UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

HOLDINGS OF U. S. GOVERNMENT SECURITIES, INC., Plaintiff, v. SECURITIES AND EXCHANGE COMMISSION, Defendant.	Civil Action No. 79-1032

MEMORANDUM OF POINTS AND AUTHORITIES OF THE SECURITIES AND EXCHANGE COMMISSION, DEFENDANT, IN SUPPORT OF ITS MOTION TO DISMISS THE ACTION OR, ALTERNATIVELY, FOR SUMMARY JUDGMENT.

PRELIMINARY STATEMENT

The Securities and Exchange Commission (the "Commission") submits this memorandum in support of its motion to dismiss the plaintiff's action or, in the alternative, for summary judgment.

This action arises out of an interim determination by the staff of the Commission not to exercise its delegated authority to declare effective a post-effective amendment to a registration statement filed by the plaintiff, Holdings of U. S. Government Securities, Inc. ("HUSGSI"), under the Securities Act of 1933, for the public offering of its securities. The staff declined to declare the amendment effective because HUSGSI had failed to disclose, in the post-effective amendment, material information relating to the subject matter of a Commission investigation involving HUSGSI and certain other affiliated companies and individuals.

The complaint seeks an order of this court (1) finding that the staff acted unlawfully in refusing to exercise its delegated authority to declare the amendment effective, and (2) compelling the staff to exercise its authority.

The Commission moves to dismiss this suit because HUSGSI has bypassed the administrative procedure for the processing of post-effective amendments established by Congress and the Commission. HUSGSI seeks to obtain relief from this Court without having resorted to, or exhausted, available administrative remedies. Specificially, HUSGSI has failed not only to appeal the staff's decision to the Commission, as was its undisputed statutory right, but also even to obtain a final staff determination. Plaintiff can point to no case in which a similar challenge to a staff determination not to declare a post-effective amendment effective has even been brought to the courts prior to exhaustion of the administrative process. Indeed, in a recent case, a mutual fund affiliated with HUSGSI unsuccessfully sought redress in the courts only after having obtained Commission review of a staff determination not to declare an amendment effective. See Fundpack, Inc. v. Securities and Exchange Commission, [Current Binder] CCH Fed. Sec. L. Rep. ¶96,755 (D. D.C. Jan. 20, 1979). Moreover, HUSGSI also failed to take advantage of an alternative statutory procedure — the filing of a new registration statement in lieu of a post-effective amendment. For reasons described at pages 16-19, infra, HUSGSI could have avoided the need to seek staff action if it had filed such a registration statement.

Assuming that this Court reaches the merits of HUSGSI's claim, the Commission should be granted summary judgment. The staff's determination with respect to HUSGSI's post-effective amendment was fully consistent with the proper and lawful exercise of its discretion not to declare a post-effective amendment effective in circumstances where the amendment fails to disclose material matters pertaining to an investigation raising serious questions as to the integrity of the management of an investment company.

Accordingly, the Commission moves this Court to dismiss this action or, in the alternative, to grant summary judgment in its favor.

STATUTORY BACKGROUND

As an open-end investment company, or mutual fund, continuously engaged in the offering and sale of securities to the public, the plaintiff is subject to registration, reporting and other requirements imposed by the Securities Act of 1933 1/ and the Investment Company Act of 1940. 2/ Both acts were designed to provide significant protections to persons who invest their capital in enterprises managed by others. The Securities Act requires full disclosure of the information necessary to enable the purchaser of a security intelligently to appraise the risks involved when making an investment decision. The Securities Act provides that when securities are sold to the public a registration statement must be filed with the Commission under that Act and must have become effective. The registration statement (and prospectus, which is part of the registration statement and is disseminated to investors) must contain complete and current financial and business information with respect to the issuer of the securities. 3/

The Investment Company Act provides additional investor protections, beyond the full disclosure requirements of the Securities Act, when the investor's interest takes the form of a participation in a fund or pool of securities. The Investment Company Act seeks, inter alia, to foster integrity in the management of investment companies, to permit greater participation by shareholders in the affairs of their companies, to provide shareholders with information concerning their companies, and to regulate certain practices involved in the sale of investment company shares. 4/

1/ 15 U.S.C. 77a, et seq.

2/ 15 U.S.C. 80a-1, et seq.

3/ See, Sections 4, 5, 7, 10 and Schedule A of the Securities Act, 15 U.S.C. 77d, 77e, 77g, 77j, 77aa.

4/ See Sections 10, 13, 15, 16, 17, 30 and 36 of the Investment Company Act, 15 U.S.C. 80a-10, 80a-13, 80a-15, 80a-16, 80a-17, 80a-29 and 80a-35.

Because mutual funds, unlike most other issuers, are continuously engaged in the offering and sale of securities to the public, Congress determined that such a company would be required to update periodically the information contained in its registration statement and prospectus as filed with the Commission by filing either a new registration statement or a post-effective amendment to its earlier registration statement. 5/ Specifically, once a prospectus becomes "stale" — that is, nine months have elapsed and the prospectus contains information, including financial information, more than 16 months old — such prospectus may not be used by an investment company until the information therein is updated in a post-effective amendment or new registration statement which has become effective. 6/ And, while a registration statement may become effective merely by lapse

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5/ Section 10(a)(3) of the Securities Act provides in pertinent part:

> "When a prospectus is used more than nine months after the effective date of the registration statement, the information contained therein shall be as of a date not more than sixteen months prior to such use, so far as such information is known to the user of such prospectus or can be furnished by such user without unreasonable effort or expense."

Section 24(e)(3) of the Investment Company Act provides, in pertinent part:

> "Except to the extent the Commission otherwise provides by rules or regulations as appropriate in the public interest or for the protection of investors, no prospectus relating to a * * * security issued by an open-end management company or unit investment trust which varies for the purposes of subsection (a)(3) of section [10 of the Securities Act of 1933] from the latest prospectus filed as a part of the registration statement shall be deemed to meet the requirements of said Section [10] unless filed as part of an amendment to the registration statement under said Act and such amendment has become effective."

Thus, a prospectus must be kept current within the meaning of Section 10(a)(3) of the Securities Act, and the only means for keeping prospectuses current for an open-end investment company is to file a post-effective amendment to its registration statement, unless a new registration statement is filed. If a non-current prospectus is employed, sales of securities by an issuer using such a prospectus would violate Section 5(b)(2) of the Securities Act, 15 U.S.C. 77(e)(b)(2), which makes it unlawful to sell any security, unless it is accompanied by a prospectus meeting the requirements of Section 10.

6/ See S. Rep. No. 1836, 83d Cong., 2d Sess. at 21 (1954).

of time, 7/ an amendment to a registration statement does not become effective until the Commission so determines. 8/

The Commission has delegated authority to its Division of Investment Management to determine the effective dates of amendments to registration statements filed by investment companies such as HUSGSI. 17 C.F.R. 200.30-5. 9/ In the present case, HUSGSI did not seek Commission review of the staff's determination not to declare the amendment effective, as it was entitled to do under Section 4-1 of the Securities Exchange Act, 15 U.S.C. 78d-1 10/. Thus, it is the preliminary action of the staff rather than a Commission decision which HUSGSI requests this Court to find unlawful.

The Commission and its staff have developed procedures to carry out in an efficient and timely manner the examination of registration statements and post-effective amendments. The objective of these procedures is to promote complete

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7/ Securities Act, Section 8(a), 15 U.S.C. 77(h)(a). See, n.19, infra.

8/ Securities Act, Section 8(c), 15 U.S.C. 77(h)(c):

> "An amendment filed after the effective date of the registration statement, if such amendment, upon its face, appears to the Commission not to be incomplete or inaccurate in any material respect, shall become effective on such date as the Commission may determine, having due regard to the public interest and the protection of investors."

9/ The delegation to the Division of Investment Management at 17 C.F.R. 200.30-5(b) is by reference to a provision which delegates authority to the Commission's Division of Corporation Finance. That provision, 17 C.F.R. 200.30-1(a)(1), delegates authority "[t]o determine the effective dates of amendments to registration statements filed pursuant to Section 8(c) of the [Securities] Act * * *."

10/ Section 4-1(b) of the Securities Exchange Act provides:

> "(b) With respect to the delegation of any of its functions, * * * the Commission shall retain a discretionary right to review the action of any such division of the Commission, * * * upon its own initiative or upon petition of a party to or intervenor in such action, within such time and in such manner as the Commission, by rule, shall prescribe: Provided, * * * That a person or party shall be entitled to review by the Commission if he or it is adversely affected by action at a delegated level which (1) * * * denies any request for action pursuant to * * * section 77h(c) of this title * * * [relating to post-effective amendments]."

and accurate disclosure of all material information in registration statements or amendments before the statement or amendment becomes effective and securities are sold to the public. The procedures involve the issuance of comments setting forth the deficiencies in the document by the Commission's staff, which has developed considerable expertise in securing complete and accurate disclosure. Companies typically respond to the staff's comments by filing amendments to their registration statements, or by discussing the matter with the staff (Declaration of Carolyn Uberman, ¶ 2). The Commission has described this process as follows:

> "If the filing appears to afford inadequate disclosure, as for example through omission of material information or through violation of accepted accounting principles and practices, the usual practice is to bring the deficiency to the attention of the person who filed the document * * * and to afford a reasonable opportunity to discuss the matter and make the necessary corrections." 11/

In some cases, the process of issuing and responding to comments is repeated several times before a registration statement or amendment contains adequate disclosure and is declared effective. This process has proved to be an effective mechanism for obtaining disclosure of all material information, and in virtually all cases involving post-effective amendments the process results in a determination by the staff to exercise its delegated authority to declare the filing effective (Declaration of Carolyn Uberman, ¶ 3). In this case, however, HUSGSI did not follow these procedures, and instead interrupted the comment process to commence this suit.

STATEMENT OF FACTS

On December 13, 1978, HUSGSI filed with the Commission a post-effective amendment to its registration statement under the Securities Act. The amendment was filed for the purpose of updating the financial statements and narrative information in HUSGSI's registration statement and to register additional securi-

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11/ 17 C.F.R. 202.3(a). Comments are not generally furnished "when the deficiencies appear to stem from careless disregard of the statutes and rules or a deliberate attempt to conceal or mislead * * *." 17 C.F.R. 202.3(a). See Boruski v. Division of Corporation Finance of the U. S. Securities and Exchange Commission, 321 F. Supp. 1273 (S.D.N.Y. 1971).

ties (Declaration of Carolyn Uberman, ¶ 4; Declaration of Roger Morris, ¶ 2).

At the time of HUSGSI's filing, the Commission was engaged in an investigation of possible violations of antifraud and other provisions of the securities laws by, among others, the management of HUSGSI, including its investment adviser and directors. By December 13, 1978, the investigation had produced, in the view of the Commission's Division of Enforcement, ample evidence that HUSGSI's management had committed a wide range of serious violations of these laws (Declaration of Kenneth G. Lay, ¶ 3). 12/

HUSGSI was not ignorant of the investigation, and was aware that the Commission's staff was about to recommend to the Commission the institution of an enforcement action involving HUSGSI's management and was also aware of the nature of the allegations against, inter alia, HUSGSI's management which the staff thought appropriate based on its investigation. Indeed, as early as June 26, 1978, almost six months before HUSGSI filed its amendment, and again on January 14, 1979, a member of the Commission's Division of Enforcement, in conversations with counsel for HUSGSI, described in considerable detail the investigation and the factual and legal matters which formed the basis for the impending staff recommendation (Declaration of Kenneth G. Lay, ¶ 4). But, the post-effective amendment filed by HUSGSI contained no disclosure of matters relating to possible violations of the federal securities laws which were the subjects of the Commission's investigation (Declaration of Carolyn Uberman, ¶ 5).

12/ The Commission's formal order of investigation, entered on March 10, 1978 (Attachment A to the Commission's present Motion (hereinafter the "Motion") named as subjects in the investigation The Fundpack, Inc. and Holding Trust, two mutual funds affiliated with HUSGSI; Fundpack Management, Inc., the investment adviser for all three mutual funds; and Fundpack Securities, Inc. and Mutual Funds Advisory, Inc., both broker-dealer subsidiaries of the investment adviser. However, the formal order was entered as a result of reports by members of the Commission's staff tending to show violations by the named parties "and others" of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. And, the Commission's order authorized "that a private investigation be made to determine whether the aforesaid persons or any other persons have engaged or are about to engage in any acts or practices of similar purport or object * * *."

In accordance with normal procedures, the Division of Investment Management reviewed HUSGSI's filing. On January 24, 1979, a staff member of the Division gave comments (which had been prepared in writing in advance) by telephone to counsel for HUSGSI (Declaration of Roger Morris, ¶3; Declaration of Carolyn Uberman, ¶ 6). These comments addressed deficiencies in the disclosure in both the narrative section and financial statements of the amendment. Because of its concern about matters uncovered in the Commission's investigation, the Division of Investment Management included among its comments a request for disclosure as follows:

> "Disclose any information you have, which you know to be true and which is material to an investment in HUSGSI, about matters pertaining to either Holding Trust, Fundpack, or HUSGSI which involve areas of concern covered by the staff's investigation of Holding Trust and Fundpack or which concern areas touched upon by prior Commission comments to any or all of the Funds."

(Declaration of Roger Morris, ¶ 4, 5; Declaraton of Carloyn Uberman, ¶¶ 7, 8).

On January 25, 1979, the staff discussed its comments, including the comment set forth above, during a telephone conversation with Victor H. Polk, chairman of the boards of HUSGSI, the two affiliated mutual funds and the investment adviser and the owner of 31 percent of the outstanding stock of the adviser. Mr. Polk, a person whose conduct was being investigated and ultimately a defendant in the Commission's enforcement action commenced as a result of the investigation, proclaimed ignorance of any information, relating to the investigation, which was material to an investment in HUSGSI (Declaration of Roger Morris, ¶ 6; Declaration of Kenneth G. Lay, ¶ 5).

On January 30, 1979, HUSGSI filed with the Commission a new post-effective amendment in response to the staff's comments. This amendment, which also contained no disclosure with respect to the investigation, was reviewed by the staff, and again comments were made pertaining to the narrative and financial disclosure. These comments were given by telephone to HUSGSI's counsel on February 2, 1979. Discussions about these comments ensued between the staff, Victor Polk, and HUSGSI' accounting firm, Mendive and Finkelstein, on February 5 and February 6, 1979. These discussions centered primarily around staff comments originally given to

HUSGSI on January 24, but which HUSGSI had not appropriately responded to in the amendment of January 30 (Declaration of Roger Morris, ¶¶ 7, 8, 9).

As a result of these discussions, the staff and HUSGSI resolved many of the issues raised in the comment process. At the conclusion of the discussions, the staff determined that HUSGSI had satisfactorily complied with all of its prior comments, except the comment relating to the matters revealed by the Commission's investigation (Declaration of Carolyn Uberman, ¶¶ 11, 12; Declaration of Roger Morris, ¶¶ 10, 11). In a conversation with the staff on February 9, 1979, Mr. Polk reiterated his original position that there was no information material to an investment in HUSGSI, concerning matters covered by the Commission's investigation, which should be included in HUSGSI's prospectus. The staff expressed its disagreement with Mr. Polk's conclusion (Declaration of Roger Morris, ¶12). At the time, as HUSGI's counsel was aware, the Commission's investigation was completed and the staff was preparing to recommend that the Commission institute an enforcement action against HUSGSI, its investment adviser and officers and directors and related individuals and entities (Declaration of Kenneth G. Lay, ¶ 6). The staff suggested that Mr. Polk review the matter carefully and stated that the staff stood ready to examine any disclosures which he would care to submit. But, since the staff was unable to determine that HUSGSI's amendment made complete and accurate disclosure of matters relating to possible violations of the federal securities laws which were the subject of the Commission's investigation, the staff determined that, as of February 9, it would not exercise its delegated authority to declare the amendment effective. Mr. Polk was informed of this determination. 13/ And, in light of Mr. Polk's position that no disclosure was appropriate, the staff indicated that it would present the matter to

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13/ The staff did not take the position, as alleged in the plaintiff's complaint (¶ IV.11.), that HUSGSI's post-effective amendment should not be declared effective "because of an ongoing private investigation." Rather, the staff refused to declare the amendment effective because of inadequate disclosure (Declaration of Roger Morris, ¶ 17; Declaration of Carolyn Uberman, ¶ 16). Nor was HUSGSI told, as implied in HUSGSI's complaint (¶ IV.10.), that "the post-effective is not incomplete nor inaccurate in any material respect on its face, and complies with the requirements of the statute." (Declaration of Roger Morris, ¶ 18; Declaration of Carolyn Uberman, ¶ 17).

the Commission for its consideration (Declaration of Carolyn Uberman, ¶ 13; Declaration of Roger Morris, ¶ 12).

Following the conversation of February 9, the Division of Investment Management began preparing a memorandum which was to have been submitted to the Commission for its consideration of whether HUSGSI's post effective amendment should be declared effective (Declaration of Roger Morris, ¶ 13). Before the memorandum was completed and submitted to the Commission however, events occurred which indicated that the matter need not be brought to the Commission's attention, because HUSGSI appreciated the need to revise its amendment. First, on February 15, 1979, HUSGSI submitted for the staff's consideration the following proposed disclosure with respect to the Commission's investigation:

> "At the request of its staff, the Securities and Exchange Commission has authorized a private investigation of the Fundpack, Inc., and Holding Trust, both of which are affiliated with HUSGSI. The investigation centers on those affiliated funds' policies with respect to portfolio turnover, advisory agreements and investment strategy. While the outcome of the investigation cannot be anticipated at this time, HUSGSI is not involved in the investigation and in the opinion of the management its affiliated companies have complied reasonably with all applicable rules of the Securities and Exchange Commission." 14/

Second, on February 22, 1979, in a conversation with members of the Division of Investment Management, counsel for HUSGSI acknowledged that more disclosure was appropriate in light of the proposed injunctive action. The Commission's Division of Enforcement had submitted, on February 16, 1979, its recommendation to the Commission that an injunctive action be instituted against HUSGSI and its affiliated entities and individuals (Declaration of Kenneth G. Lay, ¶ 7). Counsel for HUSGSI stated that it had been made clear to him that the proposed dis-

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14/ Declaration of Roger Morris, ¶ 14. Although subsequent events — i.e., the Division of Enforcement's recommendation to the Commission, and the Commission's authorization of an injunctive action — soon rendered this proposed disclosure obsolete, the disclosure was demonstrably deficient even when submitted. Contrary to HUSGSI's statement, HUSGSI was involved in the investigation, as were its officers, directors and investment adviser. Declaration of Kenneth G. Lay, ¶¶ 3, 4. In addition, the proposed disclosure failed to apprise prospective investors of the nature of the activities being investigated by the Commission.

closure submitted by HUSGSI on February 15, concerning matters covered by the private investigation of Fundpack and Holding Trust, was not adequate in light of the enforcement action which the Division of Enforcement was recommending to the Commission. The staff informed HUSGSI's counsel that because the disclosures submitted by HSUGSI were inadequate, there would be a need to revise the post-effective amendment. HUSGSI's counsel was also informed that the Commission was scheduled to consider, on February 27, 1979, the recommendation, made by the Division of Enforcement, for enforcement action, and that if HUSGSI submitted a new post-effective amendment while the Commission was considering the enforcement recommendation, it would be difficult for the staff to assess the adequacy of the disclosure. Accordingly, the staff recommended that HUSGSI should wait until the Commission made its determination with respect to the proposed enforcement action before submitting a new post-effective amendment. Counsel was also reminded that HUSGSI had the option of filing a new registration statement, which might become effective by lapse of time (Declaration of Carolyn Uberman, ¶ 14; Declaration of Roger Morris, ¶ 15). (See pp. 16-19, infra). Counsel thus recognized that the staff was waiting for the Commission to act on the enforcement recommendation and for HUSGSI to file a new post-effective amendment.

On February 28, 1979 the Commission authorized the institution of an injunctive action against HUSGSI, the two related mutual funds, and the investment adviser and officers and directors common to all three funds (Declaration of Kenneth G. Lay, ¶ 8). The complaint in the injunctive action was filed on March 21, 1979. The Commission's complaint (Attachment B to the Motion) alleges violations of antifraud, registration, reporting, proxy and fiduciary obligation provisions of the federal securities laws. The complaint seeks an order permanently enjoining the investment adviser, officers and directors of the funds, and others from serving or acting as directors, investment advisers, principal underwriters or in various other capacities for any registered investment company. The complaint also seeks the appointment of a trustee, who would, among other things, take possession of the three mutual funds, subject to the court's supervision.

Following the Commission's decision to institute the injunctive action, HUSGSI did not submit an updated amendment with disclosure relating to the injunctive action. Indeed, despite the apparent understanding of HUSGSI's counsel as of February 22 that the staff was waiting for HUSGSI to file a new post-effective amendment, HUSGSI did not even bother to consult further with the Division of Investment Management (Declaration of Carolyn Uberman, ¶ 15; Declaration of Roger Morris, ¶ 16).

Nor did HUSGSI exercise its statutory right, under 15 U.S.C. 78d-1 (see n. 10, supra), to appeal to the Commission the staff's preliminary determination not to declare effective the post-effective amendment. Rather than resorting to its administrative remedies — that is, submitting an updated amendment with disclosure of the allegation of the injunctive action for the staff's review and comments and, if necessary, appealing the staff's determination to the Commission — HUSGSI, on April 11, 1979, sought relief from this Court by instituting the present action.

ARGUMENT

I. THE ACTION SHOULD BE DISMISSED BECAUSE IT FAILS TO PRESENT FOR JUDICIAL RESOLUTION A FINAL REVIEWABLE DETERMINATION.

The central issue in this case is whether HUSGSI is required to exhaust its administrative remedies and to obtain a final Commission decision. The Commission recognizes that in certain circumstances (see n. 21, infra) a plaintiff may have a right to judicial review of a Commission determination with respect to a post-effective amendment. But, this case, which involves an effort to obtain premature review of a determination made by the Commission's staff, does not present a reviewable decision for this Court's consideration.

A. The Plaintiff Has Not Exhausted Its Administrative Remedies.

The courts repeatedly have criticized attempts, like the plaintiff's attempt in this action, to obtain judicial review of administrative action before all

administrative remedies have been exhausted. 15/ In Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 50-51 (1938), the Supreme Court recognized "the long settled rule of judicial administration that no one is entitled to judicial relief for a supposed or threatened injury until the prescribed administrative remedy has been exhausted." The rationale behind the exhaustion doctrine is that a court's refusal to intervene prematurely in the administrative process gives the agency an opportunity to apply its expertise and to exercise its discretionary powers. See McKart v. United States, 395 U.S. 185, 193-94 (1969). Moreover, "notions of administrative autonomy require that the agency be given a chance to discover and correct its own errors." Id. at 195. This protects the integrity of the administrative process and prevents litigants from flouting the agency's procedures. It also serves to conserve judicial energies and resources.

The rule requiring exhaustion of available administrative remedies applies with particular force where, as here, failure to require exhaustion would result in judicial review not contemplated by the federal securities laws. The Court of Appeals for the District of Columbia Circuit has recognized that "when Congress 'has enacted a specific statutory scheme for obtaining review, * * * the doctrine of exhaustion of administrative remedies comes into play and requires that the statutory mode of review be adhered to notwithstanding the absence of an express statutory command of exclusiveness.'" Nader v. Volpe, 466 F.2d 261, 268 (D.C. Cir. 1972), quoting Whitney National Bank v. Bank of New Orleans, 379 U.S. 411, 422 (1965).

There can be no doubt as to the proper route for challenging staff decisions at a delegated level under Section 8(c) of the Securities Act, relating to post-effective amendments. Congress authorized the Commission, in 15 U.S.C. 78d-1, to delegate authority to its staff, and provided that the Commission retain a discretionary right to review, upon its own motion or petition of a party, certain staff actions made pursuant to such delegated authority. With respect to

15/ See, e.g., Renegotiation Board v. Bannercraft Clothing Co., 415 U.S. 1 (1974); Airport & Diesel Equipment Corp. v. Hirsch, 331 U.S. 752 (1947); Neisloss v. Bush, 293 F.2d 873 (D.C. Cir. 1961).

post-effective amendments, however, review by the Commission is not discretionary; a person adversely affected by the staff's refusal to declare the amendment effective under Section 8(c) is granted an absolute right to Commission review of the staff's determination. 15 U.S.C. 78d-1(b). See n. 10, supra. Not until the Commission reviews the staff's decision and makes its determination, may judicial review be sought. This route gives the Commission the opportunity to oversee staff action prior to having to defend such action in the courts.

This suit involves a particularly flagrant attempt by HUSGSI to bypass the administrative process — a process HUSGSI initiated when it filed its post-effective amendment. HUSGSI has not only failed to pursue its undisputed statutory right to appeal staff action to the Commission but it has failed even to obtain a final staff determination.

When HUSGSI filed its post-effective amendment with the Commission, the staff reviewed the filing and issued its comments. Through the comment process and discussions between the staff and representatives of HUSGSI, all of the staff's comments were resolved except for one. And, following the telephone conversation with counsel for HUSGSI on February 22, 1979, see pp. 11-12, supra, the staff expected that HUSGSI would submit revised disclosure. HUSGSI, however, failed to submit additional disclosure, and, instead, commenced this action.

By seeking judicial review before it has obtained a final staff determination, not to mention a final decision of the Commission, HUSGSI has avoided the statutorily established route of review. The exhaustion doctrine applies here to ensure that the Commission has ample opportunity to examine and consider disclosure issues such as that involved here, to apply its expertise and exercise its discretion. By seeking judicial review before the administrative process is completed, HUSGSI has attempted to defeat this purpose.

B. There Are No Unique Factors Here Which Warrant An Exception From The Rule Against Judicial Intervention Prior To Exhaustion Of Administrative Remedies.

In "extreme instances" 16/ courts have reviewed preliminary or intermediate agency rulings prior to exhaustion of administrative remedies. As the Court of Appeals for this Circuit has observed, judicial intervention in non-final administrative proceedings has been restricted to cases in which there has been "a showing of patent violation of agency authority or manifest infringement of substantial rights irremediable by the statutorily-prescribed method of review * * *" Nader v. Volpe, 151 U.S. App. D.C. 90, 95, 466 F.2d 261, 266 (1972).

There are no unique factors in this case which would warrant an exception from the rule against judicial intervention prior to the exhaustion of administrative remedies. This case does not involve a significant constitutional question that requires immediate resolution. See Aircraft & Diesel Equipment Corp. v. Hirsch, 331 U.S. 752 (1947). Nor does this case involve agency action in "brazen defiance" 17/ of an explicit statutory prohibition. 18/ As we demonstrate below at pages 20-24, the staff's decision not to declare HUSGSI's post-effective amendment effective, even if viewed as a final reviewable decision, constituted a reasonable exercise of its statutory authority. Finally, HUSGSI has not shown the type of substantial and irreparable injury which cannot be alleviated through the use of the appropriate administrative remedies. See Renegotiation Board v. Bannercraft Clothing, 415 U.S. 1, 24 (1974). Indeed, although HUSGSI alleges that it "has been effectively put out of business" (Complaint ¶VI. 3.), it contradicts itself in the same sentence by stating that the staff's action has increased "the cost *** [of] processing business on behalf of the Fund's share-

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16/ Thermal Ecology Must Be Preserved v. AEC, 139 U.S. App. D.C. 366, 368 433 F.2d 524, 526 (1970).

17/ United States v. Feaster, 410 F.2d 1354, 366 (5th Cir.), cert. denied, 396 U.S. 962 (1969).

18/ Leedom v. Kyne, 358 U.S. 184 (1958); Touche Ross & Co. v. Securities and Exchange Commission, [Current Binder] CCH Fed. Sec. L. Rep. ¶96,854 (2d Cir. May 10, 1979).

holders." Morever, despite HUSGSI's urgent claims, it is significant that HUSGSI has not sought preliminary relief since filing this action.

II. HUSGSI HAS AVAILABLE THE STATUTORY ALTERNATIVE OF FILING A REGISTRATION STATEMENT AND ACCORDINGLY MAY NOT OBTAIN JUDICIAL REVIEW WITH RESPECT TO THE STAFF DECISION NOT TO DECLARE EFFECTIVE ITS POST-EFFECTIVE AMENDMENT.

Even if HUSGSI had sought review by the Commission of the staff's determination not to declare the amendment effective, judicial intervention in this case would still be inappropriate since there exists an alternative statutory procedure available to HUSGSI.

Although Section 8(c) of the Securities Act permits the Commission to exercise its discretion as to the declaration of effectiveness of a post-effective amendment, the Commission does not possess similar authority with respect to the effectiveness of a registration statement. The Securities Act provides that a registration statement shall become effective by lapse of time unless the Commission commences administrative proceedings pursuant to Section 8(b) or 8(d). 19/ Such proceedings include notice to the registrant and opportunity for a hearing on the record; and the Commission's determination therein is subject to judicial review.

19/ Securities Act Section 8(a), 15 U.S.C. 77h(a), provides:

> "Except as hereinafter provided, the effective date of a registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine, having due regard to the adequacy of the information respecting the issuer theretofore available to the public, to the facility with which the nature of the securities to be registered, their relationship to the capital structure of the issuer and the rights of holders thereof can be understood, and to the public interest and the protection of investors. If any amendment to any such statement is filed prior to the effective date of such statement, the registration statement shall be deemed to have been filed when such amendment was filed; except that an amendment filed with the consent of the Commission, prior to the effective date of the registration statement, or filed pursuant to an order of the Commission, shall be treated as a part of the registration statement."

Under Section 8(a), a registration statement filed with the Commission becomes effective after twenty days, as a matter of course, unless the registrant files amendments to that statement. Any pre-effective amendment filed to the registration statement extends the effective date to twenty days from the date of the amendment's filing. The Commission can prevent the regis-

(footnote continued)

Here, HUSGSI contends that it has been denied due process of law (Complaint ¶VI. 2.), presumably because it has been deprived of the formal notice and hearing protections which are available under Sections 8(b) and 8(d). Section 8(c), limited as it is to the consideration of post-effective amendments, permits less formal procedures. However, an issuer dissatisfied with the Commission's determination not to declare such amendments effective, may, at any time, file a registration statement pursuant to Section 8(a) of the Act. And, if the Commission seeks, pursuant to Section 8(b) or Section 8(d) of the Act, to prevent the statement from becoming effective, the company will be entitled to the panoply of procedural rights afforded by those sections.

That the filing of a new registration statement serves as an adequate alternative remedy is demonstrated by a recent decision of this Court, Fundpack, Inc. v. Securities and Exchange Commission, [Current Binder] CCH Fed. Sec. L. Rep. ¶96,755 (D.D.C. Jan. 20, 1979). In that case, The Fundpack, Inc. and Holding Trust, the two companion funds of HUSGSI, brought suit alleging that the Commission had wrongfully refused to declare effective post-effective amendments to their registration statements. However, while their lawsuit against the Commission was pending, each of the plaintiffs filed a new registration statement for its securities under Section 8(a). The Commission did not seek to exercise its authority to prevent or suspend the effectiveness of those registration statements. The Court concluded that the "plaintiffs no longer have any cognizable claim of injury" resulting from the Commission's refusal to declare the amendments effective, and dismissed the action as moot. In the present case, HUSGSI

19/ (footnote continued)

tration statement from automatically becoming effective by instituting proceedings and issuing a refusal order under Section 8(b), 15 U.S.C. 77h(b), or a "stop order" under Section 8(d), 15 U.S.C. 77(h)(d). See also Las Vegas Hawaiian Development Co. v. Securities and Exchange Commission, [Current Binder] CCH Fed. Sec. L. Rep. ¶96,829 (D. Haw. Mar. 13, 1979). Because most registrants wish to lessen the likelihood of such proceedings, they file "delaying amendments" extending the effective date until staff review is completed and comments are furnished, a process which usually requires more than twenty days. See 17 C.F.R. 230.473.

has not offered an adequate explanation for its failure to pursue this alternative avenue of relief. 20/

The Fundpack decision is consistent with the well-settled principle that equitable relief is appropriate only in the absence of an adequate remedy at law. As with the Fundpack case, "[t]he gravamen of [HUSGSI's] complaint appears to be that [it] will suffer irreparable injury without an adequate remedy at law as a result of the [staff's] action in withholding a declaration of effectiveness of the pending amendment[ ] and in refusing to afford [it] notice and a hearing." Fundpack, Inc. v. Securities and Exchange Commission, supra, at 94,961. But, Fundpack clearly demonstrates the lack of merit of this claim.

Thus, even assuming that HUSGSI had taken the steps outlined in Point I above, and assuming that it had obtained a final determination of the Commission not to permit the post-effective amendment to become effective, the same principle of conserving judicial resources — which is at the heart of the exhaustion doctrine — operates to require that HUSGSI file a new registration statement, if such an alternative is practicable. 21/ See Myers v. Bethlehem Ship-

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20/ In its complaint, HUSGSI alleges that it would have been impracticable for it to file a new registration statement. This claim, however, is based upon a misconception of the requirements of the securities laws with respect to financial statements.

HUSGSI correctly notes that new registration statements filed with the Commission must contain financial statements dated within 90 days of the date of filing (see Item 25 of Schedule A of the Securities Act, 15 U.S.C. 77aa; Item 2 of Securities and Exchange Commission Form S-5, 2 CCH Fed. Sec. L. Rep. ¶ 7172), but incorrectly assumes that these statements must be audited. HUSGSI's post-effective amendment, filed on December 13, 1978, contained audited year-end financial statements dated July 31, 1978. HUSGSI appears to argue that it filed a post-effective amendment, rather than a new registration statement, to avoid the cost of a second audit (Complaint ¶ IV.8). But HUSGSI's belief that a second audit would have been required is in error. HUSGSI could have fully complied with all the requirements for new registration statements by submitting the audited year-end financial statements together with unaudited interim financial statements dated within 90 days of the filing date. See Item 25 of Schedule A of the Securities Act, supra; Item 2 of Securities Exchange Commission Form S-5, supra. See also n. 23, infra. The preparation of unaudited financial statements should create no undue burden for HUSGSI (Declaration of Lawrence A. Friend, ¶ 7).

21/ In some circumstances, the filing of a registration statement might not be practicable. For example, an issuer might obtain an adverse decision from the Commission with respect to a post-effective amendment at a time when its

(footnote continued)

building Corp., 303 U.S. 41, 50-51 (1938); Moore v. City of East Cleveland, 431 U.S. 494, 521-31 (1977) (Burger, C.J., dissenting).

III. THE COMMISSION'S STAFF, IN DECLINING TO DECLARE EFFECTIVE THE POST-EFFECTIVE AMENDMENT OF HUSGSI, DID NOT ABUSE ITS DISCRETION.

Even if the preliminary staff decision here involved were a final reviewable decision, this case should still be resolved in the Commission's favor because the staff's decision was a rational one.

A. The Standard of Review In This Court: Whethe The Commission's Staff Had A Rational Basis for Declining To Declare the Post-Effective Amendment Effective

Under Section 10(e)(2)(A) of the Administrative Procedure Act, 5 U.S.C. 706(2)(A), the standard of review of discretionary administrative action is whether such action was "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." 22/ As the court made clear in Texaco, Inc. v. Federal Energy Administration, 531 F.2d 1071, 1077 (Em. App., 1976), certiorari denied, 426 U.S. 941 (1976), "the burden is on the objectors to demonstrate * * *" that the agency acted improperly. In addition, as the Court of Appeals for this Circuit stated in Ethyl Corp. v. Environmental Protection Agency, 176 U.S. App. D.C. 373, 406, 541 F.2d 1, 34 (1976), certiorari denied, 426 U.S. 941

21/ (continued)

prospectus would become stale before a registration statement could become effective. If such an issuer would choose to cease selling securities rather than continue selling with an outdated prospectus, it may be able to show that judicial review of the Comission's decision is necessary in order to prevent possible irreparable injury.

22/ Section 10(e)(2)(A) provides in pertinent part:

"To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret consitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall —

* * *

(2) hold unlawful and set aside agency action, findings, and conclusions found to be —

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law * * *."

(1976) (citations omitted) (emphasis supplied):

> "This standard of review is a highly deferential one. It presumes agency action to be valid. * * * Moreover, it forbids the court's substituting its judgment for that of the agency * * *, and requires affirmance if a rational basis exists for the agency's decision."

As is set forth in detail below, we submit that the Commission's staff had a "rational basis" for declining to declare the post-effective amendment of HUSGSI effective.

B. The Staff's Decision Was A Rational One.

In contrast to registration statements, which may become effective by mere lapse of time (see n. 19, supra), post-effective amendments become effective only following a Commission determination that

> "* * * such amendment, upon its face, appears to the Commission not to be incomplete or inaccurate in any material respect * * * having due regard to the public interest and the protection of investors."

Securities Act Section 8(c), 15 U.S.C. 77h(c).

The staff first declined to declare HUSGSI's amendment effective because HUSGSI failed to make disclosure of the subject matter of the Commission's investigation as it directly related to the integrity of HUSGSI's management. Subsequently, when an injunctive action was instituted, HUSGSI failed to revise its disclosure to reflect this material development. The investigation and enforcement action were properly deemed by the staff to be of significance to public investors. The Commission has alleged that the members of the mutual fund complex of which HUSGSI is a member, and management of the complex, violated antifraud, registration, reporting, proxy and fiduciary obligation provisions of the federal securities laws. See ¶¶1 to 8 of the Commission's complaint (attachment B to the Motion). Although not each member of the fund complex is alleged to have violated each of these provisions, the Commission has alleged that HUSGSI itself has employed materially false and misleading materials, in violation of Section 10(b) of the Securities Exchange Act (Commission Complaint ¶¶ 31 to 64). Also, the Commission has alleged that HUSGSI violated various provisions of the Investment Company Act.

And significantly, the Commission has alleged that the funds' investment adviser has engaged in a pervasive scheme of self-dealing to enrich itself at the expense of the funds, and that the funds' directors have failed diligently to discharge their duties consistent with their fiduciary obligations to the funds (see Commission Complaint ¶30).

Closely related as they were to the adequacy of HUSGSI's disclosure in its post-effective amendment, the securities law violations which were being investigated and which were thereafter alleged by the Commission were highly relevant to the staff's consideration of the amendment. 23/ The staff's refusal to declare the amendment effective followed from its awareness of information reflecting adversely on the adequacy of HUSGSI's disclosures. The amendment failed to describe the investigation (and ultimately the legal proceedings brought by the Commission), and the relief sought by the Commission. In these circumstances, the staff could not determine either that the amendment "* * * upon its face, appear[ed] * * * not to be incomplete or inaccurate in any material respect, * * *" or that HUSGSI's amendment should be declared effective "* * * having due regard to the public interest and the protection of investors." See Securities Act Section 8(c).

HUSGSI appears to contend that the staff's reasons for withholding a declaration of effectiveness are improper because they are not apparent upon the "face" of the post-effective amendment. (See Complaint ¶¶ IV.9, 10). Such a view misconstrues the Commission's function pursuant to Section 8(c) of the Securities Act.

The statutory phrase "upon its face" should not be construed, as HUSGSI contends, to circumscribe the Commission's authority to "look behind" the bald statements of a post-effective amendment in order to assess the accuracy or completeness of the amendment. Rather, Section 8(c) permits the Commission to engage only in cursory review of of the "face" of the amendment when circumstances

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23/ The management integrity issue, in particular, was of importance for investors given the control — and commensurate opportunity for abuse — exercised by an investment adviser over the highly liquid assets of an investment company such as HUSGSI. See Tannenbaum v. Zeller, 552 F.2d 402, 405-406 (2d. Cir., 1977), cert. denied, 434 U.S. 934 (1977).

so warrant — but does not prevent the Commission from supplementing its review with other available information which may reflect adversely on the accuracy or adequacy of the amendment. In an early proceeding after enactment of the Securities Act, 24/ the Commission raised questions with respect to the treatment of certain transactions as reflected on the balance sheet of a company which had filed a post-effective amendment with the Commission. Following a hearing before an examiner at which evidence was adduced as to the nature of the transactions, the Commission determined that, because the amendment was "incomplete and inaccurate in material respects, it follows pursuant to Section 8(c) of the Act that we cannot permit it to become effective, * * *." 25/ The Commission thus supplemented, with collateral evidence, the information on the face of the registrant's post-effective amendment in order properly to discharge its obligations under section 8(c). 26/

An affirmative finding that a post-effective amendment "upon its face, appears * * * not to be incomplete or inaccurate in any material respect * * *" is implicitly embodied in every Commission determination of effectiveness of such an amendment. Unless the Commission is entitled to acknowledge the existence and relevance of material facts and information available to it, but not set forth

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24/ In the Matter of General Income Shares, Inc., 1 S.E.C. 110 (1935).

25/ Id. at 114. See also, In the Matter of the London Town Manufacturing Company 41 S.E.C. 676 (1963); Loss, Securities Regulation (2d ed) at 292 n.82.

26/ Cf. In the Matter of Red Bank Oil Company, 20 S.E.C. 863 (1945), where the Commission rejected an assertion, in a stop order proceeding pursuant to Section 8(d) of the Securities Act, that, prior to the effective date of a registration statement, the exclusive method available to the Commission for challenging a registration statement is a "refusal order" proceeding subject to Section 8(b). The Commission held that because of both the express language of the statute (limiting its consideration to the "face" of a registration statement) and the "severe time limitations" imposed upon it in a proceeding under Section 8(b) — which must be completed within twenty days after the filing of the registration statement — Section 8(b) was intended to be used only when the inadequacy of the registration statement was plain on its face (20 S.E.C. at 865). In contrast to Section 8(b), however, Section 8(c) prescribes no such severe time limitations and does not preclude the Commission from considering other possible material omissions from and misstatements in a post-effective amendment.

explicitly in an amendment which it examines, the Commission would be prevented from meaningfully evaluating the amendment. In this case the Commission's staff was unable to make the required finding because it knew of the likelihood of an enforcement action against HUSGSI and the basis therefore — information which prevented an affirmative determination that the amendment appeared "not incomplete or inaccurate." HUSGSI's construction of the statute would require the Commission to disregard any and all information reflecting adversely on the accuracy of the disclosure contained in an amendment, but not set forth explicitly in the document. This construction would render the amendment review process a sham and would result in Commission findings that post-effective amendments upon their face "appeared" not to be incomplete or misleading when the Commission had good reason to believe there were material misstatements in the documents. Such a result would be inconsistent with the Commission's statutory obligation to have "due regard for the public interest and the protection of investors" in considering whether a post-effective amendment should become effective. 27/

The Commission staff's determination that it would not exercise its discretion to declare the post-effective amendment of HUSGSI effective was thus clearly within its statutory authority. The determination, which was based upon the staff's inability to find that adequate disclosure was being made, was a rational one and did not constitute an abuse of discretion.

27/ In 1968, the Investment Company Institute proposed certain amendments to S. 1659, a bill introduced in the 90th Congress to amend the Investment Company Act. Among these amendments was a proposal to amend Section 24(e)(3) so that post-effective amendments filed by investment companies would become effective, like registration statements, twenty days after filing.

In a memorandum to Senator Sparkman (Attachment C to the Motion) the Commission opposed this amendment (which was not enacted) on the grounds that it would upset the existing procedure which "has worked well" and "the practical effect of the proposal would be that the quality of disclosure to purchasers of investment company securities would decline to some extent, or that more frequent use of expensive, time-consuming and disruptive administrative proceedings would become necessary, or both."

CONCLUSION

For the foregoing reasons, this action should be dismissed or, alternatively, summary judgment should be granted in favor of the Commission.

Respectfully submitted,

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