administer oaths, examine the issuer, the underwriter or any other person with respect to the examination and to require certain financial information.

B. Suspension of Registration

Section 12(j) of the Exchange Act authorizes the Commission to suspend the effective date, suspend for a period not exceeding twelve months, or to revoke the registration of a security, if it finds after notice and opportunity for hearing that the issuer of such security has failed to comply with any provision of the Exchange Act or any rules or regulations promulgated thereunder. That section further prohibits broker-dealers from effecting any transaction in, or to induce the purchase or sale of any security the registration of which has been and is suspended or revoked.

C. Suspension of Trading

Section 12(k) authorizes the Commission to suspend trading in any security if the public interest and the protection of investors so requires. The absence of accurate information concerning the financial condition of an issuer has been the basis for trading suspensions.

D. Section 15(c)(4) Proceedings

Section 15(c)(4) provides that if the Commission finds, after notice and opportunity for hearing, that any person subject to the provisions of Sections 12, 13 and subsection (d) of Section 15 of the Exchange Act or any rule or regulation thereunder has failed to comply with any such provision, rule or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person to comply with such provision or such rule or regulation thereunder upon such terms and conditions within such time as the Commission may specify in such order.

E. Reports of Investigation

1. Authority

In pertinent part, Section 21(a) of the Exchange Act provides:

"The Commission is authorized in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this title, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates."

2. Commission Practice With Respect to Section 21(a) Reports

a. In March 1979, the Commission issued a release concerning its practices with respect to the issuance of reports of investigation and the issuance of statements submitted to the Commission by persons pursuant to Section 21(a). (Securities Exchange Act Release No. 34-15664, March 21, 1979). In that release, the Commission stated in part:

> At least since 1940, the Commission has issued Section 21(a) reports where significant issues of public concern, widespread investor impact, or other important matters relating to the federal securities laws were present.

b. The Commission remarked that in authorizing the issuance of reports of investigation, Section 21(a) also authorizes the Commission to "permit any person to file with it a statement in writing * * * as to all the facts and circumstances concerning the matter to be investigated." Commenting on this provision, the Commission stated:

> "The Commission will utilize this process where it appears to be appropriate in the public interest and the special circumstances of the case. Thus, the Commission may allow persons who have been involved in investigative proceedings, as part of the process of resolving their involvement in the investigation, to submit statements in acceptable form with the expectation

that the Commission may make the statements public. In most cases these statements would describe the principal aspects of the matters investigated, discuss the the roles of the persons making the statements in those matters, and present any representations such persons may wish to make with regard to their furture conduct. The acceptance by the Commission of such a statement should not be interpreted as acquiescence by the Commission in the assertions set forth therein.

"The Commission intends to utilize this practice in a limited number of instances where it will help the Commission in administering its responsibilities under the federal securities laws. The Commission believes that this practice will make available information and provide disclosure in a simple and effective way."

c. This release concerning reports of investigation was issued in connection with In Re Albert's Inc., */ Securities Exchange Act Release No. 34-15665 issued March 21, 1979.

F. Civil Injunctive Actions

1. Authority

The Commission is authorized by Section 20(b) of the Securities Act and Section 21(d) of the Exchange Act to seek injunctive relief. Both sections authorize the Commission to bring an action for injunctive relief whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the relevant act.

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*/ Commissioner Karmel dissented from the determination of the Commission to the issuance of the statement for the reasons set forth in her statement which was contained in the release.

Section 21(e) of the Exchange Act, in part, provides that upon application of the Commission the district courts shall have jurisdiction to issue writs of mandamus, injunctions and orders commanding any person to comply with the provisions of the Exchange Act and the rules and regulations promulgated thereunder or any undertaking contained in a registration statement as provided in subsection (d) of Section 15.

2. Standards for the Issuance of Injunctions

a. The relevant sections also provide that "upon a proper showing a permanent or temporary injunction or restraining order shall be granted."

b. In the context of an action for a permanent injunction the courts have construed "proper showing" to require proof of a past violation and a reasonable likelihood of future violations. SEC v. Commonwealth Chemical Securities, Inc. 574 F.2d 90 (2d Cir. 1978).

c. The Commission, in seeking a statutory injunction in the public interest, has not been required to demonstrate traditional requirements for equitable relief such as irreparable harm. SEC v. Management Dynamics Inc., 515 F.2d 801 (2d Cir. 1975); SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082 (2d Cir. 1972).

d. The Commission is also not required to identify particular purchasers or sellers. The existence of a market for the security is sufficient for an enforcement action. SEC v. National Securities Inc., 393 U.S. 453 (1969); United States v. Naftalin, 441 U.S. 768 (1979). Accordingly, the concept of standing as considered in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) is not relevant to a Commission action.

3. Equitable Relief

a. In addition to injunctive relief, the Commission has often sought further equitable relief in its enforcement actions. In granting such relief the courts have utilized the inherent equitable powers of a court of

equity. In SEC v. Manor Nursing Centers, Inc. 458 F.2d 1082, 1103 (2d Cir. 1972) the court stated "[o]nce the equity jurisdiction of the district court has been properly invoked by a showing of a securities law violation, the court possesses the necessary power to fashion an appropriate remedy."

In financial disclosure cases the Commission has sought equitable relief designed to prevent a recurrence of the violative conduct alleged in the Commission's enforcement actions. Specific types of equitable relief include the restatement of financial stateents, prohibitions on culpable parties from serving as officers or directors of publicly-held companies in the future, the establishment of special committees of the board of directors such as audit or litigation committees comprised of outside directors; appointment of a special agent to conduct an investigation into conduct alleged in the Commission's complaint and the preparation of a report of investigation and identification of legal actions available to the corporation, and disgorgement of funds improperly diverted by officers and directors.

PART B

FAILURE TO DISCLOSE SELF-DEALING, PERQUISITES AND OTHER RELATED PARTY TRANSACTIONS

I. INTRODUCTION

A. One of the principal purposes of the federal securities laws is to assure that corporate management is fulfilling its fiduciary and stewardship responsibilities with regard to corporate assets and to provide a mechanism by which public investors may evaluate whether or not management is fulfilling such responsibilities.

B. The mechanisms provided by the federal securities laws include both the disclosure and anti-fraud provisions of the Securities Act and Exchange Act.

II. LEGISLATIVE HISTORY AND DEVELOPMENT OF THE COMMISSION'S POSITION

A. In 1934, Congressman Lea of California addressed the importance of disclosures concerning related party transactions with management when explaining one of the purposes of the Exchange Act:

> "[I]n recent years we have seen the directors of corporations without the knowledge of their stockholders, voting themselves vast bonuses out of all proportion to what legitimate management would justify. We have had revelations of salaries paid to directors and officers of great corporations which showed shameful management; which showed that the men in charge of some of these corporations were more concerned in managing its affairs for their own benefit then for the benefit of the stockholders."
>
> "The question of the integrity of the management of the corporation is involved; the question of the prudence of the investment represented by the stock is involved." 78 Cong. Rec. 7861-62.

B. Commission Pronouncements

1. The Franchard Decision

a. In a Commission stop order proceeding, the Commission emphasized the importance of disclosures to shareholders with regard to self-dealing, related party transactions and other matters relating to management's integrity. In the Matter of Franchard Corporation, 42 SEC 163, 169-170 (1964).

b. "Of cardinal importance in any business is the quality of its management. . . . Evaluation of the quality of management - to whatever extent it is possible - is an essential ingredient of informed investment decisions. A need so important cannot be ignored, and in a variety of ways, the disclosure requirements of the Securities Act furnish factual information to fill this need."

2. The 1976 Report to the Senate Banking Committee

a. In its May 1976 Report to Congress on "Questionable and Illegal Corporate Payments and Practices", the Commission commented that disclosure of financial relationships and data are not the only matters of importance to shareholders:

> "Disclosure requirements also should facilitate an evaluation of management's stewardship over corporate assets. In this context, investors should be vitally interested in the quality and integrity of management. A number of factors - including the background of a director nominee, changes in management, conflicts of interest, the identity of promoters, interlocking directors and officers, special benefits to management and certain stockholders and management's outside interests - are relevant to these concerns. Disclosure of these matters reflects the deeply held belief that the managements of corporations are stewards acting on behalf of the shareholders, who are entitled to honest use of, and accounting for, the

> funds entrusted to the corporation and to procedures necessary to assure accountability and disclosure of the manner in which management performs its stewardship.
>
> Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices submitted to the Committee on Banking, Housing and Urban Affairs, United States Senate, May 1976.

3. Commission's 1977 Release on Management Remuneration

In 1977 as the result of several enforcement actions brought by the Commission related to non-disclosures of perquisites, the Commission thought it was necessary to express its views in a release:

> "Full disclosure of remuneration is necessary to informed voting and investment decisions. . . because of the substantial influence of management in determining its remuneration. In addition, a determination of the value of any new securities being offered and of any securities already owned, an analysis of the use of corporate funds and assets and an assessment of the value of management to a corporation necessitate the presentations of complete remuneration information."

The Commission further emphasized that:

> "existing disclosure provisions of the Securities Acts require registrants to disclose in registration statements, reports and proxy and information statements all forms of remuneration received by officers and directors. Salaries, fees, bonuses and certain other forms of remuneration must be included within the aggregate remuneration reported. In addition, personal benefits by management from the corporation, including certain benefits sometimes referred to as "perquisites" may be forms of remuneration which should be included within the remuneration reported."

4. Commission's 1978 Release

In 1978, the Commission in an interpretative release reaffirmed its commitment to assuring disclosure of remuneration:

> ". . .registrants should keep in mind that full disclosure of the remuneration received by officers and directors is important to informed voting and investment decisions. In particular, remuneration information is necessary for an informed assessment of management and is significant in maintaining public confidence in the disclosure system."

Securities Act of 1933 Release No. 5904 issued February 6, 1978, 14 SEC Doc. 101.

III. STATUTORY AND REGULATORY FRAMEWORK

A. Securities Act of 1933

The purpose of the Securities Act is to "provide full and fair disclosure of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." In furtherance of these purposes Section 7 of the Act requires every registration statement registering securities with the Commission to contain information specified in Schedule A.

1. Schedule A. requires, among other things, the disclosure of the financial and operating condition of the company and the quality of management, conflicts of interest, remuneration, the interests of management in certain transactions and certain corporate loans to management. [see Items 14, 18-20, and 24-25.]

Item 14 of Schedule A requires the disclosure of "the remuneration, paid or estimated to be paid by the issuer or its predecessor directly or indirectly, during the past year and ensuing year to (a) the directors or persons performing similar functions and (b) its officers and any other persons naming them wherever such remuneration exceeded $25,000 during any such year."

2. The Commission's Interpretation - In the Matter of Franchard Corporation, 42 SEC 163 (1964)

a. In a "stop-order" proceeding the Commission found that three registration statements of the issuer were materially deficient for failing to disclose that the company's controlling shareholder and chief executive officer had used substantial amounts of corporate funds for his personal use in private ventures and had pledged his control stock to secure loans.

(1) The Commission stated that the failure to disclose the controlling shareholder's self-dealing was a departure from the requirements of Item 20 of Form S-1 which required disclosure of material interests of management in transactions involving the corporation.

(2) The Commission stressed that the omissions which reflected upon the controlling shareholder's ability, rendered misleading the affirmative statements made in the registration statements concerning the controlling shareholder's reputation, inasmuch as his ability and reputation were principal inducements for the public offerings of Franchard stock.

(3) The Commission further stated that, even though the controlling shareholder's diversions of corporate assets never exceeded 1.5% of the total of the company's assets, the omissions regarding self dealing were material because such information was "germane to an evaluation of the integrity of his management.

3. American Trailer Rentals Company, 41 SEC 541, 544 (1963)

In this stop order proceeding, the Commission held that a registration statement was false and misleading in that it failed to disclose, among other things, transactions of the company's officers and directors with affiliated companies, misuse of corporate funds, and, accordingly, issued a stop order.

4. Atlantic Research Corporation, 41 SEC 732, 757 (1963)

In this stop order proceeding, the Commission suspended the effectiveness of a registration statement because of, inter alia, the non-disclosure, as loans, of payments made by the registrant for construction costs relating to improvements on the estate of one of its co-founders, principal officers and shareholders.

B. Securities Exchange Act of 1934

1. Section 12(b)(1) of the Exchange Act requires a filing with the Commission of a registration statement (on Form 10) with respect to the security containing such information as the Commission may specify relating to, among other things, the remuneration of directors, officers, underwriters and security holders of more than 10% of any class of an issuers equity securities, as well as material contracts between those persons and the issuer.

2. The Commission has exercised it rulemaking authority under the Exchange Act to require registrants to report in various registration statements, annual reports and proxy and information statements the amount of remuneration paid or to be paid by the registrant to each of its directors and certain officers and other persons, and in addition, certain transactions between such persons and the issuer.

3. Prior to the integration of the disclosure requirements of the Securities Act and the Exchange Act through the adoption of Regulation S-K [Securities Act Release No. 5893 issued December 23, 1977, 13 SEC Doc. 1217], and the subsequent unification in 1978 of the disclosure requirements concerning officers and directors [Securities Act Release No. 5949 issued July 28, 1978, 15 SEC Doc. 428], management remuneration, perquisites, indebtedness to, and transactions with, the issuer were required to be disclosed in Items 16 through 19 of the Annual Report on Form 10-K and Items 7, 9, 10 and 11 of Schedule 14A. [See, inter alia, Securities Act Release No. 2887 issued December 18, 1942.]

4. With the adoption of S-K unifying the disclosure requirements, and certain later amendments to such requirements [Securities Act Release No. 6003 issued December 4, 1978, 16 SEC Doc. 321], uniformity and standardization of the specific disclosure rules and regulations was accomplished for the most part.

a. Further refinement of Regulation S-K has resulted in a separation of the disclosure requirements as follows: Item 401 - Directors and executive officers; Item 402 - Management remuneration and transactions; Item 403 - Security Ownership of certain beneficial owners and management; and Item 404 certain relationships and related transactions. [See Securities Act Release No. 6441 issued December 2, 1982 (adoption of Item 404 of Regulation S-K); Securities Act Rel. No. 6449 issued February 1, 1983 (proposed amendments to Item 402 of Regulation S-K)]

5. Section 13(a) of the Exchange Act and the Rules Thereunder

Section 13(a) requires issuers of securities registered pursuant to Section 12 to file with the Commission current information and annual and other periodic reports containing such information as the Commission may prescribe.

a. Annual Report on Form 10-K

(1) The Annual Report on Form 10-K required to be filed by Section 12 issuers contains four parts. Part III requires the issuer to disclose information cerning its officers and directors. Item 11, entitled "Management Remuneration and Transactions," requires the issuer to set forth information required by Item 402 of Regulation S-K (§229.402).

(2) Effective July 1, 1983, Item 13 of Form 10-K, entitled Certain Relationships and Related Transactions, requires the issuer to furnish information specified by Item 404 of Regulation S-K (§229.404).

(a) It should be noted that the General Instruction G(3) of Form 10-K allows an issuer to incorporate by reference the information required by Part III of Form 10-K from the issuer's definitive proxy statement filed pursuant to Regulation 14A.

(b) Of course, general concepts of materiality as expressed in Rule 12b-20 also apply. Rule 12b-20 provides that: "In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading."

6. Section 14(a) of the Exchange Act and Rules 14a-3 and 14a-9 thereunder

Section 14(a) of the Exchange Act prohibits the solicitation of proxies in contravention of rules and regulations prescribed by the Commission.

a. Regulation A and Schedule 14A set forth the disclosure requirements of the material to be used for the solicitation of proxies in compliance with Section 14(a). Among the provisions are:

(1) Item 6 - Director and Executive Officer requires disclosure of information required by Item 401 of Regulation S-K (§229.401), certain specified relationships between the nominee or director and the issuer as well as any other similar relationships.

(2) Item 7 - Remuneration of Directors and Officers requires disclosure of remuneration paid to Directors and Executive Officers as required by Item 402 and Instruction 4 to Item 103 of Regulation S-K.

b. Again, general concepts of materiality should be applied. Rule 14a-9 provides that:

"(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

IV. COURT DECISIONS CONCERNING SELF DEALING, PERQUISITES AND RELATED PARTY TRANSACTIONS

A. In recognition of the importance of the quality and integrity of management, Courts have often held that the failure to disclose payments, transactions and conflicts of interest which have inured to the benefit of management in such forms as kickbacks, perquisites, tax deductions, and advantageous business dealings, in proxy solicitation materials, Commission reports, and registration statements, violates the provisions of the federal securities laws. In many such cases, the courts have ordered appropriate injunctive and ancillary relief.

B. Criminal Cases

1. U.S. v. Pope, 189 F.Supp. 12 (SDNY 1960)

In a criminal prosecution for violations of Section 24 of the Securities Act and Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, an indictment charged officers and directors of a publicly held company with misstatements and omissions of material facts "in registration and proxy statements filed under the Acts and in proxy solicitations with regard to transactions between the publicly held company and other corporations in which the defendant officers and directors had an interest.

The defendant moved to dismiss the indictment upon the grounds that both the indictment and the Securities Act were vague. The Court upheld the constitutionality of the statutes and denied the defendant's motion.

2. U.S. v. Dixon, 536 F.2d 1388 (2d Cir. 1976)

The defendant, the president of a publicly held company, was charged with soliciting proxies in violation of the Commission's disclosure requirements contained in Schedule 14A and violating Section 13(a) of the Exchange Act by failing to disclose in the proxy soliciting materials and in the Annual Report on Form 10-K loans to the defendant during the fiscal year. The defendant was further charged with violations of the mail fraud statute by having devised "a scheme to deny the SEC information to which it was entitled and to solicit proxies in violation of its rules by reason of the failure of the proxy materials to contain the required information concerning the defendant's indebtedness.

A jury found the defendant guilty of all charges. The defendant was sentenced to one year imprisonment and a $10,000 fine. On appeal, the Court of Appeals for the Second Circuit upheld the conviction of the violations of the securities laws and found that the defendant had the requisite state of mind, but reversed the conviction based upon the mail fraud statute. The Court found that the defendant had an intention to deceive and acted knowingly and willfully when he caused the books of the corporation to show his own debts as those of his father and others. The Court's decision, however, with regard to the charge of mail fraud, was predicated on the Court's belief that the mere use of the mails to solicit proxies by a false and misleading proxy statement was insufficient to constitute a violation.

3. U.S. v. Stirling, 571 F.2d 708 (2nd Cir. 1978)

In this criminal prosecution, former officers and directors of Stirling Homex Corporation ("Homex") were convicted of securities and mail fraud, and conspiracy in connection with sales

of Homex stock. Among the specific violations was Section 17(a) of the Securities Act. The violations were based upon the failure to disclose, among other things, certain transactions and "cozy" relationships between Homex and its labor union in registration statements filed with the Commission covering the public offering of common and preferred stock.

Among the transactions which the defendants failed to disclose was certain preferential stock sales to union officials, aided by loans arranged and guaranteed by officers of Homex, at less than market value and subsequent repurchase of the stock from the officials at greater than market value. In addition, Homex funds were used to pay the interest due on the loans to the labor officials.

In rejecting the defendant's claim that compelling them to disclose such illegal activities would violate their fifth amendment privilege against self incrimination, the Court stated:

> "We have no doubt that the securities laws are essentially noncriminal and regulatory and that self reporting is essential to the fulfillment of the central purpose of the statutory scheme. . .
>
> Appellants chose to engage in a lawful activity [maintenance of good labor relations] in an unlawful manner. That unlawfulness cannot now be used to excuse them from regulatory disclosure requirements, even though such disclosures could lead to criminal prosecution under other schemes."

4. U.S. v. Fields, 592 F.2d 638 (2d Cir. 1978)

In this criminal action in which the federal district court dismissed and struck substantial portions of a securities fraud indictment because of, among other things, a failure to state a violation of law, the Court of Appeals for the Second Circuit held that a kickback scheme involving certain officers and