

Suspension

INFORMATIONAL MEMORANDUM

TO : The Commission
FROM : The Division of Enforcement
RE : Delinquent Reports Program

July 3, 1979

I. Background

This memorandum is in response to certain questions raised by Commissioner Karmel in connection with the Division's recommendation on the Emergency Calendar for Thursday, July 5, regarding two suspensions of trading and companion civil injunctive actions pursuant to the Delinquent Reports Program. Recently, the Division has attempted to orally explain its practices to the Commission. This memorandum is an attempt to memorialize those discussions.

The Commission has followed the policy over the past several years of initiating single 10-day suspensions of trading in securities listed on a national securities exchange or actively traded in the over-the-counter market because their failure to file an annual report or other periodic reports required under the Securities Exchange Act of 1934 ("Exchange Act") which has resulted in a lack of current adequate and accurate information about their financial condition and/or operating results.^{1/}

The purpose of such 10-day suspensions is to alert shareholders, public investors, broker-dealers and others to the fact that these registrants are delinquent in making required filings with the Commission and therefore the benefits of the comprehensive disclosure requirements of the Exchange Act, including audited financial statements, may not be available to the investing public.

Shortly after it initiated the Delinquent Reports Program, the Commission issued Release 34-10214 (copy attached) which expressed its concern with the failure by many issuers who are subject to the periodic reporting requirements of the securities laws to comply with those requirements and stated its belief that strict compliance with these requirements is essential to the maintenance of fair and orderly trading markets. It also warned that:

^{1/} In order to maintain an effective delinquency program, in appropriate circumstances the Commission couples this action with the institution of civil injunctive actions against the delinquent registrants.

"In appropriate instances, the Commission will consider temporarily suspending trading in securities of delinquent issuers, in order to alert the public to the lack of adequate, accurate and current information concerning such issuers." 2/

In accordance with this policy, the Division of Enforcement on June 28, 1979 submitted a Memorandum to the Commission recommending summary suspension of trading of one issuer (DeTomaso Industries, Inc.) which was approximately 90 days delinquent in filing its Annual Report for 1978 and 45 days delinquent in filing its Quarterly Report on Form 10-Q for the first quarter of 1979 and requesting authority to suspend trading in the securities of another similarly delinquent registrant (Western Preferred Corporation) if it should fail to file its Annual Report on Form 10-K by July 3, 1979. The Division also recommended that the Commission grant it authority to bring a civil injunctive complaint against those registrants in view of their chronic histories of delinquency.

II. The Importance of Timely Filing
to the Objectives of the Act

The Commission explained the critical importance of timely filing to the preservation of free, fair and informed securities markets in the Introductory Note to Rule 12b-25 under the Act, as follows:

"The disclosures required in reports filed with the Commission are essential to the preservation of free, fair and informed securities markets. It is of critical importance that such reports be furnished within the time they are required to be filed under the Commission's rules..."

2/ Release 34-10214, (June 11, 1973). According to the Commission's Annual Reports for the years 1974-1977 the following numbers of registrants were suspended in each fiscal year for this reason:

1974 nearly 200

1975 approximately 30

1976 70

1977 111 (Also includes suspensions for securities transactions suggesting possible manipulation or other violation.)

The significance of the Act's reporting provisions was explained as follows in the Committee Report of the House Committee which considered the Act in 1934:

"No investor...can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys and sells. The idea of a free and open market place is built on the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price... (T)he hiding and secreting of important information obstructs the operation of the markets as indices of real value.... The disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values, truth does find relatively quick acceptance in the market.... Delayed, inaccurate, and misleading reports are the tools of the unconscionable market operator and the recreant corporation official who speculates on inside information....

The reporting provisions of the Securities Exchange Act are a very modest beginning to afford...long denied aid...in the way of securing proper information for the investor. 3/

The Congress that passed the Exchange Act "regarded (the reporting requirements) as the minimum which is requisite for the adequate protection of investors."4/ The timely filing of required reports is essential to achieving one of the fundamental objectives of the Act--"to insure the maintenance of fair and honest markets in securities transactions..." 5/ As the Commission looks to the Form 10-K Annual Report as the key document in an integrated disclosure system, the importance of timely filing becomes even more critical.

3/ H.R. Rep. No. 1383, 73rd Cong., 2d Sess., 11-13 (1934). See also S. Rep. No. 1455, 73rd Cong., 2d Sess., 68, 74 (1934).

4/ S. Rep. No. 792, 73rd Cong., 2d Sess. 11 (1934)

5/ Exchange Act, Section 2.

III. Authority to Suspend Trading

The Commission's authority summarily to suspend trading for 10 days was originally limited by former Section 19(a)(4) of the Exchange Act to securities listed on national exchanges. This authority was extended in 1964 to securities traded in the over-the-counter market by the enactment of former section 15(c)(5) of the Act. In 1975, these two provisions were consolidated in present Section 12(k) of the Act, which states:

"If in its opinion the public interest and the protection of investors so require, the Commission is authorized summarily to suspend trading in any security (other than an exempted security) for a period not exceeding ten days." 6/

As indicated, this authority may be exercised if the Commission concludes that public interest and the protection of investors so require. 7/

The Senate Committee Report with respect to former Section 15(c)(5) strongly supports the Commission's policy of suspending trading where there is a lack of current adequate and accurate information about the registrant. It indicates that the Commission may temporarily suspend trading when some corporate event has made informed trading impossible and has created conditions in which investors are likely to be deceived. It states that trading would be allowed to resume "as soon as there has been adequate disclosure and dissemination of the facts material to investment decision." The pertinent language of the Senate Report is as follows:

"New paragraph (5) of section 15(c) would permit the Commission temporarily to suspend trading when fraudulent or manipulative practices of the issuer or other persons have deprived an over-the-counter security of a fair and orderly market, or when some corporate event has made informed trading impossible and has created conditions in which investors are likely to be deceived. Trading would be allowed to resume as soon as there has been adequate disclosure

6/ Exempted securities include those issued or guaranteed by federal, state, or local governments, interests in certain kinds of trust funds, and other securities specifically exempted by the Commission.

7/ CF. SEC v. Sloan, 98 S.Ct. 1702 (1978).

and dissemination of the facts material to investment decision." 8/

IV. Operation of the Delinquent Reports Program

The Division of Enforcement attempts to monitor compliance with the periodic reporting requirements of Sections 13(a) and 15(d) of the Exchange Act through examination of computer runs of delinquent registrants and of Form 12b-25 applications for extensions and of time to file periodic reports and through reviews of updated lists of delinquent registrants regularly submitted by the American Stock Exchange.

The goals of the program are:

1. to monitor registrants in order to promptly detect delinquencies;
2. to insure that prompt enforcement actions are taken when appropriate; and
3. to update Commission files to reflect the current filing status of various registrants.

The program places the highest priority upon compliance by those registrants whose securities are listed on a registered national securities exchange. Surveillance of registrants whose securities are quoted on the NASDAQ quotation system and traded in the over-the-counter market is next and, those registrants whose securities are quoted in the National Quotation Bureau's "Pink Sheets" at a bid price of one dollar or more are also included.9/

8/ Senate Report No. 379, 88th Cong. 1st Sess. 1963, p.26.
CF. House Report No. 1418, 88th Cong. 2d Sess. 1964, p.24.

9/ As the Commission is aware, the Division, along with other offices in the Commission, is actively engaged in developing a cumulative delinquent list which would enable the Commission to publish a monthly listing of all registrants who are delinquent in filing at least one annual report on Form 10-K. It is hoped that publication of such a list would diminish reliance on trading suspensions to alert the market place to delinquencies in filing required reports. Currently, there are several hundred registrants that are being traded at prices less than \$1 with delinquencies. The Division recently has not been recommending suspensions of these securities.

The Division utilizes the standards set forth below in determining whether to recommend a trading suspension for delinquent reports. Failure to file at least one Annual Report on Form 10-K is the present criteria for considering a suspension recommendation when the registrant's securities are traded on an exchange such as the NYSE and Amex, are quoted on NASDAQ, or are actively traded in the OTC market where there is a quoted market of \$1 or more. Factors such as the reasons for delay, the date the registrant expects to file, the registrant's historical record of delinquency and whether or not a delinquent registrant has made public its current financial condition and operating results by news release or otherwise would also have a bearing on the Division's recommendation. Depending on the registrant's filing record and the particular circumstances of each case, the Division may recommend that the Commission institute civil injunctive actions in order to compel a registrant to file delinquent reports and to obtain such other equitable relief as may be appropriate under the circumstances, including an injunction against further violations.

When the staff determines that a registrant is delinquent and that there is a sufficient trading market in its securities the Branch of the Division of Corporation Finance to which the registrant is assigned is consulted. The staff also telephones the Chief Financial Officer, the President or other responsible Executive of the registrant and a representative of the registrant's auditor to ascertain that the registrant is in fact subject to the reporting requirements of the Exchange Act and is delinquent, the reasons for the delay, the date the registrant expects to file and whether the registrant has published any financial information or operating results by news release otherwise. Often several calls are made and registrant's counsel may become involved.

When the staff has determined that it may be appropriate to recommend enforcement action, it sends the registrant a telegram confirming that it has a reporting responsibility is delinquent in filing at least one Form 10-K annual report or Form 10-Q Quarterly Report and that the staff is considering recommending enforcement action to the Commission.

The Commission has frequently indicated that it has found this program to be effective. For example, in its 1975 Annual Report the Commission told Congress:

"During fiscal 1975, the Commission suspended trading in the securities of 118 companies, a decrease of 59% from the 279 securities 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."10/

Conclusion

The lack of current adequate and accurate information about a registrant's financial condition and operating results seriously impairs the effective functioning of our securities markets. The Commission's ability to react quickly to a delinquency through a single 10-day trading suspension, sometimes in conjunction with civil injunctive actions, helps make more credible the Commission's reporting requirements and protects the public against entering into securities transactions on the basis of insufficient, inadequate and untimely information. The Division believes that its administration of this rather modest program has been responsible and that the current standards being applied are appropriate.

TLevine	51520
EHerlihy	51508
JHartigan	51660
LMendelson	51686

10/ SEC 1975 Annual Report, p. 102.

Attachment

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 10214/June 11, 1973

SECURITIES ACT OF 1933
Rel. No. 5402/June 11, 1973

INVESTMENT COMPANY ACT OF 1940
Rel. No. 7856/June 11, 1973

**COMMISSION EXPRESSES CONCERN WITH FAILURE
OF ISSUERS TO TIMELY AND PROPERLY FILE
PERIODIC AND CURRENT REPORTS**

The Securities and Exchange Commission today expressed its concern with the failure by many issuers who are subject to the periodic reporting requirements of the federal securities laws to comply with those requirements. The reporting requirements, which are designed to provide public investors with the financial and other information necessary to make informed investment decisions, are among the most important elements of the full disclosure policy of the federal securities laws.

The Commission believes that strict compliance with these requirements is essential to the maintenance of fair and orderly trading markets. For this reason, the Commission has directed its staff to monitor closely compliance with these reporting provisions. In appropriate instances, the Commission will consider temporarily suspending trading in securities of delinquent issuers, in order to alert the public to the lack of adequate, accurate and current information concerning such issuers. Brokers and dealers are reminded that no quotation may be entered at the conclusion of such a temporary suspension without strict compliance with the provisions of Securities Exchange Act Rule 15c2-11 requiring the availability of specified financial and other information. In addition, the Commission may institute court actions or administrative proceedings to compel the filing of delinquent reports and/or to enjoin future violations of the reporting requirements. Further, the Commission may refer appropriate cases to the Department of Justice for criminal prosecution.

The Commission reminds issuers that reports are deemed filed with the Commission upon receipt at the Commission's headquarters in Washington, D.C. In order to assist the Commission in processing these reports, it is requested that they be delivered or mailed to Room 130, 500 North Capitol Street, N.W., Washington, D.C. 20549, which is the Commission's central receiving facility.

The Commission also reminds issuers that there are provisions under the federal securities laws relating to requests for extensions of time within which to file reports. Issuers having questions relating to requests for such extensions of time should communicate with the Commission's Division of Corporation Finance.