

Other Litigation and Legal Activity

The Office of General Counsel provides legal services to the Commission concerning its law enforcement, regulatory, legislative, and adjudicatory activities. The office represents the Commission in appeals and in defense of civil litigation, and provides technical assistance to Congress on legislative initiatives.

What We Did

- Played a lead role in advising the Commission on the scope of its emergency powers in the wake of the September 11, 2001 terrorist attacks.
 - Played a significant role in:
 - revising the Commission’s auditor independence rules;
 - developing rules to define the scope of the Gramm-Leach-Bliley Act’s functional exceptions from broker-dealer registration for certain bank securities activities; and
 - developing interagency rules to implement the Commodity Futures Modernization Act.
-

Significant Litigation Developments

Oral Contracts and Options; Misrepresentation of Intent to Honor Option

In *Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc.*,¹²⁵ the Supreme Court held, as the Commission had urged in its friend of the court brief, that granting an oral option to buy stock while secretly intending never to honor the option is fraud that violates section 10(b) of the Securities Exchange Act of 1934 (Exchange Act). The Court rejected the defendants' arguments that section 10(b) does not cover oral contracts and that a secret reservation not to permit the exercise of an option falls outside the scope of section 10(b).

Fraud "in connection with the purchase or sale of any security"

In *SEC v. Zandford*,¹²⁶ the Commission argued in its petition for Supreme Court review that, contrary to the court of appeals' decision,¹²⁷ a stockbroker's fraud was committed "in connection with the * * * sale of any security," and therefore in violation of Exchange Act section 10(b), when he sold his customer's securities for his own benefit and used the proceeds for himself, without disclosure to his customer and authorization. The petition also argued that the court of appeals' decision conflicts with the Supreme Court's decision in *Superintendent of Insurance v. Bankers Life & Cas. Co.*,¹²⁸ which held that section 10(b) covered the fraudulent misappropriation of the proceeds of a sale of securities, and the decision of the Court of Appeals for the Ninth Circuit in *United States v. Kendrick*,¹²⁹ in which a securities salesman was held criminally liable under section 10(b) for pledging a customer's securities as collateral for loans to the customer's account and then converting the funds to his own use. The Supreme Court has granted review, and the case is pending.

Municipal Securities Underwriter's Duty of Care

In *SEC v. Dain Rauscher, Inc.*,¹³⁰ the court of appeals reversed the grant of summary judgment for a defendant, who was the lead investment banker for a series of municipal bond offerings. The defendant, following what he claimed was the standard practice in the industry, failed to investigate, or disclose to investors, the risks of the offerings. The court of appeals held that while the industry standard is one factor to be considered, it is not determinative. Rather, the standard of care for an underwriter of municipal offerings is one of reasonable prudence. More specifically, the court held that the defendant had a duty to make an investigation that would provide him with a reasonable basis for a belief that the key representations in the official statements provided to investors were truthful and complete.

Insider Trading

In *United States v. Falcone*,¹³¹ the court of appeals agreed with the Commission's friend of the court brief that a stockbroker who obtained advance notice of the contents of *Business Week's* "Inside Wall Street" column through an employee of the magazine's wholesaler and traded on the information was not too "remote" in the chain of distribution of the magazine to have owed a duty of confidence to *Business Week*. The court of appeals held that the stockbroker had a duty not to trade on that information because *Business Week* communicated the need for confidentiality to its distributor, which in turn communicated it to the wholesaler, which accepted and enforced the confidence, and the stockbroker received the information with knowledge that he was getting it in breach of the confidentiality obligation.

In *SEC v. Lipson*,¹³² a case against the chief executive officer and chairman of the board of a public company, the Commission argued that the jury was correctly instructed that, when a corporate insider trades in stock of his company while in the possession of inside information, a fact-finder may infer from the possession that

he used the information, although the defendant may rebut the inference if he shows he had a pre-existing plan to trade the same amount of stock on the same date. The appeal is pending.

Definition of a Security

In *SEC v. SG Limited*,¹³³ the court of appeals reversed a summary judgment granted in favor of the defendant, the promoter of an Internet “virtual stock exchange.” The court agreed with the Commission that one of the “virtual securities” on the defendant’s website met the elements of an investment contract, and was therefore a security under the federal securities laws, even though the defendant had called the security a game.

In *Caiola v. Citibank, N.A.*,¹³⁴ the Commission filed a friend of the court brief arguing that an option on a security that is settled by payment of cash (instead of by delivery of the underlying security), and is exercised automatically at expiration if the option is in the money, is an “option” as that term is used in defining “security” in the Exchange Act. The Commission also explained that the Commodity Futures Modernization Act of 2000 (CFMA) did not remove options on securities from the definition of security. This appeal is pending.

Interim Investment Advisers for Mutual Funds

In *Navellier v. Sletten*,¹³⁵ the court of appeals agreed with the Commission’s friend of the court brief that rule 15a-4 under the Investment Company Act, which authorizes the directors of a mutual fund to retain an interim investment adviser for the fund pending a shareholder vote, does not require a finding that an emergency or other exigent circumstances make such a vote impractical. The court also agreed that rule 15a-4 was a valid exercise of the Commission’s exemptive authority under the act.

Antitrust Immunity

In a friend of the court brief in *Friedman v. Salomon Smith Barney*,¹³⁶ the Commission urged that antitrust liability based on an alleged conspiracy to stabilize the price of newly offered securities through the practice of “privilege revocation” was preempted by the Commission’s pervasive regulation of the offering process in general, and of stabilization in particular. The appeal is pending.

In contrast, in a friend of the court brief in *In re Stock Exchanges Options Trading Antitrust Litigation*,¹³⁷ the Commission had urged that conduct that violated a Commission rule that was intended to provide for competition is not immune from antitrust liability. The district court disagreed with the Commission’s position, and the decision is on appeal.¹³⁸

Class Action Attorney Fees

In *Wolff v. Cash 4 Titles*,¹³⁹ the Commission filed a friend of the court brief urging that a request for attorney fees of up to 25% of the settlement of a class action was excessive where the class action had been settled jointly with an action brought against the same defendants by a receiver appointed in a Commission enforcement action. The Commission argued that the receiver and Commission staff performed most of the work leading to the settlement, and that the fee requested by the class counsel would give them a windfall and would directly reduce the amount to be returned to defrauded investors by the receiver. The Court agreed that the work warranted awarding lower fees to the class counsel, and set the award at 17% of the settlement fund to the class counsel. The receiver has received permission from the judge presiding over the Commission’s enforcement action to appeal on the grounds that 17% is excessive.

Private Rights of Action Under the Securities Act of 1933

In friend of the court briefs in *McKowan Lowe & Co., Ltd. v. Jasmine, Ltd.*¹⁴⁰ and *Lee v. Ernst & Young*,¹⁴¹ the Commission argued that standing to sue under section 11 of the Securities Act of 1933 (Securities Act) for misrepresentations in a registration statement is granted to all who purchase the registered securities, including secondary market purchasers, and is not limited to those who purchase in the offering. These appeals are pending.

In *In re Safety-Kleen Bondholders Litigation*,¹⁴² the Commission's friend of the court brief, filed at the request of the district court, took the position that there is no liability under section 11 or section 12(a)(2) of the Securities Act on the part of the initial purchasers of securities that are issued pursuant to the exemption from registration in rule 144A under the Securities Act, then re-sold by the initial purchasers to qualified institutional buyers, and then exchanged by those buyers with the issuer for registered securities. The district court subsequently granted the motions of the defendant's initial purchasers to dismiss the buyers' claims under these provisions.

Insider Reporting and Short-Swing Profits Liability Under Section 16 of the Exchange Act

In *Morales v. Quintel Entertainment, Inc.*,¹⁴³ the court of appeals agreed with the Commission's friend of the court brief, that in appropriate circumstances a lock-up provision may demonstrate an agreement to hold or dispose of securities, and thus may make the shareholders agreeing to the lock-up provision a group whose shares should be aggregated for the purpose of determining whether the 10% threshold of section 16 has been crossed.

In *Levy v. Southbrook International Investments, Ltd.*,¹⁴⁴ the Second Circuit held, as urged by the Commission in a friend of the court brief filed at the request of the court, that a conversion cap that denies a preferred stockholder the right to convert his shares

into common stock if the conversion would result in the holder owning more than 4.9% of the outstanding common stock, prevented the investor from becoming the beneficial owner of more than 10% percent of an issuer's common stock under section 16, even if the shareholder might serially acquire and dispose of more than 10% of the common stock within a short period of time.

Litigation under the Private Securities Litigation Reform Act

The Commission addressed the state of mind pleading standard under the Private Securities Litigation Reform Act of 1995 (PSLRA) in a friend of the court brief filed in *Caprin v. Simon Transportation Services*.¹⁴⁵ Consistent with its position in other circuits, the Commission urged the position that the pleading standard does not eliminate recklessness as a basis for liability and that, in interpreting the pleading standard, courts should rely upon the pre-PSLRA Second Circuit tests, under which a plaintiff may allege facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness or facts that show that the defendant had both a motive and an opportunity to commit fraud. This appeal is pending.

In *In re Cendant Corp. Litig.*,¹⁴⁶ the court of appeals agreed with the Commission's positions, in its friend of the court brief, that: (1) the PSLRA envisions a lead plaintiff that is active in selecting and supervising lead counsel; (2) competing lead plaintiff candidates should not be appointed "co-lead plaintiffs;" (3) a proposed lead plaintiff group should be forthcoming with information about the group, be properly constituted, and be limited to a small size so as to function as a single unit; and (4) district courts should resort to an auction to select and set a fee schedule for lead counsel only where the lead plaintiff is unable or unwilling to perform its role (including where the process is tainted by political contributions).

The Commission also addressed the PSLRA's lead plaintiff provisions in friend of the court submissions in *Lee v. Ernst &*

Young, In re Oxford Health Plans, Inc. Sec. Litig., and *In re PRI Automation, Inc. Sec. Litig.*¹⁴⁷ In *Lee*, the Commission argued that the district court has the power to appoint a replacement lead plaintiff even when the originally appointed lead plaintiff is later held to lack standing and no other class member filed an original complaint in the case or moved to be lead plaintiff within the first 60 days during which the PSLRA contemplates appointment of the initial lead plaintiff. In *Oxford*, the Commission urged the court of appeals to permit an interlocutory appeal of the district court's order certifying as class representatives competing lead plaintiff candidates the court erroneously appointed as "co-lead plaintiffs" at the outset of the case. In *PRI*, the Commission discussed standards for evaluating proposals for a lead plaintiff "group" and for multiple lead counsel. The *Lee* and *Oxford* matters are pending.

Variable Annuities Under the Securities Litigation Uniform Standards Act

In *Lander v. Hartford Life & Annuity Co.*,¹⁴⁸ the court of appeals agreed with the Commission's friend of the court brief, filed at the request of the court, that because variable annuities are securities issued by a registered investment company, they fall within the plain meaning of "covered security" under the Securities Litigation Uniform Standards Act of 1998. That statute generally preempts state fraud law class actions involving the sale of covered securities, such as the case before the court. Therefore, the court of appeals ruled that case should be dismissed.

Motions to Vacate Permanent Injunctions

In *SEC v. Coldicutt*,¹⁴⁹ the Ninth Circuit affirmed the rejection of Coldicutt's motion to lift the permanent injunction entered against her in 1992. Coldicutt argued that the injunction, which barred her from marketing unregistered securities, was no longer necessary since she had complied with the injunction for nine years, let her broker-dealer licenses lapse, and disavowed any intention of

returning to the securities industry. The court held that the mere passage of time was not sufficient grounds to vacate an injunction. It also noted that Coldicutt could market unregistered securities even without a broker's license (for example, over the Internet), and that Coldicutt had not shown that the injunction caused her any objective hardship (such as a lost business opportunity).

In *SEC v. Bechstein*,¹⁵⁰ the district court denied Bechstein's motion to lift the permanent antifraud injunction entered against him in October 2000 based on misrepresentations Bechstein made as president of a corporation during its initial public offering. Bechstein argued that the injunction was inequitable because, at the time he consented to its entry, he was unaware that it would disqualify him under the National Association of Securities Dealers' (NASD's) By-Laws and the federal securities laws and cause him to lose his job with a broker-dealer. The court held that the Commission had shown that the responsible Commission attorney had not assured Bechstein the injunction would not affect his job, and, in any event, Bechstein failed to include language in the settlement regarding the alleged assurances.

In *SEC v. Walsh*,¹⁵¹ the Commission opposed Walsh's motion seeking relief from a permanent antifraud injunction entered against him in May 1999 based on Walsh's purchase of securities in his wife's account while he was associated with a broker-dealer and in possession of material, nonpublic information. In a hearing before the trial court, Walsh argued his injunction should be vacated because he has not been able to register as a person associated with a broker-dealer in some states where he has clients. The Commission argued that this inability to register does not constitute unforeseen changed circumstances making compliance with the injunction substantially more onerous or making the injunction unworkable. It noted that the inability to register in a few states is a well-established risk of being subject to a permanent injunction, not an unforeseen changed circumstance justifying relief from the injunction. A decision is pending.

Plans of Distribution of Disgorged Assets

In *SEC v. Credit Bancorp, Ltd.*,¹⁵² the Commission defended the plan of partial distribution of customer assets disgorged from Credit Bancorp's ponzi scheme that had been approved by the trial court. The plan provided for a *pro rata* distribution of disgorged assets among all customers, whose contributions (whether in the form of cash or securities) had been commingled by Credit Bancorp in its various brokerage accounts and sold, spent, subjected to margin loans, and shifted between accounts at Credit Bancorp's whim. A customer who had transferred securities to the control of the ponzi scheme, where they were transferred between Credit Bancorp's accounts and served as collateral for margin loans to Credit Bancorp, appealed the plan of distribution to the Second Circuit, demanding the return of its unsold securities. The appeal is pending.

Actions to Enforce NASD Restitution Orders

Pursuant to section 21(e)(1) of the Exchange Act, the Commission, working with the NASD, filed applications seeking court orders requiring payments of fines and restitution imposed as NASD disciplinary sanctions that were affirmed by the Commission. Obtaining court orders enabled the NASD to enforce the disciplinary sanctions by collecting the fines and restitution. The Commission filed 15 21(e)(1) applications in 2001, and in each of those cases the Commission obtained a court order requiring payment or the NASD received payment from the respondent.

Application of the Work Product Doctrine to Work Product Shared with the Commission

The Commission filed a friend of the court brief in a private securities action in state court to explain that disclosure of attorney work product to the Commission under a confidentiality agreement does not waive the work product protection. The Commission stated that the work product doctrine should be waived because the

Commission's ability to obtain work product under confidentiality agreements plays an important role in its enforcement of the securities laws. The action is pending.

Confidentiality of Documents from Foreign Governments

The Commission filed a friend of the court brief in a Commodity Futures Trading Commission (CFTC) administrative proceeding regarding the interpretation of a Memorandum of Understanding (MOU) between the Commission, CFTC and United Kingdom authorities. The Commission argued that the MOU prohibits disclosure of investigative reports and correspondence from the United Kingdom authorities. The Commission filed the brief in support of the CFTC's Division of Enforcement after an administrative law judge (ALJ) ordered the production of documents from United Kingdom authorities and held that the MOU did not provide that the reports were confidential. The CFTC agreed with the Commission and reversed the ALJ's decision.

Requests for Access to Commission Records

The Commission received 106 subpoenas for documents and testimony. In certain of the cases, the Commission declined to produce the requested documents or testimony because the information sought was privileged.

The Commission received 2,834 requests under the Freedom of Information Act (FOIA) for access to agency records and 10,418 confidential treatment requests from persons who had submitted information to the Commission. There were 51 appeals to the Office of the General Counsel from initial denials from the FOIA Officer. One of these appeals resulted in district court litigation challenging a decision to withhold personal identifying information contained in consumer complaint letters. That case, *Registered Representative Magazine v. SEC*,¹⁵³ was dismissed.

Significant Adjudication Developments

The Commission issued 32 opinions and 25 orders, and the staff decided an additional 52 motions pursuant to its delegated authority. Appeals from decisions of Commission ALJs constituted over 35 percent of the cases decided by the Commission in 2001. This is an increase from fiscal 2000 (20%). Highlighted are some of the significant opinions issued by the Commission in fiscal 2001.

Broker-Dealer and Adviser Proceedings

On concluding that he aided and abetted an adviser's fraud, the Commission barred Marc N. Geman,¹⁵⁴ chief executive officer of Portfolio Management Consults, Inc. (PMC), a registered investment adviser, from association with a broker, dealer, or investment adviser, with the right to reapply for such association after three years. The Commission also imposed \$200,000 in civil money penalties and ordered Geman to cease and desist from violations of the antifraud and recordkeeping requirements.

Geman determined that PMC could increase its revenue by executing certain of its wrap fee program customers' market orders on a principal, rather than an agency, basis. PMC then selectively did so, at so-called "national best bid or offer" prices. The Commission found that a letter the firm sent to its customers disclosing its decision to begin principal trading was misleading--it failed to disclose that a critical reason for the capacity change was PMC's expectation that it would profit from principal trading, and that a chief source of the firm's wrap fee account-related revenue would be trading profits. Although the Commission declined to find that, additionally, PMC violated its obligation to obtain "best execution" for its customers, it stated that it was deeply troubled by PMC's trading practices, particularly the failure to use a price improvement service for its customers' trades. The Commission observed that a broker-dealer has the duty periodically to examine its practices in light of market and technology changes and to

modify those practices if necessary to obtain the best, reasonably available prices for its customers.

In another matter, *Abraham and Sons Capital, Inc.*,¹⁵⁵ the Commission revoked a firm's investment adviser registration; barred its president from association with a broker, dealer, or investment adviser, with a right to reapply after five years; and ordered each respondent to pay a civil money penalty of \$50,000 and cease and desist from violations of the antifraud and investment adviser recordkeeping and auditing requirements.

The Commission found, among other things, that the respondents wrote a series of letters to the investors in a private, pooled hedge fund that they managed, claiming that the fund gained 5.1% in value during the latter half of 1995 when, in fact, it had lost 59.7%. While the respondents claimed that they were unaware that they were misrepresenting the fund's performance, the Commission concluded that the fund's clearing firm kept them informed of the fund's results.

In *D.E. Wine Investments, Inc.*,¹⁵⁶ the Commission announced generally applicable principles for the calculation of markups and markdowns of security prices, and reiterated that all dealers, including market makers, have an obligation to charge only a reasonable markup or markdown from the prevailing market price. Undisclosed markups or markdowns on retail sales can be fraudulent if charged with scienter.

The Commission identified two general principles (which it cautioned were not rules to be enforced mechanically) for determining prevailing market price in an active and competitive market. First, appropriate trades between market makers and non-market makers are better evidence of the prevailing market price than other interdealer trades. Second, the closer in time an interdealer transaction is to a particular retail trade, the better evidence that transaction is of the prevailing market price.

Financial Statement Reporting Requirements

The Commission ordered KPMG LLP to cease and desist from violations of rules governing audit reports and from causing violations of reporting provisions.¹⁵⁷ KPMG entered into a “strategic alliance” with a newly formed financial services company and its subsidiaries. As part of this alliance, KPMG granted each of the entities the right to use the KPMG name in return for payment of a royalty fee of approximately 5% of each entity’s quarterly fee income. KPMG also lent each of the four individual owners of the parent company \$100,000 to use as an equity contribution to the entities. A company that filed reports with the Commission hired one of the subsidiaries to provide turn-around management. The head of that subsidiary (who was also an owner of the parent) became an officer of the company and directed its turn-around efforts in exchange for a management fee and a “success fee.” At the same time, KPMG audited the company’s financial statements for inclusion in an upcoming annual report.

The Commission concluded that these relationships impaired KPMG’s independence from its audit client, the company. KPMG’s loan to an officer of the audit client violated then-existing Commission independence standards and Generally Accepted Auditing Standards (GAAS) that required that auditors and their clients avoid debtor/creditor relationships. The “success fee” paid to the subsidiary, coupled with the “royalty fee” arrangement between the subsidiary and KPMG, gave KPMG the right to receive a fee attributable, in part, to the company’s financial success. The Commission determined that KPMG thereby violated a GAAS prohibition against receiving a contingent fee from an audit client.

The Commission determined that KPMG acted negligently with respect to maintaining its independence, violating the Commission’s requirements on audit reports and causing the company to violate the Commission’s reporting requirements

because the company's financial statements were not audited by independent accountants as represented. The Commission determined that KPMG's negligence was sufficient to meet the culpability standards of the cease and desist provisions. The Commission also determined that the Division of Enforcement must demonstrate some risk of future violation to warrant cease and desist relief, but that generally a past violation demonstrates the risk of a future violation. The Commission concluded that, given the lack of care at senior levels in determining KPMG's independence in this matter, it was appropriate to issue a cease and desist order against KPMG.

Legal Policy

The General Counsel's responsibilities include providing legal and policy advice on SEC enforcement and regulatory initiatives before they are presented to the Commission for a vote. The General Counsel also advises the Commission on administrative law matters, and has substantial responsibility for carrying out the Commission's legislative program, including drafting testimony, developing the Commission's position on pending bills in Congress, and providing technical assistance to Congress on legislative matters.

In the wake of the September 11, 2001 terrorist attacks, the General Counsel advised the Commission on the scope of its emergency powers under the Exchange Act in connection with the issuance of several emergency orders to promote orderly markets as discussed in the chapter entitled, "Regulation of the Securities Markets."

On the regulatory front, the General Counsel was significantly involved in the drafting of the Commission's auditor independence rules, which revised the regulatory standards for determining an outside accountant's independence from its audit clients. The office also assisted in the development of interagency rules with the

CFTC to implement the CFMA's provisions and was significantly involved in drafting regulations to define the scope of the Gramm-Leach-Bliley Act's functional exceptions from broker-dealer registration under the Exchange Act for certain bank securities activities.

Significant Legislative Developments

In fiscal 2001, Congress passed the Commodity Futures Modernization Act. The statute lifted the ban on trading of single stock and narrow-based stock index futures, which had been in place since the Shad-Johnson Accord. The CFMA also established a framework for the joint regulation of security futures products by the CFTC and SEC.

Several other bills that would affect the work of the SEC received significant attention during the year, including legislation that would reduce SEC transaction and registration fees. At year-end, Congress also was considering a bill that would expand the scope of the Commission's emergency authority under the federal securities laws.

Commission Congressional Testimony

The Commission testified at congressional hearings on the following matters during fiscal year 2001:

- the state of the U.S. financial markets following the September 11, 2001 terrorist attacks;
- the Competitive Markets Supervision Act of 2001, which would reduce certain SEC registration and securities transaction fees and give the SEC authority to match the pay and benefits of the federal banking agencies;

- information-sharing among regulators as a tool to control activities of rogue individuals in the financial services industries;
- proposals to repeal the Public Utility Holding Company Act of 1935 (PUHCA), and the impact of PUHCA on the energy crisis in California;
- the adoption of Regulation FD and the Commission’s experience in the first months under the new rule;
- appropriations for the SEC in fiscal 2002, and the fiscal demands of keeping up with technological innovations in the securities markets, the development of a global marketplace, and SEC staff retention;
- the effects on the securities markets of the conversion of quotations in equity securities and options from fractional to decimal pricing;
- conflicts of interest faced by brokerage firms and their research analysts that may affect analysts’ stock recommendations; and
- the Commission’s rules implementing the Gramm-Leach-Bliley Act’s functional exceptions to the Exchange Act’s definitions of “broker” and “dealer.”

Corporate Reorganizations

The Commission, as a statutory adviser in cases under Chapter 11 of the Bankruptcy Code, seeks to assure that the interests of public investors in companies undergoing bankruptcy reorganization are protected. During the past year, the Commission entered a formal

appearance in 56 Chapter 11 cases with significant public investor interest. The Commission also entered appearances in 36 brokerage firm liquidation proceedings under the Securities Investor Protection Act, as part of the Commission's pilot program for monitoring Securities Investor Protection Corporation proceedings. In monitoring these cases, the Commission focuses on how customer claims are resolved, the progress of cases, and administrative costs incurred by trustees and their counsel.

Official committees negotiate with debtors on the formulation of reorganization plans and participate in all aspects of a Chapter 11 case. The Bankruptcy Code provides for the appointment of official committees for stockholders where necessary to assure adequate representation of their interests. The Commission formally supported a motion for the appointment of a stockholders' committee in one case and successfully opposed the disbandment of equity committees in two other cases.

A Chapter 11 disclosure statement is a combination proxy and offering statement used to solicit acceptances for a reorganization plan. The bankruptcy staff commented on 154 of the 198 disclosure statements it reviewed during 2001. Recurring problems with disclosure statements included inadequate financial information, lack of disclosure on the issuance of unregistered securities and insider transactions, and plan provisions that contravene the Bankruptcy Code. Most of the staff's comments to debtors or plan proponents were adopted; formal Commission objections were filed in 12 cases.

The Commission was successful in persuading companies to eliminate provisions in 23 plans that were designed to improperly release officers, directors, and other related persons from liability. This is a significant issue for investors because in many cases debtors improperly seek to use the bankruptcy discharge process to protect officers and directors from personal liability for various kinds of claims, including liability under the federal securities laws. In nine cases, the Commission successfully blocked plan

provisions that would have resulted in the creation of shell companies that could have been used potentially for stock manipulation purposes. In six cases, the Commission prevented improper use of the Bankruptcy Code exemption from Securities Act registration.