when a case is transferred to Chapter X from Chapter XI, it is deemed to be a Chapter X proceeding from the inception of the Chapter XI proceeding. In addition, case authority supports equal treatment for administration costs of both proceedings.[46] At the close of the fiscal year, the court had not rendered its decision regarding approval of the plans.

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 fiscal year 411 applications for compensation totaling about $21.1 million were reviewed.

Farrington Manufacturing Company, et al.[47] – Seventeen applicants sought compensation and reimbursement of expenses aggregating about $1.3 million (including amounts previously paid) for the period January 1971 through June 1973. These requests amounted to about 28% of the assets of $4,625,000 in the combined debtor estates. The Commission recommended fees and reimbursements totaling about $927,000, while the special master recommended about $781,000. In November 1974, the district judge awarded fees and reimbursements aggregating about $670,000 for the entire proceeding, including additional requests aggregating about $215,900 for services and expenses subsequent to June 30, 1973. Two appeals were pending at the close of the fiscal year, with the Commission participating in both.

Counsel to the trustee requested an allowance for services rendered through June 1973 of $673,200 (including an interim payment) and

reimbursement of about $36,100 in expenses. The Commission recommended $575,000 compensation and the reimbursement of their expenses- without regard to additional services which would be performed. The special master recommended that their fee for the period be $450,000 plus expenses. The district judge awarded $350,000 for all services rendered and expenses incurred to November 1974 plus $10,000 for services and expenses in closing the estate but gave no indication how much was being awarded through June 1973 and how much was for the subsequent period for which counsel sought a total of about $140,300.

Counsel, supported by the Commission, appealed from the order[48] which it calculated amounted to an award of about $17 per hour. The Commission urged that trustee's counsel is a court appointee with certain duties and responsibilities for which it is entitled to “reasonable compensation” under Section 241 and is not a volunteer who is compensated on the basis of benefit to the estate. In the Commission's view, the district judge failed to balance three factors against the needs of economy: (1) that compensation should be reasonable when, as in these cases, the standard of counsel's performance is not questioned, so that competent counsel will be encouraged to participate in increasingly more complex reorganization proceedings; (2) that the Section 167 investigation is one of the most important steps in a reorganization

and is one of the protections that Chapter X is designed to provide for” public investors to which the same court of appeals addressed itself over 30 years ago in Committee v. Kent;[49] and (3) that, as a result of the investigation, a class of Farrington stockholders were accorded a modest participation under the plan of reorganization even though the debtor was insolvent, and the trustee was involved in several lawsuits which, if successful, would have increased the estates and consequently the distribution to creditors, including public investors.

The other pending matter related to the amount and manner in which fees and expenses to the indenture trustee were awarded. Both the Commission and the special master recommended that its pre-Chapter X expenses be paid from proceeds available for distribution to

debenture holders in accordance with terms of the indenture rather than as a cost of administration. The district judge agreed with the manner of payment but, without explanation, reduced the amount by 50%. With respect to compensation for services that were of benefit to the estate during the Chapter X proceeding and expenses incurred therewith, both the Commission and the special master made clear that their recommendations were to be considered costs of administration. The district judge, again without explanation, directed that this award, like the pre-Chapter X expenses, be borne by the debenture holders.

The indenture trustee, supported by the Commission, appealed.[50] The Commission urged that (1) in the absence of a finding that the pre-Chapter X expenses were not properly incurred, the indenture trustee is entitled to reimbursement in full under the indenture; and (2) compensation from the estate to an indenture trustee for beneficial services in connection with a reorganization proceeding is appropriate under Section 242.[51]

Interstate Stores, Inc.[52] – The independent trustee sought an interim allowance of $24,000 for services rendered during a 41/2 month period and the additional trustee requested a $25,000 increase in his annual salary to $100,000.

Since the trustee only spent about 45% of his time on estate matters, the Commission recommended an award of $11,500 for the period. It opposed any increase in the additional trustee's salary. The special master reported to the district judge that in his view the applications should be granted in full.

The district judge in an unreported decision stated that the Commission's recommendations should be followed in the absence of contrary reasons based on specific findings.[53] Since the special master had not made the necessary findings, the district judge awarded the amounts suggested by the Commission.

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 this Rule, which became effective as of July 1, 1974, 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. The prior procedure for filing a Chapter X petition after the granting of the motion and a separate hearing on the petition has been abolished.

Attempts are sometimes made to misuse Chapter XI so as to deprive investors of the protection which the Securities Act of 1933 and the Securities Exchange Act of 1934 are designed to provide.[54] 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.

Omega-Alpha, Inc.[55] The debtor is a publicly held holding company which wholly owns one operating subsidiary, The Okinite Company. Since its organization in 1970, debtor incurred aggregate losses of approximately $115 million. At the inception of the Chapter XI proceedings, the company's financial statements reflected a deficit net worth of about $50 million. The company's capitalization includes about $42 million in two issues of debentures held by about 3,000

public investors. The Commission in its motion to transfer the proceeding to Chapter X urged, among other things, that there was the need for a thorough investigation by an independent trustee and that rehabilitation of the company required a substantial adjustment of widely held public debt. Both indenture trustees for the two issues of debentures also filed transfer motions. The court granted the motions and transferred the proceeding to Chapter X whereupon two trustees were appointed.

U. S. Financial, Inc.[56] The Commission and certain creditor banks filed Section 328 motions to transfer to Chapter X the proceedings involving this real estate conglomerate. The debtor's capitalization includes $35 million in convertible subordinated debentures, $11 million principal amount of bearer bonds and $10 million in common stock, all publicly-held. A hearing on the Commission's motion was deferred when the debtor obtained a stipulation from the moving banks that it would be allowed a reasonable time to attempt to formulate an acceptable arrangement, the debtor agreeing to consent to Chapter X if it could not. Subsequently, however, the debtor's motion for relief from the stipulation was granted by the court, and it continued in Chapter XI.

The Commission, which was not a party to the stipulation, had pointed out that the debtor's potential liability on pending collateral securities fraud class suits filed against the debtor might prove to be insurmountable under the limited scope of Chapter XI.[57] Pending the debtor's attempt to propose an acceptable arrangement, the Commission formally appeared in the Chapter XI proceeding. Somewhat later, the banks moved for an adjudication, the debtor then filed a motion to have the case proceed under Chapter X,[58] asserting, *inter alia*, that “serious obstacles” to confirmation of an arrangement existed and that it would be in the best interest of creditors to proceed under Chapter X “wherein the problems of bars to discharge and non-dischargeability of claims are not present.” The banks contested the debtor's motions; because of the lapse of time and changed circumstances the Commission took no position. After the close of the fiscal year, the court granted the debtor's motion and appointed a trustee.

Esgro, Inc.[59] The debtor is a publicly-held holding company whose primary asset is a wholesale electrical products business not in Chapter XI. About 60 percent of some $10 million of unsecured debt is represented by subordinated convertible debentures held by approximately 700 investors.

The debtor offered its creditors $1 million in cash at confirmation, an additional $1 million within one year but only to the extent realized from the sales of certain assets, and a 49 percent equity interest. In connection with the solicitation of acceptances from debenture holders, the debtor was required to comply with the proxy provisions of Section 14(a) of the Securities Exchange Act and the rules thereunder.[60]

The Commission moved to transfer the case to Chapter X urging that the proposed material modification of publicly-held debt must be accomplished under that chapter.[61] The debtor strenuously resisted the transfer motion and sought extensive discovery. After lengthy hearings, the bankruptcy judge denied the Commission's motion without prejudice, pointing out the effort and progress toward confirmation of the Chapter XI plan made by the debtor. In its appeal to the district judge, which was pending at the end of the fiscal year, the Commission argued that where the rights of public investors will be materially affected, it is improper to deny a motion to transfer the proceeding to Chapter X on the grounds that the debtor has exerted efforts, incurred expenses and made progress toward the confirmation of a Chapter XI arrangement.[62]

Pocono Downs, Inc.,[63] – This publicly held company, which owns and operates a horse race track, has outstanding approximately $850,000 in subordinated convertible debentures held by about 800 public investors. The Commission intervened in the Chapter XI proceeding to support a motion by the indenture trustee to transfer the proceeding to Chapter X.

The Commission urged, among other things, that a disinterested trustee was needed to conduct the debtor's operations, investigate its past activities and ascertain its present financial condition. An order

enjoining the voting of about 65 percent of the debtor's outstanding stock had been entered as a result of a myriad of transactions involving that stock. No stockholders' meeting had been held since October 1973, and it was unclear who had actual authority to act on behalf of the debtor. In addition, certain officers of the debtor had interests in some of its major creditors, which gave rise to substantial conflicts of interest. Further, the Commission urged that the rehabilitation of this debtor is likely to involve more than a minor adjustment to the rights of the public debenture holders. Subsequent to the end of the fiscal year, the bankruptcy court granted the motion, transferred the proceeding to Chapter X and appointed a trustee.[64]

Equitable Mortgage Investment Corp., et al.[65] The debtor is a registered retail land developer under the Interstate Land Sales Full Disclosure Act[66] and markets recreational land in Iowa. It financed its operations through four intrastate public offerings of debt securities totaling $5 million purchased by approximately 1,300 investors. Equitable's common stock is held by American Recreation & Land Company (“American”), which operates the same business in Missouri under the same management. Substantial intercompany activity between the two. corporations was responsible for placing most of the liabilities in Equitable and most of the assets in American.

American caused Equitable to file a Chapter XI petition. Under Equitable's proposed arrangement, preferred stock would have been exchanged for public debt, and American would have retained its equity interest. In addition, accounts receivable from American of over $1 million would not have to be repaid.

The Commission in its transfer motion urged, among other things, that there was a need for a thorough investigation by an independent trustee, that Equitable's rehabilitation required 'a substantial adjustment of publicly held debt and that a close scrutiny of debtor's relationship with its parent, American, was necessary. The Commission also noted that the specter of federal securities laws violations in the sale of debtor's debt securities raised the question of whether these contingent claims could be discharged in a Chapter XI

proceeding. The court granted the Commission's motion, transferred the proceedings to Chapter X and appointed a trustee.

"U" District Building Corporation.[67] Public debenture holders, supported by the Commission, were successful in obtaining the transfer to Chapter X of the proceedings involving this owner of a seven-story office building. The debtor proposed the sale of the office building and a plan of liquidation in Chapter XI. The Commission questioned the fairness of the price and objected on the grounds that Chapter XI was not a proper vehicle for a liquidation.[68] In addition, questions had been raised concerning the conduct of management which indicated the need for the safeguards of Chapter X.

An insurance company, which was attempting to foreclose its first mortgage on the debtor's sole asset, argued that under Rule 11-44(d) the court was required to reach a determination on the reclamation petition prior to holding a hearing on the motion to transfer the proceedings to Chapter X. The court disregarded the insurance company's argument, noting the anomaly involved in asserting that a sole asset could be reclaimed from a debtor in Chapter XI when there had been no determination of whether Chapter XI or Chapter X was the proper avenue of relief. After a hearing, the court transferred the proceedings to Chapter X and appointed a trustee.

American Beef Packers, Inc.[69] The Commission intervened in this Chapter XI proceeding and joined with the States of Iowa and Nebraska in seeking the appointment of a receiver for the debtors. American Beef, which is publicly held, has assets of about $110 million and liabilities of over $92 million. The application alleged, among other things, that preferential transfers of money were made to affiliates of American Beef before and after the Chapter XI filing; that certain officers and directors were subjects of investigations by various state and federal agencies; and that American Beef was mismanaged by its officers and directors in that it diverted funds from its principal creditors, issued checks drawn on accounts insufficient to pay the checks, and applied funds necessary for its continued operations for capital improvements.

The hearing on the application was continued several times and, as of the end of the fiscal year, had not been heard. The debtor's proposed arrangement contemplates that new management would take over the operation of the business. Should it be confirmed, the appointment of a receiver would become moot.

Investors Equity of Iowa, Inc.[70] Debtor, a publicly held land development corporation with two wholly owned subsidiaries, had issued thrift certificates totaling about $1.5 million to approximately 375 holders. The Commission filed a motion to intervene in the proceeding to seek the appointment of a receiver. In its motion the Commission alleged, among other things, that the thrift certificates were issued in violation of the antifraud provisions of the federal securities laws, that the management of the debtor continued to make false statements to securities holders subsequent to the termination of the offering and that the debtor had been mismanaged.

The debtor resisted the Commission's application and specifically objected to its standing to make such an application. The bankruptcy judge, citing *S.E.C. v. American Trailer Rentals Co*.,[71] concluded that the Commission does have the right to intervene as a party in interest in a Chapter XI proceeding and granted the Commission's application for the appointment of a receiver.

Superior Mortgage Co. and Omnivest.[72] – These debtors and five other affiliated corporations are in the business of selling real estate to investors interested in gains from appreciation in land values or tax shelters. After the State of California filed a complaint against the debtors seeking injunctive and other relief, alleging violations of the State's laws regarding subdivisions,[73] credit evaporated and relief was sought under Chapter XI.

Debtors' scheduled assets of more than $41 million, included almost $23 million of land sales contracts from about 3,500 lot purchasers who had the right to terminate. Liabilities aggregated about $34.5 million, of which almost $16 million may have been secured and were owed to some 1,500 investors. A plan of arrangement was proposed which provided that creditors, including lot purchasers who terminate

their contracts and investors, would be paid in full over a period of years from a trust fund created from remaining land sales contracts receivable plus 10% of future land sales contracts.

The Commission moved to intervene in the interest of public investors, since it believed that the proposed arrangement raised a number of questions under the Federal securities laws.[74] It was concerned, among other things, with the adequacy of disclosure to be made to investor-creditors and lot purchasers and whether the proposed participation in the trust fund was an evidence of indebtedness requiring qualification under the Trust Indenture Act.[75] The debtors then disclosed additional data to investors; the staff reviewed the materials to be used in soliciting consents to the arrangement and changes were made in response to comments; and accommodations also were reached on other issues. Since the Commission effectively obtained the relief it sought, it withdrew its motion to intervene without prejudice.

Cavanagh Communities Corporation.[76] – Shortly after the commencement of these Chapter XI proceedings, the New York Stock Exchange advised the debtor of its decision to file an application with the Commission to delist the debtor's common stock and convertible subordinated debentures. Upon application of the debtor, the bankruptcy judge, holding that the stock exchange listing constitutes “property” of the debtor and thus within the jurisdiction of the bankruptcy court, entered an order enjoining the Exchange from making such application. The Exchange appealed to the district court. The Commission filed an *amicus curiae* brief urging that the order of the bankruptcy judge be reversed because of lack of jurisdiction to grant the injunctive relief sought against the Exchange. The basis for the Commission's position was that the Securities Exchange Act of 1934 embodies a comprehensive statutory scheme whereby national securities exchanges registered with the Commission are placed under its regulatory control, and that Section 12(d) of that Act vests exclusive jurisdiction over the exchange delisting process in the Commission, subject to judicial review of Commission orders only by Federal courts of appeal. The Commission did not address itself to whether exchange listing is “property” of the debtor because of its belief that, even

assuming *arguendo* that it is property, a bankruptcy court's jurisdiction over stock exchange listings is preempted by the grant of exclusive jurisdiction in Section 12 of the Securities Exchange Act of 1934. At the end of the fiscal year no decision had been rendered on this appeal.

Puts & Calls, Inc.[77] – While the Commission, which had intervened specially to enforce the Federal securities laws, was developing the record as to the adequacy of the disclosure of material facts, the non-debtor proponent withdrew its proposed arrangement. Since there was no going business to rehabilitate, there was no need for a debtor-relief proceeding. The debtor was adjudicated a bankrupt, and its more than 4,000 creditors, mostly investors, were entitled to receive a distribution of a substantial portion of the cash fund which exceeded $600,000.

Longchamps, Inc.[78] The debtor sought court authority to retain a law firm, which asserted a substantial secured claim for services rendered prior to the Chapter XI proceeding, as its counsel in the proceeding. After denying the application without prejudice, the court sought the Commission's views with respect to this matter, since the debtor is a publicly held company. The Commission concurred with the court's decision disqualifying the law firm. It pointed out that questions may arise with respect to the amount of the law firm's claim and the validity of its security interest. An attorney for a general creditor is not disqualified from such representation under Section 44c of the Bankruptcy Act and Bankruptcy Rule 215(c), but these provisions clearly do not apply where a creditor is secured or has a priority. Subsequently, the court appointed another law firm.

NOTES TO PART 7

[1]A table listing all reorganization proceedings in which the Commission was a party during the year is contained in Part 9.

[2]D. Colo., No. 71-B-2921. Previously reported in 40th Annual Report, p. 127 and 39th Annual Report, pp. 121-122.

[3]Vanston Bondholders Protective Committee v. Green, 329 U.S. 156 (1946); United States v. Edens, 189 F.2d 876 (C.A. 4, 1951), aff'd per curiam, 342 U.S. 912 (1952) (on basis of New York v. Saper, 336 U.S. 328 (1949) as controlling in Chapter X); United States v. General Engineering & Manufacturing Co., 188 F.2d 80 (C.A. 8, 1951), aff'd per curiam, 342 U.S. 912 (1952). See also, Sexton v. Dreyfus, 219 U.S. 339, 344 (1910).

[4]In re Times Sales Finance Corp., 491 F.2d 841 (C.A. 3, 1974) and In re Kingsboro Mortgage Corp., 379 F.Supp. 227 (S.D.N.Y., 1974), aff'd per curiam, No. 74-2177 (C.A. 2, April 3, 1975).

[5]S.D.N.Y., 'No. 74-B-1454, 1455 and 74_B-1511-1542, inclusive.

[6]W.D. Mien., Nos. G-74-1113-B-1 and G-74-1114-B-1.

[7]E.D. Pa. No. 70-354. Previously reported in 39th Annual Report, p. 122.

[8]In re Dolly Madison Industries, Inc., 504 F. 2d 499 (C.A. 3, 1974).

[9]S.D.N.Y., No. 69-B-461. Previously reported in 40th Annual Report, pp. 128-129; 37th Annual Report, pp. 183, 194-195; 36th Annual Report, p. 179.

[10]Abarta Corp. v. Kilsheimer, 508 F. 2d 1126 (C.A. 2, 1975).

[11]S.D. III., No. RI-Bk-73-295. Previously reported in 40th Annual Report, p. 124.

[12]In the Matter of East Moline Downs, Inc. C.A. 7, No. 74-1298, (May 27, 1975)

[13]E.D. Va., Nos. 17-71-A, 256-71-A, and 257-71-A. Previously reported in 39th Annual Report, pp. 123-124; 38th Annual Report, p. 118.

[14]Davidge v. White, 377 F. Supp. 1084 (S.D.N.Y. 1974).

[15]Davidge v. White, No. 72-Civ.-4333, S.D.N.Y., July 15, 1975

[16]F.O.F. Proprietary Funds, Ltd. v. Arthur Young & Company, S.D.N.Y. No. 73-Civ.-3262.

[17]Caplin v. Marine Midland Grace Trust Co., 406 U.S. 416, 434, (1972). In Webb & Knapp, Inc., SONY, No. 65-B-365, the case in which Caplin arose, an order was entered on October 14, 1974, granting plaintiffs' and defendant's counsel in a class action on behalf of debenture holders against the indenture trustee access to the debtor's records.

[18]The dismissal was based on two recent decisions of the Court of Appeals for the Second Circuit: Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (1975), and ITT v. Vencap, Ltd., 519 F.2d 1001 (1975).

[19]S.D.N.Y., No. 73-B-468. Previously reported in 40th Annual Report, p. 131.

[20]Vinar v. Cohen, et al., S.D.N.Y., 72 Civ. 1602.

[21]In re Air Industrial Research, Inc., N.D. Calif., No. 3-74-328-OJC; In re Diversified Mountaineer Corp., S.D. W.Va., No. 74-71-CH; In re Dolly Madison Industries, E.D. Pa., No. 70-354; In re Lyntex Corporation, S.D.N.Y., No. 73-B-75; In re North Western Mortgage Investors Corp., W.D. Wash., No. 642-73-B-2; In re Pan American Financial Corporation, D. Hawaii, No. 72-280. After the close of the fiscal year the Commission published one advisory report (In re King Resources Company, Corporate Reorganization Release No. 316 (August 13, 1975), 7 S.E.C. Docket 615), and supplemented a prior advisory report (In re Imperial '400' National, Inc., Corporate Reorganization Release No. 315 (July 30, 1975), 7 S.E.C. Docket 604).

[22]E.D. Pa. No. 70-354. Previously reported in 39th Annual Report, p. 122.

[23]The Commission historically has opposed the issuance of warrants as an unsound financial device and as contravening the feasibility requirement. Childs Company, 24 S.E.C. 85, 120-122 (1946). See also Sections 216 (12)(a) and (b).

[24]See Consolidated Rock Products Co. v. DuBois, 312 U.S. 510, 528, 531 (1941).

[25]S.D. W. Va., No. 74-71-CH, 74-73-CH, 74-75-81-CH. Previously reported in 40th Annual Report, p. 127.

[26]Consolidated Rock Products Co. v. DuBois, 312 U.S. 510 (1941).

[27]W.D. Wash., No. 642-73-B-2

[28]Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 130 (1939).

[29]Section 216 (12) requires, *inter alia*, that the plan contains fair and equitable provision for the retirement of any securities issued pursuant to a plan.

[30]Protective Committee v. Anderson, 390 U.S. 414, 424-425 (1968); National Security Co. v. Coriell, 289 U.S. 426, 436 (1933).

[31]Case v. Los Angeles Lumber Products Co., supra, at 122.

[32]N.D. Calif., No. 3-74-328-OJC.

[33]Cf. In re Imperial '400' National, Inc., 429F.2d671 (C.A. 3, 1970).

[34]Since the California Attorney General had brought an action alleging violations of the State's Corporate Securities Act in the issuance of the limited partnership interests, the trustee considered the limited partners as holding rescission claims. See In re Los Angeles Land & Investments, Ltd., 282 F.Supp. 448 (D. Hawaii, 1968).

[35]Price v. Spokane Silver & Lead Co., 97 F.2d 237 (C.A. 8, 1938).

[36]D.C. Hawaii, No. Bk 72-280.

[37]See In re Palisades-on-the-Desplaines, 89 F. 2d 214 (C.A. 7, 1937); In re Los Angeles Land & Investments, Ltd., 282 F. Supp. 488 (D. Hawaii 1968), previously reported in 37th Annual Report p. 187.

[38]15 U.S.C. §1701,et seq.

[39]N.D. Ga., No. 70556. Previously reported in 40th Annual Report, p. 128.

[40]In re Atlanta International Raceway, Inc., 505 F. 2d 732 (C.A. 5, 1974).

[41]Price v. Cotton, 421 U.S. 976 (1975).

[42]Texas Hotel Securities Corp. v. Waco Development Co., 87 F. 2d 395, 400 (C.A. 5, 1936), certiorari denied sub nom. Waco Development Co. v. Rupe, 300 U.S. 679 (1937). Accord, Gross v. Bush Terminal Co., 105 F. 2d, 930, 932 (C.A. 2, 1939). See also Country Life Apartments v. Buckley, 145 F. 2d 935, 938 (C.A. 2, 1944).

[43]E.D.N.Y., No. 63-B-663. Previously reported in 36th Annual Report, p. 90; 35th Annual Report, p. 163; 33rd Annual Report, p. 134; 32nd Annual Report, p. 90.

[44]James Talcott, Inc. v. Irving L. Wharton, 517 F.2d 997, (C.A. 2, 1975).

[45]S.D.N.Y., No. 73-B-751. Previously reported in 40th Annual Report, p. 131.

[46]In re Arlington Discount Company, 408 F. 2d 490 (C.A. 6, 1969); In re Barchris Construction Corp., (1966-1967 Transfer Binder) Banker. L. Rep. 1i 61,793 (S.D.N.Y. 1966).

[47]E.D. Va., Nos. 17-71-A, 256-71-A and 257-71-A. Previously reported in 39th Annual Report, pp. 123-124; 38th Annual Report, p. 118.

[48]In re Farrington Manufacturing Company (Robert E. McLaughlin and Steptoe & Johnson, Appellants), C.A. 4, No. 75-1355.

[49]143 F. 2d 685 (1944).

[50]In re Farrington Manufacturing Company (New England Merchants National Bank, Appellant), C.A. 4, No. 75-1354.

[51]The terms of Section 242(1) are designed to carry put the Congressional intent of encouraging indenture trustees to participate actively in the reorganization process on behalf of those whom they represent. House Hearings before Judiciary Committee on H.R. 6439 (reintroduced as H. R. 8046 and enacted in 1935), 75th Cong., 1st Sess. (1937) 186.

[52]S.D.N.Y. No. 74 B 614-802, Inclusive.

[53]See Scribner & Miller v. Conway, 238 F. 2d 905, 907 (C.A. 2, 1956); Securities Investor Protection Corp. v. Charisma Securities Corp., 506 F. 2d 1191, 1196 (C.A. 2, 1974).

[54]See 40th Annual Report, p. 130; 39th Annual Report, p. 127; 38th Annual Report, p. 126; 37th Annual Report, p. 138.

[55]N.D. Texas, No. Bk-3-74-454-G.

[56]S.D. Calif., No. 17007-K.

[57]Under Section 17a(2) of the Bankruptcy Act, fraud claims are not dischargeable in Chapter XI. Since they are unliquidated and contingent, they also are not provable (Section 57d).

[58]While the SEC or any other party must make a transfer motion within 120 days after the first date set for the first meeting of creditors, Rule

11-15(a) provides that a debtor may make a transfer motion “at any time.”

[59]C.D. Calif., No. 73-02510.

[60]Debentures convertible into common stock are “equity securities” as that term is defined in Section 3(a)(11) of the Securities Exchange Act. When held by more than 500 persons at the end of a fiscal year, they are subject to registration under Section 12 of that Act which in turn subjects them to the provisions of Section 14.

[61]The Supreme Court held in SEC v. American Trailer Rentals Company, 379 U.S. 594, 613 (1965), that “. . . as a general rule Chapter X is the appropriate proceeding for adjustment of publicly-held debt.”

[62]Cf. In re Peoples Loan & Investment Company of Fort Smith, 410 F.2d 851 (C.A. 8, 1969).

[63]M.D. Pa., No. Bk-74-437.

[64]First Pocono Corp. v. L.P. Properties, No. 878, January Term, 1975 (Allegheny County Court of Common Pleas, order dated February 18, 1975).

[65]S.D. Iowa, Nos. 74-509-C, 74-528-C, 74-537-C.

[66]15 U.S.C. §1701, et seq.

[67]W.D. Wash., No. B-74-11098.

[68]See In re Northern Illinois Development Corp., 324 F.2d 104, 106-108 (C.A. 7, 1963), cert, denied, 376 U.S. 938 (1964); In re Pure Penn Petroleum Co., 188 F.2d 851 (C.A. 2, 1951).

[69]D. Nebraska, No. Bk-75-0-17. Beef-land International, Inc., a wholly-owned subsidiary, also filed a Chapter XI petition. No. Bk-75-0-18.

[70]S.D. Iowa, No. 74-464-C.

[71]379 U.S. 594 (1965). The Court stated, at p. 613, that: ". . . we hold that, under the statutory scheme, while not charged with express statutory rights and responsibilities as in Chapter X, the SEC is entitled to intervene and be heard in a Chapter XI proceeding."

[72]C.D. Cal., Nos. 74-9406-AAH and 74-9410-AAH.

[73]People of California v. Exceptional Properties Co., et al., No. C-90080 (Superior Court of the State of California for the County of Los Angeles, June 3, 1974).

[74]The Supreme Court has held that the Commission's right to intervene in Chapter XI proceedings is not limited solely to moving for a transfer to Chapter X. Securities and Exchange Commission v. American Trailer Rentals Co., 379 U.S. 594, 612-613 (1965). See also Fed. R. Civ. P. 24.

[75]An exchange of an evidence of indebtedness for unsecured claims against a debtor is exempt from registration under Section 5 of the Securities Act pursuant to Section 393a(2) of Chapter XI, but it is not exempt from qualification under the Trust Indenture Act. Cf. Trust Indenture Act Release No. 30 (August 28, 1944), which deals with the issuance of debt securities pursuant to a similar provision found in Section 264a(2) of Chapter X.

[76]S.D.N.Y. No. 75-B-243.

[77]C.D. Cal., No. 73-03706. Previously reported in 40th Annual Report, pp. 131 – 132.

[78]S.D.N.Y., No. 75-B-953.

PART 8

SEC MANAGEMENT OPERATIONS

A number of important developments occurred in 1975, contributing to increased operating efficiency, improved service to the public, and effective use of the Commission's resources.

ORGANIZATIONAL CHANGES

One major change was aimed at strengthening the Commission's capacity for economic research and ensuring critical support to the new National Market Advisory Board. Towards this end, the Commission has grouped its Offices of Economic Research and Policy Planning under a Directorate of Economic and Policy Research. The new unit is responsible for, among other things, collecting and processing reports on the holdings and trading of institutional investors called for by the Securities Acts Amendments of 1975 and improving the Commission's ability to develop timely and accurate data on the capital markets, in order to identify fundamental changes affecting the markets and to help formulate Commission policy reflecting awareness of such changes. It is expected that the consolidation of units under a single office will enable the Commission to better define problems and collect the empirical evidence needed to regulate effectively the various components of the securities industry for which it is responsible.

Shortly after the close of the fiscal year, the Office of Registrations and Reports and the Office of Records were merged to form a new Office of Reports and Information Services, (“ORIS”). The new Office's responsibilities encompass all of the duties of the two former offices, including the receipt, initial examination, distribution and storage of all the Commission's official filings; the control of Commission records and correspondence; the management of the Commission's public reference services; the coordination of responses to investor inquiries and complaints; the substantive examination of certain reports and applications; and the maintenance of numerous computer records. In addition, ORIS assumed primary responsibility for implementing the provisions of the amended Freedom of Information Act (FOIA), and the Privacy Act of 1974, as they relate to material filed with the

Commission. FOIA requests were formerly handled by the Office of Public Information. Due to the increase in the number of requests and new demands created by the Privacy Act of 1974, the Commission decided to centralize all operations in these areas in ORIS. A special section has been set up within ORIS to coordinate the processing of these requests.

INFORMATION HANDLING

Significant progress was made during the year to improve the SEC's information processing capabilities.

In recognizing the need for an orderly extension of its use of advanced technology, the Commission, with the assistance of consulting support services, completed an agency-wide information systems review. As a result of this review, the Commission initiated the preparation of five-year plan for developing more comprehensive information processing systems and enhancing its overall computer support capability. In addition, the Office of Data Processing, having determined that an immediate requirement existed for drastically improving the method by which computer-based information is processed, explored the feasibility of utilizing telecommunications[1] for accessing and maintaining the Commission's information systems. This exploration process consisted of the introduction, on a very limited and experimental basis, of telecommunications equipment and techniques to two of the Commission's most widely utilized information systems, and the preparation and completion of a feasibility study report. This report sets forth recommended courses of action for the Commission to follow in proceeding with the expansion and further development of telecommunications for internal information processing. The recommendations are clearly consistent with the short-term phases of the aforementioned five-year plan that is being developed.

The Office of Data Processing also expended a considerable amount of time in modifying and improving many of its existing information systems and the manner in which information is processed. These modifications and improvements were made possible by the additional equipment installed in the latter part of fiscal year 1974,[2] and resulted

in a substantial increase in the number and timeliness of jobs processed through the computer.

A most important new system was developed during the year. This system was designed to facilitate the Commission's monitoring of negotiated commission rates and the impact that such rates will have on the securities industry.

In the area of new legislation, the Office of Data Processing was and continues to be heavily involved in the formulation of Commission policy and procedures, as they relate to automated information systems, to carry-out the provisions of the Freedom of Information Act Amendments and the Privacy Act. In addition, preliminary work was carried-out during the latter part of the year to determine what computer and analytical support would be required in meeting the provisions of the Securities Acts Amendments of 1975.

CONSUMER SERVICES

The Commission took several important steps in the development of a comprehensive consumer education program. The program is intended to result in the creation of written materials and audiovisual aids that will enhance effective communication between the Commission and the various constituencies it serves.

The first product of this program was the production, in conjunction with a prominent organization for continuing legal education, of a 30-minute color sound film of an actual Commission meeting. It is believed to be the first such record of an actual meeting by an independent regulatory agency. The film was developed for, and has been shown to, educational and legal organizations who wish to have a better understanding of how the Commission approaches, formulates and resolves problems facing it.

On a more fundamental level, production was completed of a 12-minute narrated color slide program entitled “Eagle on the Street”. This program was designed to provide lay audiences with a basic understanding of why the Commission was created, how it is

structured and operates, what its mission is, and how it can be of assistance to the general public. This program has been well received by a number of educational and professional organizations. Plans are underway to develop a broad distribution to ensure the program's availability to any interested groups.

Finally, the Commission has undertaken to write, publish and distribute a series of consumer education booklets. The first such booklet, “Investigate Before You Invest”, was distributed in connection with the Consumer Information Center. More than 10,000 copies of the booklet were requested by and distributed to members of the public. A second booklet, “The SEC and the FOIA”, was designed to provide answers to basic questions concerning the Commission's administration of the Freedom of Information Act. It is available at the Commission's home, regional and branch offices. Other educational publications are currently in production and are expected to be completed and distributed during the upcoming fiscal year.

A new consumer brochure, “How To Avoid Ponzi and Pyramid Schemes”, has been prepared and is in the process of being printed. It cautions investors about these schemes and suggests some ways of recognizing them. This brochure should be ready for distribution in early 1976.

ACTIVITY UNDER FREEDOM OF INFORMATION ACT

Amendments to the Freedom of Information Act were enacted into law on December 19, 1974. From an operations standpoint, the Commission had to quickly adjust its procedures and reassign manpower to cope with the flow of FOIA requests and the records administration problems that accompany such requests. The Commission on February 19, 1975, revised its own Freedom of Information rules to conform to the December 1974 amendments.

These revisions 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 and other information filed by registered companies has always been available

for inspection or copying by the public. However, the public was denied access to certain categories of material, notably investigatory records. Pursuant to various FOIA requests, during this fiscal year, the Commission has made available for public inspection many records which had traditionally been considered confidential.

Among these records are portions of the Broker-Dealer and the entire lnvestment Advisers and Investment Company Inspection Manuals, the Summary of Administrative Interpretations under the Securities Act of 1933 and the Commission's periodic Securities Violations Bulletin. Moreover, the Commission has made available, pursuant to particular FOIA requests, staff letters of comment on registration statements or other filings and Wells Committee submissions.

Between February 19, 1975, when the Commission revised its rules, and June 30, 1975, the close of the fiscal year, the Commission received 267 requests for information pursuant to the FOIA.

PERSONNEL MANAGEMENT

The permanent personnel strength of the Commission totaled 1,951 employees on June 30, 1975, as shown below:

Commissioners: 5
Headquarters Office Staff: 1,223
Regional Office Staff : 723
Total Staff: 1,946

Grand Total: 1,951

Recruitment

With only a small increase in staff, the Commission did not pursue its normal vigorous on-campus recruiting efforts, although it did continue active efforts to recruit secretarial and clerical employees. For professional positions, the Commission received an overwhelming number of applications from extremely well qualified candidates for the vacancies that did occur. The competition for all professional jobs has

been extremely keen and the credentials of the candidates outstanding.

Success of the Commission's Equal Employment Opportunity affirmative action program was most evident in its attorney staffing. At the close of the fiscal year, minority attorney employment stood at 33, up from 11 two years earlier, and female attorney employment reached 55, up from 24 at the end of fiscal year 1973.

The Civil Service Commission completed its nationwide review and inspection of the Commission's personnel management program with a visit to the Headquarters Offices during October and November 1974. Their written evaluation report had not been received by the end of the fiscal year.

The Commission's internal personnel management evaluation program was revised and updated in October 1974 in accordance with new civil service requirements. As an integral part of that program, the Office of Personnel also initiated a quarterly management reporting system, with statistical summaries of personnel activities in each unit being sent to the Regional Administrators and the Directors of the operating division and larger support offices.

Training and Development

With the addition of a full-time Employee Development Specialist to its staff, the Commission was able to expand its training and development activities during FY 1975.

The Tuition Support Program, under which employees who enroll in college degree programs receive tuition assistance for courses which relate to the Commission's work, was expanded, as were counseling services for employees taking courses under the program. The Career Opportunities Program, a basic skills program, graduated nine employees who were ready to move into typist positions. By the end of the year, four employees had already been placed in positions offering them greater career advancement and opportunities to use their new skills.

A 12-hour Personnel Procedure Class was inaugurated to introduce supervisors and managers to Commission policies and procedures as they pertain to personnel management. This class will be expanded next year into a 40-hour basic supervision class.

The emphasis on onsite technical staff training continued this year. Under a contract with the American Institute of Certified Public Accountants, six accounting courses were offered at the Headquarters Office for SEC accountants and persons

in related fields. The Regional Offices continued to offer 3-5 day seminars on enforcement and regulatory matters for their staffs and for those of Federal, State and local law-enforcement agencies in their areas. An integrated comprehensive training program for securities compliance examiners was instituted with developmental training programs for both SEC examiners and the examiners of the self-regulatory organizations; the program includes self-study and periodic seminars in regional offices. Seminars on investment company and investment adviser matters were held in two regional offices and in the Headquarters. Training guides were developed for the staff during the past year covering the taking of testimony in investigative proceedings and sanctions in SEC administrative proceedings.

An Executive Development program was developed and implemented to provide executive development training for employees at grades GS-16 and above and managerial training for employees at GS-14 and GS-15. Executives (GS-16 and above) are expected to attend one executive development course per year. Managers and their supervisors are expected to prepare Individual Development Plans to identify the on-the-job and formal training they need for performance on their assigned position and to maintain an overall high level of management expertise throughout the Commission. Funds also have been set aside for GS-14 and GS-15 employees who wish to apply to receive additional training to develop managerial skills.

OFFICE SPACE

The Office of Administrative Services provided assistance to the Los Angeles, Chicago and Atlanta Regional Offices and to the Houston and Philadelphia Branch Offices in gaining larger quarters, either through relocation or expansion of existing facilities.

Some progress was made in improving the Commission's presently unsatisfactory space arrangement in Washington, where Commission staff are scattered in three different locations and many offices are severely overcrowded. Both houses of Congress authorized the General Services Administration to obtain a new headquarters location for the Commission, but GSA's choice of an unsatisfactory site resulted in a time-consuming appeal to the Office of Management and Budget. At the close of the year it appeared likely that the Commission had successfully contested the selection of this proposed sight, but a decision as to an acceptable alternative appeared to be some months away.

FINANCIAL MANAGEMENT

Altogether, fees collected by the Commission in fiscal 1975 amounted to 54 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.

With reference to the fee schedule, on March 29, 1974, the Commission announced the repeal of certain provisions of Rule 203-3 under the Investment Advisers Act of 1940, which required each investment adviser to pay an annual fee to the Commission during the period of its registration. The Commission subsequently announced, in Release IA-486, that all fees affected would be refunded to those advisers and former advisers who paid them in any of the years in which the fee was imposed. The action was taken following the

Commission's consideration of recent decisions of the United States Supreme Court[3] with respect to the Independent Offices Appropriation Act of 1952, 31 U.S.C. 483(a), which was thought to provide the statutory basis for establishing these fees.

NOTES TO PART 8

[1]Telecommunications is an on-line technique whereby television-like display devices, called CRT terminals, are used to directly communicate with the computer facility.

[2]40th Annual Report, p. 139

[3]National Cable Television Association, Inc. v. United States, 415 U.S. 336 (1974); Federal Power Commission v. New England Power Co., 415 U.S. 345 (1974).