Suspension of Trading

MEMORANDUM

June 13, 1978

TO: William D. Moran
Regional Administrator

FROM: Edwin H. Nordlinger Edwin H. Nordlinger
Assistant Regional Administrator

RE: Suspension of Trading in a Security

On May 15, 1978, the U.S. Supreme Court ruled, in the case of S.E.C. v. Sloan, [Current] CCH Fed. Sec. L. Rep. Par. 96, 423 (U.S. Sup. Ct. May 15, 1978), that the Commission could not summarily suspend trading in a security longer than 10 days. Thus, the technique of "tacking" 10 day suspensions, one upon the other, can no longer be utilized by the Commission to suspend trading in a security for longer than one 10 day period.1/

Although two forms of longer suspension power are still available to the Commission, i.e., the 90 day summary suspension that requires presidential approval (Section 12(k) of the Act), and the 12 month suspension which must be preceded by notice, a hearing and findings of fact (Section 12(j) of the Act), these procedures are rarely utilized. There are, however, other possible means of preventing the resumption of trading upon expiration of the 10 day suspension period. These methods will be analyzed herein.

I. Limitations Upon Trading

1. Pursuant to an informal agreement between the Commission and the National Quotation Bureau ("NQB"), a security suspended from trading can not again be listed in the "pink sheets", either through the submission of a quotation or on a "name only" basis, unless the broker-dealer seeking such listing submits a Form 211 application to the NQB and meets one of the alternative conditions enumerated under Rule 15c2-11(a) under the Act. Each of these conditons ensures the availability of adequate current information about the issuer.

Reliance on this informal agreement would appear to represent a solution to the resumption of trading in a security which has been suspended from trading due to a deficiency in the issuer's reports or publicly available information, since the NQB will not publish a listing for that security.

1/ It should be noted that since 1976 the Commission voluntarily eliminated its practice of summarily extending the initial 10 day suspension period authorized by Section 12(k) of the Securities and Exchange Act of 1934 ("the Act").

2. If a security whose trading is suspended is listed on one of the major exchanges, and the Commission wishes to prevent such security from trading after the initial 10 day period, it usually advises the exchange of such fact, and the exchange will, on its own, prohibit the resumption of trading.

3. The available remedies consist of the filing of an injunctive action and/or the commencement of a suspension proceeding pursuant to Section 12(j) of the Act. Both of these procedures are time consuming and probably will not be in place at the cessation of the inital 10 day suspension period. The need for these remedies is mandated only if the issuer of the "manipulated" security is current in its reports and/or the broker-dealer can satisfy the conditions for resumed trading as enumerated in Rule 15c2-11 of the Act.

II. Effect of Sloan Case on Informal Agreement With NQB

The above informal agreement between the NQB and the Commission (see I.1. above) appears to have no legal basis and appears to unenforceable due to the fact that Rule 15c2-11 applies only to quotations made in an inter-dealer quotation system. A "name only" listing clearly is not a quotation since the Rule defines "quotation" as "any bid or offer at a specified price with respect to a security." (Rule 15c2-11(e)(3)). Thus, the agreement prevents trading when there is no apparent lawful justification for so doing.

This weak foundation underlying the informal agreement with the NQB is even more tenuous in the light of S.E.C. v. Sloan, supra. As stated above, the direct pronouncement by the Supreme Court in Sloan was that the Commission could not "tack" together 10 day suspensions to prevent trading in a security, but was limited in its suspension powers under Section 12(k) of the Act. The rationale for the decision is predicated upon due process considerations, i.e., to prevent trading in a security for a longer period, the Commission must afford notice and the opportunity to be heard. In the wake of Sloan, it would appear that the informal agreement with the NQB is unlawful since the Commission and the NQB are doing by indirection what cannot be done directly, i.e., indefinitely preventing trading in securities with no legal predicate for doing so under Rule 15c2-11 (or under any other statute, rule, or regulation) and without due process.

III. Prevention of Trading After Expiration of Suspension Period

Because the Commission can no longer suspend trading pursuant to Section 12(k) of the Act for more than a single 10 day period and because the Commission's informal agreement with the NQB is highly vulnerable to challenge, the only immediate remedy presently available to prevent the resumption of trading after the expiration of the suspension period is, as noted above, moral suasion. This influence can be made quite effective if the Commission, in issuing a release announcing a suspension, specifies the reason(s) for the suspension in greater detail than is presently done.

Broker-dealers wishing to trade in a recently suspended security (upon the lifting of the suspension) could then be referred to the release indicating the specific reason or reasons for the suspension and could be gently reminded about (1) their legal obligations under the "shingle" theory and (2) the Commission's view that market making in the absence of information is suspect, since such situation presents a ripe opportunity for fraud.

IV. Available Alternative

Seek legislation authorizing the Commission to summarily suspend trading in a security for periods in excess of 10 days, when it is in the public interest to do so.

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