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U.S. House of Representatives
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Room 2125, Rayburn House Office Building
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February 10, 1987
CHAIRMAN'S OFFICE

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SEC. & EXCH. COMM.

The Honorable John S. R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N. W.
Washington, D. C. 20549

Dear Chairman Shad:

Pursuant to Rules X and XI of the Rules of the U.S. House of Representatives and our continuing oversight of the Nation's securities markets, the Subcommittee requests updated information on the status of the Commission's investigation in the matter of transactions in Washington Public Power Supply System (WPPSS) bonds in connection with the summer 1983 default of WPPSS on interest payments due on \$2.25 billion in outstanding bonds.

Recent complaints to the Subcommittee and press reports -- "Draft of SEC Report on WPPSS Default May Be Released Within Next 60 Days," Bond Buyer, Tuesday, December 9, 1986; "SEC Staff Meeting With The Lawyers For Various Targets of WPPSS Inquiry," Bond Buyer, Tuesday, January 20, 1987 -- have raised concerns that the Commission may not pursue enforcement action against members of the investment community (Wall Street underwriters, financial advisers, dealers, their trading departments and unit investment trusts, issuers, rating firms, bond counsel) but instead merely will issue administrative reports on the Commission's investigation.

If true, serious concerns are raised about the ability and willingness of the Commission vigorously to enforce the federal securities laws for the protection of investors. Available data suggests that, as a disruption of the municipal bond market, the WPPSS default is unmatched by any event since the Great Depression. The effect on investors to whom WPPSS bonds were retailed was in many cases devastating.

Serious questions have been raised, for example, about the misrepresentations and omissions in the so-called Official Statements prepared by WPPSS before each of the bond sales, the credit analyses prepared by John Nuveen & Co. in 1979 and the early 1980s, and similar reports prepared by Smith Barney, Blyth Eastman, and others.

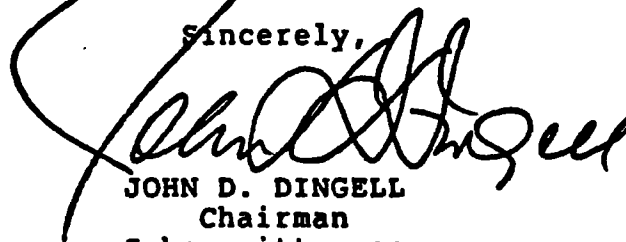
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February 10, 1987
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Merrill Lynch was lead manager in three of WPPSS's last five bond sales for Projects 4 and 5 and co-lead manager, along with Bache and Salomon Brothers Inc., in all five. Merrill Lynch's fixed-income research department issued a critical report in July 1981 entitled Washington Public Power Supply System: At the Crossroads (Sitzer and Karvelis 1981). The report discussed portfolio saturation; the likelihood that Plants 4 and 5 would be terminated; the serious difficulties involved in financing such a termination; the improbability of a state or federal bailout of the projects; new, much lower regional power-use growth forecasts; and the increasingly inhospitable political climate in Washington State. But the firm's sales staff aggressively marketed the bonds nonetheless. Reportedly the authors of the Crossroads report were told not to speak to the press and we are informed that they left Merrill Lynch shortly after the bond sale. Unit investment trusts such as the Municipal Investment Trust Fund, sponsored by Merrill Lynch, Dean Witter, Shearson, and Bache, bought and held increasingly heavy amounts of bonds through the early 1980s, thereby supporting the market for the bonds long after the denial of market access should have occurred, and accordingly denying individual investors the danger signal that an institutional dumping of WPPSS securities would have provided.

Please advise the Subcommittee whether any civil or criminal cases have been or will be filed as a result of your investigation. Identify any and all targets or their representatives who have been shown your draft report or advised of your enforcement intentions and provide us with copies of any and all Wells submissions received by and summaries of any oral presentations made to the Commission on their behalf. Advise what legislative or administrative changes the Commission would recommend to clarify or strengthen the legal responsibility of investment and rating firms for adequate disclosure and financial advice.

We appreciate your cooperation and prompt response to our request. We are desirous of seeing to it that the Commission has the necessary tools and that the appropriate regulations are in place so that the WPPSS situation will not be repeated.

Sincerely,



JOHN D. DINGELL
Chairman
Subcommittee on
Oversight and Investigations

Enclosures

cc: The Honorable Edward J. Markey
The Honorable Norman F. Lent