~~MAY 2006~~

June 2006

SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

CHRISTOPHER COX, CHAIRMAN

CYNTHIA A. GLASSMAN, COMMISSIONER

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE NAZARETH, COMMISSIONER

49 Documents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

April 24, 2006

IN THE MATTER OF **IMAGE GLOBE SOLUTIONS, INC.** File No. 500-1	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Image Globe Solutions, Inc. ("Image Globe"), a Nevada corporation headquartered in Toronto, Ontario. Questions have arisen regarding the accuracy of assertions by Image Globe, and by others, in press releases and internet postings to investors concerning, among other things: (1) the company's assets, (2) the stated financing of the company's operations, (3) the company's private placement of 10 million shares of its common stock in January 2006, and (4) the company's stated investments in other start-up businesses.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above listed company is suspended for the period from 9:30 a.m. EDT, April 24, 2006, through 11:59 p.m. EDT, on May 5, 2006.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53929 / June 1, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2435 / June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12321

In the Matter of **WILLIAM T. OWENS, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTION**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against William T. Owens ("Respondent" or "Owens") pursuant to Rules 102(e)(2) and 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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[1] Rule 102(e)(2) provides, in relevant part, that:

Any . . . person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission.

Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III, 3 and III, 5 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanction ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. William T. Owens, age 47, is and has been a certified public accountant licensed to practice in the State of Alabama. Owens was the chief financial officer of HealthSouth Corp. ("HealthSouth") from February 2000 to August 2001, its president and chief operating officer from August 2001 until August 2002, and its president and chief executive officer from August 2002 through January 2003. Owens also served as HealthSouth's executive vice president and chief financial officer from January 2003 until March 2003.

2. HealthSouth was, at all relevant times, a Delaware corporation with its principal place of business in Birmingham, Alabama. HealthSouth was in the business of, among other things, providing outpatient diagnosis and surgery. At all relevant times, HealthSouth's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

3. On March 31, 2003, the Commission filed a complaint against Owens in SEC v. Weston L. Smith and William T. Owens (Civil Action No. CV-03-C-0720-S, amended to CV-03-CO-0720-S). On May 22, 2006, the court entered an order permanently enjoining Owens, by consent, from future violations of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and from aiding and abetting violations of Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13a-14 thereunder.

4. The Commission's complaint alleged, among other things, that Owens and other senior officers of HealthSouth engaged in a fraudulent scheme which resulted in HealthSouth filing materially false and misleading financial statements in the company's annual reports on Forms 10-K and periodic reports on Forms 10-Q from 1997 through 2002. Among other

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the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

things, the complaint alleged that Owens directed other HealthSouth employees to make entries on the company's books which fraudulently overstated income and reflected fictitious assets in amounts which matched generally the fraudulent overstatements of income. The complaint alleged that the fraudulent entries were designed to avoid detection by HealthSouth's independent auditors.

5. On December 9, 2005, a judgment of conviction was entered against Owens in United States v. Owens, CR-03-3B-00131-SLB, in the United States District Court for the Northern District of Alabama, finding him guilty of one count of conspiracy to commit wire fraud and securities fraud, one count of wire fraud and one count of filing a false certification of financial information with the Commission.

6. As a result of this conviction, Owens was sentenced to five years incarceration followed by two years of supervised release, and was ordered to forfeit $2.5 million.

IV.

In view of the foregoing, the Commission finds that Owens has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice. The Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Owens's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

Owens is forthwith suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53919 / June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12315

In the Matter of

Philadelphia Stock Exchange, Inc.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 19(h) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate, in the public interest, and for the protection of investors that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Philadelphia Stock Exchange, Inc. ("Phlx").

II.

In anticipation of the institution of these proceedings, Phlx has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Phlx consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 19(h) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Phlx's Offer, the Commission finds that:

A. Summary

This matter involves Phlx's failure to adequately enforce certain rules governing options[1] and equities trading and order handling rules. From approximately April 1999 through at least January 2002, Phlx had several deficiencies in its surveillance procedures for assuring compliance with its rules as well as the federal securities laws. Phlx did not conduct adequate surveillance for certain types of trading and order handling violations by its specialists. Phlx's failure to adequately surveil for certain rule violations was a result of either Phlx's failure to develop any program to detect such violations, or the programs in place were not adequate to detect such violations. These deficiencies were a substantial cause of Phlx's failure to adequately enforce certain of its rules governing options and equities trading and order handling. As a result, Phlx violated Section 19(g) of the Exchange Act.

B. Respondent

Phlx, located in Philadelphia, Pennsylvania, is a national securities exchange registered with the Commission pursuant to Section 6 of the Exchange Act. Phlx trades nearly 2,000 stocks, 1,600 equity options, 18 sectors index options, and currency options.

C. Discussion

Section 19(g) of the Exchange Act requires registered exchanges to comply with their own rules, as well as the federal securities laws, and, absent reasonable justification or excuse, to enforce compliance with them by their members and persons associated with their members. Phlx had deficient surveillance programs related to options and equities trading and order handling rules. As a result, it did not properly enforce the provisions of the Exchange Act, the rules and regulations thereunder, and its own rules and, therefore, violated Section 19(g) of the Exchange Act.

The regulatory failures addressed here follow others in the late 1990s, which the Commission addressed in an order issued in September 2000. In the Matter of Certain Activities of Options Exchanges, Sec. Rel. No. 43268 (September 11, 2000) ("September 2000 Order"). The September 2000 Order found that, among other things, Phlx failed to adequately enforce its order handling rules, policies, and procedures in its options market and ordered the Phlx to enhance and improve its surveillance, investigative and enforcement processes with respect to options order handling rules.[2] In response to the September 2000 Order, Phlx implemented

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[1] All references in this Order to the term "options" refers specifically and solely to equity and equity index options.

[2] See September 2000 Order at Paragraph IV.B.f.

numerous enhancements to its regulatory program. However, despite these enhancements, certain inadequacies continued in Phlx's surveillance programs for order handling in its options market. Phlx also had inadequate surveillance programs for trading violations in its options market and trading and order handling violations in its equities market.

From at least April 1999 through at least January 2002, Phlx had deficiencies in its surveillance programs related to options and equities trading and order handling rules. Because of this inadequate surveillance, Phlx failed to detect certain violations by specialists.

1. Options Market

In Phlx's options market, Phlx did not adequately surveil for violations of rules relating to priority of options orders. Phlx rules prohibit specialists from trading for their own account or for an account in which they have an interest at prices equal to or better than open customer orders,[3] and generally grant customer orders priority over all other orders on the floor when competing at the same price.[4] Priority rule violations include trading ahead and interpositioning violations. Trading ahead occurs when a specialist executes an order for his/her own account, or an account in which he/she holds an interest, while holding unexecuted customer orders, which would be entitled to an execution at the price the specialist received.[5] Interpositioning occurs when a specialist fails to match two marketable orders and instead executes the orders with its proprietary account as contra-party to each order to capture the spread between the orders. Phlx surveiled for potential violations of the priority rule by reviewing certain exception reports. However, in generating these reports, Phlx employed surveillance parameters that improperly excluded certain transactions and consequently, potential priority rule violations, from review.

Phlx's failure to properly surveil for priority rule violations in its options market included two main categories of transactions. First, Phlx's surveillance reports excluded instances in which a specialist traded in advance of customer orders that were eventually executed or cancelled. During the relevant time period, Phlx was only surveiling for priority rule violations for orders that remained on the specialists' books. Second, Phlx also improperly excluded from its surveillance reports instances in which customer orders represented by a specialist failed to participate in trades occurring between other floor participants, such as Registered Options Traders[6] ("ROTs"). Such occurrences can be indicative of a violation of the specialist's obligation to exercise due diligence in the representation of customer orders entrusted to him.

Phlx also did not adequately surveil for violations of the firm quote rule in its options market. Exchange Act Rule 11Ac1-1, effective in April 2001,[7] requires "every responsible

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[3] See Phlx Rules 452 and 1019.

[4] See Phlx Rule 1014(g).

[5] See Phlx Rules 452, 1019, and 1014(g).

[6] A Registered Options Trader ("ROT") is a participant on the exchange trading for their own or their firm's account who is responsible for making two-sided markets. A ROT is also referred to as a market maker.

[7] See Securities Exchange Act Rel. No. 43591 (Nov. 17, 2000), 65 FR 75489 (Dec. 1, 2000). This rule is now Rule 602 of Regulation NMS.

broker or dealer" to execute options transactions with customers at prices at least as favorable as their published bids or offers at the time the orders are presented and in any amount of contracts up to their published sizes.[8] Phlx surveiled for potential violations of the firm quote rule by reviewing certain exception reports. However, again, Phlx employed parameters that improperly excluded certain transactions, and consequently, certain firm quote rule violations, from review.

Phlx's failure to properly surveil for firm quote rule violations in its options market included four main categories of transactions. First, Phlx's surveillance reports for violations of the firm quote rule improperly excluded instances in which the customer order was received when the Phlx quote was not part of the national best bid or offer ("NBBO"). Second, Phlx improperly excluded instances in which the customer order was received when the NBBO was locked or crossed. Third, Phlx excluded from its firm quote surveillance report orders received prior to 9:45 a.m., and, as a result, did not surveil for any violations of the firm quote rule that occurred between the open of the market and 9:45 a.m. Finally, Phlx excluded all or none orders from its surveillance reports.[9]

2. Equities Market

In its equities market, Phlx's surveillance programs had similar deficiencies during the same time period relating to rules governing equities order handling, including the firm quote rule, priority rules, and limit order display.[10] Specifically, Phlx had not implemented any type of surveillance of its equities market to monitor its specialists for compliance with the firm quote rule. Furthermore, as with its options surveillance, Phlx also used exception reports to surveil for potential priority violations in its equities market. However, the reports improperly omitted instances in which the specialist traded ahead of a customer order where the customer order was eventually executed.

Phlx also had deficiencies with respect to surveillance for violations of equities trading rules relating to short sales, front-running,[11] marking the close,[12] and wash trades.[13] Specifically, Phlx had not implemented any type of surveillance of its equities market to monitor its

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[8] A responsible broker or dealer is excused from its obligations under the firm quote rule under specified conditions set forth in that rule. See Rule 602 of Regulation NMS; see also Phlx Rule 1082.

[9] All or none orders are market or limit orders that are to be executed either in their entirety or not at all. See Phlx Rule 1066(c)(4). Phlx improperly excluded from its surveillance reports all or none orders with a size less than or equal to the Phlx disseminated size and, consequently, failed to surveil for possible firm quote violations.

[10] The limit order display rule requires specialists to immediately display a bid or offer that reflects the price and the full size of each customer limit order held by the specialist that improves the bid or offer of such specialist, and the full size of a customer limit order held by the specialist that (1) is priced equal to the bid or offer of such specialist, (2) is priced equal to the national best bid or offer, and (3) represents more than a de minimus change in the size of the specialist's bid or offer. See Rule 604 of Regulation NMS and Phlx Equity Floor Procedure Advice A-1.

[11] Front-running involves a trader taking a position in a security to profit from advance non-public knowledge of an imminent order that may affect the market price of that security. See Phlx Rules 782 and 707.

[12] Phlx Rules 707 and 782 prohibit marking the close which involves trading at the end of the day in order to manipulate reported closing prices.

[13] See Phlx Rules 707 and 782.

specialists for short sale violations. Furthermore, the reports generated to detect front-running, marking the close, and wash trade violations did not actually reflect the violations they were meant to detect. For example, Phlx had been unable to utilize its exception report effectively to identify potential instances of front-running because it generated an excessive number of alerts, most of which were false positives. Further, Phlx had not developed or implemented an adequate exception report to detect marking the close activity. The report Phlx used to detect wash trades was also ineffective, as it listed trades that were subsequently cancelled, and trades reported either the day, or several days, after the trade. This did not necessarily detect violative behavior. These surveillance programs were inadequate to fulfill Phlx's regulatory obligations.

3. Written Surveillance Procedures

In addition to having inadequate surveillance reports, Phlx also did not maintain adequate written surveillance procedures for Phlx investigators reviewing the surveillance reports for options and equities trading and order handling violations. As a result, there was no adequate written guidance available to investigators to assist them in understanding what each report contained, how to review the reports, and how to identify items on the reports that required further scrutiny. For example, the surveillance procedure manuals were not updated to reflect changes in surveillance procedures including the actual practices of Phlx investigative staff reviewing the surveillance reports or as new exception reports were developed. Further, the written surveillance procedures for interpositioning, marking the close, and pegging and capping[14] violations did not accurately describe the content of the respective exception reports. Finally, Phlx did not provide sufficient written guidance to its investigative staff in certain sections of the procedural manual with respect to closing an exception without further action.

D. Violations

Section 19(g)(1) of the Exchange Act requires every national securities exchange and self-regulatory organization to comply with the provisions of the Exchange Act, the rules and regulations thereunder, and its own rules, and, absent reasonable justification or excuse, enforce compliance with such provisions by its members and persons associated with its members. As described above, Phlx violated Section 19(g)(1) of the Exchange Act by failing to meet these responsibilities.

Phlx's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Phlx, cooperation afforded the Commission staff, and the commitment to improve the oversight of its regulatory function described in Section IV below. These remedial acts

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[14] The purpose of pegging or capping is to manipulate the price of a security so that an option on the security will be out of the money at the time of expiration. Pegging involves trying to increase the value of the underlying security so that it will not be put to the option writers, while capping involves trying to decrease the value of the underlying security so that it will not be called. See Phlx Rules 707 and 782.

include but are not limited to Phlx engaging outside counsel and consultants to conduct a complete review of its regulatory programs, augmenting the ranks of regulatory staff and management, and significantly increasing its regulatory budget in an effort to enhance its regulatory programs.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Phlx's Offer.

Accordingly, pursuant to Sections 19(h) and 21C of the Exchange Act it is hereby ORDERED that:

A. Respondent Phlx cease and desist from committing or causing any violations and any future violations of Section 19(g) of the Exchange Act.

B. Phlx shall comply with the following undertakings:

1. Phlx shall, within 180 days after issuance of the final order, design and implement a mandatory, annual training program for all floor members and members of Phlx's regulatory staff responsible for surveillance, investigation, examination, and discipline of floor members that addresses compliance with the federal securities laws and Phlx's rules in place to prevent and deter unlawful trading by floor members.

2. Phlx shall:

a. In 2006 and 2008, retain a Third Party Auditor ("Auditor"), not unacceptable to the Commission staff, to conduct a comprehensive audit of Phlx's surveillance, examination, investigation, and disciplinary programs relating to trading applicable to all floor members in order to achieve the following audit objectives:

i. To determine whether Phlx's policies and procedures are reasonably designed and effective to ensure compliance with and to detect and deter violations of the federal securities laws and Phlx's rules relating to trading; and

ii. To determine whether Phlx is in compliance with (1) the policies and procedures identified in Paragraph (a)(i) above; (2) any outstanding commitments made by Phlx in relation to recommendations made by the Commission's Office of Compliance Inspections and Examinations ("OCIE") or the Division of Market Regulation relating to compliance with trading rules or surveillance for trading rule violations; and (3) any undertakings contained in this order, or Paragraph IV.B.f. of the September 2000 Order.

b. Phlx shall require the Auditor and other qualified persons hired by the Auditor ("qualified persons") to have adequate knowledge and understanding of Phlx's regulatory programs, policies and procedures and shall possess sufficient competence and resources necessary to assess Phlx's surveillance, examination, investigation, and disciplinary programs.

c. Phlx shall require the Auditor to develop a written audit plan of sufficient scope and detail to achieve the audit objectives described in paragraph (a) above, and to identify regulatory areas in need of special consideration. In performing the audit, the Auditor and the qualified persons shall exercise due professional care and independence in performing the audit.

d. Phlx shall require the Auditor to formulate an opinion based on sufficient, competent evidential matter that is obtained through, among other things, (i) inspection of documents, including written procedures, rules, and staff files; (ii) observation of trading processes and Phlx's regulatory systems and practices; (iii) interviews of regulatory staff, floor members and other relevant persons; and (iv) case studies and testing of various regulatory functions and trading practices.

e. Phlx shall cooperate fully with the Auditor and qualified persons and provide the Auditor and qualified persons with access to its files, books, records, and staff as reasonably requested for the audit.

f. Phlx shall ensure that the audit is concluded within 180 days of the start of the field work. No later than 45 days after the audit is concluded, Phlx shall require the Auditor to submit an audit opinion as to its assessment of Phlx's surveillance, examination, investigation, and disciplinary programs to the Phlx's Board of Directors and to the following officials at the Commission (the "Commission Officials"): (i) the Director of OCIE and (ii) the Director of the Division of Market Regulation. The audit opinion shall also be included in Phlx's annual report.

g. No later than 45 days after the audit is concluded, Phlx shall require the Auditor to also submit an audit report to Phlx's Board of Directors and to the Commission Officials (i) describing the purpose, scope and nature of the audit; and (ii) identifying any significant deficiencies or weaknesses in Phlx's policies and procedures or Phlx's compliance with the policies and procedures, OCIE recommendations, and undertakings described in paragraphs 1 and 2(a) above.

h. No later than 90 days after the date of the audit report, Phlx shall review all significant deficiencies or weaknesses identified in the audit report and develop a written plan of corrective actions to address each deficiency or weakness, including a date by which each corrective action shall be implemented. Phlx shall maintain a copy of such plan for the entire period of this undertaking and shall provide the plan to the Commission staff upon request.

i. Phlx shall bear the full expense of the audits. In 2006 and 2008, Phlx shall allocate $500,000 for the establishment, retention and payment of the Auditor. If the expenses for the audits exceed the designated funds, the Phlx shall use additional funds to pay the costs of the audits. If any funds remain after the audit period, those funds shall be used solely for regulatory matters.

j. Phlx shall require the Auditor to provide the Commission staff with any documents or other information the Commission staff requests regarding the Auditor's work pursuant to this undertaking. Phlx shall not assert, and shall require the Auditor to agree not to assert, privilege or work product claims in response to any of the Commission staff's requests.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53927 / June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12319

In the Matter of KYLE ROWE, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Kyle Rowe ("Rowe" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From at least August to November 2000, Rowe was the President and Chairman of the board of directors of Salomon Grey Financial Corporation ("Salomon Grey"), a broker-dealer registered with the Commission during the relevant time period, with six branch offices located in Florida, Georgia, New York and Texas. During that time period, Rowe was also a 50% owner of the holding company that owned Salomon Grey. Rowe was previously associated with four other broker-dealers dating back to 1993. Rowe, 39 years old, is currently a resident of Dallas, Texas.

2. On May 30, 2006, a final judgment was entered by consent against Rowe in the civil action entitled Securities and Exchange Commission v. Allen Z. Wolfson, et al., Civil Action Number 2:02 CV-1086, in the United States District Court for the District of Utah, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aiding and abetting violations of Section 15(c)(1) of the Exchange Act.

3. The Commission's complaint alleged, among other things, that Rowe and another defendant were involved in a pre-existing arrangement to obtain deeply discounted blocks of shares of Freedom Surf, Inc., from other defendants for retail sales to the public at manipulated prices. The complaint alleges in particular that Rowe participated in negotiating Salomon Grey's purchase, on October 24, 2000, of a block of 25,000 Freedom Surf shares at a fifty percent discount to the manipulated market price and concealed this arrangement from the market. Beginning on that day, Salomon Grey began selling Freedom Surf shares to its customers at illegally marked-up prices. Rowe set the prices for Salomon Grey's Freedom Surf retail trades. The complaint also alleged that Rowe participated in unregistered sales of Freedom Surf shares.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Rowe's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Rowe be, and hereby is, barred from association with any broker or dealer.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12314

In the Matter of **Universal Medical Systems, Inc.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Universal Medical Systems, Inc. (n/k/a Moray Way Holdings, Inc.) (CIK No. 1007016) is a Nevada corporation located in Clearwater, Florida with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Universal is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on April 24, 1997. On May 26, 2006, the company changed its name to Moray Way Holdings, Inc. without notifying the Commission and changed its stock symbol from "UMSIE" to "MRWH." As of May 31, 2006, the company was quoted on the Pink Sheets, had seven market makers, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. The Respondent is delinquent in its periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), having repeatedly failed to meet its obligation to file timely periodic reports, and failed to heed a delinquency letter sent to its last known address by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

4. As a result of its failure to file required periodic filings, Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II of this Order are true, and to afford the Respondent an opportunity to establish any defenses to such allegations; and

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months or to revoke the registrations of each class of securities registered pursuant to Exchange Act Section 12 of the Respondent identified in Section II.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon each Respondent personally, by certified or registered mail, or by any other means permitted by the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Attachment

Appendix 1

Chart of Delinquent Filings

In the Matter of Universal Medical Systems, Inc.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Universal Medical Systems, Inc.					
	10-KSB	06/30/97	09/29/97	Not filed	104
	10-QSB	09/30/97	11/14/97	Not filed	102
	10-QSB	12/31/97	02/17/98	Not filed	99
	10-QSB	03/31/98	05/15/98	Not filed	96
	10-KSB	06/30/98	09/28/98	Not filed	92
	10-QSB	09/30/98	11/16/98	Not filed	90
	10-QSB	12/31/98	02/16/99	Not filed	87
	10-QSB	03/31/99	05/17/99	Not filed	84
	10-KSB	06/30/99	09/28/99	Not filed	80
	10-QSB	09/30/99	11/15/99	Not filed	78
	10-QSB	12/31/99	02/14/00	Not filed	75
	10-QSB	03/31/00	05/15/00	Not filed	72
	10-KSB	06/30/00	09/28/00	Not filed	68
	10-QSB	09/30/00	11/14/00	Not filed	66
	10-QSB	12/31/00	02/14/01	Not filed	63
	10-QSB	03/31/01	05/15/01	Not filed	60
	10-KSB	06/30/01	09/28/01	Not filed	56
	10-QSB	09/30/01	11/14/01	Not filed	54
	10-QSB	12/31/01	02/14/02	Not filed	51
	10-QSB	03/31/02	05/15/02	Not filed	48
	10-KSB	06/30/02	09/30/02	Not filed	44
	10-QSB	09/30/02	11/14/02	Not filed	42
	10-QSB	12/31/02	02/14/03	Not filed	39
	10-QSB	03/31/03	05/15/03	Not filed	36
	10-KSB	06/30/03	09/29/03	Not filed	32
	10-QSB	09/30/03	11/14/03	Not filed	30
	10-QSB	12/31/03	02/17/04	Not filed	27
	10-QSB	03/31/04	05/17/04	Not filed	24
	10-KSB	06/30/04	09/28/04	Not filed	20
	10-QSB	09/30/04	11/15/04	Not filed	18
	10-QSB	12/31/04	02/14/05	Not filed	15
	10-QSB	03/31/05	05/16/05	Not filed	12
	10-KSB	06/30/05	09/28/05	Not filed	8
	10-QSB	09/30/05	11/14/05	Not filed	6
	10-QSB	12/31/05	02/14/06	Not filed	3
	10-QSB	03/31/06	05/15/06	Not filed	1
Total Filings Delinquent	36				

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53925 / June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12317

In the Matter of CHRISTOPHER ROUNDTREE, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Christopher Roundtree ("Roundtree" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From at least August to November 2000, Roundtree was the head trader at Salomon Grey Financial Corporation ("Salomon Grey"), a broker-dealer registered with the Commission during the relevant time period, with six branch offices located in Florida, Georgia, New York and Texas. From 1997 to 1999, Roundtree was associated with Pacific Cortez Securities, Inc. Roundtree, 28 years old, is currently a resident of Frisco, Texas.

2. On May 30, 2006, a final judgment was entered by consent against Roundtree in the civil action entitled Securities and Exchange Commission v. Allen Z. Wolfson, et al., Civil Action Number 2:02 CV-1086, in the United States District Court for the District of Utah, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aiding and abetting violations of Section 15(c)(1) of the Exchange Act.

3. The Commission's complaint alleged, among other things, that Roundtree's co-defendants had a pre-existing arrangement with certain other defendants to obtain deeply discounted blocks of shares of Freedom Surf, Inc., from other defendants for retail sales to the public at manipulated prices. On October 24, 2000, Salomon Grey bought a block of 25,000 Freedom Surf shares at a fifty percent discount to the manipulated market price. Roundtree executed the trade. With Roundtree's knowledge, Salomon Grey brokers then sold Freedom Surf shares to its customers at illegally marked up prices without disclosing these illegal and excessive markups to them. Roundtree also executed trades to Salomon Grey customer accounts at the illegally marked-up prices.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Roundtree's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Roundtree be, and hereby is barred from association with any broker or dealer with the right to reapply for association after 1 year to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Campos Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53926 / June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12318

In the Matter of **ANGELO PAUL KOUPAS,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Angelo Paul Koupas ("Koupas" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From at least August to November 2000, Koupas, now 37, was the Chief Executive Officer of Salomon Grey Financial Corporation ("Salomon Grey"), a broker-dealer registered with the Commission during the relevant time period, with six branch offices located in Florida, Georgia, New York and Texas. During that time period, Koupas was also a 50% owner of the holding company that owned Salomon Grey. Koupas was previously associated with six different broker-dealers dating back to 1991.

2. On May 30, 2006, a final judgment was entered by consent against Koupas in the civil action entitled Securities and Exchange Commission v. Allen Z. Wolfson, et al., Civil Action Number 2:02 CV-1086, in the United States District Court for the District of Utah, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and aiding and abetting violations of Section 15(c)(1) of the Exchange Act.

3. The Commission's complaint alleged, among other things, that Koupas and another defendant were involved in a pre-existing arrangement to obtain deeply discounted blocks of shares of Freedom Surf, Inc., from other defendants for retail sales to the public at manipulated prices. Koupas arranged for Salomon Grey to buy, on October 24, 2000, a block of 25,000 Freedom Surf shares at a fifty percent discount to the manipulated market price and concealed this arrangement from the public. Salomon Grey then sold its discounted Freedom Surf shares to its customers at manipulated prices with Koupas' knowledge. The Complaint also alleged that Koupas participated in unregistered sales of Freedom Surf shares.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Koupas' Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Koupas be, and hereby is, barred from association with any broker or dealer.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53928 / June 1, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12320

In the Matter of **SALOMON GREY FINANCIAL CORPORATION,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Salomon Grey Financial Corporation ("Salomon Grey" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Salomon Grey is a broker-dealer registered with the Commission. Salomon Grey is a Texas corporation that, during the relevant time period, was wholly-owned by Southwestern United Enterprises Corporation, a Nevada corporation. Angelo Paul Koupas and Kyle Rowe each owned, during the relevant time period, 50% of Southwestern United Enterprises Corporation.

2. On May 30, 2006, a final judgment was entered by consent against Salomon Grey, permanently enjoining it from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 15(c)(1) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Allen Z. Wolfson, et al., Civil Action Number 2:02-CV-1086, in the United States District Court for District of Utah, Central Division.

3. The Commission's complaint alleged, among other things, that during the time period of July through November 2000, the principals of Salomon Grey had a pre-existing arrangement to obtain deeply discounted blocks of shares of Freedom Surf, Inc., from other defendants for retail sales to the public at manipulated prices. On October 24, 2000, Salomon Grey, through its head trader, bought a block of 25,000 Freedom Surf shares at a 50% discount to the manipulated market price and concealed this arrangement from the public. Salomon Grey then sold its discounted Freedom Surf shares to its customers. The Complaint also alleged that Salomon Grey participated in unregistered sales of Freedom Surf shares.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Salomon Grey's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(4) of the Exchange Act that the registration of Respondent Salomon Grey be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 1, 2006

In the Matter of **Universal Medical Systems, Inc.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Universal Medical Systems, Inc. (n/k/a Moray Way Holdings, Inc.) because it has not filed any periodic reports since it filed a Form 10-SB registration statement on April 24, 1997.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed company is suspended for the period from 9:30 a.m. EDT on June 1, 2006, through 11:59 p.m. EDT on June 14, 2006.

By the Commission.

Nancy M. Morris
Secretary

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Commissioner Campos Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
June 2, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12322

In the Matter of **JAMES T. MCCURDY, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against James T. McCurdy, CPA ("McCurdy" or "Respondent") pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice to determine whether McCurdy engaged in improper professional conduct.[1]

II.

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

[1] Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have engaged in unethical or improper professional conduct.

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A. SUMMARY

1. This matter concerns failed audits of the financial statements of two mutual funds, the Liquid Green Money Market Fund ("Liquid Green") and the Florida Street Bond Fund ("Florida Street"), as the result of improper professional conduct by James T. McCurdy, CPA.

2. McCurdy engaged in improper professional conduct during the audit of Liquid Green's financial statements for the fiscal year ended September 30, 2001 ("the 2001 Liquid Green audit"). During the 2001 Liquid Green audit, McCurdy, who was the concurring review partner, became aware that more than half of the securities in the fund's portfolio had stated maturity dates exceeding the 397-day period set forth in Rule 2a-7 under the Investment Company Act of 1940 ("Investment Company Act"), and did not assure that the engagement partner performed audit procedures to determine whether the securities were in fact eligible for a money market fund or otherwise to test the fund's compliance with Rule 2a-7.

3. Because he did not require the engagement partner to audit Liquid Green's financial statements in accordance with generally accepted auditing standards ("GAAS") and did not do so himself, McCurdy allowed his firm to issue an audit report with an unqualified opinion even though the fund's financial statements were not prepared in comformity with generally accepted accounting principles ("GAAP") because the fund was using the amortized cost method of valuing its securities and holding itself out as a money market fund when it was not eligible to do so, in violation of the Investment Company Act.

4. McCurdy also engaged in improper professional conduct during the audits of Florida Street's financial statements for the fiscal years ended October 31, 1999 (the "1999 Florida Street audit") and October 31, 2000 (the "2000 Florida Street audit"). McCurdy assigned two inexperienced auditors as engagement partners and designated himself as the concurring review partner for the 1999 and 2000 Florida Street audits.

5. Because McCurdy failed to ensure that the 1999 Florida Street audit was conducted in accordance with GAAS, he failed to detect (i) that the fund was over-accruing interest for bonds that had missed interest payments, were in default, or had previously been sold and were no longer held by the fund; (ii) that a significant portion of the fund's interest receivable balance was uncollectible; and (iii) that Florida Street's financial statements were not fairly presented in conformity with GAAP.

6. Florida Street's overstated interest receivable balance came to light during the 2000 Florida Street audit. As a result of the discovery, the fund was re-priced, the fund wrote off the uncollectible interest, and it was determined that the fund made a return of capital that had not been disclosed to shareholders. None of these events was disclosed in the October 31, 2000 financial statements in violation of GAAP.

7. As a result of McCurdy's reckless or at least highly unreasonable conduct, his accounting firm issued audit reports with unqualified opinions on Liquid Green's financial statements as of September 30, 2001, and Florida Street's financial statements as of October 31, 1999 and October 31, 2000, each of which falsely represented that those financial statements were

fairly presented in conformity with GAAP and the audits were conducted in accordance with GAAS.

B. RESPONDENT

8. **McCurdy**, age 58, resides in Westlake, Ohio and has been a licensed certified public accountant ("CPA") in Ohio since 1979. From February 1980 until December 2003, McCurdy was the principal shareholder and managing partner of McCurdy & Associates CPAs, Inc. ("McCurdy & Associates"), an accounting firm that specialized in performing mutual fund audits. McCurdy was the concurring review partner for the 2001 Liquid Green audit and 1999 and 2000 Florida Street audits. McCurdy & Associates sold its investment industry practice, including its auditing practice, to Cohen McCurdy, Ltd. in January 2004. McCurdy & Associates continues to provide tax services to clients. The firm resigned its Public Company Accounting Oversight Board ("PCAOB") registration effective August 17, 2004. On May 19, 2005, McCurdy was temporarily denied the privilege of appearing or practicing before the Commission as an accountant for one year, as a result of his improper professional conduct in connection with the 1998 audit of the financial statements of the JWB Aggressive Growth Fund.

C. RELATED PARTIES

9. **AmeriPrime Advisors Trust ("AAT"),** an Ohio business trust, is an open-end series investment company[2] that has been registered with the Commission since 1999. On September 20, 2001, AAT organized Liquid Green as one of its series of funds. On September 28, 2001, Liquid Green acquired the assets and assumed the liabilities of the Unified Taxable Money Market Fund ("UTMM"), which was a series of the open-end series investment company Unified Funds. UTMM transferred its assets to Liquid Green and dissolved.[3] As of September 30, 2001, Liquid Green had total net assets valued at $37,695,013. In February 2002, Liquid Green dissolved after transferring all of its assets to another money market fund.

10. **AmeriPrime Funds ("AF")**, an Ohio business trust, is an open-end series investment company that has been registered with the Commission since 1995. From June 1997 until November 2001, Florida Street was a high-yield bond fund under AF. As of October 31, 2001, Florida Street reported total assets of $13,184,855. AF liquidated and closed Florida Street in November 2001.

11. **Unified Fund Services, Inc. ("Unified")**, an Indiana corporation located in Indianapolis, Indiana, has provided administrative and accounting services to mutual funds since 1990. Unified's clients included AAT and AF. As fund administrator and fund accountant for Liquid Green and Florida Street, Unified was responsible for, among other things, keeping the funds' books and records and preparing their financial statements.

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[2] Although a series investment company such as AAT is organized as a single corporate entity, it may be comprised of several different series or portfolios that function as separate investment companies.

[3] For the purposes of this Order, "Liquid Green" refers collectively to both Liquid Green and its predecessor UTMM.

D. MCCURDY'S IMPROPER PROFESSIONAL CONDUCT

Applicable Professional Standards

12. The "applicable professional standards" of care for accountants practicing before the Commission include, but are not limited to, GAAP and GAAS. GAAS consists of ten auditing standards, including three general standards, three standards of fieldwork and four standards of reporting.

13. The first general standard requires that an audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor. AU §210.01.

14. The third general standard provides that "due professional care is to be exercised in the performance of the audit and the preparation of the report." AU §230.01. Among other things, due professional care requires an auditor to observe the field work and reporting standards of GAAS. AU §230.02. Additionally, due professional care requires an auditor to employ professional skepticism, which is "an attitude that includes a questioning mind and a critical assessment of audit evidence." AU §230.07. Professional skepticism requires an auditor to obtain no less persuasive evidence merely because he assumes that management is honest. AU §230.09.

15. The first standard of fieldwork requires that audit work be adequately planned and supervised. AU §310.01.

16. The third standard of fieldwork requires that "sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." AU §330.01. GAAS further provide that "representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU §333.02. "[W]hen evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity." AU §326.21(a).

17. The first standard of reporting states, "The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles." AU §410.01. The third standard of reporting further provides that "informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report." AU §431.01. "If management omits from the financial statements, including the accompanying notes, information that is required by generally accepted accounting principles, the auditor should express a qualified or an adverse opinion and should provide the information in his report, if practicable, unless its omission from the auditor's report is recognized as appropriate by a specific Statement on Auditing Standards." AU §431.03

18. As set forth below, McCurdy engaged in improper professional conduct in connection with the 2001 Liquid Green audit and the 1999 and 2000 Florida Street audits because he failed to comply with GAAS.

The 2001 Liquid Green Audit

19. Between March 20, 2001 and December 6, 2001, Liquid Green's portfolio manager followed an investment strategy of purchasing fixed-rate, government agency bonds with remaining maturities of between 2 1/2 and 12 years. The bonds were callable within 397 days at the discretion of the government agency, but not at the option of the purchaser. As of September 30, 2001, the last day of fiscal year 2001, these bonds made up over 53.1% of the fund's assets.

20. Under Rule 2a-7(c)(2)(i) under the Investment Company Act, a mutual fund cannot acquire securities with maturities in excess of 397 days and hold itself out as a money market fund unless the securities have a maturity-shortening feature as provided by the rule. Furthermore, Rule 2a-7(b)(1) expressly provides that it is a material misrepresentation under Section 34(b) of the Investment Company Act for a mutual fund to hold itself out as a money market fund when it does not meet the risk-limiting conditions of Rule 2a-7.

21. In this case, the callable bonds purchased by Liquid Green did not have a maturity-shortening feature as provided for by Rule 2a-7. Thus, during the time period when the fund held these bonds, Liquid Green was not permitted to hold itself out as a money market fund and it was a material misrepresentation for the fund to do so.

22. In addition, a money market fund that does not meet the requirements of Rule 2a-7 is not permitted to use the amortized cost method of valuing the securities in its investment portfolio but instead must calculate the current net asset value of its portfolio securities on a daily basis to reflect current market prices. Because Liquid Green did not meet the requirements of Rule 2a-7 during the time period when it held the ineligible bonds, the fund was not permitted to use the amortized cost method to value its securities.

23. AAT engaged McCurdy & Associates to provide audit and tax services to its series of funds, including Liquid Green. McCurdy assigned another member of his firm to be the engagement partner for the 2001 Liquid Green audit while he assigned himself the role of concurring review partner. As concurring review partner, McCurdy reviewed all of the audit workpapers, including the results of all of the fieldwork performed by the engagement partner.

24. The audit plan for the 2001 Liquid Green audit did not contain any procedures designed to test the fund's compliance with Rule 2a-7.

25. During the 2001 Liquid Green audit, McCurdy learned that more than one half of Liquid Green's investment portfolio consisted of callable bonds with stated maturities of greater than 397 days. McCurdy became aware of the callable bonds when he reviewed Liquid Green's financial statements, which included a schedule of investments that listed the callable bonds and their maturities.

26. Despite knowing that more than half of Liquid Green's portfolio consisted of callable bonds with stated maturities that appeared to make them ineligible for a money market fund under Rule 2a-7, McCurdy did not require the performance of any audit procedures to test the

fund's compliance with the rule by the engagement partner; nor did he perform any such procedures himself.

27. As a result of his failure to properly follow up on red flags discovered during his review of the audit of Liquid Green's financial statements, McCurdy failed to require the fund to correct its audited financial statements containing material misrepresentations, including that Liquid Green was a "money market fund" and that it was proper for the fund to use the amortized cost method to value its portfolio securities.

28. McCurdy & Associates issued an audit report dated October 10, 2001, containing an unqualified opinion on Liquid Green's financial statements as of September 30, 2001, that was included in the fund's annual report filed with the Commission on November 28, 2001.[4]

29. The audit report stated that McCurdy & Associates "audited the statements of assets and liabilities, including the portfolios of investments, of Liquid Green Money Market Fund (formerly Unified Taxable Money Market Fund) as of September 30, 2001." The report further falsely represented that (i) the fund's financial statements were presented in conformity with GAAP, and (ii) that McCurdy & Associates had audited the fund's financial statements in accordance with GAAS.

30. As the concurring review partner on the 2001 Liquid Green audit, McCurdy was required to conduct himself in accordance with GAAS. McCurdy was also responsible for reviewing documentation of the resolution of any significant auditing, accounting and financial reporting matters that arose during the audit and using professional judgment to determine whether reviewing more documentation and employing other procedures were necessary.

31. With respect to the 2001 Liquid Green audit, McCurdy failed to exercise sound professional judgment to determine whether additional procedures were in fact necessary to determine whether Liquid Green was in compliance with Rule 2a-7.

32. McCurdy failed to conduct himself in accordance with the first standard of fieldwork under GAAS because he failed to require the engagement partner to include in the audit plan procedures to test the fund's Rule 2a-7 compliance, even after discovering that a large percentage of the securities in the fund's portfolio had stated maturity dates that appeared not to comply with Rule 2a-7.

33. McCurdy violated the third standard of fieldwork because he failed to ensure that the engagement partner obtained sufficient competent evidential matter regarding Liquid Green's compliance with Rule 2a-7 and did not have a reasonable basis for allowing the issuance of the firm's audit report containing the opinion that the fund's financial statements were fairly presented in conformity with GAAP.

[4] Liquid Green's 2001 annual report was originally filed on November 28, 2001 under the wrong investment company name. After the fund administrator discovered the error, the annual report was re-filed, with no changes, under the correct investment company name on December 26, 2001.

34. McCurdy failed to exercise due professional care in accordance with the third general standard by (i) failing to ensure that the audit plan included procedures appropriate to test the fund's Rule 2a-7 compliance; (ii) failing to ensure that sufficient competent evidential matter was obtained to determine whether the fund was in compliance with Rule 2a-7; and (iii) allowing his firm to issue an audit report with an unqualified opinion on Liquid Green's financial statements, even though those financial statements improperly held Liquid Green out as a money market fund, represented that the amortized cost method was appropriate, and improperly used the amortized cost method to value securities in the fund.

35. McCurdy violated the reporting standards under GAAS when he allowed McCurdy & Associates to issue an audit report with an unqualified opinion on Liquid Green's financial statements as of September 30, 2001 even though the financial statements contained material misrepresentations and failed to disclose material matters.

The 1999 and 2000 Florida Street Audits

36. From at least August 1999 until November 2001, Florida Street failed properly to account for interest due from its portfolio of bonds. During that time period, Florida Street continued to accrue interest for bonds that had missed interest payments, were in default or were no longer owned by the fund.

37. Because of these improper interest accruals, the interest receivable reflected in Florida Street's accounting books and records included a significant amount of uncollectible interest. As of August 1, 1999, Florida Street's interest receivable included approximately $195,120 in uncollectible interest. By October 31, 2000, Florida Street's interest receivable balance was overstated by approximately $796,356. Between November 1, 2000 and October 31, 2001, Florida Street accrued additional uncollectible interest of approximately $473,275.

38. The uncollectible interest was included in Florida Street's trial balance and used to compute the fund's daily net asset value ("NAV"). From at least December 1, 1999 through June 25, 2001, Florida Street's daily NAV was overstated by between $.01 and $.34 per share. Throughout this period, the fund was redeeming and selling shares at inflated NAVs.

39. McCurdy & Associates audited Florida Street's financial statements for the fiscal year ended October 31, 1999. McCurdy assigned another member of his firm to serve as the engagement partner for the 1999 Florida Street audit even though she did not have adequate technical training, experience and proficiency as an auditor to serve as an engagement partner for an audit of a high-yield bond fund.

40. McCurdy assumed the role of concurring review partner for the 1999 Florida Street audit. As concurring review partner, McCurdy reviewed all of the audit workpapers. In addition, McCurdy provided the engagement partner with the audit program to be used for the audit and trained her on how to carry out the audit procedures.

41. At the time of the 1999 Florida Street audit, the fund accountant could not provide the auditors with information to substantiate an interest receivable balance of over $913,264 that

had been carried over from the predecessor accountant. The unsubstantiated balance was included on Florida Street's trial balance and was used to calculate the fund's NAVs. Florida Street's recording of the unsubstantiated interest was inconsistent with GAAP because revenue must be (1) recognizable and (2) measurable to be recorded. Statement of Financial Accounting Concepts No. 6 ¶145.

42. Based on her training by McCurdy, the engagement partner for the 1999 Florida Street audit did not perform audit procedures to test the collectibility of Florida Street's interest receivable balance. McCurdy knew that such audit procedures, such as confirmation of the receivable balance, were not performed.

43. Because the auditors failed to conduct the 1999 Florida Street audit properly, they failed to detect (i) that the fund was over-accruing interest for bonds that had missed interest payments, were in default, or had previously been sold and were no longer held by the fund, (ii) that a significant portion of the fund's interest receivable balance was in fact uncollectible, and (iii) that the financial statements were not prepared in conformity with GAAP.

44. McCurdy & Associates also audited Florida Street's financial statements for the fiscal year ended October 31, 2000. As with the prior year's audit, McCurdy assigned an inexperienced auditor from his firm to serve as the engagement partner for the 2000 Florida Street audit, and assigned himself the role of concurring review partner.

45. Florida Street's overstated interest receivable balance came to light during the 2000 Florida Street audit. As a result of the discovery, the fund was re-priced back to December 1, 1999 and the fund wrote off a total of $1,269,631 in uncollectible interest, approximately $796,356 of which was attributable to periods on or before October 31, 2000. As a result of the interest write-offs, Florida Street's distributions from net investment income exceeded the fund's net investment income in 2000, and therefore constituted a return of capital.

46. Florida Street failed to disclose the repricing, interest write offs and return of capital in its financial statements for the fiscal year ended October 31, 2000, which were included in Florida Street's annual report filed with the Commission on March 22, 2002. Furthermore, Florida Street erroneously classified the return of capital distributions in its financial statements as being derived from the fund's net investment income.

47. McCurdy reviewed Florida Street's 2000 annual report and allowed his firm to issue an audit report with an unqualified opinion on the financial statements, even though he knew that the financial statements did not disclose the repricing, interest write-offs and return of capital.

48. Furthermore, despite knowing that a portion of the interest Florida Street wrote off during the fiscal year ended October 31, 2000 related to the prior fiscal year ended October 31, 1999, McCurdy did not require the recording of a prior period adjustment or take any steps to determine whether Florida Street should restate its financial statements for prior periods.

49. McCurdy did not comply with the first general standard under GAAS during the 1999 and 2000 Florida Street audits because he failed to assign staff members to those audits who possessed adequate technical training and proficiency.

50. McCurdy violated the third standard of fieldwork with respect to the 1999 Florida Street audit because he failed to ensure that the audit staff performed tests to confirm the fund's interest receivable balance even though he knew that collectibility of interest was an area of risk for an audit of a high-yield bond fund.

51. McCurdy failed to exercise due professional care as provided by the third general standard during the 1999 and 2000 Florida Street audits because he (i) failed to assign staff with sufficient technical training and proficiency, (ii) failed to require sufficient competent evidential matter be obtained regarding the fund's interest receivable during the 1999 audit, and (iii) and allowed McCurdy & Associates to issue unqualified audit reports falsely stating that the financial statements conformed with GAAP and that the audits were conducted in accordance with GAAS.

52. McCurdy violated the first standard of reporting during the 1999 and 2000 Florida Street audits when he allowed McCurdy & Associates to issue audit reports with unqualified audit opinions on Florida Street's financial statements falsely stating that the financial statements conformed with GAAP and that the audits were conducted in accordance with GAAS.

E. VIOLATION

As a result of the conduct described above, McCurdy engaged in improper professional conduct as defined in Rule 102(e)(1)(ii), in that his conduct constituted:

(A) intentional or knowing conduct, including reckless conduct, that resulted in violation of applicable professional standards; or

(B) negligent conduct, consisting of (1) a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which McCurdy knew, or should have known, that heightened scrutiny was warranted, or (2) repeated instances of unreasonable conduct by McCurdy, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. Whether Respondent should be censured by the Commission or temporarily or permanently denied the privilege of appearing or practicing before the Commission.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 200

Release No. 34-53937

RIN 3235-AJ56

File No. S7-10-06

Amendments to Plan of Organization and Operation Effective During Emergency Conditions

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is adopting amendments to certain of its rules that operate in the event of emergency conditions to revise the provisions on delivering submittals, the line of succession to the Chairman in the event of the Chairman's incapacity or unavailability, and make conforming changes. These changes are intended to update these provisions.

EFFECTIVE DATE: [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: Stephen M. Jung, Assistant General Counsel for Legislation and Financial Services, Office of the General Counsel, at (202) 551-5162.

SUPPLEMENTARY INFORMATION:

I. Background

Subpart G of Part 200 of Title 17 of the Code of Federal Regulations "describes the plan of organization and operation which will be observed by the Securities and Exchange Commission in discharging its duties and responsibilities in the event of

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[specified emergency conditions]."[1] It includes provisions for designating the location of the offices of the Commission; delivering requests, filings, reports, or other submittals to the Commission; and designating the successor to the Chairman and the division and office heads in the event of their incapacity or unavailability during emergency conditions.

II. Summary of Amendments

The amendments provide guidance on certain terms used in subpart G; revise the provisions on delivering requests, filings, reports, or other submittals during emergency conditions; revise the line of succession to the Chairman in the event of the Chairman's incapacity or unavailability during emergency conditions; and make conforming changes.

A. Guidance on General Terms

The amendments provide guidance on the terms "unavailable or incapacitated" and "emergency conditions," as used in subpart G.

1. Unavailable or Incapacitated. The amendments clarify that a person shall be considered unavailable or incapacitated in any situation and from any cause that prevents the person from assuming or performing on a timely basis his or her authorized duties, roles, or responsibilities of office, whether from a primary or alternate facility, or any other location. This language is intended to be a general statement of the concepts of unavailability and incapacity rather than an exhaustive definition of the terms. The statement is a flexible one that is intended to cover unforeseen, and perhaps novel, circumstances.

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[1] 17 CFR 200.200.

2. Emergency Conditions. The amendments also provide that emergency conditions shall be deemed to commence upon the occurrence, or the imminent threat of the occurrence, of a natural or man-made disturbance, including, but not limited to, an armed attack against the United States, its territories or possessions, terrorist attack, civil disturbance, fire, pandemic, hurricane, or flood, that results in, or threatens imminently to result in, a substantial disruption of the organization or operations of the Commission. Such conditions shall be deemed to continue until the Commission shall, by notice or order, resume its normal organization and operations, whether at its headquarters in Washington, DC or elsewhere.

The prior concept of emergency conditions contemplated that emergency conditions would "commence at the time of an armed attack upon the United States, its territories and possessions, at the time of official notification of the likelihood or imminence of such attack, or at a time specified by authority of the President, whichever may first occur, and shall continue until official notification of cessation of such conditions."[2] Recent global developments, however, have demonstrated the need for a broader concept of emergency conditions, one that encompasses all hazards that may substantially disrupt the normal organization or operations of the Commission. This broader concept is the basis for the revised definition of emergency conditions.

While the "all hazards" approach embodied in the new definition of emergency conditions is broad, not all disturbances that might affect the operations of the Commission will trigger the commencement of emergency conditions. For example, a number of events could require closure or evacuation of the Commission's headquarters

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2 17 CFR 220.201.

in Washington, DC without substantially disrupting the Commission's operations. In most circumstances, a snow emergency, water leak, disruption of water service, temporary power outage, localized fire, fire alarm, or other condition that might require the temporary closure or evacuation of all or a part of the headquarters would not trigger the commencement of emergency conditions.

The "all hazards" approach in the new definition of emergency conditions also underlies the Commission's current Headquarters Continuity of Operations ("HQ COOP") Plan, which establishes operational procedures to sustain the essential functions of the Commission during any emergency or situation that may disrupt normal operations. The Commission expects that, in most circumstances, the occurrence, or the imminent threat of the occurrence, of a disturbance that leads to full or partial activation of the HQ COOP Plan also will trigger the commencement of emergency conditions.

Under the HQ COOP Plan, the Chairman is responsible for directing full or partial activation of the HQ COOP Plan. The Chairman may be unavailable or incapacitated, however, upon the occurrence, or the imminent threat of the occurrence, of a disturbance that likely will require activation of the HQ COOP Plan. In that situation, it would be useful to invoke the Chairman succession provisions in 17 CFR 200.203(c)(1), so that the Chairman's successor could determine whether or not to activate the HQ COOP Plan. Because the succession provisions become operative only during emergency conditions, however, a definition of emergency conditions that was limited to situations in which the Chairman already had activated the HQ COOP Plan would be problematic. Thus, the definition of emergency conditions contemplates that such conditions commence upon the occurrence, or the imminent threat of the occurrence, of certain disturbances, rather than upon an official response or reaction to the disturbance.[3]

B. Operation of Subpart G

Prior 17 CFR 200.201 included language that indicated when the provisions of subpart G would be operative. Specifically, the language stated that subpart G would become operative "as at the commencement of emergency conditions and continue until cessation of those conditions, or until the Commission shall by notice or order resume its normal operations." This language is no longer necessary, because all of the provisions in subpart G are contingent upon the existence of emergency conditions,[4] and the revised definition of "emergency conditions" specifies that emergency conditions will continue until the Commission shall, by notice or order, resume its normal organization and operations.

C. Delivery of Documents

The amendments also revise the provision on delivering requests, filings, reports, or other submittals during emergency conditions. The revised provision specifies that, during emergency conditions, all formal or informal requests, filings, reports, or other submittals shall be submitted to the Commission as permitted in non-emergency conditions, unless the Chairman or his or her successor specifies another means or location for submission of such requests, filings, reports, or other submittals, by a notice that is disseminated through a method (or combination of methods) that is reasonably

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3 In most circumstances, a Continuity of Operations message directing the Securities and Exchange Commission to assume a COGCON 1 readiness posture will be issued as a result of an event that triggers the commencement of emergency conditions and also leads to activation of the HQ COOP Plan.

4 Prior 17 CFR 200.204 was not explicitly contingent on the existence of emergency conditions. However, as discussed below, the amendments make a conforming change to this section to clarify that it operates only under such conditions.

designed to provide broad distribution of the information to the public.

The prior provision contemplated that all submittals would be "delivered to the Commission at designated offices" or addressed to an address no longer used by the Commission. The reference to "designated offices" was a reference to the requirement in 17 CFR 200.202(a) that the Chairman, or his or her successor, designate, during emergency conditions, the location of headquarters and, if different from the normal location, each Regional and District office.[5] The new provision provides the Chairman with greater flexibility to designate a location for submission of formal or informal requests, filings, reports, or other submittals during emergency conditions. For example, the Chairman may find it appropriate, during emergency conditions, to designate a location geographically remote from headquarters, whether at its normal location or a new location, for the submission of filings that ordinarily would be submitted to the headquarters. The new provision also enables the Chairman to specify a different means for the submission of requests, filings, reports, or other submittals during emergency conditions. In this regard, the new provision accommodates the fact that many filings now are required or permitted to be submitted to the Commission in electronic format.

During emergency conditions, persons may experience difficulties submitting requests, filings, reports, or other submittals to the Commission, whether by normal means or by means otherwise specified by the Chairman. These difficulties could arise from disruptions at the location of the person seeking to make the submittal, disruptions in the means of transmittal (for example, breakdowns in mail services, electronic

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[5] In the absence of communication with the Chairman, 17 CFR 200.202(a) specifies that, during emergency conditions, the Regional Director or District Administrator for an office, or his acting successor, will designate the location of the office, if different from the normal location.

transmission facilities, or courier services), or disruptions at the location of the Commission office to which the submittal is attempted to be made. In such cases, the person could seek,[6] or the Commission on its own initiative could provide, appropriate relief. Of course, the ability to seek or provide relief may be hindered by disruptions in communications between persons seeking to make submittals and the Commission.

Because the nature of any relief would be dictated by the specific circumstances of any disruptions, and the Commission has broad authority to provide relief in appropriate circumstances, the amended provision does not address directly the consequences of a disruption in the ability to submit requests, filings, reports, or other submittals during emergency conditions. The provision, however, does provide some flexibility for responding to disruptions in the ability to transmit requests, filings, reports, or other submittals by allowing the Chairman to specify the means and/or location for submission during emergency conditions.

D. Succession Provisions

The amendments revise the line of succession to the Chairman in the event of the Chairman's incapacity or unavailability during emergency conditions. Specifically, the amendments revise the current order of succession within the categories of Division Directors, Regional Directors, and District Administrators so that that the order of succession in each category will be as designated by the Chairman in the most recent designation prior to the commencement of emergency conditions, or if no such designation has occurred, in order of seniority. The current order of succession within

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6 For example, if a submittal is required to be transmitted to the Commission electronically, but electronic transmission is disrupted at the time the submittal is due, the filer could seek appropriate relief, including pursuant to 17 CFR 232.13(b), 232.201, or 232.202.

these categories is based on seniority. The change would give the Chairman the flexibility to accommodate the fact that, at any given time, there may be particular areas of expertise that might militate in favor of an order not based strictly on seniority. In addition, the amendments eliminate the Executive Director and the Executive Assistant to the Chairman from the line of succession.

E. Other Provisions

The amendments also revise 17 CFR 200.203(e), which currently provides for a line of succession to a division or office head in the event of his or her absence or incapacity during emergency conditions. The amendments make a conforming change and specify that a successor to a division or office head is delegated all of the authority that the Commission has delegated to the division or office head. Currently, a successor to a division or office head may discharge all of the duties of the division or office head, but is not explicitly delegated all of the authority that the Commission has delegated to the division or office head. In addition, the amendments make a conforming change to 17 CFR 200.204, which sets forth the line of succession for certain administrative staff, to clarify that the provision applies only during emergency conditions.

III. Related Matters

A. Administrative Procedure Act and Other Administrative Laws

The Commission has determined that these amendments to its rules relate solely to the agency's organization, procedure, or practice. Therefore, the provisions of the Administrative Procedure Act ("APA") regarding notice of proposed rulemaking and opportunity for public participation are not applicable.[7] For the same reason, and

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[7] 5 U.S.C. 553(b).

because these amendments do not substantially affect the rights or obligations of non-agency parties, the provisions of the Small Business Regulatory Enforcement Fairness Act are not applicable.[8] In addition, the provisions of the Regulatory Flexibility Act, which apply only when notice and comment are required by the APA or other law, are not applicable.[9] Finally, these amendments do not contain any collection of information requirements as defined by the Paperwork Reduction Act of 1995, as amended.[10]

B. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The Commission believes that the amendments to its rules that it is adopting today will produce the benefit of providing greater clarity to the plan of organization and operation that will be observed by the Commission in discharging its duties and responsibilities during certain emergency conditions. The Commission also believes that these rules will not impose any costs on non-agency parties, or that if there are any such costs, they are negligible.

C. Consideration of Burden on Competition

Section 23(a)(2) of the Securities Exchange Act of 1934 ("Exchange Act") requires the Commission, in making rules pursuant to any provision of the Exchange Act, to consider among other matters the impact any such rule would have on competition. The Commission does not believe that the amendments that the Commission is adopting today will have any impact on competition.

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8 5 U.S.C. 804.

9 5 U.S.C. 601 - 612.

10 44 U.S.C. 3501 - 3520.

STATUTORY AUTHORITY

The amendments to the Commission's rules are adopted pursuant to the authorities set forth therein.

List of Subjects in 17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies).

TEXT OF AMENDMENTS

For reasons set out in the preamble, Title 17, Chapter II, subpart G, of the Code of Federal Regulations is amended as follows:

Part 200 - Organization; Conduct and Ethics; and Information Requests

Subpart G - Plan of Organization and Operation Effective During Emergency Conditions

1. The general authority citation for Part 200, subpart G is revised and the subauthority is removed.

The revision reads as follows:

Authority: 15 U.S.C. 77s, 78d, 78d-1, 78w, 77sss, 80a-37, 80b-11; Reorganization Plan No. 10 of 1950 (15 U.S.C. 78d nt).

2. Section 200.200 is amended by:

   a. Removing the authority citation following the section; and

   b. Revising the phrase "a national emergency" to read "emergency conditions,".

3. Section 200.201 is revised to read as follows:

§ 200.201 General provisions.

(a) For purposes of this subpart, a person shall be considered unavailable or incapacitated in any situation and from any cause that prevents the person from assuming or performing on a timely basis his or her authorized duties, roles, or responsibilities of office, whether from a primary or alternate facility, or any other location.

(b) For purposes of this subpart, emergency conditions shall be deemed to commence upon the occurrence, or the imminent threat of the occurrence, of a natural or man-made disturbance, including, but not limited to, an armed attack against the United States, its territories or possessions, terrorist attack, civil disturbance, fire, pandemic, hurricane, or flood, that results in, or threatens imminently to result in, a substantial disruption of the organization or operations of the Commission. Such conditions shall be deemed to continue until the Commission shall, by notice or order, resume its normal organization and operations, whether at its headquarters in Washington, DC or elsewhere.

4. Section 200.202 is amended by:

a. Removing the authority citation following the section; and

b. Revising paragraph (b) to read as follows:

§ 200.202 Offices, and information and submittals.

* * * * *

(b) During emergency conditions, all formal or informal requests, filings, reports, or other submittals shall be submitted to the Commission as permitted in non-emergency conditions, unless the Chairman or his or her successor acting pursuant to § 200.203(c)(1) of this subpart specifies another means or location for submission of such requests, filings, reports, or other submittals, by a notice that is disseminated through a method (or combination of methods) that is reasonably designed to provide broad distribution of the information to the public.

5. Section 200.203 is amended by:

a. Removing the authority citation following the section;

b. Revising paragraph (c)(1);

c. In the first sentence of paragraph (e), revising the phrase "in the absence or incapacity of such person during the emergency conditions" to read "in the event of the unavailability or incapacity of such person during emergency conditions"; and

d. Adding a sentence to the end of paragraph (e).

The revision and addition read as follows:

§ 200.203 Organization, and delegation of authority.

* * * * *

(c) * * *

(1) In the event of the unavailability or incapacity of the Chairman of the Commission during emergency conditions, the authority of the Chairman to govern the affairs of the Commission and to act for the Commission, as provided for by law and by delegation from the Commission, will pass to the available person highest on the following list, until such time as the Chairman is no longer unavailable or incapacitated, or a successor Chairman has assumed office pursuant to Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d) and Reorganization Plan No. 10 of 1950 (15 F.R. 3175, 64 Stat. 1265):

(i) The Commissioners in order of seniority.

(ii) The General Counsel.

(iii) The Division Directors in the order designated by the Chairman in the most recent designation prior to the commencement of emergency conditions, or if no such designation has occurred, in order of seniority.

(iv) The Regional Directors in the order designated by the Chairman in the most recent designation prior to the commencement of emergency conditions, or if no such designation has occurred, in order of seniority.

(v) The District Administrators in the order designated by the Chairman in the most recent designation prior to the commencement of emergency conditions, or if no such designation has occurred, in order of seniority.

* * * * *

(e) * * * A person who discharges or assumes the duties of the head of a division or office pursuant to this subsection is hereby delegated, throughout the period of the unavailability or incapacity of the head of the division or office during the emergency conditions, all of the functions that the Commission has delegated to the head of the division or office.

6. Section 200.204 is amended by:

a. Removing the authority citation following the section; and

b. Revising the phrase "In the absence of unavailability of the appropriate staff officer or his successor" to read "In the event of the unavailability or incapacity of the appropriate staff officer or his or her successor during emergency conditions".

7. Section 200.205 is amended by removing the authority citation following the section.

By the Commission. Nancy M. Morris

Nancy M. Morris
Secretary

Dated: June 5, 2006

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53940; File No. 4-516)

June 5, 2006

Joint Industry Plan; Order Approving Options Regulatory Surveillance Authority Plan by the American Stock Exchange LLC, Boston Stock Exchange, Inc., Chicago Board Options Exchange, Incorporated, International Securities Exchange, Inc., Pacific Exchange, Inc. (n/k/a NYSE Arca, Inc.) and Philadelphia Stock Exchange, Inc.

I. Introduction

On January 31, 2006, pursuant to Rule 608 under the Securities Exchange Act of 1934 ("Act"),[1] the American Stock Exchange LLC, Boston Stock Exchange, Inc., Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange, Inc., Pacific Exchange, Inc. (n/k/a NYSE Arca, Inc.)[2] and Philadelphia Stock Exchange, Inc. (collectively, "Exchanges") filed with the Securities and Exchange Commission ("Commission") the Options Regulatory Surveillance Authority Plan, a plan providing for the joint surveillance, investigation and detection of insider trading on the markets maintained by the Exchanges ("ORSA Plan").[3]

On April 10, 2006, a detailed summary of the ORSA Plan was published for comment in the Federal Register.[4] The Commission received no comments on the ORSA Plan. This Order

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1 17 CFR 242.608.

2 On March 6, 2006, the Pacific Exchange, Inc. ("PCX") filed with the Commission a proposed rule change, which was effective upon filing, to change the name of PCX, as well as several other related entities, to reflect the recent acquisition of PCX Holdings, Inc., the parent company of PCX, by Archipelago Holdings, Inc. ("Archipelago") and the merger of the New York Stock Exchange, Inc. with Archipelago. See File No. SR-PCX-2006-24. All references herein have been changed to reflect these transactions.

3 The Exchanges initially filed the ORSA Plan with the Commission on May 5, 2005. The Exchanges filed revised versions of the ORSA Plan on July 6, 2005 and September 29, 2005.

4 See Securities Exchange Act Release No. 53589 (April 4, 2006), 71 FR 18120. The full text of the plan was made available to interested persons on the Commission's Web site.

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approves the ORSA Plan as proposed pursuant to Section 11A of the Act[5] and Rule 608 thereunder.[6]

II. Summary of the ORSA Plan

The purpose of the ORSA Plan is to permit the Exchanges to act jointly in the administration, operation, and maintenance of a regulatory system for the surveillance, investigation, and detection of the unlawful use of undisclosed, material information in trading on one or more of their markets. By sharing the costs of these regulatory activities and by sharing the regulatory information generated under the ORSA Plan, the Exchanges believe they will be able to enhance the effectiveness and efficiency with which they regulate their respective markets and the national market system for options. The Exchanges also believe that the ORSA Plan will avoid duplication of certain regulatory efforts on the part of the Exchanges.

A. Policy Committee

The ORSA Plan provides for the establishment of a Policy Committee, on which each Exchange will have one representative and one vote. The Policy Committee is responsible for overseeing the operation of the ORSA Plan and for making all policy decisions pertaining to the ORSA Plan, including, among other things, the following:

1. determining the extent to which regulatory, surveillance, and investigative functions will be conducted on behalf of the Exchanges;
2. making all determinations pertaining to contracts with (i) persons who provide goods and services under the ORSA Plan, including parties to the ORSA Plan who provide such goods and services, and (ii) parties to the ORSA Plan and other

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5 15 U.S.C. 78k-1.

6 17 CFR 242.608.

self-regulatory organizations who engage in regulatory, surveillance, or investigative activities under the ORSA Plan;

3. reviewing and approving surveillance standards and other parameters to be used by self-regulatory organizations who perform regulatory and surveillance functions under the ORSA Plan; and

4. determining budgetary and financial matters.

All decisions by the Policy Committee, except as otherwise indicated, will be by majority vote, subject to any required approval of the Commission. Disputes arising in connection with the operation of the ORSA Plan will be resolved by the Policy Committee acting by majority vote.

B. Delegation of Functions

The ORSA Plan permits the Exchanges, as and to the extent determined by the Policy Committee, to delegate all or part of the regulatory and surveillance functions under the ORSA Plan (other than the Policy Committee's own functions) to one or more Exchanges or other self-regulatory organizations. The Policy Committee has determined to delegate the operation of the surveillance and investigative facility contemplated by the ORSA Plan to CBOE. The Exchanges have entered into a Regulatory Services Agreement ("RSA") with CBOE, as service provider, pursuant to which CBOE will perform certain regulatory and surveillance functions under the ORSA Plan and use its automated insider trading surveillance system to perform these functions on behalf of the Exchanges.

Although CBOE will be delegated responsibility for these activities, the ORSA Plan specifically provides that each Exchange will remain responsible for the regulation of its market and for bringing enforcement proceedings whenever it appears that persons subject to its regulatory jurisdiction may have violated the Exchange's own rules, the Act, or the rules of the Commission thereunder.

C. Review of Service Provider

The Policy Committee must periodically, but not less frequently than annually, review the performance of persons to whom regulatory and surveillance activities have been delegated under the ORSA Plan. The Policy Committee must evaluate whether such activities have been performed by the service provider in a reasonably acceptable manner consistent with any contract governing the performance of such services and whether the costs of such services are reasonable. If the Policy Committee determines that the performance of delegated activities is not reasonably acceptable or that the costs are unreasonable, the Policy Committee may terminate the delegation of activities to such persons subject to applicable contractual terms.

D. Potential Insider Trading Violations

When in the course of performing regulatory and surveillance functions the Exchanges acting under the ORSA Plan, or a self-regulatory organization to whom such functions have been delegated, obtain information indicating that there may have been an insider trading violation by members or associated persons of one or more of the Exchanges, the Exchanges or such delegatee will promptly inform all such parties of the relevant facts. The Exchanges acting jointly will not have authority to take disciplinary action against members or associated persons of any individual Exchange. All such authority will remain that of the Exchanges acting in their individual capacities.

E. Other Regulatory or Surveillance Functions

The ORSA Plan permits the Exchanges to provide for the joint performance of any other regulatory or surveillance functions or activities that the Exchanges determine to bring within the scope of the ORSA Plan, but any determination to expand the functions or activities under the

ORSA Plan would require an amendment to the ORSA Plan subject to Commission approval and the requirements for amendments described below.

F. Allocation of Costs

The costs under the ORSA Plan to be allocated among the Exchanges will consist of all costs duly incurred by any Exchange as a direct result of its performing regulatory or surveillance functions under the ORSA Plan, together with any amounts charged under the ORSA Plan (or charged to any Exchange authorized to incur such charges under the ORSA Plan) by any other person for goods or services provided under the ORSA Plan. The costs incurred by CBOE in developing the insider trading surveillance system to be used by CBOE as the ORSA Plan service provider will be borne by CBOE without reimbursement. Costs incurred by CBOE in maintaining and upgrading its system going forward will be allocated among the Exchanges, provided that such costs have been authorized by the Exchanges.

Costs in each calendar quarter will be allocated among the Exchanges in accordance with a three element formula: (i) fifty percent of costs will be allocated equally among the Exchanges (with a pro rata adjustment for any exchange that was not an Exchange for the entire calendar quarter); (ii) twenty-five percent of costs will be allocated among the Exchanges in accordance with their respective contract volume market shares during the calendar quarter; and (iii) twenty-five percent of costs will be allocated among the Exchanges in accordance with their respective numbers of classes of securities options traded at any time during the calendar quarter.

G. New Parties to the ORSA Plan; Participation Fee

Any other self-regulatory organization that maintains a market for the trading of securities options in accordance with rules approved by the Commission may become a party to the ORSA Plan, subject to agreeing to the terms and conditions of the ORSA Plan, agreeing to the terms and conditions of any contract pursuant to which the parties to the ORSA Plan have delegated regulatory and surveillance functions under the ORSA Plan, and payment of a participation fee.

The participation fee will be an amount determined by a majority of the Exchanges to be fair and reasonable compensation for the costs incurred in developing and maintaining the facilities used under the ORSA Plan and in providing for participation by the new party. In determining the amount of the participation fee, the Exchanges must consider the following factors:

1. The portion of costs previously paid for the development, expansion and maintenance of facilities used under the ORSA Plan which, under generally accepted accounting principles, would have been treated as capital expenditures and would have been amortized over the five years preceding the admission of the new party;
2. an assessment of costs incurred and to be incurred, if any, to accommodate the new party, which are not otherwise required to be paid by the new party; and
3. previous participation fees paid by other new parties.

If the Exchanges and a new party cannot agree on the amount of the participation fee, the matter will be subject to review by the Commission.

A self-regulatory organization that does not maintain a market for the trading of securities options may become a party to the ORSA Plan, and a self-regulatory organization that ceases to maintain such a market may continue to be a party to the ORSA Plan, only if permitted by a majority of the other parties.

H. Term and Termination

The ORSA Plan will remain in effect for so long as there are two or more parties to the ORSA Plan. Any Exchange may withdraw from the ORSA Plan at any time on not less than six months prior written notice to each of the other parties. Any Exchange withdrawing from the ORSA Plan will remain liable for its proportionate share of costs allocated to it for the period during which it was a party, but it will have no further obligations under the ORSA Plan or to any of the other Exchanges with respect to the period following the effectiveness of its withdrawal. The right of an Exchange to participate in joint regulatory services under the ORSA Plan is not transferable without the consent of the other Exchanges.

I. Amendments

The ORSA Plan may be amended by the affirmative vote of all of the parties, provided that the provisions pertaining to the allocation of costs may be amended by the affirmative vote of not less than two-thirds of the parties, subject in each case to any required approval of the Commission.

III. Discussion

In Section 11A of the Act,[7] Congress directed the Commission to facilitate the development of a national market system consistent with the objectives of the Act. In particular, Section 11A(a)(3)(B) of the Act[8] authorizes the Commission "by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities thereof." Rule 608 under the Act establishes the procedures for filing, amending, and approving national market system plans.[9] Pursuant to paragraph (b)(2) of Rule 608, the Commission's approval of a national market system plan is conditioned upon a finding that the proposed plan "is necessary or appropriate in

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7 15 U.S.C. 78k-1.

8 15 U.S.C. 78k-1(a)(3)(B).

9 17 CFR 242.608.

the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act."[10] After carefully considering the ORSA Plan, the Commission finds that the ORSA Plan is appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, and in furtherance of the purposes of the Act. In particular, the Commission finds that the ORSA Plan is consistent with Section 11A of the Act[11] and Rule 608 thereunder.[12]

The Commission believes that the ORSA Plan, which would permit the Exchanges to pool their resources for the regulation and surveillance of insider trading, should allow the Exchanges to more efficiently implement an enhanced surveillance program for the detection of insider trading, while eliminating redundant effort. In this regard, the Commission believes that the ORSA Plan should promote more effective regulation and surveillance of insider trading across all the options markets maintained by the Exchanges.

In approving the ORSA Plan, the Commission is authorizing the Exchanges to work together according to the procedures provided for under the ORSA Plan. The Commission is not approving or disapproving the terms of the RSA, nor is the Commission passing judgment on the surveillance performance of CBOE or the other Exchanges, acting individually or jointly under the ORSA Plan, or on the quality of their surveillance standards or any other parameters used for regulatory and surveillance functions. The ultimate responsibility and primary liability for self-regulatory failures remains with each Exchange, and the ORSA Plan does not relieve an

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10 17 CFR 242.608 (b)(2).

11 15 U.S.C. 78k-1.

12 17 CFR 242.608.

Exchange of its obligations as a self-regulatory organization under the Act. In this regard, the ORSA Plan specifically provides that each Exchange remains responsible to enforce compliance by persons subject to its regulatory jurisdiction with its own rules, the Act, and the rules and regulations thereunder.

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 11A of the Act,[13] and Rule 608 thereunder,[14] that the ORSA Plan submitted by the Exchanges is approved.

By the Commission.

Nancy M. Morris
Secretary

JmP
By: Jill M. Peterson
Assistant Secretary

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13 15 U.S.C. 78k-1.

14 17 CFR 242.608.

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2520 / June 6, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12324

In the Matter of **CapitalWorks Investment Partners, LLC and Mark J. Correnti,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AS TO CAPITALWORKS INVESTMENT PARTNERS, LLC AND MARK J. CORRENTI**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against CapitalWorks Investment Partners, LLC and Mark J. Correnti (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted individual Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

Respondents

1. CapitalWorks Investment Partners, LLC ("CapitalWorks") has been registered with the Commission as an investment adviser since June 9, 1999. (File No. 84-5718) It is a wholly owned subsidiary of CapitalWorks Investment Group LLC, a limited liability company owned by four principals. CapitalWorks is based in San Diego, California, and currently has approximately $736 million in assets under management.

2. Mark J. Correnti ("Correnti) is a principal of CapitalWorks' parent company. Since 1999, he has been CapitalWorks' Director of Client Service and Marketing. Until March 2005, he was also the head of compliance. Correnti, 46, resides in San Diego, California.

Summary

3. This matter involves CapitalWorks' violations of the antifraud provisions of the Advisers Act, and Correnti's aiding and abetting of CapitalWorks' violations, in connection with false and misleading representations to prospective clients, current clients, and consultants regarding the results of a prior Commission examination.

4. The Pacific Regional Office's ("PRO") examination staff examined CapitalWorks in June 2002 and cited various deficiencies, which required CapitalWorks to take corrective action. However, in subsequent responses to requests for proposals (RFPs) from potential clients, periodic requests for information from existing clients, and consultant questionnaires, CapitalWorks falsely stated that the examination did not result in any deficiencies or require any corrective action. Correnti, as Director of Client Service and Marketing, had ultimate responsibility for the accuracy of the responses. He was fully aware of the deficiencies noted in the PRO's 2002 examination but failed to ensure their disclosure in the responses to RFPs.

5. Additionally, CapitalWorks, aided and abetted by Correnti, violated Rule 206(4)-7 under the Advisers Act, which required investment advisers to adopt by October 5, 2004 written procedures reasonably designed to prevent violations of the Advisers Act. CapitalWorks failed to adopt any written procedures that would have addressed the types of issues that arose regarding the responses until April 2005. As head of compliance, Correnti failed to ensure that CapitalWorks adopted such procedures.

Facts

6. At the conclusion of the PRO's examination of CapitalWorks in July 2002, the staff issued a "deficiency letter" to CapitalWorks on August 7, 2002, which identified various problems under the federal securities laws that needed to be rectified. The deficiencies related to CapitalWorks' advertising, marketing and performance, custody of client assets, assignment of advisory contracts, and internal controls.

7. During an exit interview at the conclusion of the examination, the staff discussed with Correnti details of the deficiencies and recommended that CapitalWorks take certain corrective action. Correnti worked on drafting a letter to the Commission staff dated September 19, 2002, in which CapitalWorks set out the steps it intended to take to address these deficiencies.

8. From August 2002 through December 2004, CapitalWorks responded to 39 RFPs. An RFP is a solicitation by or on behalf of a prospective investor (generally a pension plan or a large institutional investor) that is submitted to investment advisers interested in providing investment management services. The request is framed as a questionnaire and generally transmitted electronically to an investment adviser, often through an intermediary consultant, to be completed and returned to the prospective investor. A request may also seek updated information for a current client or a consultant, often on a quarterly basis. Consultants use requests to obtain information to apprise investors of the investment adviser's services and to match investment advisers with investors.

9. During this period, CapitalWorks had no written policies or procedures relating to client communications, including responses to RFPs. Although Correnti was responsible for drafting and modifying the compliance manual, he did not initiate or implement any written procedures. CapitalWorks' unwritten procedure, however, was that one of Correnti's subordinates in the Company's Client Service and Marketing Group prepared a draft response using answers from a database of prior responses. When an RFP presented a new question or had even slight variations, the Client Service and Marketing Group drafted a new response for it. After Correnti's final approval, the responses were transmitted by e-mail to the requesting parties.

10. Of the 39 RFPs, 12 requested specific information relating to regulatory audits, inspections or examinations. CapitalWorks made false and/or misleading statements about the 2002 examination as follows:

a) In 10 responses, CapitalWorks falsely answered that "[t]he SEC did not find any deficiencies and required no follow-up actions" or that "[n]o violations were found."

b) In one response, CapitalWorks answered "N/A," even though it had received the 2002 deficiency letter just 5 months previously.

c) In one response, the Company also claimed that it had never been subject to a regulatory inspection.

11. As CapitalWorks' Director of Client Service and Marketing, Correnti was ultimately responsible, and gave final approval, for each completed RFP response prepared by CapitalWorks. Out of the 12 false responses, CapitalWorks only transmitted one response without Correnti's prior express approval.

12. The PRO examination staff conducted another examination of CapitalWorks in August 2004, at which time the staff informed Correnti of the false statements in the prior

responses. Nevertheless, after August 2004, Correnti approved and CapitalWorks sent out another false response dated after October 5, 2004, the compliance date for Rule 206(4)-7.

13. Despite its knowledge of the staff's concerns, CapitalWorks failed to adopt any written procedures that would have addressed the types of issues that arose regarding the responses until April 2005. As head of compliance, Correnti failed to ensure that CapitalWorks adopted such written procedures.

Legal Discussion

14. Section 206(2) of the Advisers Act makes it unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

15. Section 206(4) prohibits any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, from engaging in any act, practice, or course of business which the Commission has determined to be fraudulent, deceptive, or manipulative. Rule 206(4)-7 under the Advisers Act requires an investment adviser registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder. The effective date of the rule was February 5, 2004, and investment advisers were required to be in compliance with the rule by October 5, 2004.

16. Based on the conduct described above, CapitalWorks willfully violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Based on the conduct described above, Correnti willfully aided and abetted and was a cause of CapitalWorks' violations of these provisions.

IV.

CapitalWorks shall comply with the following undertakings to:

17. Retain, not later than 60 days after the date of this Order, at its expense, an Independent Consultant, not unacceptable to the Commission's staff. CapitalWorks shall require the Independent Consultant to conduct quarterly reviews for a two-year period, from the date of this Order, of CapitalWorks' compliance with its written policies and procedures for responding to RFPs with a view to detect and prevent CapitalWorks from publishing, circulating, or distributing false or misleading information regarding the Commission staff's examination;

18. At the end of each quarterly review, but in no event no later than fifteen days after the end of each quarter, CapitalWorks shall require the Independent Consultant to submit to CapitalWorks and to Kelly Bowers of the Commission's Pacific Regional Office a Consultant's Report. The Consultant's Report shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary to make the policies and procedures adequate and address the deficiencies identified in Section III of the Order. CapitalWorks may

suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Consultant. The Independent Consultant may accept or reject CapitalWorks' proposed alternative procedure. CapitalWorks, however, shall abide by the Independent Consultant's final recommendation;

19. Take all necessary and appropriate steps to adopt and implement the recommendations contained in the quarterly Consultant's Report;

20. Mail a copy of this Order to each existing investment advisory client within 30 days following the entry of this Order. The Order shall be sent by certificate of mailing, along with a cover letter in a form not unacceptable to the staff of the Commission;

21. From the effective date of this Order until the expiration of 12 months, provide a copy of the Order to all prospective investment advisory clients not less than 48 hours prior to entering into any written or oral investment advisory contract (or no later than the time of entering into such contract, if the client has the right to terminate the contract without penalty within five business days after entering into the contract); and

22. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with CapitalWorks, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Pacific Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with CapitalWorks, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in CapitalWorks' and Correnti's Offers.

Accordingly, it is hereby ORDERED that:

A. CapitalWorks and Correnti be, and hereby are, censured;

B. CapitalWorks and Correnti cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder;

C. CapitalWorks and Correnti shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $40,000 and $25,000, respectively, to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check, or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies CapitalWorks and Correnti as the respondents in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kelly Bowers, Assistant Regional Director, Securities and Exchange Commission, Los Angeles Office, 5670 Wilshire Blvd., 11th floor, Los Angeles, California 90036; and

D. CapitalWorks shall comply with the undertakings enumerated in paragraphs 17-22, above.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53944 / June 6, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2437 / June 6, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12325

In the Matter of DAVID A. RODRIGUEZ, CPA, Respondent.	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against David A. Rodriguez, CPA ("Rodriguez" or "Respondent") pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have engaged in . . . improper professional conduct.

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II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. SUMMARY

1. David A. Rodriguez, CPA, engaged in improper professional conduct in the audit of the financial statements of the Liquid Green Money Market Fund ("Liquid Green") for the fiscal year ended September 30, 2001. Because he did not audit Liquid Green's financial statements properly, Rodriguez (i) failed to detect that the fund was holding itself out as a money market fund and using the amortized cost method to value its securities when it was not entitled to do so, in violation of the Investment Company Act of 1940 ("Investment Company Act"); and (ii) caused his accounting firm, McCurdy & Associates CPAs, Inc. ("McCurdy & Associates") to issue an unqualified audit report falsely representing that Liquid Green's financial statements fairly presented the fund's financial position in conformity with generally accepted accounting principles ("GAAP") and that McCurdy & Associates had conducted its audit in accordance with generally accepted auditing standards ("GAAS").

B. RESPONDENT

2. **Rodriguez,** age 49, has been an Ohio-licensed certified public accountant ("CPA") since 1985. From May 1993 until December 2003, Rodriguez was a partner in McCurdy & Associates, an accounting firm in Westlake, Ohio that specialized in performing mutual fund audits. Rodriguez was the engagement partner for McCurdy & Associates' audit of Liquid Green's financial statements for the fiscal year ended September 30, 2001 (the "2001 Liquid Green audit"). McCurdy & Associates sold its investment industry practice, including its auditing practice, to Cohen McCurdy, Ltd. in January 2004. From January 2004 until November 2004, Rodriguez held the position of principal at Cohen McCurdy. Since November 2004, Rodriguez has been employed outside of public accounting.

[2] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

C. OTHER RELEVANT ENTITY

3. **AmeriPrime Advisors Trust ("AAT"),** an Ohio business trust, is an open-end series investment company[3] that has been registered with the Commission since 1999. On September 20, 2001, AAT organized Liquid Green as one of its series of funds. On September 28, 2001, Liquid Green acquired the assets and assumed the liabilities of the Unified Taxable Money Market Fund ("UTMM"), which was a series of the open-end series investment company Unified Funds. UTMM transferred its assets to Liquid Green and thereafter dissolved.[4] As of September 30, 2001, Liquid Green had total net assets valued at $37,695,013. In February 2002, Liquid Green dissolved after transferring all of its assets to another money market fund.

D. FACTS

4. Between March 20, 2001 and December 6, 2001, Liquid Green's portfolio manager followed an investment strategy of purchasing fixed-rate, government agency bonds with remaining maturities of between 2 1/2 and 12 years. The bonds were callable within 397 days at the discretion of the government agency, but not at the option of the purchaser. As of September 30, 2001, the last day of fiscal year 2001, these callable bonds made up over 53.1% of the fund's assets.

5. Under Rule 2a-7(c)(2)(i) of the Investment Company Act, a mutual fund cannot acquire securities with maturities in excess of 397 days and hold itself out as a money market fund unless the securities have a maturity shortening feature as provided by the rule. Furthermore, Rule 2a-7(b)(1) expressly provides that it is a material misrepresentation under Section 34(b) of the Investment Company Act for a mutual fund to hold itself out as a money market fund when it does not meet the risk limiting conditions of Rule 2a-7.

6. In this case, the callable bonds purchased by Liquid Green did not have a maturity shortening feature as provided for by Rule 2a-7 because the bonds were callable only at the discretion of the issuer. Thus, during the time period when the fund held these bonds, Liquid Green was not permitted to hold itself out as a money market fund and it was a material misrepresentation for the fund to do so.

7. In addition, a money market fund that does not meet the requirements of Rule 2a-7 is not permitted to use the amortized cost method of valuing the securities in its investment portfolio, but instead must calculate the current net asset value of its portfolio securities on a daily basis to reflect current market prices. Because Liquid Green did not meet the requirements of Rule 2a-7 during the time period when it held the ineligible bonds, the fund was not permitted to use the amortized cost method to value its securities.

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[3] Although a series investment company such as AAT is organized as a single corporate entity, it may be comprised of several different series or portfolios that function as separate investment companies.

[4] For the purposes of this Order, "Liquid Green" refers collectively to both Liquid Green and its predecessor UTMM.

8. AAT engaged McCurdy & Associates to provide audit and tax services to its series funds, including Liquid Green. Rodriguez was assigned as the engagement partner for the 2001 Liquid Green audit. As engagement partner, he had primary responsibility for planning the audit and performing the fieldwork.

9. During the fieldwork for the 2001 Liquid Green audit, Rodriguez learned that more than one half of Liquid Green's investment portfolio consisted of bonds with stated maturities greater than 397 days. Rodriguez became aware of these bonds because: (i) he reviewed Liquid Green's portfolio listing for the annual report, which accurately reported the bonds' maturities; (ii) he reviewed the "Investment Review" prepared by the fund's portfolio manager for the annual report, which stated that during 2001 the fund had "endeavored to maximize our yields" by investing in agency bonds "with a duration of many years but with a right for the agency to 'call' or redeem the bonds"; and (iii) he discussed the fund's investment strategy of purchasing callable securities with long maturities with staff of the fund administrator.

10. Despite knowing that more than half of Liquid Green's portfolio consisted of bonds with stated maturities that appeared to make them ineligible for a money market fund under Rule 2a-7, Rodriguez did not perform adequate audit procedures to review or test the bonds held in the fund's investment portfolio to determine whether they were in fact eligible for a money market fund.

11. As a result of his failure to adequately test Liquid Green's compliance with Rule 2a-7, Rodriguez failed to detect that the fund's financial statements and related notes contained material misrepresentations, including that Liquid Green was a "money market fund" and that it was proper for the fund to use the amortized cost method to value its portfolio securities.

12. On October 10, 2001, McCurdy & Associates issued an unqualified audit report on Liquid Green's financial statements as of September 30, 2001 that was included in the fund's annual report filed with the Commission on November 28, 2001.[5]

13. The unqualified audit report stated that McCurdy & Associates "audited the statements of assets and liabilities, including the portfolios of investments, of Liquid Green Money Market Fund (formerly Unified Taxable Money Market Fund) as of September 30, 2001." The report further falsely represented that (i) the fund's financial statements were presented in conformity with GAAP, and (ii) that McCurdy & Associates had audited the fund's financial statements in accordance with GAAS.

14. GAAS consist of ten auditing standards, including three general standards, three standards of fieldwork and four standards of reporting.

15. The first standard of fieldwork requires that audit work be adequately planned and supervised. AU §310.01. Rodriguez failed to comply with the first standard of fieldwork because

[5] Liquid Green's 2001 annual report was originally filed on November 28, 2001 under the wrong investment company name. After the fund administrator discovered the error, the annual report was re-filed, with no changes, under the correct investment company name on December 26, 2001.

he failed to include in the audit plan procedures to test the fund's Rule 2a-7 compliance, even after discovering that a large percentage of the fund's portfolio appeared not to comply with Rule 2a-7.

16. The third standard of fieldwork requires that "sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." AU §330.01. GAAS further provide that "representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU §333.02. "[W]hen evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity." AU §326.21(a).

17. Rodriguez violated the third standard of fieldwork because he failed to obtain competent evidential matter of Liquid Green's compliance with Rule 2a-7 and did not have a reasonable basis for opining that the fund's financial statements and related notes were fairly presented in accordance with GAAP.

18. The third general standard under GAAS provides that, "[d]ue professional care is to be exercised in the performance of the audit and the preparation of the report." AU §230.01. Among other things, due professional care requires an auditor to observe the field work and reporting standards of GAAS. AU §230.02. Additionally, due professional care requires an auditor to employ professional skepticism, which is "an attitude that includes a questioning mind and a critical assessment of audit evidence." AU §230.07. Professional skepticism requires an auditor to obtain no less persuasive evidence merely because he assumes that management is honest. AU §230.09.

19. Rodriguez failed to exercise due professional care during the 2001 Liquid Green audit by (i) failing to include in the audit plan appropriate procedures to test the fund's Rule 2a-7 compliance; (ii) failing to obtain sufficient competent evidential matter to determine whether the fund was in compliance with Rule 2a-7; and (iii) signing off on the unqualified audit report for Liquid Green even though the fund's financial statements and related notes improperly held Liquid Green out as a money market fund and misrepresented that the fund was properly using the amortized cost method of valuing securities.

20. The reporting standards under GAAS provide that an audit report "shall state whether the financial statements are presented in accordance with generally accepted accounting principles." AU §410.01. The auditor's opinion that financial statements present fairly an entity's financial position, results of operations and cash flows in conformity with GAAP should be based on a judgment that, among other things, the accounting principles are appropriate under the circumstances and that the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation. AU §411.04. Furthermore, the presentation of financial statements in conformity with GAAP includes adequate disclosure of material matters, including matters relating to the form, arrangement and content of the financial statements and their appended notes. AU §431.02.

21. Rodriguez violated the reporting standards under GAAS when he caused McCurdy & Associates to issue an unqualified audit report on Liquid Green's financial statements as of September 30, 2001 even though the financial statements and related notes contained material misrepresentations and failed to disclose material matters.

E. VIOLATIONS

22. Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in pertinent part, that, "[t]he Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have engaged in unethical or improper professional conduct."

23. With respect to persons licensed to practice as accountants, such as Rodriguez, "improper professional conduct" under Rule 102(e)(1)(ii) includes:

> (A) intentional or knowing conduct, including reckless conduct, that resulted in violation of applicable professional standards; or
>
> (B) negligent conduct, consisting of (1) a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which an accountant knows, or should have know, that heightened scrutiny was warranted, or (2) repeated instances of unreasonable conduct by an accountant, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

24. The conduct described above constitutes negligent conduct consisting of a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Rodriguez knew, or should have known, that heightened scrutiny was warranted.

F. FINDINGS

25. Based on the foregoing, the Commission finds that Rodriguez engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Rule 102(e)(1) of the Commission's Rules of Practice, it is hereby **ORDERED**, effective immediately, that:

A. Respondent Rodriguez is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After twelve (12) months from the date of this order, Respondent Rodriguez may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision.

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependant on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53953 / June 7, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2441 / June 7, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12326

In the Matter of NEVANNA SACKS, CPA, Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Nevanna Sacks, CPA ("Respondent" or "Sacks") pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of

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1 Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may … deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found … to have engaged in … improper professional conduct.

Document 15 of 49

the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. RESPONDENT

Nevanna Sacks is a certified public accountant licensed in California and Florida. Sacks was an audit manager on Arthur Andersen LLP's ("Arthur Andersen") audit of the fiscal year 2001 financial statements of Peregrine Systems, Inc. ("Peregrine") and on Arthur Andersen's reviews of Peregrine's quarterly financial statements for the company's third quarter of 2001 and first, second and third quarters of 2002.[3] Sacks previously was an audit senior on Arthur Andersen's audit of Peregrine's fiscal year 2000 financial statements and review of the company's quarterly financial statements for the third quarter of 2000 and the first and second quarters of 2001. Sacks left Arthur Andersen in May 2002. She is currently the CFO of a privately-held company.

B. OTHER RELEVANT ENTITY

Peregrine Systems, Inc. was a Delaware corporation headquartered in San Diego, California. Peregrine developed and marketed infrastructure management software products. Peregrine's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934, from its initial public offering in April 1997 until its acquisition by Hewlett-Packard Company in December 2005. Peregrine filed a Form 15 on December 19, 2005.

In February 2003, Peregrine restated its financial results for its fiscal years 2000 and 2001 and for the first three quarters of its fiscal year 2002. In its restatement for fiscal year 2001 – the year-end audit for which Sacks served as an audit manager – Peregrine reduced previously reported software license revenues by approximately \$259.7 million, from \$354.6 million down to approximately \$94.9 million.[4]

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[2] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceedings.

[3] Peregrine's fiscal year ended on March 31. Therefore, Peregrine's fiscal year 2001 involves the period from April 1, 2000, to March 31, 2001. Peregrine filed a materially false and misleading Form 10-K with the Commission for its fiscal year 2001 on June 29, 2001.

[4] In June 2003, the Commission filed a civil injunctive action against Peregrine, and the U.S. District Court in San Diego entered a Final Judgment by consent against the company, which, among other

C. FACTS

1. Sacks' Conduct

Peregrine's Reseller Revenue Scheme

a. Sacks' improper professional conduct as an auditor occurred in the context of a revenue recognition fraud being conducted by Peregrine personnel and others. Peregrine sometimes used "resellers" to help in the marketing of its software. Resellers – also called "channel partners" – are companies that purchase software for resale to end users. Peregrine frequently entered into undisclosed oral or written agreements with channel partners that made its "sales" to them conditional. These agreements freed the channel partners from any enforceable obligation to Peregrine if they failed to resell the software. Despite these side agreements, Peregrine generally recognized the revenue from these reseller agreements and used reseller revenue to meet or exceed revenue predictions. However, Peregrine's channel partners frequently failed to resell the software, and therefore failed to pay Peregrine on the deals. As a result, Peregrine did not have a history of collecting payment on its agreements with channel partners.

b. Peregrine's recognition of reseller revenue did not comply with generally accepted accounting principles ("GAAP"). The recognition of revenue from the sale of software products is controlled by the American Institute of Certified Public Accountants' Statement of Position (SOP) 97-2, "Software Revenue Recognition." SOP 97-2 prohibited Peregrine from recognizing revenue on software sales unless each of four criteria was met: (a) persuasive evidence of an arrangement exists; (b) delivery has occurred; (c) the fee is fixed or determinable; and (d) collectibility is probable. Peregrine's undisclosed side agreements with resellers made revenue recognition improper. As a separate matter, much of Peregrine's reseller revenue was not properly recognized under GAAP because collectibility was less than probable. Historically, Peregrine often failed to collect payment on agreements with resellers.

c. In addition, Peregrine's reseller agreements sometimes included extended payment terms, giving resellers as long as three years to pay Peregrine. If payment terms exceed one year, SOP 97-2 presumes the fee is not fixed or determinable and therefore revenue can not be recognized. Peregrine could overcome this presumption only by demonstrating a history of successfully collecting all payments as due under comparable arrangements. Peregrine did not have such a history.

Sacks Failed to Exercise Due Professional Care While Conducting the Peregrine Audit

d. During her work as audit senior on the Peregrine engagement, Sacks learned that other Arthur Andersen auditors had concerns regarding Peregrine's

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things, enjoined it from further violations of the anti-fraud, reporting, and books and records provisions of the federal securities laws.

reseller arrangements. In January 2000, shortly after she began work on the Peregrine engagement, Sacks learned that the Arthur Andersen partner then assigned to the Peregrine audit was concerned that Peregrine channel partners appeared to be reselling Peregrine software more slowly than the Arthur Andersen partner had anticipated. Sacks understood that as a result of his concerns, the audit partner had advised Peregrine not to recognize revenue on reseller agreements with extended payment terms. Sacks knew that Peregrine – already identified by Arthur Andersen as a high-risk audit client due to revenue recognition issues – had agreed to stop recognizing revenue on these agreements due to the audit partner's concerns. Additionally, in April 2000 a German affiliate of Arthur Andersen ("Arthur Andersen Germany"), after reviewing Peregrine's German subsidiary ("Peregrine Germany"), suspected that Peregrine Germany had been improperly recording reseller revenue. In an email memorandum dated April 14, 2000, an Arthur Andersen Germany auditor informed Sacks that, in Arthur Andersen Germany's opinion, Peregrine Germany was recording "bad revenue."

e. Sacks became an audit manager on the Peregrine engagement in September 2000 (Peregrine's second quarter of fiscal year 2001), reporting to a new partner on the engagement. Peregrine was Sacks' first assignment as an audit manager. Almost immediately after becoming a manager, Sacks received additional reports and information putting her on notice of risks regarding Peregrine's revenue recognition. For example, in October 2000, Sacks and others on the Arthur Andersen U.S. audit team received a report from an auditor with Arthur Andersen Germany identifying what the auditor characterized as "major revenue recognition issues." Later that month, Sacks was provided with a significant Peregrine contract with a reseller that provided the reseller with the right to cancel the contract. Despite the conditional nature of the agreement with the reseller, Sacks and the Arthur Andersen U.S. audit team failed to question Peregrine's recognition of revenue on it.

f. The next quarter – Peregrine's third quarter of fiscal year 2001, ended December 31, 2000 – Sacks received a report stating that a Peregrine subsidiary in the United Kingdom was experiencing collection problems on deals with resellers. Sacks also knew that the amount of channel inventory Peregrine reported to the Arthur Andersen U.S. audit team had increased by more than 25% since she had become an audit manager. Sacks also learned that Peregrine had resumed recording material amounts of software license revenue on contracts with extended payment terms. This was contrary to Peregrine's prior policy – adopted on the advice of Andersen – not to recognize revenue on agreements with extended payment terms. Sacks and the Arthur Andersen U.S. audit team did not obtain sufficient competent evidence establishing that Peregrine had the history of collections required under GAAP to recognize this revenue.

g. Sacks also served as audit manager on Arthur Andersen's audit of Peregrine's financial statements to be included in Peregrine's Form 10-K for the company's fiscal year 2001, ended March 31, 2001. Peregrine filed that Form 10-K with the Commission on June 29, 2001. During the audit, Sacks learned that auditors with Arthur Andersen Germany had refused to issue a report on the financial statements of Peregrine Germany due to revenue recognition issues, control issues, and what they described as "questionable system integrity." The Andersen Germany auditors therefore concluded that the financial statements for Peregrine Germany – identified by the Arthur Andersen U.S. audit team as a material subsidiary – were not auditable. Sacks also knew that the Arthur Andersen Germany auditors had identified three reseller contracts that Peregrine Germany had entered into in the fourth quarter of 2001 that granted extended payment terms. Sacks learned that the Arthur Andersen Germany auditors concluded that it was inappropriate to recognize revenue on these extended payment term contracts.

h. Sacks knew that the Arthur Andersen Germany auditors refused to provide an audit report regarding Peregrine's material German subsidiary. Despite the Arthur Andersen Germany auditors' refusal to provide an audit report, Sacks and the Arthur Andersen U.S. audit team did not obtain sufficient competent evidence to provide a reasonable basis for Arthur Andersen to form an opinion on Peregrine's consolidated financial statements, which included the revenue from the Peregrine Germany contracts with extended payment terms.

i. As audit manager, Sacks failed to appropriately plan and perform the audit of Peregrine's accounts receivable to obtain sufficient competent evidence to conclude that Peregrine's recognition of revenue on extended payment term deals was appropriate. In particular, Sacks did not obtain sufficient competent evidence establishing that Peregrine had the history of collections required by SOP 97-2 to overcome the presumption that revenue should not be recognized on extended payment term contracts. Peregrine had no such history of collections. The company rarely collected its reseller receivables, and Sacks knew that Peregrine had millions of dollars in unpaid inventory with resellers. Peregrine inappropriately recognized material amounts of revenue on reseller agreements in violation of GAAP, and the company materially overstated its software license revenue in its fiscal year 2001 financial statements.

j. Additionally, Sacks assisted in preparing Peregrine's response to a Comment Letter issued by the Commission's Division of Corporation Finance on March 28, 2001 ("Comment Letter"). The Comment Letter questioned certain aspects of Peregrine's reporting in its Form 10-K for fiscal year 2000 and Forms 10-Q for fiscal year 2001, including how it accounted for concession risks in extended payment term and other contracts. Peregrine's response to the Comment Letter, dated April 12, 2001, included false statements regarding, among other things, the company's history of collections. In particular, the company's response to the Comment Letter falsely stated that Peregrine had successfully collected on all extended payment term contracts. Sacks helped to prepare an initial draft of Peregrine's response to the Comment Letter, and also reviewed the final version of the response with Peregrine executives and the Arthur Andersen audit partner then assigned to the engagement before the false and misleading response was submitted to the Commission staff.

k. The conduct described above represents repeated instances of unreasonable conduct that resulted in violations of professional standards in the performance of Sacks' reviews and audit of Peregrine's financial statements.

2. Violations

a. Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides that the Commission may deny the privilege of appearing or practicing before it to any person who is found to have engaged in improper professional conduct. With respect to persons licensed to practice as accountants, "improper professional conduct" may include negligent conduct evidenced by "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." Rule 102(e)(1)(ii).

b. Sacks engaged in improper professional conduct by repeatedly engaging in unreasonable conduct, resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission. As discussed above, Sacks (i) failed to adequately audit Peregrine's accounts receivable; (ii) did not obtain sufficient competent evidential matter to conclude that Peregrine had a history of collecting on reseller agreements; (iii) failed to make adequate inquiries into Peregrine's agreements with resellers; (iv) failed to obtain sufficient competent evidential matter to afford a reasonable basis for Andersen to issue a report on the financial statements of Peregrine, which consolidated the financial statements of Peregrine Germany, a material subsidiary, after Arthur Andersen Germany refused to provide an audit report on the financial statements of Peregrine Germany; (v) failed to exercise due professional care in connection with Peregrine's false and misleading response to a Commission Comment Letter; and (vi) failed to exercise due professional care in connection with the audit and reviews.

3. Findings

a. Based on the foregoing, the Commission finds that Sacks engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Sacks' Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Sacks is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After two (2) years from the date of this order, Sacks may request that the Commission consider her reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in her practice before the Commission will be reviewed either by the independent audit committee of the public company for which she works or in some other acceptable manner, as long as she practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which she is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which she is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges her responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that her state CPA license is current and she has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 53957 / June 8, 2006

Admin. Proc. File No. 3-12072

In the Matter of the Application of

RYAN R. HENRY
10450 Billings Street
Commerce City, CO 80022

For Review of Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION - - REVIEW OF NASD ACTION

Failure to Provide Requested Information

Former registered representative of a member firm of registered securities association who failed to respond to requests for information appealed association's imposition of a bar. Held, proceedings are remanded for further consideration.

APPEARANCES

Ryan R. Henry, pro se.

Marc Menchel, Alan Lawhead, and Michael J. Garawski, for NASD.

Appeal filed: October 4, 2005
Last brief received: December 30, 2005

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I.

Ryan R. Henry, formerly a registered representative associated with 1st Discount Brokerage, Inc. ("Discount"), an NASD member firm, seeks review of NASD action. NASD found that Henry failed to provide information that it requested pursuant to NASD Investigations Rule 8210. 1/ As a result of his failure to respond, NASD barred Henry from association with any member firm in any capacity. We base our findings on an independent review of the record.

II.

By letter dated March 17, 2004, NASD staff requested that Henry provide information about allegations contained in an arbitration complaint filed with NASD. The arbitration complaint alleged that Henry had defrauded and breached his fiduciary duty to one of his customers by his conduct with respect to the customer's account. 2/

The NASD staff letter asked that Henry provide a written statement addressing these allegations by March 31, 2004. This letter was sent to the residential address listed in the Central Registration Depository ("CRD") for Henry ("Henry CRD Address"). 3/ The NASD staff sent the letter to the Henry CRD Address by certified mail, return receipt requested, and by first-class mail. The certified mail receipt was signed by Henry's grandmother, Evelyn Linsenmaier, on March 18, 2004 and returned to NASD the following day.

On April 6, 2004, NASD staff sent a second letter to the Henry CRD Address, reiterating the request for information and requiring a written response by April 20, 2004. This letter warned Henry that failure to comply with this request could subject him to disciplinary action. This letter was sent to the Henry CRD Address by certified mail, return receipt requested, and by first-class mail. The certified mail receipt was signed for on April 7, 2004. The signature is not legible, and the signatory did not print his or her name as requested by the form in the line below the signature block. The signer checked the box "agent," rather than "addressee." Henry did not respond to either the March 17 or April 6 letter.

On August 23, 2004, NASD staff sent a "Notice of Intent to Suspend" to Henry, noting that Henry had failed to respond to the staff's March 17 and April 6, 2004 letters and informing

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1/ NASD Investigations Rule 8210 requires members and associated persons to provide information if requested by NASD as part of an investigation, complaint, examination, or proceeding.

2/ Henry states that the arbitration complaint was subsequently dismissed.

3/ The Henry CRD Address appears to have been the residence of Henry's mother.

Henry that, pursuant to NASD Procedural Rule 9552, 4/ if Henry did not take corrective action by providing the information NASD had requested by September 17, 2004, NASD would suspend him from association in all capacities with any member. 5/

The Notice of Intent stated that it was sent to the Henry CRD Address by Federal Express and by first-class mail. The record does not contain a receipt that the notice was delivered to the Henry CRD Address. NASD submitted a declaration of the person responsible for sending the Notice of Intent. She avers that she was familiar with NASD's August 23, 2004 Notice of Intent and that, at the direction of NASD Regional Counsel, she mailed the Notice of Intent to the Henry CRD Address by first-class mail and by an overnight delivery service. She further attests that, in the ordinary course of business, NASD places correspondence that is returned to NASD as undeliverable in the official file for that proceeding. The declarant states that she reviewed NASD's records and determined that "it does not contain anything indicating that the Notice of Intent to Suspend was returned to NASD as undeliverable."

On September 23, 2004, NASD sent Henry, at the Henry CRD Address, a Notice of Suspension From Association With Any NASD Member ("Initial Suspension Notice"). The Initial Suspension Notice stated that because Henry failed to provide requested information or take corrective action, he was suspended from association with any NASD member. But the Initial Suspension Notice incorrectly stated that Henry had been suspended on August 18, 2004, instead of September 18, 2004. NASD sent this Notice to the Henry CRD Address by an overnight delivery service and by first-class mail. The record does not contain any documentation concerning delivery information for the overnight delivery service. The first-class envelope was returned marked in unidentified handwriting "Not At This Address" and "Return to Sender" and stamped "Returned to Sender - Attempted Not Known."

On September 28, 2004, NASD sent Henry, at the Henry CRD Address, an Amended Notice of Suspension From Association With Any NASD Member ("Amended Suspension Notice"). This Notice corrected the Initial Suspension Notice by stating that, because Henry failed to provide requested information or take corrective action, he was suspended effective September 18, 2004 from association with any NASD member. NASD sent the Amended Suspension Notice to the Henry CRD Address by an overnight delivery service and by first-class

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4/ NASD Procedural Rule 9552(a) provides that, if an associated person fails to furnish to NASD requested information, NASD may provide written notice specifying the nature of that associated person's failure and stating that the failure to take corrective action within twenty-one days after service of such written notice will result in the suspension of that person's association.

5/ The notice further stated that Henry could request a hearing pursuant to NASD Procedural Rule 9552(e), which would operate as a stay. NASD Procedural Rule 9552(e) provides that a person requesting a hearing must do so in writing before the effective date of the suspension.

mail. The record does not contain any documentation concerning delivery information for the overnight delivery service. The first-class envelope was returned stamped "Return to Sender" and "Returned to Sender - Not Deliverable As Addressed Unable to Forward," with a notation in unidentified handwriting of "FOE – Not Accepted here."

Both the Initial and Amended Suspension Notices stated that Henry could file a written request for termination of the suspension under NASD Procedural Rule 9522(f) on the grounds of full compliance with the Notice of Intent. Both Suspension Notices further stated that, pursuant to NASD Procedural Rule 9522(h), if Henry failed to request termination of the suspension within six months of the date of the Notice of Intent, he would automatically be barred from associating with any member in any capacity. 6/ NASD included copies of the Notice of Intent and its prior information requests with both the Initial and Amended Suspension Notices. Henry failed to file a written request for termination of the suspension within six months of the date of the Notice of Intent.

On March 1, 2005, NASD advised Henry that, effective immediately, he was barred from associating with any NASD member firm in any capacity (the "Bar Notice"). The Bar Notice informed Henry that he could appeal the bar to the Commission and that, "[t]o comply with the SEC's rule regarding timeliness, [Henry] must file an application for review within thirty days of [his] receipt of this letter." The Bar Notice was sent to the Henry CRD Address by an overnight delivery service and by first-class mail. The overnight delivery receipt shows that the Bar Notice was delivered to the Henry CRD Address on March 2, 2005 by leaving it at the front door.

On October 4, 2005, Henry appealed the NASD action to the Commission.

III.

Section 19(f) of the Securities Exchange Act of 1934 provides the standard for our review. 7/ We review these proceedings to determine whether "the specific grounds" on which NASD based its action "exist in fact," whether NASD's determination not to permit Henry's

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6/ NASD Procedural Rule 9552(f) provides that a person subject to a suspension pursuant to Procedural Rule 9552 may file a written request for termination of the suspension on the ground of full compliance with the notice or decision. NASD Procedural Rule 9552(h) provides that a person who is suspended under Rule 9552 and fails to request termination of the suspension within six months of issuance of the original notice of suspension will be barred automatically.

7/ 15 U.S.C. § 78s(f).

association is in accordance with its rules, and whether the rules were applied in a manner consistent with the purposes of the Exchange Act. 8/

Henry did not respond to any of NASD's communications. Henry asserts that during the period when NASD was attempting to contact him, he had moved to a new address and, consequently "was unaware that the NASD was sending correspondence to [his] previous address." Henry cites his mother's notarized letter affirming that he had moved from the Henry CRD Address and a copy of his February 2004 telephone bill to demonstrate that he was residing at a different address.

However, Henry's change of address does not excuse his failure to respond. We have emphasized the importance of associated persons, such as Henry, keeping their records current. 9/ Henry remained subject to NASD's disciplinary jurisdiction for two years after the effective date of the termination of his registration. 10/ We have previously stated that associated persons have "a continuing duty to notify the Association . . . of [their] current address, and to receive and read mail sent to [them] at that address." 11/ As we have held, Henry "cannot shift the burden of keeping information current to the NASD" because "NASD must be able to rely on its records." 12/ Otherwise, "an applicant could thwart an NASD investigation"

8/ We also consider whether NASD's action imposes an undue burden on competition. Robert J. Langley, Securities Exchange Act Rel. No. 50917 (Dec. 22, 2004), 84 SEC Docket 1959, 1963. Henry does not claim, and the record does not show, that NASD's action has imposed an undue burden on competition.

9/ See David I. Cassuto, Exchange Act Rel. 48087 (June 25, 2003), 80 SEC Docket 1775, 1779 (former registered representative who failed to comply with NASD information requests had a "responsibility to maintain a current address in the CRD . . . .").

10/ NASD Bylaws, Article V, Section 4.

11/ Warren B. Minton, Jr., Exchange Act Rel. No. 46709 (Oct. 23, 2002), 78 SEC Docket 2369, 2375 n.15 (quoting William T. Banning, 50 S.E.C. 415, 416 (1990)). Moreover, all registered representatives are required to sign and file a Form U-4 application for registration, which, among other duties, "obligates them to keep a current address on file with the NASD at all times)). Nazmi C. Hassanieh, 52 S.E.C. 87, 90 (1994). NASD By-Laws, Art. V, Sec. 2(c) requires that Form U-4 applications be "kept current at all times by supplementary amendments."

12/ Hassanieh, 52 S.E.C. at 90-91 n.13 (rejecting defense, in failure-to-cooperate proceeding, that "NASD failed to take reasonable steps to locate" respondent by contacting his former attorney).

(continued...)

by changing his address without notifying NASD or making arrangements to forward his mail. 13/

Nevertheless, we have determined that, under the circumstances of this case, a remand of this proceeding to NASD is warranted. As indicated above, certain factual aspects of this case are unclear from the record. For example, Henry maintains that "the Notice of Bar was sent to [his] parent's home and was signed by [his] grandmother Evelyn Linsenmaier who passed away shortly thereafter." In support of this assertion, Henry submitted a notarized letter from his mother that states that Linsenmaier had "apparently signed for a number of communications" from NASD that were "discovered . . . while going through [Linsenmaier's] things after her death." Henry has also submitted a copy of Linsenmaier's death certificate. NASD notes that it sent the Bar Notice to the Henry CRD Address on March 1, 2005 -- four months after Ms. Linsenmaier's death on October 27, 2004. The initial March 31, 2004 request for information clearly is signed for by Linsenmaier. The signature on the receipt acknowledging NASD's April 6 letter is illegible. The first-class envelopes transmitting the September 23 and 28 Suspension Notices were returned as undeliverable, and the Notice of Bar was left at the front door.

12/ (...continued)
NASD Procedural Rule 8210(d) requires that notice to an associated person of a member be given to the address listed for that person in CRD unless there is a "more current address . . . known" to the staff. Langley, 84 SEC Docket at 1984.

13/ Cassuto, 80 SEC Docket at 1779. See also Ashton Noshir Gowadia, 53 S.E.C. 786, 790 (1998); Hassanieh, 52 S.E.C. at 91; Alan Howard Gold, 51 S.E.C. 998, 1001 (1994).

Even if Henry were unaware of NASD's requirement to maintain a current address, his ignorance is not an excuse. Warren B. Minton, Jr., 78 SEC Docket at 2375 n.16 (rejecting claim that former registered representative was unaware of obligation to keep his address current after he left the securities industry); Richard J. Lanigan, 52 S.E.C. 375, 377 (1995) (rejecting claim that applicant was unaware of duty to keep current Form U-4 on file with NASD). Cf. Carter v. SEC, 726 F.2d 472, 473-74 (9th Cir. 1983) (rejecting claim that applicant was unaware of NASD prohibition against private securities sales).

A registered representative is "assumed as a matter of law to have read and have knowledge of these rules and requirements." Carter v. S.E.C., 726 F.2d at 473-474. See also Walter T. Black, 50 S.E.C. 424, 426 (1990) ("lack of familiarity with the NASD's rules cannot excuse [registered representative's] conduct").

We believe that a remand is appropriate to give NASD an opportunity to determine whether a bar is the appropriate sanction. 14/ Henry was barred based on NASD's expedited procedures, without any hearing or review by any NASD adjudicatory panel. On remand, we ask the parties to determine whether, under the circumstances of this case, barring Henry is consistent with the purposes of the Exchange Act. In remanding, we do not intend to suggest any view as to a particular outcome.

An appropriate order will issue. 15/

By the Commission (Chairman COX and Commissioners GLASSMAN, ATKINS, CAMPOS, and NAZARETH).

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

14/ NASD Sanction Guidelines with respect to violation of NASD Rule 8210 suggest a bar in the event the individual did not respond in any manner, but state that, where mitigation exists a suspension for up to two years may be appropriate.

15/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 53957 / June 8, 2006

Admin. Proc. File No. 3-12072

In the Matter of the Application of

RYAN R. HENRY
10450 Billings Street
Commerce City, CO 80022

For Review of Action Taken by

NASD

ORDER REMANDING PROCEEDING TO REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the proceedings with respect to Ryan R. Henry be, and they hereby are, remanded to NASD for further consideration.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
June 8, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12327

In the Matter of ROBERT E. SHANNON, Respondent.	:	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Robert E. Shannon ("Shannon" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent Shannon, age 54 (CRD #731092) is a resident of Annapolis, Maryland. From September 1996 until at least July 2003, Shannon was employed by Prudential Securities, Inc. ("PSI"), a broker-dealer and investment adviser. Shannon was the branch manager of PSI's Boston, Massachusetts branch office from approximately late 2001 until at least July 2003.

2. During the relevant time period, PSI, headquartered in Newark, New Jersey, was registered with the Commission as a broker-dealer (File No. 8-27154) and investment adviser (File No. 801-16801). Shannon was associated with PSI from in or about September 1996 until at least July 2003.

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3. During the relevant period, Shannon was a person associated with a broker or dealer.

4. During the relevant period, Shannon was a person associated with an investment adviser.

B. RESPONDENT'S CRIMINAL CONVICTION

5. On March 29, 2006, the United States Attorney for the District of Massachusetts filed a criminal Information against Shannon concerning his aiding and abetting of others' use of deceptive trading practices to trade in shares of a mutual fund on June 26, 2003. The Information charged Shannon with one count of aiding and abetting a violation of Section 10(b) of the Exchange Act. The case was filed in the United States District Court for the District of Massachusetts and is entitled *United States v. Robert E. Shannon* (Criminal No. 06-cr-10083-RWZ).

6. On May 3, 2006, Shannon pleaded guilty to the one count alleged in the Information, aiding and abetting others' violations of Section 10(b) of the Exchange Act. The misconduct underlying the criminal Information to which Shannon pleaded guilty occurred during the period in which Shannon was associated with a broker or dealer and an investment adviser.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true, and to afford the Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. IC-27392 / June 12, 2006

In the Matter of

MORGAN STANLEY & CO. INCORPORATED
1585 Broadway
New York, NY 10036-8293

MORGAN STANLEY AIP GP LP
MORGAN STANLEY DISTRIBUTION, INC.
One Tower Bridge
100 Front Street, Suite 1100
West Conshohocken, PA 19428

MORGAN STANLEY ASSET & INVESTMENT TRUST MANAGEMENT CO., LIMITED
Yebisu Garden Place Tower, # 4-20-3
Shibuya-Ku, Tokyo, Japan 150-6009

MORGAN STANLEY INVESTMENT ADVISORS INC.
MORGAN STANLEY INVESTMENT MANAGEMENT INC.
MORGAN STANLEY DISTRIBUTORS INC.
1221 Avenue of the Americas
New York, NY 10020

MORGAN STANLEY INVESTMENT MANAGEMENT COMPANY
23 Church Street, # 16-01 Capital Square
Singapore, Singapore 049481

MORGAN STANLEY INVESTMENT MANAGEMENT LIMITED
25 Cabot Square
Canary Wharf
London, UK E14 4QA

VAN KAMPEN ADVISORS INC.
40 Broad Street, Suite 915
Boston, MA 02109

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VAN KAMPEN ASSET MANAGEMENT :
VAN KAMPEN FUNDS INC. :
1 Parkview Plaza :
Oakbrook Terrace, IL 60181-5555 :

MORGAN STANLEY CAPITAL PARTNERS III, INC. :
MORGAN STANLEY GLOBAL EMERGING MARKETS, INC. :
MORGAN STANLEY PRIVATE EQUITY ASIA, INC. :
MORGAN STANLEY VENTURE CAPITAL III, INC. :
MSDW CAPITAL PARTNERS IV, INC. :
MSDW OIP INVESTORS, INC. :
MSDW REAL ESTATE SPECIAL SITUATIONS II MANAGER, L.L.C. :
MSDW VENTURE PARTNERS IV, INC. :
MSREF II, INC. :
MSREF III, INC. :
MSREF IV, L.L.C. :
MSREF V, L.L.C. :
MSVP 2002, INC. :
1585 Broadway :
New York, NY 10036 :

(812-13291) :

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

Morgan Stanley & Co. Incorporated ("MS&Co."), Morgan Stanley AIP GP LP, Morgan Stanley Asset & Investment Trust Management Co., Limited, Morgan Stanley Investment Advisors Inc., Morgan Stanley Investment Management Company, Morgan Stanley Investment Management Inc., Morgan Stanley Investment Management Limited, Van Kampen Advisors Inc., Van Kampen Asset Management, Morgan Stanley Distribution, Inc., Morgan Stanley Distributors Inc., Van Kampen Funds Inc., Morgan Stanley Capital Partners III, Inc., Morgan Stanley Global Emerging Markets, Inc., Morgan Stanley Private Equity Asia, Inc., Morgan Stanley Venture Capital III, Inc., MSDW Capital Partners IV, Inc., MSDW OIP Investors, Inc., MSDW Real Estate Special Situations II Manager, L.L.C., MSDW Venture Partners IV, Inc., MSREF II, Inc., MSREF III, Inc., MSREF IV, L.L.C., MSREF V, L.L.C. and MSVP 2002, Inc. filed an application on May 10, 2006 and an amendment to the application on May 19, 2006 requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting applicants and any other company of which MS&Co. is or hereafter becomes an affiliated person (together, "Covered Persons") from section 9(a) of the Act with respect to a securities-related injunction entered by the U.S. District Court for the District of Columbia on May 12, 2006.

On May 15, 2006, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting applicants from section 9(a) of the Act (Investment Company Act Release No. 27318) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the conduct of the applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application, as amended, filed by Morgan Stanley & Co. Incorporated, et al. (File No. 812-13291), that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of an injunction, described in the application, entered by the U.S. District Court for the District of Columbia on May 12, 2006.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC-27395; File No. S7-03-04]

RIN 3235-AJ05

Investment Company Governance

AGENCY: Securities and Exchange Commission.

ACTION: Request for additional comment.

SUMMARY: On April 7, 2006, a federal appeals court invalidated certain amendments adopted by the Securities and Exchange Commission ("Commission") to rules under the Investment Company Act of 1940 ("Act"). The Court found that the Commission had failed to seek comment on the data used to estimate the costs of the amendments, but suspended issuing its mandate in order to give the Commission an opportunity to request further comment. Because the Court's decision called into question the regularity of our proceedings, the Commission now invites further comment on the amendments, including particularly their costs. The amendments, first proposed on January 15, 2004, would impose two conditions on investment companies ("funds") relying on certain exemptive rules. First, fund boards would have to be comprised of at least 75 percent independent directors. Second, the boards would have to be chaired by an independent director. In addition to the costs of the two conditions, commenters may address any issue related to the underlying purpose of the two conditions, which is the protection of funds and fund shareholders. As required by section 2(c) of the Investment Company Act, the Commission specifically seeks comment on whether the proposed rule amendments will promote efficiency, competition, and capital formation.

DATES: Comments must be received on or before August 21, 2006.

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ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only.

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-03-04 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number S7-03-04. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Vincent Meehan, Staff Attorney, or Penelope Saltzman, Branch Chief, Office of Regulatory Policy, (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

On July 27, 2004, the Commission adopted amendments to ten exemptive rules under the Investment Company Act[1] ("Exemptive Rules") to require funds that rely on one or more of those rules to adopt certain governance practices.[2] The conditions were part of a package of amendments designed to protect the interests of funds and the fund shareholders they serve. Among other things, the amendments added two conditions for funds relying on the Exemptive Rules. First, such a fund must have a board of directors with no less than 75 percent independent directors.[3] Second, such a fund must be chaired by an independent director. The reasons for the Commission's adoption of these conditions, as well as other amendments to the Exemptive Rules, were set forth at length in the Adopting Release issued July 27, 2004.[4]

The two conditions were challenged in the United States Court of Appeals for the District of Columbia Circuit. On June 21, 2005, the Court remanded to the Commission for consideration of two deficiencies that it identified in the rulemaking.[5] After considering those two issues at a public meeting on June 29, 2005, the Commission issued a release announcing its decision not to modify the rule amendments ("Remand Release").[6] The June 29 action was then

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1 15 U.S.C. 80a.

2 Investment Company Governance, Investment Company Act Release No. 26520 (July 27, 2004) [69 FR 46378 (Aug. 2, 2004)] ("Adopting Release"). The Exemptive Rules are listed in the Adopting Release at footnote 9.

3 In this Release, we are using "independent director" to refer to a director who is not an "interested person" of the fund, as defined by the Act. See section 2(a)(19) of the Act [15 U.S.C. 80a-2(a)(19)].

4 See Adopting Release, supra note 2.

5 Chamber of Commerce v. Securities and Exchange Commission, 412 F.3d 133 (D.C. Cir. 2005).

6 See Investment Company Governance, Investment Company Act Release No. 26985 (June 30, 2005) [70 FR 39390 (July 7, 2005)] ("Remand Release").

challenged, and the Court on April 7, 2006, issued an opinion holding that the Commission violated the Administrative Procedure Act[7] by failing to seek comment on the data used to estimate the costs of the two conditions.[8] The Court vacated the two conditions, but withheld its mandate for 90 days to afford the Commission an opportunity to reopen the record for comment.[9]

II. DISCUSSION

The 75 percent condition and the independent chair condition have been extensively discussed in the prior Commission releases,[10] and commenters are referred to the discussion in those releases for a detailed treatment of them. The Commission requests comment on the costs associated with the two conditions, and suggestions for additional provisions designed to achieve the underlying purpose of the amendments, which is the protection of funds and fund shareholders.

The Court found the Commission's discussion of costs, together with an expressed expectation that these costs would be "minimal," to be inadequate. To address this, the Commission particularly seeks reliable cost data in support of commenters' assertions.

For example, in the Remand Release we attempted to identify all of the potential costs associated with the 75 percent and independent chair conditions when we assigned an estimate of direct and indirect costs to each of them; we seek comment on all of these and any other potential costs. In addition, while the Remand Release acknowledged that these costs would likely vary depending upon which of various methods funds chose to come into compliance with the

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7 5 U.S.C. 553(c).

8 Chamber of Commerce v. Securities and Exchange Commission, 443 F.3d 890 (D.C. Cir. 2006).

9 Id. at 909.

10 Investment Company Governance, Investment Company Act Release No. 26323 (Jan. 15, 2004) [69 FR 3472 (Jan. 23, 2004)] ("Proposing Release"); Adopting Release, supra note 2; Remand Release, supra note 6.

conditions, such as whether a fund came into compliance with the 75 percent condition as a result of the resignation of one or more interested directors or the selection of one or more new independent directors,[11] the Court was critical of the fact that we based those estimates in part on data from an industry survey that was not a part of the rulemaking record. We specifically solicit comment, therefore, on the adequacy of those estimates and on other appropriate measures of costs.

The Court directed our attention to gaps in the rulemaking record. We now solicit comment regarding current cost data, including such items as implementation data for funds that have voluntarily complied with either or both of the conditions. We also request comment on any other costs that funds may incur, in coming into compliance with the two conditions, that were not identified in the Remand Release. We are particularly interested in the costs incurred by small fund groups.[12]

With respect to the 75 percent condition, we request comment generally on both the monetary and non-monetary costs that funds experienced specifically relating to compliance. What were the costs of hiring and recruiting independent directors?[13] Has the increased

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[11] In the Adopting Release we estimated that approximately 60 percent of funds met the 75 percent condition at the time we adopted the rule. Adopting Release, supra note 2, at n.78. Of those that subsequently came into compliance, our staff estimates that, based upon filings made with the Commission during the last year, 49 percent did so solely as a result of one or more interested directors resigning from the board of directors, and 14 percent did so solely as a result of adding one or more independent directors. Thirty-seven percent of funds coming into compliance with the 75 percent condition experienced a change in the composition of their boards as a result of (i) the addition of independent directors and the resignation or retirement of interested directors, (ii) the resignation or retirement of both independent and interested directors, or (iii) the addition of both independent and interested directors.

[12] For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, we request comment on the potential impact of the conditions on the U.S. economy on an annual basis. 5 U.S.C. 804(2). In addition, we incorporate the Regulatory Flexibility Act analyses contained in the prior Commission releases, including the solicitation of comments therein.

[13] Our staff estimates that, based upon filings made with the Commission during the last year, 54

percentage resulted in the hiring of additional legal or other resources to support the independent directors? If so, what are the associated costs?

What were the monetary and non-monetary costs to funds of complying with the independent chair condition?[14] What were the costs of hiring and compensating an independent chair? Do independent chairs, as we anticipated they might, use additional legal services? If so, how much? Did they hire additional staff? If so, what are the associated costs? The Court, in discussing the two conditions in its April 7 opinion, found that the Commission viewed the costs to an individual fund of the independent chair condition to derive principally from the increased compensation for the independent chair and the costs of additional staff, without allowing sufficient comment on these matters. Are there other costs that should be taken into account? Are there better sources of information than those upon which the Commission relied?

Comment on costs may be made on an industry-wide basis or on an individual fund basis. Comments that are accompanied by supporting data and analysis are of greatest assistance.[15]

Finally, we note that the underlying purpose of the two conditions was, and remains, the protection of funds and fund shareholders, and that, as we have been reminded by the Court, we are bound in this rulemaking under the Investment Company Act to consider "whether the action will promote efficiency, competition, and capital formation." For these reasons we solicit

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percent of funds that came into compliance with the 75 percent condition solicited a shareholder vote to elect directors.

14 See Adopting Release, supra note 2, at n.81. Our staff estimates, based upon filings made with the Commission during the last year, 97 percent of newly selected independent chairmen were selected from among the incumbent independent directors.

15 The Commission considers costs in connection with its obligations under section 2(c) of the Investment Company Act, which requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. See 15 U.S.C. 80a-2(c). We solicit comment on any other aspect of the conditions

comment on any issue related to the underlying purpose of the two conditions, and any issue related to our required determination whether the amendments promote efficiency, competition, and capital formation.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: June 13, 2006

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that would affect this consideration.

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 27394 / June 13, 2006

In the Matter of

PROSHARES TRUST and
PROSHARE ADVISORS LLC
7501 Wisconsin Avenue, Suite 1000
Bethesda, MD 20814

SEI INVESTMENTS DISTRIBUTION
COMPANY
One Freedom Valley Drive
Oakes, PA 19456

(812-12354)

ORDER UNDER SECTIONS 6(c) AND 17(b) OF THE INVESTMENT COMPANY ACT OF 1940

ProShares Trust ("Trust"), ProShare Advisors LLC and SEI Investments Distribution Company filed an application on December 5, 2000, and amendments to the application on January 7, 2005, June 22, 2005, July 6, 2005 and March 29, 2006 requesting an order under section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 24(d) of the Act and rule 22c-1 under the Act, and under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1) and (a)(2) of the Act.

The order permits series of the Trust, an open-end management investment company, to issue shares of limited redeemability that trade in the secondary market at negotiated prices. The order allows dealers to sell shares of the series to purchasers in the secondary market unaccompanied by a prospectus, when the Securities Act of 1933 ("Securities Act") does not require prospectus delivery. The order also permits certain affiliated persons of the series to deposit securities into, and receive securities from, the series in connection with the purchase and redemption of aggregations of the series' shares.

On May 18, 2006, a notice of the filing of the application was issued (Investment Company Act Release No. 27323). The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

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The matter has been considered and it is found, on the basis of the information set forth in the application, as amended, that granting the requested exemptions is appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

In addition, it is found that the terms of the proposed transactions, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and that the proposed transactions are consistent with the policy of each registered investment company concerned and with the general purposes of the Act.

Accordingly, in the matter of ProShares Trust, et al. (File No. 812-12354),

IT IS ORDERED, under section 6(c) of the Act, that the requested exemption from sections 2(a)(32), 5(a)(1), 22(d) and 24(d) of the Act and rule 22c-1 under the Act are granted, effective immediately, subject to the conditions contained in the application, as amended.

IT IS FURTHER ORDERED, under sections 6(c) and 17(b) of the Act, that the requested exemption from sections 17(a)(1) and (a)(2) of the Act are granted, effective immediately, subject to the conditions contained in the application, as amended.

The exemption from section 24(d) of the Act does not affect a purchaser's rights under the civil liability and anti-fraud provisions of the Securities Act. Thus, rights under section 11 and section 12(a)(2) of the Securities Act extend to all purchasers who can trace their securities to a registration statement filed with the Commission, whether or not they were delivered a prospectus in connection with their purchase.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 15, 2006

IN THE MATTER OF	
America's Sports Voice, Inc. (n/k/a Milagro Holdings, Inc.), Dawcin International Corp., and Trans Continental Entertainment Group, Inc.	**: ORDER OF SUSPENSION : OF TRADING**
File No. 500-1	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of America's Sports Voice, Inc. (n/k/a Milagro Holdings, Inc.) because it has not filed a periodic report since the period ended June 30, 2001.

It also appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Dawcin International Corp. because it has not filed a periodic report since the period ended March 31, 1997.

It also appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Trans Continental Entertainment Group, Inc. because it has not filed a periodic report since the period ended January 31, 2003.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, IT IS ORDERED THAT, pursuant to Section 12(k) of the Securities Exchange Act of 1934, trading in the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 15, 2006, through 11:59 p.m. EDT on June 28, 2006.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8712 / June 15, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 53993 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12336

In the Matter of GEORGE J. CANNAN, JR., Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b)(6) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against George J. Cannan, Jr. ("Respondent" or "Cannan Jr.").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Respondent

1. Respondent is a resident of Ft. Lauderdale, Florida. He worked as a registered representative of A.G. Edwards & Sons, Inc., where he was the representative for separate accounts that he, other Cannan family members, and a corporation controlled by Harris Ballow owned. After A.G. Edwards, he has been employed as a day trader.

Other Relevant Persons

2. EpicEdge, Inc., a Texas corporation, is the product of a 1999 merger between Design Automation Systems, Inc. ("DASI"), a closely-held computer equipment reseller, and a public shell called Loch Exploration, Inc. Immediately after the merger the public company retained the Loch Exploration name, then took on the DASI name later in 1999 and finally the EpicEdge name in March 2000. The Order will use the name EpicEdge to identify the public company at all times after the merger. EpicEdge was an Internet consulting firm. At times relevant to this Order EpicEdge's stock traded over-the-counter and on the American Stock Exchange.

3. EVTC, Inc., a Delaware corporation, was engaged in the sale of refrigerants and related products. At times relevant to this Order, EVTC's stock traded on the Nasdaq Small-Cap Market.

4. George J. Cannan, Sr., is a resident of Ft. Lauderdale, Florida and Ocean Gate, New Jersey. Cannan, Sr. was the chairman and CEO of EVTC and its largest shareholder. Cannan, Sr. resigned his positions as CEO of EVTC in May 2001 and chairman in May 2002.

5. Harris D. "Butch" Ballow ("Ballow") is a four-time convicted felon who resided in Galveston, Texas, until he was incarcerated after being indicted on federal charges in Houston in early 2003. On July 9, 2004, the Commission filed an action against Ballow and others in federal district court in connection with the matters described herein. SEC v. Rose, et al., Civil Action No. H-04-CV-2799 (S.D. Texas). Ballow is currently a fugitive from justice.

Facts and Violations

6. During 1999 and 2000, Ballow and others engaged in manipulative trading and unregistered distributions of the stocks of EpicEdge and EVTC. This Order concerns Respondent Cannan Jr.'s role in the manipulation of EpicEdge and EVTC stocks.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

7. To carry out the scheme, Ballow acquired large amounts of EpicEdge stock in 1999 in a transaction registered with the Commission on Form S-8. He used this stock to finance purchases of EVTC stock, sharply diminishing the supply of EVTC stock, for the purpose of driving up the price of EVTC stock. An EVTC officer purchased EpicEdge stock on Ballow's recommendation, and such purchases helped maintain the price of the EpicEdge stock that Ballow was using to finance the purchases of EVTC stock. To enhance the effects of the purchases, Ballow made many purchases at rising prices, particularly in the last half hour of trading, and engaged in simultaneous or near simultaneous purchases and sales of stock.

8. Cannan Jr. became a registered representative at A.G. Edwards in approximately June 1999. Cannan Sr. opened an account at A.G. Edwards shortly thereafter but did little in the account until December 1999. Cannan Sr. referred Ballow to Cannan Jr., and Ballow and his associate opened an account in the name of Belsly Investment at A.G. Edwards with Cannan Jr. as the registered representative. Between January and September 2000, Ballow and his associates through Respondent placed approximately two hundred trades of EVTC and EpicEdge.

9. Cannan Jr. generally discussed the trades at A.G. Edwards with both Ballow and Cannan Sr. Respondent was reckless in not knowing that Ballow and others were engaged in a manipulation of EVTC and EpicEdge.

10. The trades placed by Respondent for Ballow included sales of EpicEdge stock that were not registered with the Commission and were not exempt from registration. The trades also included purchases of both EpicEdge and EVTC stock that occurred while Ballow was engaged in distributions of those securities.

11. As a result of the conduct described above, Cannan Jr. willfully aided and abetted and caused: (A) violations of Sections 5(a) and (c) of the Securities Act, which prohibit sales and offers of securities made without a registration statement being in effect or filed with the Commission; (B) violations of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities; (C) violations of Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities; and (D) violations of Rule 101 of Regulation M, which, among other things, prohibits persons participating in a distribution of a security from purchasing or inducing others to purchase the security.

IV.

Respondent has submitted a sworn Statement of Financial Condition dated November 30, 2005 and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest and a civil penalty.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Cannan Jr.'s Offer.

Accordingly, it is hereby ORDERED:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that Respondent Cannan Jr. cease and desist from committing or causing any violations and any future violations of Sections 5(a) and (c) and 17(a) of the Securities Act, Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Rule 101 of Regulation M.

B. Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Cannan Jr. be, and hereby is, suspended from association with any broker or dealer for a period of six (6) months, effective on the second Monday following the entry of this Order.

C. Respondent shall pay disgorgement of $18,454.00 plus prejudgment interest, but based upon Respondent's sworn representations in his Statement of Financial Condition dated November 30, 2005 and other documents submitted to the Commission, payment of such disgorgement amount is waived and the Commission is not imposing a penalty against Respondent.

D. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement and pre-judgment interest and the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest and a penalty should not be ordered; (3) contest the amount of disgorgement and interest as found in this Order; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53987 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12330

In the Matter of **Pillowtex Corporation,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), against Pillowtex Corporation ("Pillowtex" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of the foregoing, the Commission finds that:

1. Pillowtex (CIK No. 896265) is a Delaware corporation based in Kannapolis, North Carolina. At all times relevant to this proceeding, the common stock of Pillowtex has been registered under Exchange Act Section 12(g). As of December 23, 2005, the

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common stock was quoted on the Pink Sheets (current symbol: PWTXQ). The Respondent and its direct and indirect subsidiaries filed Chapter 11 bankruptcy cases on July 30, 2003.

2. Pillowtex has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its common stock was registered with the Commission, in that it has not filed quarterly or annual reports on forms 10-Q and 10-K subsequent to the annual period ended December 28, 2002.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that the registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53988 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12331

In the Matter of **The Arlen Corporation,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against The Arlen Corporation ("ARRD" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. ARRD (CIK No. 7346) is a New York corporation based in New York, New York. At all times relevant to this proceeding, the common stock and 4% preferred stock of ARRD have been registered with the Commission under Exchange Act Section 12(g). As of January 3, 2006, the common stock of ARRD was quoted on the Pink Sheets (symbol "ARRD").

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2. ARRD has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ending November 30, 1997.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that the registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53989 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12332

In the Matter of **Optimark Holdings, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Optimark Holdings, Inc. ("Optimark" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of the foregoing, the Commission finds that:

1. Optimark (CIK No. 1062023), a Delaware corporation based in New York, New York, is a holding company for two software development subsidiaries. At all times relevant to this proceeding, the common stock of Optimark has been registered

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under Exchange Act Section 12(g). The stock is neither quoted nor traded on any securities exchange, electronic bulletin board or on the Pink Sheets.

2. Optimark has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder, while its common stock was registered with the Commission in that it has not filed any periodic reports subsequent to the period ending June 30, 2003.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that the registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53990 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12333

In the Matter of **Polar Cargo Systems, Inc.** **(n/k/a Coldwall, Inc.),** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Polar Cargo Systems, Inc. (n/k/a Coldwall, Inc.) ("CDWL" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. CDWL (CIK No. 1100715) is a Delaware corporation based in Florham Park, New Jersey. At all times relevant to this proceeding, the common stock of CDWL has been registered with the Commission under Exchange Act

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Section 12(g) under its prior name of Polar Cargo Systems, Inc. As of January 5, 2006, the common stock of CDWL was quoted on the Pink Sheets (symbol "CDWL").

2. CDWL has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed periodic reports for any fiscal period subsequent to the registration of its securities under Exchange Act Section 12(g) on April 15, 2000.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that the registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53991 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12334

In the Matter of **Auspex Liquidating Corp. (f/k/a Auspex Systems, Inc.),** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Auspex Liquidating Corp. (f/k/a Auspex Systems, Inc.) ("Auspex" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Auspex (CIK No. 0000860749) is a Delaware corporation based in Santa Clara, California. At all times relevant to this proceeding, the common stock of Auspex has been registered with the Commission under Exchange Act Section 12(g) since May 11, 1993 (the "Effective Date"). From the Effective Date until May 1, 2003 the stock was listed on the Nasdaq Stock Market. Since May 2, 2003, the stock has been traded on the over-the-counter markets on an unsolicited basis (symbol "ASPXQ"). The Respondent filed a Chapter 11 bankruptcy proceeding on April 22, 2003.

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2. Auspex has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its common stock was registered with the Commission in that it has not filed an Annual Report on Form 10-K for any fiscal year subsequent to the fiscal year ending June 30, 2002, or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending December 31, 2002.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that the registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act, be, and hereby is, revoked.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 53992 / June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12335

In the Matter of **Legacy Mining Ltd.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Legacy Mining Ltd. (f/k/a Cardstakes.Com, Inc.) ("Legacy" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Legacy (CIK No. 1089565) is a Nevada corporation based in Bellingham, Washington. At all times relevant to this proceeding, the common stock of Legacy has been registered with the Commission under Exchange Act

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Section 12(g). As of November 30, 2005, the common stock of Legacy was traded on the over-the-counter markets (symbol "LGMN").

2. Legacy has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period since its Form 10-SB12G became effective on August 31, 1999.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that the registration of each class of Respondent's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M Morris

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
June 15, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12329

In the Matter of	
America's Sports Voice, Inc. (n/k/a Milagro Holdings, Inc.), EnterTech Media Group, Inc., Entertainment Boulevard, Inc., Dawcin International Corp., Easton, Inc., and Trans Continental Entertainment Group, Inc.,	**: ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**
Respondents.	

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>RESPONDENTS</u>

1. Respondent America's Sports Voice, Inc. (n/k/a Milagro Holdings, Inc.) ("America's Sports Voice") (CIK No. 1056715) is a New York corporation last reported to be located in Valley Stream, New York. America's Sports Voice has a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). America's Sports Voice is delinquent in its periodic filings with the Commission. Its last periodic report to the Commission was an incomplete 10-KSB (lacking financial statements) for the period ended June 30, 2001, filed August 15, 2001. As of June 5, 2006 America's Sports Voice's stock was quoted on the Pink Sheets (symbol MLGH), was "piggy-back" exempt under Exchange Act Rule 15c2-11(f)(3), and it had several active market makers.

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2. Respondent EnterTech Media Group, Inc. ("EnterTech") (CIK No. 1088569) is a Nevada corporation last reported to be located in Reno, Nevada. EnterTech has a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission. Its last periodic report was a Form 10-QSB for the period ended June 30, 2001, filed August 8, 2001, which reported a net loss of $30,790 on $103,890 in sales for the quarter. On March 30, 2006, the Nevada Secretary of State's on-line database showed the status of the company as "Revoked" as of December 1, 2003. As of June 5, 2006, EnterTech (symbol EMGI) was not publicly traded.

3. Respondent Dawcin International Corp. ("Dawcin") (CIK No. 856130) is a New York corporation last reported to be located in Garden City, New York. Dawcin has a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Dawcin is delinquent in its periodic filings with the Commission. Its last periodic report was a Form 10-QSB for the period ended March 31, 1997, filed May 15, 1997, which reported that the company had a net loss of $2,347,570 for the nine months then ended. On March 30, 2006, the New York Secretary of State's on-line database showed Dawcin as "Inactive." As of June 5, 2006, Dawcin's stock was quoted on the Pink Sheets (symbol DAWC), was "piggy-back" exempt under Exchange Act Rule 15c2-11(f)(3), and it had several active market makers.

4. Respondent Entertainment Boulevard, Inc. ("Entertainment Boulevard") (CIK No. 1097719) is a Nevada corporation last reported to be located in Los Angeles, California. Entertainment Boulevard has a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission. Its last periodic report was a Form 10-QSB for the period ended September 30, 2000, filed November 14, 2000, which reported that the company had sustained a loss since inception on April 1, 1997 of $73.6 million. On March 30, 2006, the Nevada Secretary of State's on-line database showed the status of the company as "Revoked" as of January 1, 2002. As of June 5, 2006, Entertainment Boulevard (symbol EBLD) was traded on the over-the-counter market.

5. Trans Continental Entertainment Group, Inc. ("Trans Continental") (CIK No. 741012) is a Nevada corporation last reported to be located in Orlando, Florida. Trans Continental has a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Trans Continental is delinquent in its periodic filings with the Commission. Its last periodic report was a Form 10-QSB for the quarter ended January 31, 2003, filed March 17, 2003, which reported that the company had no cash and virtually no revenue or tangible assets. On March 30, 2006, the Nevada Secretary of State's on-line database showed the status of the company as "Revoked" as of August 1, 2005. As of June 5, 2006, Trans Continental's stock was quoted on the Pink Sheets (symbol TCTE), was "piggy-back" exempt under Exchange Act Rule 15c2-11(f)(3), and it had several active market makers.

6. Easton, Inc. ("Easton") (CIK No. 1116202) is a Delaware corporation last reported to be located in Santa Monica, California. Easton has a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). The company is delinquent in its periodic filings with the Commission. Its last periodic report was a Form 10-QSB for the period ended June 30, 2002, filed September 12, 2002, which reported that the company had no revenue, $261 in cash and $2,970 total assets. The report also stated that Easton is "currently in the development stage and has no significant operations to date." As of June 5, 2006, Easton (symbol ETNI) was traded on the over-the-counter market.

B. <u>DELINQUENT PERIODIC FILINGS</u>

7. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1). They have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation of Finance requesting compliance with their periodic filing obligations, or they did not receive such letters due to their failure to keep current their address with the Commission as required. All of the respondents also are or have been associated with one another in business or through individuals who are or have been officers or directors of some of the respondents.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II of this Order are true, and to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registrations of each class of securities of the Respondents identified in Section II pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and placed to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If any Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified mail or by any other means permitted by the Commission's Rule of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Attachment

Appendix 1

Chart of Delinquent Filings

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Easton, Inc.					
	10-QSB	09/30/02	11/14/02	Not filed	43
	10-KSB	12/31/02	03/31/03	Not filed	39
	10-QSB	03/31/03	05/15/03	Not filed	37
	10-QSB	06/30/03	08/14/03	Not filed	34
	10-QSB	09/30/03	11/14/03	Not filed	31
	10-KSB	12/31/03	03/30/04	Not filed	27
	10-QSB	03/31/04	05/17/04	Not filed	25
	10-QSB	06/30/04	08/16/04	Not filed	22
	10-QSB	09/30/04	11/15/04	Not filed	19
	10-KSB	12/31/04	03/31/05	Not filed	15
	10-QSB	03/31/05	05/16/05	Not filed	13
	10-QSB	06/30/05	08/15/05	Not filed	10
	10-QSB	09/30/05	11/14/05	Not filed	7
	10-KSB	12/31/05	03/31/06	Not filed	3
Total Filings Delinquent	14				
Entertech Media Group, Inc.					
	10-QSB	09/30/01	11/14/01	Not filed	55
	10-KSB	12/31/01	04/01/02	Not filed	50
	10-QSB	03/31/02	05/15/02	Not filed	49
	10-QSB	06/30/02	08/14/02	Not filed	46
	10-QSB	09/30/02	11/14/02	Not filed	43
	10-KSB	12/31/02	03/31/03	Not filed	39
	10-QSB	03/31/03	05/15/03	Not filed	37
	10-QSB	06/30/03	08/14/03	Not filed	34
	10-QSB	09/30/03	11/14/03	Not filed	31
	10-KSB	12/31/03	03/30/04	Not filed	27
	10-QSB	03/31/04	05/17/04	Not filed	25
	10-QSB	06/30/04	08/16/04	Not filed	22
	10-QSB	09/30/04	11/15/04	Not filed	19
	10-KSB	12/31/04	03/31/05	Not filed	15
	10-QSB	03/31/05	05/16/05	Not filed	13
	10-QSB	06/30/05	08/15/05	Not filed	10
	10-QSB	09/30/05	11/14/05	Not filed	7
	10-KSB	12/31/05	03/31/06	Not filed	3
Total Filings Delinquent	18				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Entertainment Boulevard, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	62
	10-QSB	03/31/01	05/15/01	Not filed	61
	10-QSB	06/30/01	08/14/01	Not filed	58
	10-QSB	09/30/01	11/14/01	Not filed	55
	10-KSB	12/31/01	04/01/02	Not filed	50
	10-QSB	03/31/02	05/15/02	Not filed	49
	10-QSB	06/30/02	08/14/02	Not filed	46
	10-QSB	09/30/02	11/14/02	Not filed	43
	10-KSB	12/31/02	03/31/03	Not filed	39
	10-QSB	03/31/03	05/15/03	Not filed	37
	10-QSB	06/30/03	08/14/03	Not filed	34
	10-QSB	09/30/03	11/14/03	Not filed	31
	10-KSB	12/31/03	03/30/04	Not filed	27
	10-QSB	03/31/04	05/17/04	Not filed	25
	10-QSB	06/30/04	08/16/04	Not filed	22
	10-QSB	09/30/04	11/15/04	Not filed	19
	10-KSB	12/31/04	03/31/05	Not filed	15
	10-QSB	06/30/05	08/15/05	Not filed	10
	10-QSB	09/30/05	11/14/05	Not filed	7
	10-KSB	12/31/05	03/31/06	Not filed	3
Total Filings Delinquent	20				
Dawcin International Corp.					
	10-KSB	06/30/97	09/29/97	Not filed	105
	10-QSB	09/30/97	11/14/97	Not filed	103
	10-QSB	12/31/97	02/16/98	Not filed	100
	10-QSB	03/31/98	05/15/98	Not filed	97
	10-KSB	06/30/98	09/28/98	Not filed	93
	10-QSB	09/30/98	11/16/98	Not filed	91
	10-QSB	12/31/98	02/15/99	Not filed	88
	10-QSB	03/31/99	05/17/99	Not filed	85
	10-KSB	06/30/99	09/28/99	Not filed	81
	10-QSB	09/30/99	11/15/99	Not filed	79
	10-QSB	12/31/99	02/14/00	Not filed	76
	10-QSB	03/31/00	05/15/00	Not filed	73
	10-KSB	06/30/00	09/28/00	Not filed	69
	10-QSB	09/30/00	11/14/00	Not filed	67
	10-QSB	12/31/00	02/14/01	Not filed	64
	10-QSB	03/31/01	05/15/01	Not filed	61
	10-KSB	06/30/01	09/28/01	Not filed	57

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Dawcin International Corp. (cont.)					
	10-QSB	09/30/01	11/14/01	Not filed	55
	10-QSB	12/31/01	02/14/02	Not filed	52
	10-QSB	03/31/02	05/15/02	Not filed	49
	10-KSB	06/30/02	09/30/02	Not filed	45
	10-QSB	09/30/02	11/14/02	Not filed	43
	10-QSB	12/31/02	02/14/03	Not filed	40
	10-QSB	03/31/03	05/15/03	Not filed	37
	10-KSB	06/30/03	09/29/03	Not filed	33
	10-QSB	09/30/03	11/14/03	Not filed	31
	10-QSB	12/31/03	02/16/04	Not filed	28
	10-QSB	03/31/04	05/17/04	Not filed	25
	10-KSB	06/30/04	09/28/04	Not filed	21
	10-QSB	09/30/04	11/15/04	Not filed	19
	10-QSB	12/31/04	02/14/05	Not filed	16
	10-QSB	03/31/05	05/16/05	Not filed	13
	10-KSB	06/30/05	09/28/05	Not filed	9
	10-QSB	09/30/05	11/14/05	Not filed	7
	10-QSB	12/31/05	02/14/06	Not filed	4
Total Filings Delinquent	35				
Americas Sports Voice, Inc. n/k/a Milagro Holdings, Inc.					
	10-QSB	09/30/01	11/14/01	Not filed	55
	10-QSB	12/31/01	02/14/02	Not filed	52
	10-QSB	03/31/02	05/15/02	Not filed	49
	10-KSB	06/30/02	09/30/02	Not filed	45
	10-QSB	09/30/02	11/14/02	Not filed	43
	10-QSB	12/31/02	02/14/03	Not filed	40
	10-QSB	03/31/03	05/15/03	Not filed	37
	10-KSB	06/30/03	09/29/03	Not filed	33
	10-QSB	09/30/03	11/14/03	Not filed	31
	10-QSB	12/31/03	02/16/04	Not filed	28
	10-QSB	03/31/04	05/17/04	Not filed	25
	10-KSB	06/30/04	09/28/04	Not filed	21
	10-QSB	09/30/04	11/15/04	Not filed	19
	10-QSB	12/31/04	02/14/05	Not filed	16
	10-QSB	03/31/05	05/16/05	Not filed	13
	10-KSB	06/30/05	09/28/05	Not filed	9

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Americas Sports Voice, Inc. n/k/a Milagro Holdings, Inc. (cont.)					
	10-QSB	09/30/05	11/14/05	Not filed	7
	10-QSB	12/31/05	02/14/06	Not filed	4
Total Filings Delinquent	18				
Trans Continental Entertainment Group, Inc.					
	10-KSB	04/30/03	07/29/03	Not filed	35
	10-QSB	07/31/03	09/15/03	Not filed	33
	10-QSB	10/31/03	12/15/03	Not filed	30
	10-QSB	01/31/04	03/16/04	Not filed	27
	10-KSB	04/30/04	07/29/04	Not filed	23
	10-QSB	07/31/04	09/14/04	Not filed	21
	10-QSB	10/31/04	12/15/04	Not filed	18
	10-QSB	01/31/05	03/17/05	Not filed	15
	10-KSB	04/30/05	07/29/05	Not filed	11
	10-QSB	07/31/05	09/14/05	Not filed	9
	10-QSB	10/31/05	12/15/05	Not filed	6
	10-QSB	01/31/06	03/17/06	Not filed	3
Total Filings Delinquent	12				

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2523 / June 16, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12337

In the Matter of Kenneth W. Corba, Respondent.	:	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Kenneth W. Corba ("Corba" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Corba, age 53, a resident of Greenwich, Connecticut, was the Chief Executive Officer, Chief Investment Officer, and Managing Director of PEA Capital LLC (the sub-adviser for the PIMCO Growth, PIMCO Growth & Income, PIMCO

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Opportunity, PIMCO Target, and PIMCO Value Funds), and was the portfolio manager for the PIMCO Growth Fund and the PIMCO Select Growth Fund. Corba joined PEA Capital in 1999 and resigned on April 13, 2004. Corba became a Certified Financial Analyst in 1987 and received an MBA from the University of Michigan in 1984. He has NASD Series 2, 7, 63, and 65 licenses. On August 24, 1995, the Texas Securities Commission entered a consent order against Corba for providing investment advice without proper registration. Corba was reprimanded and granted registration. He has no other disciplinary history.

2. On June 13, 2006, a final judgment was entered by consent against Corba, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, Section 34(b) of the Investment Company Act of 1940, and Sections 206(1) and 206(2) of the Advisers Act in the civil action entitled Securities and Exchange Commission v. Stephen J. Treadway and Kenneth W. Corba, Case Number 04 Civ. 3464 (VM), in the United States District Court for the Southern District of New York. Corba was also ordered to pay a civil penalty in the amount of $200,000.

3. The Commission's complaint alleged that Corba, along with his co-defendant, engaged in a scheme to defraud investors of various PIMCO equity funds by entering into an undisclosed market timing arrangement with Canary Capital Partners LLC ("Canary") in exchange for Canary's $25 million investment of "sticky assets" into a PIMCO equity fund. The Complaint further alleges that Corba negotiated this arrangement despite disclosures in the PIMCO Funds' prospectus that the PIMCO Funds discouraged and restricted market timing. Moreover, the Complaint alleges that Corba managed the PIMCO Growth Fund, which provided $30 million in market timing capacity to Canary, and the PIMCO Select Growth Fund, which received the $25 million "sticky asset" investment from which PEA Capital LLC collected management fees.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Corba's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, Respondent Corba be, and hereby is, barred from association with any investment adviser, with the right to reapply for association after one year to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 270, and 274

[Release Nos. 33-8713; IC-27399; File No. S7-18-03]

RIN 3235-AI30

Fund of Funds Investments

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting three new rules under the Investment Company Act of 1940 that address the ability of an investment company ("fund") to acquire shares of another fund. Section 12(d)(1) of the Act prohibits, subject to certain exceptions, so-called "fund of funds" arrangements, in which one fund invests in the shares of another. The rules broaden the ability of a fund to invest in shares of another fund in a manner consistent with the public interest and the protection of investors. The Commission also is adopting amendments to forms used by funds to register under the Investment Company Act and offer their shares under the Securities Act of 1933. The amendments improve the transparency of the expenses of funds of funds by requiring that the expenses of the acquired funds be aggregated and shown as an additional expense in the fee table of the fund of funds.

DATES: Effective Date: July 31, 2006.

Compliance Dates: All new registration statements on Forms N-1A, N-2, N-3, N-4, or N-6, and all post-effective amendments that are annual updates to effective registration statements on Forms N-1A, N-2, N-3, N-4, or N-6 filed on or after January 2, 2007, must include the disclosure required by the amendments.

FOR FURTHER INFORMATION CONTACT: Dalia Osman Blass, Attorney, or Penelope

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W. Saltzman, Branch Chief, Office of Regulatory Policy, (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission today is adopting new rules 12d1-1, 12d1-2 and 12d1-3 under the Investment Company Act of 1940 (the "Investment Company Act" or the "Act") that address the ability of an investment company ("fund" or "acquiring fund") registered under the Act to invest in shares of another investment company ("fund" or "acquired fund").[1] We also are adopting amendments to Forms N-1A, N-2, N-3, N-4, and N-6 to require that prospectuses of funds of funds disclose the expenses investors in the acquiring fund will bear, including those of any acquired funds.[2] Forms N-1A and N-2 are the registration forms used by open-end management funds and closed-end management funds, respectively, to register under the Act and to offer their shares under the Securities Act of 1933 ("Securities Act").[3] Forms N-3, N-4 and N-6 are the forms used by insurance company separate accounts to register under the Act and to offer their variable annuity and variable life insurance contracts under the Securities Act.

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1 The Investment Company Act is codified at 15 U.S.C. 80a. The new rules will be found in the Code of Federal Regulations at 17 CFR 270.12d1-1, 17 CFR 270.12d1-2, and 17 CFR 270.12d1-3, respectively. For convenience, any reference we make in this release to rules 12d1-1, 12d1-2 or 12d1-3, or any paragraph of the rules, will be to those sections of the Code of Federal Regulations.

2 Rules requiring use of these forms under both the Investment Company Act and the Securities Act of 1933 may be found in the Code of Federal Regulations at: 17 CFR 239.15A, 17 CFR 274.11A (Form N-1A); 17 CFR 239.14, 17 CFR 274.11a-1 (Form N-2); 17 CFR 239.17a, 17 CFR 274.11b (Form N-3); 17 CFR 239.17b, 17 CFR 274.11c (Form N-4); and 17 CFR 239.17c, 17 CFR 274.11d (Form N-6).

3 The Securities Act is codified at 15 U.S.C. 77a. The terms "open-end management funds" and "closed-end management funds" are defined in 15 U.S.C. 80a-5(a)(1) and (2), respectively.

Table of Contents

I. BACKGROUND

The federal securities laws restrict substantially the ability of a fund to invest in shares of other funds. These restrictions are designed to prevent fund of funds arrangements that have been used in the past to enable investors in an acquiring fund to control the assets of an acquired fund and use those assets to enrich themselves at the expense of acquired fund shareholders.[4] Under section 12(d)(1) of the Act, funds are subject to certain prohibitions relating to fund of funds investments. Section 12(d)(1)(A) prohibits a registered fund (and companies or funds it controls) from—

- Acquiring more than three percent of a fund's outstanding voting securities;
- Investing more than five percent of its total assets in any one acquired fund; or

[4] For a discussion of these "pyramiding" schemes and the additional problems fund of funds arrangements can create for shareholders, see Fund of Funds Investments, Investment Company Act Release No. 26198 (Oct. 1, 2003) [68 FR 58226 (Oct. 8, 2003)] ("Proposing Release"). See also U.S. SECURITIES AND EXCHANGE COMMISSION, INVESTMENT TRUSTS AND INVESTMENT COMPANIES, H.R. DOC NO. 279, 76th Cong., 1st Sess., pt. 3, at 2721-95 (1939).

- Investing more than ten percent of its total assets in all acquired funds.[5]

Section 12(d)(1)(B) prohibits a registered open-end fund from selling securities to any fund (including unregistered funds) if, after the sale, the acquiring fund would—

- Together with companies and funds it controls, own more than three percent of the acquired fund's voting securities; or
- Together with other funds (and companies they control) own more than ten percent of the acquired fund's voting securities.[6]

Although these two provisions of section 12(d)(1) have proven quite effective in putting a stop to the abusive practices that characterized previous fund of funds arrangements, Congress has recognized that they also had the effect of preventing legitimate fund of funds arrangements. To prevent this, Congress created three statutory exceptions.[7] Our rulemaking today relates to two of those exceptions:

Unaffiliated Fund of Funds Arrangements. Section 12(d)(1)(F) permits a registered fund to take small positions in an unlimited number of other funds (an "unaffiliated fund of funds"). A fund taking advantage of the exception provided in section 12(d)(1)(F) of the Act (and its affiliated persons) may acquire no more than three percent of another fund's outstanding stock;[8]

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5 See 15 U.S.C. 80a-12(d)(1)(A). If the acquiring fund is not registered under the Act, the prohibitions apply only with respect to its acquisition of securities in funds that are registered under the Act. Funds (together with companies or funds they control and funds that have the same adviser) also are limited to acquiring no more than 10 percent of the outstanding voting stock of a closed-end fund. 15 U.S.C. 80a-12(d)(1)(C).

6 See 15 U.S.C. 80a-12(d)(1)(B). By limiting the sale of registered fund shares to other funds, section 12(d)(1)(B) prevents the creation of a fund of registered funds regardless of the limitations of U.S. law to regulate the activities of foreign funds. For a discussion of the events that led to the adoption of sections 12(d)(1)(A) and 12(d)(1)(B) of the Act, see Proposing Release, supra note 4, at nn.7-13 and accompanying text.

7 See sections 15 U.S.C. 80a-12(d)(1)(E), 15 U.S.C. 80a-12(d)(1)(F), and 15 U.S.C. 80a-12(d)(1)(G).

8 See 15 U.S.C. 80a-12(d)(1)(F)(i).

cannot charge a sales load greater than 1½ percent;[9] and is restricted in its ability to redeem shares of the acquired fund.[10] In addition, the fund's adviser would not be able to influence the outcome of shareholder votes in the acquired fund.[11]

Affiliated Fund of Funds Arrangements. Section 12(d)(1)(G) permits a registered open-end fund or unit investment trust ("UIT")[12] to acquire an unlimited amount of shares of other registered open-end funds and UITs that are part of the same "group of investment companies," (typically known as a fund complex).[13] A fund taking advantage of this exception (an "affiliated fund of funds") is restricted in the types of other securities it can hold in addition to shares of registered funds in the same group of investment companies.[14] The acquired funds must have a policy against investing in shares of other funds in reliance on section 12(d)(1)(F) or 12(d)(1)(G) (to prevent multi-tiered structures),[15] and overall distribution expenses are limited

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9 See 15 U.S.C. 80a-12(d)(1)(F)(ii).

10 A fund whose shares are acquired pursuant to section 12(d)(1)(F) is not obligated to redeem more than 1 percent of its total outstanding securities during any period of less than 30 days. 15 U.S.C. 80a-12(d)(1)(F).

11 Section 12(d)(1)(F), by reference to section 12(d)(1)(E) of the Act, requires the acquiring fund to vote shares of an acquired fund either by seeking instructions from the acquiring fund's shareholders, or to vote the shares in the same proportion as the vote of all other shareholders of the acquired fund. See 15 U.S.C. 80a-12(d)(1)(E)(iii)(aa).

12 The Act defines "unit investment trust" as a fund that: (i) is organized under a trust indenture, contract of custodianship or agency, or similar instrument; (ii) does not have a board of directors; and (iii) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities, but does not include a voting trust. 15 U.S.C. 80a-4(2).

13 15 U.S.C. 80a-12(d)(1)(G). For purposes of the exception, the term "group of investment companies" means "any 2 or more registered investment companies that hold themselves out to investors as related companies for purposes of investment and investor services." 15 U.S.C. 80a-12(d)(1)(G)(ii).

14 In addition to investing in securities of registered funds in the same group of investment companies, the Act permits these funds to invest only in government securities and short-term paper. See 15 U.S.C. 80a-12(d)(1)(G)(i)(II).

15 See 15 U.S.C. 80a-12(d)(1)(G)(i)(IV).

(to prevent excessive sales loads).[16] Relying on this provision, several large fund complexes include a fund of funds, which allocates and periodically reallocates its assets among funds in the complex.[17]

II. Discussion

Since 1940 we have provided limited relief for funds to acquire shares of other funds when the proposed arrangements did not present the risk of abuses that section 12(d)(1) was designed to prevent. We issued those orders under our general exemptive authority in section 6(c) of the Act.[18] In 1996, when Congress added section 12(d)(1)(G), it also gave us specific authority to exempt any person, security or transaction, or any class or classes of transactions, from section 12(d)(1) of the Act if the exemption is consistent with the public interest and the

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16 See 15 U.S.C. 80a-12(d)(1)(G)(i)(III). The provision permits a fund to invest in shares of another fund only if either (i) the acquiring fund does not charge a sales load or distribution-related fee or does not pay (and is not assessed) sales loads or distribution-related fees on securities of the acquired fund, or (ii) the aggregate sales loads or distribution-related fees charged by the acquiring fund on its securities and paid by the acquiring fund on acquired fund securities are not excessive under rules adopted under section 22(b) [15 U.S.C. 80a-22(b)] or 22(c) [15 U.S.C. 80a-22(c)] by a securities association registered under section 15A of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. 78o-3] or the Commission. The NASD has adopted limits on sales loads and distribution-related fees applicable to funds as well as to funds of funds. See NASD Rule 2830(d)(3) ("NASD Sales Charge Rule").

Under the NASD Sales Charge Rule for funds of funds, if neither the acquiring nor acquired fund has an asset-based sales charge (12b-1 fee), the maximum aggregate sales load that can be charged on sales of acquiring fund and acquired fund shares cannot exceed 8.5 percent. See NASD Sales Charge Rule 2830(d)(3)(A). Any acquiring or acquired fund that has an asset-based sales charge must individually comply with the sales charge limitations on funds with an asset-based sales charge, provided, among other conditions, that if both funds have an asset-based sales charge, the maximum aggregate asset-based sales charge cannot exceed .75 of 1 percent per year of the average annual net assets of both funds; and the maximum aggregate sales load may not exceed 7.25 percent of the amount invested, or 6.25 percent if either fund pays a service fee. See NASD Sales Charge Rule 2830(d)(3)(B). The rule is designed so that cumulative charges for sales-related expenses, no matter how they are imposed, are subject to equivalent limitations. See Order Approving Proposed Rule Change Relating to the Limitation of Asset-Based Sales Charges as Imposed by Investment Companies, Exchange Act Release No. 30897 (July 7, 1992) [57 FR 30985 (July 13, 1992)], at text accompanying n.9.

17 See, e.g., T. Rowe Price Retirement Funds, Prospectus 1-10 (Oct. 1, 2005).

18 15 U.S.C. 80a-6(c).

protection of investors.[19]

In October 2003, we proposed three new rules to address the ability of a registered fund to invest in shares of another fund without first having to seek Commission approval.[20] The rules were proposed to codify and expand upon a number of exemptive orders we have issued that permit funds to invest in other funds.[21] We also proposed amendments to Forms N-1A, N-2, N-3, N-4, and N-6 to require funds of funds to disclose acquired fund expenses in their prospectuses. We received five comments on the proposal.[22] Commenters supported the proposed rules and amendments, but suggested changes. Today, we are adopting rules 12d1-1, 12d1-2 and 12d1-3, and amendments to Forms N-1A, N-2, N-3, N-4, and N-6 substantially as proposed, with changes that respond to issues raised by commenters.

A. Rule 12d1-1: Investments in Money Market Funds

Rule 12d1-1 allows funds to invest in shares of money market funds in excess of the limits of section 12(d)(1). The rule is designed to permit "cash sweep" arrangements in which a fund invests all or a portion of its available cash in a money market fund rather than directly in short-term instruments. Commenters agreed with our assessment that fund investments in money market funds, which did not exist in 1940, do not raise the concerns that underlie section

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19 National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 202, 110 Stat. 3416, 3427 (1996) (codified at 15 U.S.C. 80a-12(d)(1)(J)).

20 Proposing Release, supra note 4.

21 See id, at nn.36, 72 and 87.

22 See Comment Letter of Fidelity Management & Research Company ("FMR") (Dec. 19, 2003); Comment Letter of the Investment Company Institute ("ICI") (Dec. 3, 2003); Comment Letter of IMRC Group (Nov. 18, 2003); Comment Letter of Man Investments, Inc. (Dec. 1, 2003); Comment Letter of Joel Torrance (June 17, 2004). The comment letters are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 (File No. S7-18-03). The comment letters are also available on the Commission's Internet Web site (http://www.sec.gov/rules/proposed/s71803.shtml).

12(d)(1).[23] Some, however, persuaded us to make some modifications to the rule, which we describe below.[24]

1. Scope of Exemption

(a) Registered Money Market Funds

Rule 12d1-1 permits a fund to invest an unlimited amount of its uninvested cash in a money market fund rather than directly in short-term instruments.[25] Any investment would, of course, have to be consistent with the fund's investment objectives and policies.[26] The acquired fund may be a fund in the same fund complex or in a different fund complex. Thus, a fund in a small complex that does not have a money market fund may invest available cash in an unaffiliated money market fund.

In addition to providing an exemption from section 12(d)(1) of the Act, the rule provides exemptions from section 17(a) and rule 17d-1, which restrict a fund's ability to enter into

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23 See Comment Letter of IMRC Group (Nov. 18, 2003); Comment Letter of ICI (Dec. 3, 2003). For a more extensive discussion of this analysis, see Proposing Release, supra note 4, at nn.38-39 and accompanying text.

24 One commenter recommended amending rule 17d-1 to permit joint transactions that would allow funds to take advantage of other cash management tools, such as joint repurchase agreements where the fund participates on terms not different from those applicable to its affiliated participant. See Comment Letter of ICI (Dec. 3, 2003). The broader relief suggested is outside the scope of our proposals. We are, however, adopting a technical amendment to rule 12d1-1 in response to this commenter's assertion that the proposed defined term "Administrative Fees" could create confusion because the term is used elsewhere in our rules. See, e.g., 17 CFR 270.11a-3 and Instruction 3 to Item 3 of Form N-1A. We have eliminated the term and defined the fees subject to the rule in the applicable provision without any substantive changes to the provision. See rule 12d1-1(b)(1).

25 Rule 12d1-1(a). Our exemptive orders had limited cash sweep investments to 25 percent of the acquiring fund's total assets. See, e.g., Vanguard Group, Inc., et al., Investment Company Act Release Nos. 26406 (Mar. 29, 2004) [69 FR 17460 (Apr. 2, 2004)] (notice) and 26436 (Apr. 23, 2004) (order); Putnam American Government Income Fund, et al., Investment Company Act Release Nos. 26200 (Oct. 1, 2003) [68 FR 57937 (Oct. 7, 2003)] (notice) and 26414 (Apr. 9, 2004) (order) ("Putnam Order"); Credit Suisse Asset Management, LLC, et al., Investment Company Act Release Nos. 25789 (Oct. 29, 2002) [67 FR 67220 (Nov. 4, 2002)] (notice) and 25832 (Nov. 22, 2002) (order).

26 See infra note 49.

transactions and joint arrangements with affiliated persons.[27] These provisions would otherwise prohibit an acquiring fund from investing in a money market fund in the same fund complex,[28] or prohibit a fund that acquires five percent or more of the securities of a money market fund in another fund complex from making any additional investments in the money market fund.[29]

Commenters agreed with us that an acquiring fund's purchase and redemption of money market fund shares at net asset value would provide little opportunity for the insider self-dealing or overreaching that section 17 was designed to prevent.[30] They agreed that these exemptions

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27 Section 17(a) generally prohibits affiliated persons of a registered fund ("first-tier affiliates") or affiliated persons of the fund's affiliated persons ("second-tier affiliates") from selling securities or other property to the fund (or any company the fund controls). 15 U.S.C. 80a-17(a). Section 17(d) of the Act makes it unlawful for first- and second-tier affiliates, the fund's principal underwriters, and affiliated persons of the fund's principal underwriters, acting as principal, to effect any transaction in which the fund, or a company it controls, is a joint or a joint and several participant in contravention of Commission rules. 15 U.S.C. 80a-17(d). Rule 17d-1(a) prohibits first- and second-tier affiliates of a registered fund, the fund's principal underwriters, and affiliated persons of the fund's principal underwriter, acting as principal, from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which the fund (or any company it controls) is a participant unless an application regarding the enterprise, arrangement or plan has been filed with the Commission and has been granted. 17 CFR 270.17d-1.

28 An affiliated person of a fund includes any person directly or indirectly controlling, controlled by, or under common control with such other person. See 15 U.S.C. 80a-2(a)(3)(C) (definition of "affiliated person"). Most funds today are organized by an investment adviser that advises or provides administrative services to other funds in the same complex. Funds in a fund complex are generally under common control of an investment adviser or other person exercising a controlling influence over the management or policies of the funds. See 15 U.S.C. 80a-2(a)(9). Not all advisers control funds they advise. The determination of whether a fund is under the control of its adviser, officers, or directors depends on all the relevant facts and circumstances. See Investment Company Mergers, Investment Company Act Release No. 25259 (Nov. 8, 2001) [66 FR 57602 (Nov. 15, 2001)], at n.11. For purposes of this release, we presume that funds in a fund complex are under common control because funds that are not affiliated persons would not require, and thus not rely on, the exemptions from section 17(a) and rule 17d-1.

29 An affiliated person of a fund also includes: (i) any person directly or indirectly owning, controlling, or holding with power to vote, five percent or more of the outstanding voting securities of the fund; and (ii) any person five percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote by the fund. See 15 U.S.C. 80a-2(a)(3)(A), (B). Thus, a fund that acquires five percent of the securities of another fund would be affiliated with that fund and any transactions with the fund would be subject to the limitations of section 17. See supra note 27.

30 See Comment Letter of IMRC Group (Nov. 18, 2003).

would benefit funds and their shareholders, supporting our conclusion that these provisions are appropriate and in the public interest.[31]

One commenter expressed concern, however, that without additional relief from section 17, acquiring funds might not be able to take full advantage of the proposed exemption.[32] If a fund in one fund complex acquired more than five percent of the assets of a money market fund in another fund complex, any broker-dealer affiliated with that money market fund would become a (second-tier) affiliated person of the acquiring fund.[33] As a result of the affiliation, the broker-dealer's fee for effecting the sale of securities to the acquiring fund would be subject to the conditions set forth in rule 17e-1, including the quarterly board review and recordkeeping requirements with respect to certain securities transactions involving the affiliated broker-dealer.[34] We believe that it is unlikely that a broker-dealer would be in a position to take advantage of a fund merely because that fund owned a position in a money market fund affiliated with the broker-dealer.[35] Accordingly, the final rule permits an acquiring fund to pay

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31 See Comment Letter of ICI (Dec. 3, 2003); Comment Letter of FMR (Dec. 19, 2003).

32 See Comment Letter of IMRC Group (Nov. 18, 2003). Although the commenter requested additional relief from section 17 of the Act, the commenter did not specify any sections or rules other than section 17(e) and rule 17e-1 thereunder. The additional section 17 relief we are providing is limited to certain provisions of rule 17e-1 under the Act.

33 See supra note 29.

34 Section 17(e)(2) of the Act prohibits an affiliated person (or second-tier affiliate) of a fund from receiving compensation for acting as a broker, in connection with the sale of securities to or by the fund if the compensation exceeds limits prescribed by the section unless permitted by rule 17e-1 under the Act. 15 U.S.C. 80a-17(e)(2). Rule 17e-1 sets forth the conditions under which a commission, fee or other remuneration shall be deemed as not exceeding the "usual and customary broker's commission" for purposes of section 17(e)(2)(A) of the Act. Rule 17e-1(b)(3) requires the fund's board of directors, including a majority of the directors who are not interested persons under section 2(a)(19) of the Act, to determine at least quarterly that all transactions effected in reliance on the rule have complied with procedures which are reasonably designed to provide that the brokerage compensation is consistent with the rule's standards. Rule 17e-1(d)(2) specifies the records that must be maintained by each fund with respect to any transaction effected pursuant to rule 17e-1.

35 The money market fund's adviser would have no influence over the decisions made by the

commissions, fees, or other remuneration to a (second-tier) affiliated broker-dealer without complying with the quarterly board review and recordkeeping requirements set forth in rules 17e-1(b)(3) and 17e-1(d)(2).[36] This relief is available only if the broker-dealer and the acquiring fund become affiliated solely because of the acquiring fund's investment in the money market fund. We believe this additional relief will enable more funds to take advantage of the exemption provided by the rule.

(b) Unregistered Money Market Funds

Rule 12d1-1 also permits funds to invest in money market funds that are not registered investment companies ("unregistered money market funds"). Unregistered money market funds are typically organized by a fund adviser for the purpose of managing the cash of other funds in a fund complex and operate in almost all respects as a registered money market fund, except that their securities are privately offered and thus not registered under the Securities Act.[37] Although a fund's investments in unregistered money market funds are not restricted by section 12(d)(1),

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acquiring fund's adviser. In addition, because the interests of the adviser to the money market fund and the adviser to the acquiring fund are directly aligned with their respective funds, transactions between the acquiring fund and a broker-dealer affiliate of the money market fund are likely to be at arm's length.

36 Rule 12d1-1(c). This exemption also is available for payments to broker-dealer affiliates of unregistered money market funds. See infra notes 37-42 and accompanying text. The relief provided by this exemption is similar to relief provided in a number of exemptive orders issued by the Commission. See, e.g., SunAmerica Series Trust, et al., Investment Company Act Release Nos. 21203 (July 14, 1995) [60 FR 37485 (July 20, 1995)] (notice) and 21276 (Aug. 9. 1995) (order); Prudential Investments LLC, et al., Investment Company Act Release Nos. 25736 (Sept. 18, 2002) [67 FR 59869 (Sept. 24, 2002)] (notice) and 25771 (Oct. 16, 2002) (order). An acquiring fund relying on this exemption is required to comply with all of the provisions of rule 17e-1, except 17e-1(b)(3) and (d)(2). We do not believe that having to comply with the other provisions contained in rule 17e-1 would deter acquiring funds from taking full advantage of the exemption provided by the rule.

37 See 15 U.S.C. 80a-3(c)(1) (excepting from the definition of "investment company" an issuer whose securities are owned by no more than 100 persons and which is not making and does not presently propose to make a public offering of its securities); 15 U.S.C. 80a-3(c)(7) (excepting from the definition of "investment company" an issuer whose securities are owned exclusively by "qualified purchasers" and which is not making and does not presently propose to make a public offering of its securities).

these investments are subject to the affiliate transaction restrictions in the Act and rules thereunder and thus require exemptions from section 17(a) and rule 17d-1.[38]

Commenters had no specific comments on this provision of the proposal, and we have adopted it substantially as proposed.[39] The exemption is available only for investments in an unregistered money market fund that operates like a money market fund registered under the Act. To be eligible, an unregistered money market fund is required to (i) limit its investments to those in which a money market fund may invest under rule 2a-7 under the Act,[40] and (ii) undertake to comply with all the other provisions of rule 2a-7.[41] In addition, the unregistered money market fund's adviser must be registered as an investment adviser with the Commission.[42] Finally, the acquiring fund is required to reasonably believe that the unregistered money market fund operates like a registered money market fund and that it complies with certain provisions of the Act.[43] A fund would reasonably believe that an acquired fund was in

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38 See supra notes 27-29 and accompanying text.

39 We have made a technical change to conform the wording in paragraphs 12d1-1(b)(2)(i)(A) through (E) by adding to paragraph 12d1-1(b)(2)(i) the words "satisfies the following conditions as if it were a registered open-end investment company."

40 See 17 CFR 270.2a-7.

41 Rule 12d1-1(d)(2)(ii).

42 Rule 12d1-1(b)(2)(ii). In order for a registered fund to invest in reliance on rule 12d1-1 in an unregistered money market fund that does not have a board of directors (because, for example, it is organized as a limited partnership), the unregistered money market fund's investment adviser must perform the duties required of a money market fund's board of directors under rule 2a-7. Rule 12d1-1(d)(2)(ii)(B).

43 Rule 12d1-1(b)(2)(i). To rely on the rule, an acquiring fund must reasonably believe that the unregistered money market fund complies, as if it were a registered open-end fund, with provisions of the Act that limit affiliate transactions (sections 17(a), (d), and (e)), issuance of senior securities (section 18), and suspension of redemption rights (section 22(e)). Rule 12d1-1(b)(2)(i)(B). The fund also must reasonably believe that the unregistered money market fund (i) has adopted and periodically reviews procedures designed to ensure compliance with these requirements, and maintains books and records describing the procedures, and (ii) maintains and preserves the books and records required under rules 31a-1(b)(1) [17 CFR 270.31a-1(b)(1)], 31a-1(b)(2)(ii) [17 CFR 270.31a-1(b)(2)(ii)], 31a-1(b)(2)(iv) [17 CFR 270.31a-1(b)(2)(iv)], and 31a-1(b)(9) [17 CFR 270.31a-1(b)(9)]. Rule 12d1-1(b)(2)(i)(C), (D).

compliance with these provisions if, for example, it received a representation from the acquired fund (or the adviser to the acquired fund) that the fund would comply with the relevant provisions in all material respects and if the acquiring fund had no reason to believe that the acquired fund was not, in fact, complying with the relevant provisions in all material respects. Thus, an acquired fund's failure to comply will not automatically result in the loss of the acquiring fund's exemption.

(c) Closed-End Funds of Funds

The exemptions we are adopting are also available for closed-end funds, including business development companies,[44] which are closed-end funds that are exempted from registration under the Act.[45] In response to comments, the final rule provides an additional exemption from section 57 of the Act, which restricts certain transactions between business development companies and certain of their affiliates.[46] This relief is consistent with the relief we are granting from section 17(a) and rule 17d-1 with respect to affiliated money market funds. We agree with the commenter that the possibility of self-dealing or overreaching in the case of business development companies that invest in money market funds does not appear to be any greater than investments in money market funds by registered closed-end funds.

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44 A business development company is any closed-end fund that: (i) is organized under the laws of, and has its principal place of business in, any state or states; (ii) is operated for the purpose of investing in securities described in section 55(a)(1) - (3) of the Act [15 U.S.C. 80a-54(a)(1)-(3)] and makes available "significant managerial assistance" to the issuers of those securities, subject to certain conditions; and (iii) has elected under section 54(a) of the Act to be subject to the sections addressing activities of business development companies under the Act. See 15 U.S.C. 80a-2(a)(48). Section 60 of the Act [15 U.S.C. 80a-59] extends the limits of section 12(d) to a business development company to the same extent as if it were a registered closed-end fund.

45 Section 6(f) of the Act [15 U.S.C. 80a-6(f)] exempts from registration and other provisions of the Act companies that have elected to be regulated as business development companies under section 54 [15 U.S.C. 80a-53].

46 15 U.S.C. 80a-56. See Comment Letter of IMRC Group (Nov. 18, 2003).

(d) Unregistered Funds of Funds

Unregistered funds also are subject to the section 12(d)(1) restrictions on the acquisition of shares of registered funds.[47] As proposed, the final rule permits unregistered funds to invest their cash in shares of a registered money market fund. This allows a hedge fund, for example, to sweep its cash into a registered money market fund pending investment or distribution of the cash to investors. In the Proposing Release, we asked whether any special concerns arise with respect to unregistered funds' use of money market funds in cash sweep arrangements, and we received no comment on the question.

2. Conditions

As proposed, we are eliminating most of the conditions that have been included in our exemptive orders.[48] One condition we have retained precludes the acquiring fund from paying a sales load, distribution fee, or service fee on acquired fund shares, or if it does, the acquiring fund's investment adviser must waive a sufficient amount of its advisory fee to offset the cost of the loads or distribution fees.[49] Rarely do institutional investors (such as an acquiring fund) pay

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47 See 15 U.S.C. 80a-12(d)(1)(A); 15 U.S.C. 80a-12(d)(1)(B). In the case of unregistered investment companies (such as most foreign funds) the full restrictions of sections 12(d)(1)(A) and (B) apply. Companies that are unregistered because they are excepted from the definition of investment company by sections 3(c)(1) and 3(c)(7) of the Act are prohibited from acquiring more than three percent of the outstanding voting securities of a registered fund. Both section 3(c)(1) and section 3(c)(7) deem issuers that rely on these sections to be investment companies for the purposes of sections 12(d)(1)(A)(i) and 12(d)(1)(B)(i) with respect to their acquisition of registered funds. See 15 U.S.C. 80a-3(c)(1); 15 U.S.C. 80a-3(c)(7)(D).

48 See Proposing Release, supra note 4, at n.36.

49 See Rule 12d1-1(b)(1). As discussed in the Proposing Release, we did not propose to limit the amount an acquiring fund could invest in a money market fund because a fund's own investment restrictions should provide appropriate investment limitations. See Proposing Release, supra note 4, at text following n.64. With respect to cash sweeps into unregistered money market funds, we have also retained the requirement in our prior exemptive orders that the money market funds operate as if they were money market funds registered under the Act. As proposed (unlike our exemptive orders), the final rule requires the acquiring fund to "reasonably believe," rather than "determine," that the unregistered money market funds operate in this manner. See supra notes 40-43 and accompanying text; see, e.g., Putnam Order, supra note 25.

sales loads or bear distribution expenses on an investment in a money market fund. Thus, a money market fund that charges a sales load or distribution fees to the acquiring fund may not be an appropriate investment for that fund. Commenters who addressed the issue generally supported this condition.[50]

Unlike our prior exemptive orders, the rule does not limit advisory fees or require directors to make any special findings that investors are not paying multiple advisory fees for the same service.[51] A fund could pay duplicative fees if an adviser invests a fund's cash in a money market fund (which itself pays an advisory fee) without reducing its advisory fee by an amount it was compensated to manage the cash. As we noted in the Proposing Release, fund directors have fiduciary duties,[52] which obligate them to protect funds from being overcharged for services provided to the fund, regardless of any special findings we might require. Moreover, and as we describe in more detail below, we have adopted amendments to the disclosure rules that require a registered fund of funds to disclose to shareholders expenses paid by both the acquiring and

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50 See Comment Letter of IMRC Group (Nov. 18, 2003). One commenter recommended we impose another condition to allow a money market fund to limit the percentage of fund assets that another fund complex can redeem during a business day as long as the limits are disclosed in the money market fund's registration statement. Id. We do not believe this is necessary in the context of money market funds, which are designed to easily accommodate large redemptions. Money market funds with large investors, such as a fund of funds, may need to pay particularly close attention to their obligations under rule 2a-7, however, because a large redemption may result in a growth in any deviation between the fund's net asset value per share, as computed using available market quotations, and the money market fund's amortized cost per share.

51 See Proposing Release, supra note 4, at n.65 and accompanying text.

52 See id, at n.66 and accompanying text; see also 15 U.S.C. 80a-35(a). See generally 2 T. FRANKEL, THE REGULATION OF MONEY MANAGERS, § 9.05 (2001). Section 15(c) of the Act requires the board of directors to evaluate the terms (which would include fees, or the elimination of fees, for services provided by an acquired fund's adviser) of any advisory contract. See 15 U.S.C. 80a-15(c). Section 36(b) of the Act [15 U.S.C. 80a-35(b)] imposes on fund advisers a fiduciary duty with respect to their compensation. We believe that to the extent advisory services are being performed by another person, such as the adviser to an acquired money market fund, this fiduciary duty would require an acquiring fund's adviser to reduce its fee by the amount that represents compensation for the services performed by the other person. See Proposing Release, supra note 4, at n.66.

acquired funds so that shareholders may better evaluate the costs of investing in a fund with a cash sweep arrangement.[53]

B. Rule 12d1-2: Affiliated Funds of Funds

As discussed above, section 12(d)(1)(G) permits a registered open-end fund to acquire an unlimited amount of shares of registered open-end funds and UITs that are part of the same "group of investment companies" as the acquiring fund.[54] We proposed to codify, and in some cases expand, three types of relief we have provided for these fund of funds arrangements that we concluded were consistent with the public interest and the protection of investors, but that did not conform to section 12(d)(1)(G) limits. We proposed to permit an affiliated fund of funds to make investments in addition to shares of funds in the same group of investment companies. Commenters supported the proposal, and we are adopting rule 12d1-2 substantially as proposed.[55]

1. Investments in Unaffiliated Funds

Rule 12d1-2 permits an affiliated fund of funds to acquire securities of funds that are not part of the same group of investment companies, subject to the limits in section 12(d)(1)(A) or

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53 Of course, disclosure of the cumulative amount of fees does not absolve the directors of their obligations to evaluate fund expenses. See supra note 52; Investment Company Governance, Investment Company Act Release No. 26520 (July 27, 2004) [69 FR 46378 (Aug. 2, 2004)], at text accompanying n.17. Nevertheless, we believe that the disclosure requirements are essential because they provide investors with the relevant information to compare directly the costs of investing in alternative funds of funds, or the costs of investing in a fund of funds to a more traditional fund.

54 See supra notes 12-17 and accompanying text.

55 See, e.g., Comment Letter of IMRC Group (Nov. 18, 2003); Comment Letter of ICI (Dec. 3, 2003); Comment Letter of Man Investments, Inc. (Dec. 1, 2003). The other limitations in section 12(d)(1)(G) will continue to apply to a fund of funds relying on that provision. One commenter requested expanding relief under rule 12d1-2 to permit funds to obtain shares of an acquired fund using in-kind transfers and exempt such transactions from the "for cash" requirement of rule 17a-7 under the Act. See Comment Letter of ICI (Dec. 3, 2003). That relief is outside the scope of our proposal.

12(d)(1)(F).[56] This exemption, in effect, permits funds to combine the relief provided by the statutory exceptions. There do not appear to be any greater risks to an acquired fund or its shareholders if three percent of its shares are acquired by an affiliated fund of funds as opposed to being acquired by other types of funds specifically permitted to purchase shares by section 12(d)(1)(A) or 12(d)(1)(F).[57]

2. Investments in Other Types of Issuers

Rule 12d1-2 also provides an exemption from section 12(d)(1)(G) of the Act to permit an affiliated fund of funds to invest directly in stocks, bonds, and other types of securities (i.e., securities not issued by a fund).[58] Those investments would, of course, have to be consistent with the fund's investment policies.[59] A significant consequence of the rule is that an equity or bond fund can invest any portion of its assets in an affiliated fund if the acquisition is consistent

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56 Rule 12d1-2(a)(1). A fund relying on section 12(d)(1)(A) (together with any companies or funds it controls) could not acquire more than 3 percent of the outstanding voting securities of any other fund in a different fund group. In addition, the acquiring fund would be limited to investing no more than 5 percent of its own assets (together with assets of any companies it controls) in the securities of any one fund in a different fund group, and no more than 10 percent of its assets (together with assets of any companies it controls) in securities of other funds in one or more different fund groups, in the aggregate. See 15 U.S.C. 80a-12(d)(1)(A)(i) - (iii). A fund relying on section 12(d)(1)(F) (together with its affiliates) could not acquire more than 3 percent of the outstanding stock of any other fund in a different fund group. The acquiring fund also would be required either to seek instructions from its shareholders as to how to vote shares of those acquired funds, or to vote the shares in the same proportion as the vote of all other shareholders of the acquired fund. See 15 U.S.C. 80a-12(d)(1)(F) (referencing 15 U.S.C. 80a-12(d)(1)(E)). In addition, the acquiring fund would be limited to charging a sales load of 1½ percent on its shares and could be prevented from redeeming more than 1 percent of the shares of any acquired fund during any period of less than 30 days. Id.

57 A commenter also suggested that we clarify the scope of rule 12d1-2(a)(1) because it could be read to subject investments in registered funds in the same complex as the acquiring fund to the limits of sections 12(d)(1)(A) or 12(d)(1)(F). See Comment Letter of ICI (Dec. 3, 2003). We agree, and the final rule clarifies that the limits apply only to investments in securities of unaffiliated funds rather than registered funds in the same complex. See rule 12d1-2(a)(1).

58 Rule 12d1-2(a)(2). Under this exemption, a fund may invest in any security as that term is defined under the Act. See 15 U.S.C. 80a-2(a)(36).

59 See Item 4 of Form N-1A (requiring disclosure of fund's investment objectives and principal investment strategies).

with the investment policies of the fund and the restrictions of the rule.[60] Commenters agreed that these investments would allow an acquiring fund greater flexibility in meeting investment objectives that may not be met as well by investments in other funds in the same fund group, while not presenting any additional concerns that section 12(d)(1)(G) was intended to address.[61]

3. Investments in Money Market Funds

Rule 12d1-2 permits an affiliated fund of funds to invest in affiliated or unaffiliated money market funds in reliance on rule 12d1-1, which, as discussed above, is designed to permit cash sweep arrangements involving money market funds.[62] This provision allows the affiliated fund of funds the same opportunities as any other fund to invest in a cash sweep arrangement that will provide the greatest benefit to the acquiring fund. As proposed, we are conditioning the investment on compliance with rule 12d1-1 in order to ensure that the same limitations on sales loads and distribution expenses apply to any fund's investment in a money market fund. Thus, any fund that invests in a money market fund in reliance on rule 12d1-2 must comply with the

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60 See Proposing Release, supra note 4, at nn.81-82 and accompanying text. To the extent that a fund that normally invests directly in securities begins to make investments in affiliated funds in reliance on the rule, we would expect the fund's directors to be aware of the investments, particularly in the context of their consideration of potentially duplicative fees. See supra notes 52-53 and accompanying text.

61 See Comment Letter of ICI (Dec. 3, 2003); Comment Letter of IMRC Group (Nov. 18, 2003).

62 Rule 12d1-2(a)(3). See supra notes 23-50 and accompanying text. A collateral effect of our rule is to permit an affiliated fund of funds to invest in an acquired fund that itself has a cash sweep arrangement. As discussed above, section 12(d)(1)(G) prohibits a fund from acquiring shares of another fund that does not have an investment policy prohibiting it from investing in shares of funds in reliance on section 12(d)(1)(F) or (G). An acquired fund investing in a money market fund under a cash sweep arrangement permitted under rule 12d1-1 would not be relying on either of those sections. The fees and expenses of acquired funds would be aggregated and shown in the fee table in the acquiring fund's prospectus. See discussion below at Section II.D of this release.

We are not, as one commenter suggested, providing expanded section 17 relief under rule 12d1-2. See Comment Letter of IMRC Group (Nov. 18, 2003). Affiliated funds of funds' investments in money market funds will be made in reliance upon rule 12d1-1, and we are including additional relief from certain provisions of rule 17e-1 in rule 12d1-1. We do not believe it is necessary to provide a duplicative exemption under rule 12d1-2. See supra notes 32-35 and accompanying text.

conditions in rule 12d1-1.

C. Rule 12d1-3: Unaffiliated Funds of Funds

Section 12(d)(1)(F) of the Act provides an exemption from section 12(d)(1) that allows a registered fund to invest all its assets in other registered funds if: (i) the acquiring fund (together with its affiliates) acquires no more than 3 percent of the outstanding stock of any acquired fund; and (ii) the sales load charged on the acquiring fund's shares is no greater than 1½ percent.[63]

Rule 12d1-3 allows funds relying on section 12(d)(1)(F) to charge sales loads greater than 1½ percent provided that the aggregate sales load any investor pays (i.e., the combined distribution expenses of both the acquiring and acquired funds) does not exceed the limits on sales loads established by the NASD for funds of funds.[64] The rule is intended to provide funds greater flexibility in structuring sales loads, consistent with the approach Congress took in section 12(d)(1)(G) to prevent excessive sales loads in affiliated funds of funds, while providing shareholders greater protection by requiring that funds relying on the rule limit overall distribution fees (rather than only sales loads).[65] We are adopting this rule substantially as

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63 See 15 U.S.C. 80a-12(d)(1)(F)(i)-(ii). Section 12(d)(1)(F) also provides that the acquired fund is not obligated to redeem more than 1 percent of its outstanding securities held by the acquiring fund in any period of less than 30 days, and requires the acquiring fund to vote shares of an acquired fund either by seeking instructions from the acquiring fund's shareholders or by voting in the same proportion as the other shareholders of the acquired fund.

64 See NASD Sales Charge Rule 2830(d)(3), supra note 16. We note that any fund relying on the exemption provided in rule 12d1-3 must comply with the limitations set forth in NASD Sales Charge Rule 2830(d)(3), regardless of whether sales of the fund's shares by broker-dealers are otherwise subject to the rule according to its terms. See NASD Sales Charge Rule 2830(d) (NASD Sales Charge Rule limits apply to sales of open-end funds, any closed-end funds that make periodic repurchase offers under rule 23c-3(b) under the Act and offer their shares on a continuous basis, or single payment plans issued by UITs). Unlike the proposal, the final rule text limits sales charges and service fees charged with respect to the acquiring fund, but the rule does not specifically limit those fees when aggregated with sales charges and service fees charged with respect to acquired funds. The additional language on aggregation is not necessary in the rule because limits in NASD Sales Charge Rule 2830(d)(3) specifically apply to fees imposed by the acquiring fund, the acquired fund and those funds in combination.

65 See Proposing Release, supra note 4, at n.88 and accompanying text. An affiliated fund of funds

proposed.[66]

D. Amendments to Disclosure Forms: Transparency of Fund of Funds Expenses

We are also adopting amendments to our disclosure requirements to require each fund that invests in shares of other funds to disclose in its prospectus fee table the expenses of funds in which it invests. The amendments are designed to provide investors with a better understanding of the actual costs of investing in a fund that invests in other funds, which have their own expenses that may be as high or higher than the acquiring fund's expenses.[67] Investors may not be aware of these potentially higher expenses. Most commenters supported these amendments, which we are adopting substantially as proposed.[68]

Open-End Funds. Form N-1A is used by open-end management funds to register under the Act and to offer their securities under the Securities Act. Form N-1A sets forth the disclosure requirements for fund prospectuses. Our amendments to Form N-1A require any registered open-end fund investing in shares of another fund to include in its prospectus fee table an additional line item titled "Acquired Fund Fees and Expenses" under the section that discloses total annual fund operating expenses.[69] The line item will set forth the acquiring fund's pro rata

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may rely on rule 12d1-2 to invest in funds in a different fund complex subject to the limits of section 12(d)(1)(A) or 12(d)(1)(F). If the acquiring fund's investment is subject to the limits of section 12(d)(1)(F), the acquiring fund may also rely on the exemption provided under rule 12d1-3 to charge sales loads greater than 1½ percent provided it complies with the conditions of rule 12d1-3.

66 Commenters generally supported this provision. See Comment Letter of ICI (Dec. 3, 2003); Comment Letter of FMR (Dec. 19, 2003).

67 A fund of funds may have higher fees and expenses than a fund that invests directly in debt and equity securities.

68 See Comment Letter of ICI (Dec. 3, 2003); Comment Letter of FMR (Dec. 19, 2003) (supporting position taken in the ICI comment letter); Comment Letter of IMRC Group (Nov. 18, 2003); Comment Letter of Joel Torrance (June 17, 2004).

69 The item will appear directly above the line item titled "Total Annual Fund Operating Expenses." The proposed instructions to Form N-1A would have permitted funds to use terms in the fee table other than the term "Acquired Fund." We received no comment in response to our question

portion of the cumulative expenses charged by funds in which the acquiring fund invests. Those costs will be included in the acquiring funds' total annual fund operating expenses, which will be reflected in the "Example" portion of the fee table.[70] One commenter suggested that we add an instruction to permit a fund to omit the new separate line item if the aggregate expenses attributable to acquired funds do not exceed 0.01 percent (one basis point) of average net assets of the acquiring fund. We agree with the commenter that the disclosure of this de minimis amount in a separate line item would not be important to investors. Therefore, the instructions to the amended fee table allow these expenses to be included in "Other Expenses."[71]

We also are adopting instructions to assist an acquiring fund in determining the amount of acquired funds' fees and expenses that must be reflected in its fee table. The acquiring fund must aggregate the amount of total annual fund operating expenses of acquired funds (which are indirectly paid by the acquiring fund) and transaction fees (which are directly paid by the acquiring fund over the past year) and express the total amount as a percentage of average net assets of the acquiring fund. Under this approach, the acquiring fund must determine the average

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whether the proposed instructions were consistent with the current fee table. We have decided not to permit funds to use other terms, however, because no variation is permitted for other line items in the fee table (except for the subcaptions that may be used under "Other Expenses" in order to identify the largest expenses comprising "Other Expenses"). Accordingly, the instruction, as adopted, is consistent with the other line items in the expense table, and allows investors to more easily compare disclosure among funds. In the event a fund uses another defined term to describe acquired funds in its prospectus, it may include this term in a parenthetical following the title of the new line item. See Instruction 3(f)(i) to Item 3 of Form N-1A. We are adopting conforming amendments to Forms N-2 and N-3. See Instruction 10.a to Item 3.1 of Form N-2; Instruction 19(a) to Item 3(a) of Form N-3.

70 The fee table example requires the fund to disclose the cumulative amount of fund expenses of 1, 3, 5, and 10 years based on a hypothetical investment of $10,000 and an annual 5% return. See Item 3 of Form N-1A.

71 See Comment Letter of ICI (Dec. 3, 2003). See Instruction 3(f)(i) to Item 3 of Form N-1A. Inclusion of the de minimis amount under "Other Expenses," however, ensures that the acquired funds' expenses will be included in the acquiring fund's total annual operating expense ratio. Form N-2 and Form N-3 filers may also rely on this exception and we have amended the relevant instructions accordingly. See Instruction 10.a to Item 3.1 of Form N-2; Instruction 19(a) to Item 3(a) of Form N-3.

invested balance and number of actual days invested in each acquired fund.[72] We also are adopting the proposed instruction that requires the acquiring fund to include in the expense calculation any transaction fee the acquiring fund paid to acquire or dispose of shares of a fund during the past fiscal year (even if it no longer holds shares of that fund).[73]

Our proposed instructions would have required an acquiring fund in the same fund

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72 See Instruction 3(f)(ii) to Item 3 of Form N-1A (to calculate the pro rata share of total annual fund operating expenses for each acquired fund, an acquiring fund will divide the acquired fund's expense ratio by the number of days in the relevant calendar year, and multiply the result by the average invested balance and the number of days invested in the acquired fund). We have revised the divisor in the calculation for the daily expense ratio from the proposed 365 days to the number of days in the fiscal year to reflect that some fiscal years will have 366 days. One commenter asserted that our proposed formula in Instruction 3(f)(ii) to Item 3 of Form N-1A would not correspond to the expense ratio (i.e., the Ratio of Expenses to Average Net Assets) currently in Item 8 of Form N-1A, "Financial Highlights Information." The commenter stated that, as a result, the total annual fund operating expenses disclosed in response to Item 3 would be generally higher than those reflected in response to Item 8 because the expense ratio in Item 8 would only reflect expenses paid directly by the acquiring fund. See Comment Letter of ICI (Dec. 3, 2003). We agree that this potential discrepancy may be confusing to investors, and have revised the instruction to permit funds to address this discrepancy in a clarifying footnote to the fee table. See Instruction 3(f)(vii) to Item 3 of Form N-1A. Because Form N-2 and Form N-3 filers would face the same issue, the adopted instructions permit those funds also to include a clarifying footnote. See Instruction 10.i to Item 3.1 of Form N-2; Instruction 19(g) to Item 3(a) of Form N-3. We also have directed the staff to continue monitoring funds of funds' disclosure to determine whether additional disclosure of acquired funds' fees is needed, such as in the financial highlights section or shareholder reports.

We are also revising Instruction 3(f)(v) to Item 3 of Form N-1A. The proposed instructions would have required the acquiring fund to calculate an "average invested balance" based on month-end balances. One commenter recommended that funds be permitted to calculate "average invested balances" based on the value of investment measured no less frequently than monthly to allow funds the flexibility of using daily balances. See Comment Letter of ICI (Dec. 3, 2003). We believe that the recommendation will allow the most accurate disclosure for funds that use the more frequent measure and have revised the instruction to allow the acquiring fund to calculate "average invested balance" based on the value of investment measured no less frequently than monthly. See Instruction 10.e to Item 3.1 of Form N-2; Instruction 19(e) to Item 3 of Form N-3.

73 See Instruction 3(f)(ii) to Item 3 of Form N-1A ("transaction fees" included in the calculation for acquired funds' fees and expenses include the total amount of sales loads, redemption fees, or other transaction fees paid by the acquiring fund in connection with acquiring or disposing of shares in acquired funds during the year). We clarified this instruction to indicate that "transaction fees" include fees paid in connection with acquiring and disposing of shares. If an acquired fund charges a performance fee, the fee would be included in the disclosure of acquired funds' fees and expenses. The amended instructions to Form N-1A would require an acquiring fund to include a performance fee that is accounted for as an incentive allocation, in conformance with the amended instructions to Form N-2. See infra notes 83, 84.

complex as the acquired fund to calculate the acquired fund's actual total annual expense ratio for the period covering the acquiring fund's fiscal year.[74] For funds in a different fund complex, our proposal would have required the acquiring funds to use the gross expense ratio disclosed in an acquired fund's most recent semi-annual report filed with the Commission, or if the fund does not file reports with the Commission or the gross expense ratio is not provided, to use the expense ratio provided in a recent communication from the acquired fund.[75]

One commenter questioned whether funds in the same fund complex should have to calculate this special purpose expense ratio and recommended that an acquiring fund use the acquired fund's annual expense ratio as disclosed in its most recent semi-annual report filed with the Commission.[76] We agree with the commenter that it is unnecessary to calculate a special purpose expense ratio for funds in the same fund complex because expense ratios typically do not fluctuate much from year to year. Therefore, acquired fund expense disclosure based on a special purpose expense ratio would in most cases be identical to or negligibly different from the disclosure based on the expense ratio as disclosed in the most recent shareholder report. Accordingly, the instructions as adopted require an acquiring fund to calculate the acquired funds' expenses using the net expense ratios reported in the acquired funds' most recent shareholder reports.[77] We also believe that allowing acquiring funds to use the net expense ratio

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74 See Proposing Release, supra note 4.

75 Id.

76 See Comment Letter of ICI (Dec. 3, 2003).

77 See Instruction 3(f)(iv) to Item 3 of Form N-1A. The proposal would have required acquiring funds to use a gross expense ratio, which would have excluded the effect of waivers or reimbursements. Amended instruction 3(f)(iv) requires use of the net operating expense ratio, which includes the effect of waivers or reimbursements by the acquired fund's investment adviser or sponsor. We believe that permitting funds to use the net operating expense ratio that is disclosed in shareholder reports instead of the gross expense ratio (which may not be available in shareholder reports because it is not required disclosure) will significantly reduce the need for special calculations or communications between the acquiring and acquired fund because the

disclosed in shareholder reports (which may or may not be filed with the Commission depending on whether the fund is registered with the Commission), instead of reports filed with the Commission, will permit more acquiring funds to rely on a readily available expense ratio and will eliminate the need for any special communication between the funds.[78] If an acquired fund does not provide a net expense ratio in its most recent shareholder report or is a newly formed fund that has not prepared a report, the acquiring fund must use the acquired fund's total annual fund operating expenses over average annual net assets as reported in its most recent communication to the acquiring fund.[79]

The new disclosure requirements we are adopting today also will apply with respect to investments in any unregistered fund that would be an investment company under section 3(a) of the Act but for the exceptions provided in sections 3(c)(1) and 3(c)(7) of the Act.[80] Thus, a fund with a cash sweep arrangement will be required to report the expenses of the unregistered money market fund in which the acquiring fund invests.

Closed-End Funds. Form N-2 is used by closed-end management funds to register under the Act and to offer their securities under the Securities Act. Closed-end funds sometimes invest

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acquiring fund will not have to adjust the net expense ratio disclosed in the shareholder report to exclude the effect of waivers and reimbursements. We have made conforming amendments to Forms N-2 and N-3. See Instruction 10.d to Item 3.1 of Form N-2; Instruction 19(d) to Item 3(a) of Form N-3.

78 Funds may use the most recent shareholder report, whether it is an annual or semi-annual report. If the acquiring fund relies on a semi-annual report, however, it must use an annualized expense ratio. See Instruction 3(f)(iv) to Item 3 of Form N-1A; Instruction 10.d to Item 3.1 of Form N-2; Instruction 19(d) to Item 3(a) of Form N-3.

79 See Instruction 3(f)(iv) to Item 3 of Form N-1A. We also are conforming the instruction with respect to the expense ratio used for funds in a different fund complex in order to establish a uniform instruction. We believe that this revision will provide greater consistency among funds of funds' expense disclosures. Id. We have made conforming changes to Forms N-2 and N-3. See Instruction 10.d to Item 3.1 of Form N-2; Instruction 19(d) to Item 3 of Form N-3.

80 See Instruction 3(f)(i) to Item 3 of Form N-1A, Instruction 10.a to Item 3.1 of Form N-2, Instruction 19(a) to Item 3 of Form N-3. See also 15 U.S.C. 80a-3(c)(1), 80a-3(c)(7), and supra note 37.

in other funds and unregistered pools of investments, such as hedge funds.[81] The amendments to Form N-2 require a registered closed-end fund of funds (including a closed-end fund of hedge funds) to include its pro rata portion of the cumulative expenses charged by the acquired funds, including management fees and expenses, transaction fees and performance fees (including incentive allocations), as a line item in its fee table.[82] As adopted, the instructions provide generally that any incentive allocations (fees based on a share of income, capital gains and/or appreciation) must be reflected in the acquired fund's fees and expenses.[83]

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81 Hedge funds are often "private funds" as defined in rule 203(b)(3)-1(d) of the Investment Advisers Act of 1940. 17 CFR 275.203(b)(3)-1(d) (a "private fund" is a fund (i) that would be an investment company under section 3(a) of the Investment Company Act but for the exceptions to that definition in sections 3(c)(1) and 3(c)(7) of the Act, (ii) that permits its owners to redeem any portion of their ownership interests within two years of the purchase of such interests, and (iii) interests in which are or have been offered based on the investment advisory skills, ability or expertise of the investment adviser). See also Registration Under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)], at Section II.E. Closed-end funds also may invest in private equity funds, venture capital funds, or other funds that generally require capital contributions over the life of the fund and the long-term commitment of capital. See id. at nn. 224-225.

82 See Instruction 10 to Item 3.1 of Form N-2. Consistent with the required disclosure of master-feeder funds' expenses under Form N-1A, the instructions to Form N-2 clarify that in the event a closed-end fund of funds is a master-feeder fund, the feeder fund must disclose in its fee table the aggregate expenses of the feeder fund and master fund. The aggregate expenses of the master fund must also include fees and expenses incurred indirectly by the feeder fund as a result of the master fund's investment in shares of one or more acquired funds. See Instruction 10.h to Item 3.1 of Form N-2. See also Proposing Release, supra note 4, at n.90.

As with a fund of registered funds, investors may not be aware that a fund of hedge funds may have higher fees and expenses than an alternate fund of funds or a fund that invests directly in debt and equity securities. See NASD Investor Alert, Funds of Hedge Funds – Higher Costs and Risks for Higher Potential Returns (Aug. 23, 2002) (available at: http://www.nasd.com/Investor/alerts/alert_hedgefunds.htm); STEPHEN J. BROWN, WILLIAM N. GOETZMANN, AND BING LIANG, FEES ON FEES IN FUNDS OF FUNDS, 3 (Yale International Center for Finance Working Paper No. 02-33, June 14, 2004). See also supra note 67.

83 See Instruction 10.b to Item 3.1 of Form N-2. The adviser of an acquired fund may charge its shareholders a fee based on a share of income, capital gains and/or appreciation of the assets of the shareholder in the acquired fund. This fee, which is paid to the adviser or an affiliate, is called either a performance fee or an incentive allocation depending on the way the acquired fund accounts for it in its financial statements. Performance fees are reflected in the acquired fund's statement of operations, but incentive allocations are reported in the statement of changes of capital. The effect of this accounting treatment is that performance fees are included in the acquired fund's expense ratio reported in the shareholder report but incentive allocations are not.

Each acquiring closed-end fund must determine expenses attributable to its investments in acquired funds during the most recent fiscal year together with, if applicable, any investments it intends to make with the proceeds of its present offering. The instructions require a fund to reflect the amount of expenses attributed to the intended investments assuming those investments had been held by the acquiring fund during its most recent fiscal year.[84] Given the extensive due diligence that we understand fund of hedge fund managers undertake in order to create an investment strategy for the fund, we believe that each acquiring fund should be able to provide these estimates of expenses based on written fee arrangements with acquired funds in which it invests or intends to invest.[85]

Therefore, in order to provide complete disclosure of fees incurred when funds invest in hedge funds, we are requiring acquiring funds to include these incentive allocations in the formula for calculating acquired funds' fees and expenses. We have made conforming amendments to Form N-1A. See Instruction 3(f)(ii) to Item 3 of Form N-1A.

84 See Instruction 10.f to Item 3.1 of Form N-2. The instructions to Item 3.1 clarify that an acquiring fund must use the expenses (of assumed investments) for the previous fiscal year rather than predict expenses of the acquired funds in which the acquiring fund assumes it will invest. The instructions further clarify that acquiring funds must include anticipated net proceeds from the offering in the average invested balance in each acquired fund and the average net assets of the acquiring fund. See Instructions 10.c and 10.f to Item 3.1 of Form N-2. This treatment is consistent with the treatment for funds offering shares under Form N-1A. See Instruction 3(f)(vi) to Item 3 of Form N-1A. The instructions also clarify that a fund that intends to invest in a fund that has no operating history should include fees to be paid to the adviser to that fund (or its affiliate) as disclosed in the registration statement, offering memorandum or similar document without giving effect to any performance component. See Instruction 10.d to Item 3.1 of Form N-2. We have made conforming amendments to Form N-1A. See Instruction 3(f)(iv) to Item 3 of Form N-1A.

85 Typically, funds of hedge funds invest in 15 to 25 hedge funds. See Rory B. O'Halloran, An Overview and Analysis of Recent Interest in Increased Hedge Fund Regulation, 79 TUL. L. REV. 461, 480 (2004). Most hedge fund investors perform extensive due diligence prior to making initial and subsequent investments. According to a survey of institutional investors, 60 percent of institutional investors take between two to six months to complete due diligence on a single hedge fund. Deutsche Bank, Equity Prime Services Alternative Investment Survey Results Part 2: Inside the Mind of the Hedge Fund Investor, Mar. 2003, at 1, 7. One manager of a fund of hedge funds estimates that initial due diligence on a single hedge fund manager takes 3 to 4 weeks. See George Van, The Smartest Way to Invest in Hedge Funds, available at http://www.hedgefund.com/smartest/Smartest_Way_professional.pdf. In light of our understanding that fund of hedge funds managers engage in this time consuming initial diligence, we believe that a fund is likely to have an investment allocation strategy prior to filing its

One commenter opposed our proposed disclosure requirement for a fund of hedge funds for several reasons.[86] The commenter questioned whether disclosure based on historical hedge fund expenses may be misleading because future expenses could differ materially due to the impact on performance fees of fund performance and portfolio changes. The commenter also expressed concern that investors may conclude that the acquired funds' expenses are fixed costs and not subject to change over time.[87] The commenter expressed concern that the potential fluctuation in acquired fund fees and expenses might require a fund of hedge funds to continually monitor its disclosure to guard against material misstatements or omissions in its registration statement.[88]

The Commission understands that the presentation of acquired hedge fund fees and expenses poses particular challenges for funds of hedge funds because their fees may be more variable than other types of pooled investment vehicles, such as mutual funds. The commenter's suggestion to disclose the estimated ranges of fees that hedge funds could charge in a footnote or in text somewhere other than in the fee table would not improve transparency of expenses.

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registration statement and, therefore, would be able to make the necessary assumptions in order to provide the required disclosure.

86 See Comment Letter of Man Investments, Inc. (Dec. 1, 2003).

87 The commenter also asserted that the instructions could inaccurately portray expenses of acquired hedge funds because fees may vary widely among investors in a hedge fund as a result of individual rates negotiated through side letters. Id. We share the commenter's concern. Accordingly, the final instructions require the acquiring fund to rely on the expense ratio in the shareholder report or, if applicable, any written fee agreements with acquired hedge funds to determine acquired fund fees and expenses. See Instruction 10.d to Item 3.1 of Form N-2.

88 See Comment Letter of Man Investments, Inc. (Dec. 1, 2003). The commenter also stated its belief that actual returns over time are the most important factor in comparing funds of hedge funds. We do not disagree that actual returns over time are a relevant factor for investors to consider. We believe, however, that the required disclosure will assist a fund of hedge funds investor in making an informed investment decision as to whether the benefit of diversification provided by investing in a fund of hedge funds outweighs any layering of costs. We also continue to believe that the disclosure will provide investors with the relevant information to compare directly the costs of investing in alternative funds of funds, or the costs of investing in a fund of funds to a more traditional fund. See supra note 53.

While the amount of acquired fund expenses may vary, they are expenses that we believe should be included in the total annual fund operating expenses disclosed to investors in order to provide them a more complete presentation of the aggregate direct and indirect costs of investing in a fund of funds.

We believe that we can address the commenter's concerns and still provide investors in funds of hedge funds with a better understanding of the multiple layers of fees that are charged in a fund of hedge funds investment. To accomplish this, first we have revised the instructions to require a fund of hedge funds to include in a footnote to the new line item the typical performance fee charged by acquired hedge funds in which it invests. The footnote also would alert investors that acquired hedge fund fees are based on historical expenses and could be substantially higher or lower due to potential fluctuations in acquired hedge fund performance.[89] Second, we have provided an exception that allows funds to exclude from the expense ratio disclosed in the fee table acquired fund performance fees that are calculated solely on the realization and/or distribution of gains or the sum of the realization and/or distribution of gains and unrealized appreciation of assets distributed in-kind.[90] This type of performance fee is typically paid by a private equity fund upon liquidation of the fund or when a fund has terminated an investment and distributed the proceeds or the appreciated assets to investors.[91]

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89 See Instruction 10.g to Item 3.1 of Form N-2. The footnote could, for example, state:

> [Some/All] Acquired Funds in which the Registrant invests charge a performance fee based on the Acquired Funds' earnings. The "Acquired Fund Fees and Expenses" disclosed above are based on historic earnings of the Acquired Funds, which may change substantially over time and, therefore, significantly affect Acquired Fund Fees and Expenses. The typical performance fee charged by Acquired Funds in which the Registrant invests is [INSERT PERCENTAGE].

90 See Instruction 10.d to Item 3.1 of Form N-2. We have made a conforming change to the instructions for Form N-1A. See Instruction 3(f)(iv) to Item 3 of Form N-1A.

91 See JAMES M. SCHELL, PRIVATE EQUITY FUNDS, BUSINESS STRUCTURE AND OPERATIONS §§ 1.03[3][a], 1.04[3][a] (2006).

We agree that in these circumstances, the performance fees associated with a particular period may be unrelated to the costs of investing in a fund of funds.[92]

Insurance Company Separate Accounts. We received no specific comments on our proposed amendments to Forms N-3, N-4 and N-6, and we are adopting them substantially as proposed.[93] These forms will require separate accounts to include disclosures regarding the expenses of acquired funds in their prospectuses.[94]

III. PAPERWORK REDUCTION ACT

Rule 12d1-1 will impose a new "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[95] The title of the new collection is "Rule 12d1-1." Rule 12d1-1 permits a fund to invest in unregistered money market funds notwithstanding the limitations of section 17 and rule 17d-1, if the unregistered money market funds meet certain conditions under rule 2a-7 of the Act and preserve records under rule 31 of the Act. Both rules 2a-7 and 31 contain collection of information requirements. Compliance

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92 In contrast, hedge funds generally charge performance fees that are calculated as a percentage of the hedge fund's net investment income, realized capital gains and unrealized capital appreciation. See STAFF OF U.S. SECURITIES AND EXCHANGE COMMISSION, REPORT TO THE COMMISSION ON IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS (2003) at text preceding n. 212.

93 As with the instructions to Forms N-1A and N-2, the instructions to Form N-3 require that the line item expense disclosure be titled: "Acquired Fund Fees and Expenses." See supra note 69 and accompanying text.

94 The amended instructions to Form N-3 require the same disclosure and calculation as required in the amended instructions to Forms N-1A and N-2. The amended instructions for Forms N-4 and N-6 are different from the instructions in Forms N-1A, N-2, and N-3, however, because Forms N-4 and N-6 already require registrants (i.e., separate accounts) to disclose expenses of funds ("portfolio companies") in which the separate account invests. See Item 3 of Form N-4; Item 3 of Form N-6. Accordingly, the amended instructions to Forms N-4 and N-6 require that if a portfolio company invests in other (acquired) funds, the separate account must include in the item disclosing the portfolio company's "other expenses," the acquired funds' fees and expenses calculated according to the instructions to Form N-1A. Unlike the proposal, the instructions refer specifically to portfolio companies instead of using the term "Acquiring Fund" in describing the disclosure of acquired funds' fees and expenses incurred by the portfolio company.

95 44 U.S.C. 3501.

with the collection of information requirements of rule 12d1-1 is necessary to obtain a benefit for unregistered money market funds that seek investments by registered funds that may be made only in reliance on rule 12d1-1. Responses to the collection of information requirements of rule 12d1-1 will not be kept confidential.

In the Proposing Release, Commission staff estimated that the annual hour burden of the proposed rule's collection of information requirements for unregistered money market fund compliance with rule 2a-7 would be 21,175 hours.[96] The staff also estimated that the requirements under rules 31a-1(b)(1), 31a-1(b)(2)(ii), 31a-1(b)(2)(iv), and 31a-1(b)(9) would not impose any additional burden because the costs of maintaining records would be incurred by unregistered money market funds in any case to keep books and records that are necessary to prepare financial statements for shareholders, to prepare the fund's annual income tax returns, and as a normal business practice.[97] We submitted the collection for rule 12d1-1 to the Office of Management Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. No commenters addressed these burden estimates for the collection of information requirements, and we continue to believe that they are appropriate. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. OMB approved the collection of information under control number 3235-0212 (expiring on May 31, 2007).[98]

In addition, the Commission is adopting amendments to certain forms that currently contain mandatory "collection of information" requirements. The titles for the existing

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96 See Proposing Release, supra note 4, at n.138 and accompanying text.

97 Id. at text following n.138.

98 We are adopting rule 12d1-1 with some modifications, which are described in Section II of this release. None of the modifications affects the PRA analysis or collection of information burden approved by OMB.

collections are: (i) "Form N-1A under the Securities Act of 1933 and the Investment Company Act of 1940, Registration Statement of Open-End Management Investment Companies;" (ii) "Form N-2 under the Securities Act of 1933 and the Investment Company Act of 1940, Registration Statement of Closed-End Management Investment Companies;" (iii) "Form N-3 under the Securities Act of 1933 and the Investment Company Act of 1940, Registration Statement of Separate Accounts Organized as Management Investment Companies;" (iv) "Form N-4 under the Securities Act of 1933 and the Investment Company Act of 1940, Registration Statement of Separate Accounts Organized as Unit Investment Trusts;" and (v) "Form N-6 under the Securities Act of 1933 and the Investment Company Act of 1940, Registration Statement of Separate Accounts Organized as Unit Investment Trusts that Offer Variable Life Insurance Policies." The amendments require that investors in a registered fund of funds receive more transparent disclosure of the costs of investing in these arrangements. The disclosure is designed to provide investors with a more complete presentation of the actual costs of investing in a fund that invests in other funds, which have their own expenses that may be as high or higher than the acquiring fund's expenses. Compliance with the disclosure requirements of Forms N-1A, N-2, N-3, N-4 and N-6 is mandatory. Responses to the disclosure requirements will not be kept confidential.

In the Proposing Release, Commission staff estimated that the amendment to the disclosure requirement will add up to 7 hours per portfolio to the existing hour burden associated with completing Forms N-1A, N-2 and N-3, and 0.5 hours to the existing hour burden associated with completing Forms N-4 and N-6.[99] No commenters addressed the burden estimates for the collection of information requirements associated with Forms N-1A, N-3, N-4 and N-6, and we

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[99] See Proposing Release, supra note 4, at nn.139-161 and accompanying text.

continue to believe that they are appropriate.[100]

One commenter, a fund of hedge funds, disagreed with our Form N-2 estimate. The commenter asserted that calculating the costs would entail vast amounts of time by numerous personnel reviewing a large number of hedge funds that provide information in varying formats. The commenter added that it believes a fund of hedge funds would be required to monitor and recalculate actual performance fees paid on an ongoing basis to guard against a material misstatement in the fee table.[101] The commenter provided cost estimates but did not provide any specific estimates of burden hours. Funds offering their shares on a continuous or delayed basis in reliance on Rule 415 under the Securities Act must update their registration statements under certain circumstances.[102] We have revised the PRA estimate to reflect staff estimates that funds

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[100] We have revised the final instructions for calculating acquired funds' expenses as described above. See supra notes 77-79 and accompanying text. Although the staff believes that these modifications may provide funds with some time and cost savings, we are not changing our hour burden estimates. We will review the estimates when the collection of information requirements must be resubmitted for review, and at that time we will be able to consider funds' actual experience in complying with them.

[101] See Comment Letter of Man Investments, Inc. (Dec. 1, 2003).

[102] See 17 CFR 230.415. Section 10(a)(3) of the Securities Act provides that "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." 15 U.S.C. 77j(a)(3). In general, funds that are offering their securities on a continuous or delayed basis in reliance on Rule 415 file annual post-effective amendments to update the prospectus in the registration statement pursuant to section 10(a)(3). In addition to the statutory provisions of section 10(a)(3), Rule 415 and Form N-2 require that the registrant undertake to file a post-effective amendment to reflect: (i) any prospectus required by section 10(a)(3) of the Securities Act; (ii) facts or events arising after the effective date that "represent a fundamental change in the information set forth in the registration statement;" and (iii) material information with respect to the plan of distribution not disclosed previously in the registration statement or any material change to such information in the registration statement See 17 CFR 230.415(a)(3); Item 34.4.a of Form N-2. In the release adopting Rule 415, the Commission noted that "the term 'fundamental' is intended to reflect current staff practice under which post-effective amendments are filed when major and substantial changes are made to information contained in the registration statement. Material changes that can be stated accurately and succinctly in a short sticker will continue to be permitted. While many variations in matters such as operating results, properties, business, product development, backlog, management and litigation ordinarily would not be fundamental, major changes in the issuer's

offering their shares on a continuous basis file updated registration statements on at least an annual basis. The revised estimated annual burden per fund of hedge fund is 213 hours.[103]

Based on recent Commission filings, 23 registered funds of hedge funds offer their shares on a continuous basis under rule 415 of the Securities Act. Therefore, the staff estimates the additional annual burden for funds of hedge funds to update the acquired fund expenses in their prospectuses pursuant to the requirements of section 10(a)(3) of the Securities Act is 2450 hours.[104]

Based on recent filings, Commission staff estimates that, on an annual basis, registrants

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operations, such as significant acquisitions or dispositions, would require the filing of a post-effective amendment. Also, any change in the business or operations of the registrant that would necessitate a restatement of the financial statements always would be reflected in a post-effective amendment." See Adoption of Integrated Disclosure System, Securities Act Release No. 6383 (Mar. 3, 1982) [47 FR 11380 (Mar. 16, 1982)] at text accompanying nn.79-81. See also Guide 8 to Form N-2. In addition, purchasers of an issuer's securities in a registered offering have private rights of action for materially deficient disclosure in prospectuses and oral communications under section 12(a)(2) of the Securities Act. See 15 U.S.C. 77l(a)(2); see also Securities Offering Reform, Securities Act Release No. 8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)] at Section IV.A (discussing information conveyed by the time of sale for purposes of liability under section 12(a)(2)).

103 The increase in annual hour burden was estimated using an average of the range of costs the commenter estimated a fund of hedge funds would incur to prepare the disclosure ($16,500) and dividing that cost by the estimated hourly cost to prepare the disclosure: $16,500 ÷ $77.42. = 213.12. Therefore, the estimated total annual burden per fund of hedge funds to prepare the disclosure is 213 hours. The estimated hourly cost is the weighted average of the cost to prepare the disclosure for other closed-end funds ($404 (cost of 6 hours of an accountant's time) + $138 (cost of 1 hour of an attorney's time) ÷ 7 = $77.42). See infra note 120. This estimate also includes the costs of including the footnote to the line item that discloses the typical performance fee charged by the hedge funds in which the acquiring fund invests or intends to invest.

104 Any post-effective amendment to a registration statement filed to update the information in the prospectus for purposes of section 10(a)(3) of the Securities Act or to reflect fundamental changes in the information in the prospectus contained in the registration statement would also revise the information regarding the acquired funds' fees and expenses. Because only a portion of acquired funds' fees and expenses may be updated in the annual post-effective amendment to reflect additional or revised fees and expenses, since the date of the last updating, resulting from existing, newly acquired or to be acquired funds, the Commission estimates that a fund of hedge funds in continuous offering would spend approximately 50% of the time it takes to determine the initial acquired hedge funds disclosure (213 hours) to review and update its calculation of acquired funds' fees and expenses prior to filing a post-effective amendment. Therefore, the annual burden for funds of hedge funds in continuous registration is an additional 2450 hours ((213 hours ÷ 2 = 106.5 hours) (106.5 hours x 23 funds = 2449.5 hours)).

file 234 initial registration statements (of which 11 are funds of hedge funds) and 38 post-effective amendments (including 23 post-effective amendments for funds of hedge funds in continuous registration). The current estimated total annual burden for the preparation and filing of Form N-2 is 120,673 hours.[105] Accordingly, we estimate the total annual burden for all funds for the preparation and filing of initial registrations statements and post-effective amendments to Form N-2 would be 125,389 hours.[106]

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. We submitted the collections of information associated with Forms N-1A, N-2, N-3, N-4 and N-6 to OMB to review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. OMB approved the collections of information under control numbers 3235-0307 (Form N-1A, expiring on December 31, 2007), 3235-0026 (Form N-2, expiring on January 31, 2008, revised submission currently under review by OMB), 3235-0316 (Form N-3, expiring on July 31, 2007), 3235-0318 (Form N-4, expiring on March 31, 2007), and 3235-0503 (Form N-6, expiring on March 31, 2007).

IV. Cost-Benefit Analysis

We are sensitive to the costs and benefits imposed by our rules. As discussed above in sections II.A - II.C, the new rules provide relief to funds by providing additional exemptions from the limitations on fund of funds arrangements without requiring the funds or their advisers

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105 The Commission made this estimate in connection with its submission for approval of recent proposed amendments to Form N-2. See Executive Compensation and Related Party Disclosure, Investment Company Act Release No. 27218 (Jan. 27, 2006) [71 FR 6542 (Feb. 8, 2006)].

106 This estimate is based on the following calculation: 120,673 + 2450 + (11 x 206) = 125,389. The current estimated total annual hour burden already incorporates the time estimated in the proposing release to prepare the disclosure required by the amendments (7 hours for each closed-end fund that invests in other funds). The revised estimate includes the additional 206 hours (213 minus 7 hours included in the approved total annual hour burden) the staff estimates it may take a closed-end fund of hedge funds to complete the required disclosure, based on the commenter's cost estimates.

to obtain an exemptive order. As discussed in section II.D, the amendments to Forms N-1A, N-2, N-3, N-4, and N-6 provide additional information to shareholders regarding the costs of acquired funds in a fund of funds arrangement.

A. Rules 12d1-1, 12d1-2 and 12d1-3

We have issued a number of exemptive orders that have broadened the ability of funds to invest in other funds and provided certain funds of funds greater flexibility in structuring their sales charges. These orders have provided exemptions from statutory limitations. A fund that has obtained the benefit of an exemption has incurred costs of applying for an exemptive order as well as costs of satisfying any conditions imposed in the order. Application costs are primarily legal and include costs of drafting the application and analyzing the ways in which the conditions fit the fund's business model. The costs of satisfying conditions include ongoing compliance costs of meeting those conditions. We assume that a fund only seeks an exemptive order if the benefits of the additional flexibility provided by the exemption outweigh the costs of obtaining and satisfying the conditions of an order. We solicited but did not receive comments with respect to the cost-benefit analysis for rules 12d1-1, 12d1-2 and 12d1-3.

1. Benefits

Rule 12d1-1 codifies our prior exemptive orders that permit a fund to invest all or a portion of its available cash in money market funds rather than directly in short-term instruments. The rule retains one condition included in our orders that the acquiring fund pays no sales load or distribution or service fee on the acquired money market fund shares unless the acquiring fund's investment adviser waives a sufficient amount of its advisory fee to offset the cost of those fees.[107] We believe that any further restrictions on an acquiring fund's investments

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107 With respect to investments in unregistered money market funds, we also have retained the requirement in our prior exemptive orders that the money market funds operate as if they were

in money market funds should be governed by the fund's investment policies and limitations and the fiduciary obligations of its board of directors. Consequently, we believe that the rule will provide greater flexibility for certain funds than exemptive orders we have issued.

Under the rule, funds also may invest in money market funds advised by a different adviser. We believe that this will allow all funds, particularly small funds without a money market fund in their fund group, the opportunity currently available to large funds to engage in cash sweep arrangements. In addition, we have provided additional relief under section 17 of the Act. If a fund in one fund complex acquired more than five percent of the assets of a money market fund in another complex, any broker-dealer affiliated with the money market fund would become a (second-tier) affiliated person of the acquiring fund. As a result of the affiliation, the broker-dealer's fee for effecting the sale of securities to the acquiring fund would be subject to the conditions set forth in rule 17e-1, including the quarterly board review and recordkeeping requirements with respect to certain securities transactions involving the affiliated broker-dealer.[108] The final rule permits an acquiring fund to pay commissions, fees, or other remuneration to an affiliated broker-dealer without complying with the quarterly board review and recordkeeping requirements set forth in rules 17e-1(b)(3) and 17e-1(d)(2).[109] This relief is available only if the broker-dealer and the acquiring fund become affiliated solely because of the acquiring fund's investment in the money market fund. We believe this additional relief will enable more funds to take advantage of the exemption provided by the rule.

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money market funds registered under the Act. Unlike our exemptive orders, however, and as we proposed, we are requiring the acquiring fund to reasonably believe, rather than to determine, that the unregistered money market funds operate in this manner. See supra notes 40-43 and accompanying text; see, e.g., Putnam Order, supra note 25.

108 See supra note 34.

109 See supra notes 32-36 and accompanying text.

Rule 12d1-1 also codifies our orders permitting funds to invest in unregistered money market funds that operate like a money market fund registered under the Act. The acquiring fund is required to "reasonably believe" that the unregistered money market fund operates in compliance with rule 2a-7 and complies with certain provisions of the Act, as well as other requirements.[110] This standard is slightly different than the condition in our exemptive orders, which requires the acquiring fund to determine that the acquired fund is in compliance with rule 2a-7 and certain provisions of the Act. A fund would reasonably believe that an acquired fund was in compliance with these provisions if, for example, it received a representation from the acquired fund (or the adviser to the acquired fund) that the fund would comply with the relevant provisions in all material respects and if the acquiring fund had no reason to believe that the acquired fund was not, in fact, complying with the relevant provisions in all material respects. Thus, an acquired fund's failure to comply will not automatically result in the loss of the acquiring fund's exemption. Rule 12d1-1 does not include certain conditions imposed in the exemptive orders that we believe are already adequately addressed by other provisions of the Act or rules thereunder.[111]

Rule 12d1-2 codifies, and in some cases expands upon, three types of relief that we provided to affiliated funds of funds. The rule permits affiliated funds of funds to acquire up to three percent of the securities of funds that are not part of the same group of investment companies, subject to the limits in section 12(d)(1)(A) or 12(d)(1)(F) of the Act. The rule also permits an affiliated fund of funds to acquire securities not issued by a fund. These investments would have to be consistent with the fund's investment policies. Finally, the rule permits affiliated funds of funds to invest in affiliated or unaffiliated money market funds in reliance on

110 See supra notes 40-43 and accompanying text.

111 See Proposing Release, supra note 4, at n.49.

rule 12d1-1.

Rule 12d1-3 codifies the exemptive orders we have issued permitting funds relying on section 12(d)(1)(F) to charge a sales load greater than 1½ percent provided that the aggregate sales load any investor pays (i.e., the combined distribution expenses of both the acquiring and acquired funds) does not exceed the limits on sales loads established by the NASD for funds of funds. This exemption also would be available to an affiliated fund of funds relying on rule 12d1-2 to invest in funds in a different fund group.

We anticipate that funds and their shareholders will benefit from the rules. Funds increasingly have sought exemptive orders (which the Commission has granted) to engage in most of the activities the rules permit. The application process involved in obtaining exemptive orders imposes direct costs on funds, including preparation and revision of an application, as well as consultations with the staff. The rules will benefit funds and their shareholders by eliminating the direct costs of applying to the Commission to engage in activities permitted under the rules.[112] The rules will further benefit funds by eliminating the uncertainty that a particular applicant might not obtain relief to engage in the activities permitted under the rules.

The exemptive application process also involves other indirect costs. Funds that apply for an order to permit additional investments forgo potentially beneficial investments until they receive the order, while other funds forgo the investment entirely rather than seek an exemptive

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112 For example, in calendar years 2003 and 2004, 11 funds sought exemptive relief to invest uninvested cash and/or cash collateral from securities lending activities in money market funds, and 3 of those funds also sought exemptive relief to invest cash collateral in unregistered money market funds. In the past 5 years, 9 funds investing in other funds in the same fund group in reliance on section 12(d)(1)(G) have sought exemptive relief to invest in securities other than government securities or short-term paper. During that time, 9 funds investing in other funds in reliance on section 12(d)(1)(F) have sought exemptive relief to charge a sales load greater than 1½ percent, subject to the NASD Sales Charge Rule. In the Proposing Release, we estimated that the cost to a fund for submitting one of these applications ranges from $7,000 to $67,000. See Proposing Release, supra note 4, at n.125. We did not receive any comments on these estimates and continue to believe that they are appropriate.

order because they have concluded that the cost of seeking an exemptive order would exceed the anticipated benefit of the investment. Eliminating direct and indirect costs of the proposed activities also eliminates factors that discriminate against smaller funds, for which the cost of an exemptive application can often exceed the potential benefit.

2. Costs

We do not believe that the rules will impose mandatory costs on any fund. As discussed above, the rules are exemptive, and we believe that a fund would not rely on any of them if the anticipated benefits did not justify the costs. We believe the costs of relying on the rules will be the same as or less than the costs to a fund that relies on an existing exemptive order because each of the rules includes the same or fewer conditions than existing orders that provide equivalent exemptive relief.[113]

The rules will affect different types of funds in different ways. A fund that has not sought and would not seek exemptive relief from section 12(d)(1) of the Act will not be affected by the rules. The cost for a fund that currently relies on exemptive relief covered by our rules will be the same as or less than the costs of relying on its exemptive order because the rules contain the same or fewer conditions than existing orders.[114] In addition, a fund that currently relies on an exemptive order can satisfy all the conditions of any of the rules that provide similar exemptive relief without changing its operation. For example, in the case of rule 12d1-1, the

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113 Our analysis compares the costs a fund would bear to comply with the rules with the costs a fund would bear under the current system of obtaining equivalent exemptive relief. Because the conditions in the rules are the same or less onerous than the conditions in the exemptive orders, the costs discussed in this section primarily are costs that a fund would bear to obtain an exemptive order and comply with its conditions.

114 Such a fund may face a one-time "learning cost" to determine the difference between the fund's exemptive order and the rule. We do not believe this cost would be significant given the similarity of conditions in our rules and existing exemptive orders.

fund will simply be satisfying conditions that are no longer required.[115] Finally, a fund that has not relied on an exemptive order and that intends to rely on one of the rules will bear the same continuing costs of complying with conditions that it would have borne had it obtained an exemptive order. In that case, its total costs would have been the same as or greater than the costs associated with the rules.

B. Amendments to Forms N-1A, N-2, N-3, N-4, and N-6

Forms N-1A, N-2 and N-3 currently do not require registered funds to disclose information regarding the expenses associated with acquired funds. The amendment to Form N-1A requires a registered open-end fund that invests in other funds to include a line item in its fee table, under the total annual fund operating expenses, that lists the aggregate fees and costs of acquired funds. The amendment to Form N-2 requires registered closed-end funds that invest in other funds to provide the same disclosure.[116] The amendment to Form N-3 requires the same disclosure for separate accounts organized as management investment companies that offer variable annuity contracts. The new disclosure requirements include instructions on calculating the fees and operating costs of acquired funds. The calculation will aggregate the annual fund operating expenses of acquired funds, transaction costs and, as applicable, incentive allocations incurred by the acquiring fund, and express the aggregate fees as a percentage of average net assets of the acquiring fund.

Forms N-4 and N-6 currently require separate accounts organized as UITs that offer

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115 We note that a fund may choose to rely on an existing exemptive order and comply with the conditions of that order. A fund might conclude that continued reliance on an existing order is appropriate, for example, because the existing order was tailored to circumstances specific to a fund complex and may provide additional exemptive relief that is not covered under the rules we are adopting today.

116 In addition, closed-end funds of hedge funds must add a footnote to the line item that discloses the typical performance fee charged by acquired hedge funds in which the acquiring fund invests.

variable annuity and variable life contracts, respectively, to disclose the range of minimum and maximum operating expenses of the portfolio companies in which they invest. The amendment to each of these forms requires a separate account organized as a UIT that invests in a portfolio company that itself invests in other funds, to include the portfolio company's costs of investing in other funds in the portfolio company's operating expenses disclosed in the Form N-4 or Form N-6 fee table.

1. Benefits

Under current disclosure requirements, a fund's shareholders may not understand the fees and operating costs of a fund's investment in acquired funds, costs that investors bear indirectly. We believe that the amendments to Forms N-1A, N-2, N-3, N-4, and N-6 will enable shareholders to better understand the expenses that relate to acquired funds, and provide investors the means to compare directly the costs of investing in alternative funds of funds, or the costs of investing in a fund of funds to a more traditional fund. The increased transparency may provide further benefits by allowing investors to choose funds that more closely reflect their preferences for fees and performance.[117]

2. Costs

The amendments to Forms N-1A, N-2, N-3, N-4, and N-6 will result in costs to registered open-end and closed-end funds, and to separate accounts that offer variable annuity and variable life contracts, which may be passed on to those funds' shareholders. The amendments will require a new disclosure to the annual operating expense item in the fee table for funds that invest in other funds. It also will require separate accounts organized as UITs that offer variable annuity and variable life contracts to include an additional expense in their calculations of annual

117 We requested comments as well as any quantifying data in the Proposing Release, but did not receive any.

portfolio company operating expenses. The costs of the disclosures will include both internal costs (for attorneys and accountants) to prepare and review the disclosure, and external costs (for printing and typesetting the disclosure).

First, with respect to Forms N-1A, N-2 and N-3, the disclosures will add a single line item to the fee table for funds that invest in other funds.[118] In the context of the prospectus for Forms N-1A, N-2 and N-3, we believe that the external costs of including this additional line of disclosure per registered fund will be minimal.[119] With respect to Forms N-4 and N-6, the disclosure will require registrants to include in the item for annual portfolio company operating expenses, any fees and expenses of acquired companies, as disclosed in the portfolio company's most recent prospectus. Accordingly, we believe there will be no additional external costs for Forms N-4 and N-6 as a result of the amendments.

Second, for purposes of the PRA, Commission staff estimated in the proposal that the disclosure requirement for calculating the line item according to the instructions will add up to 7 hours per portfolio to the burden of completing Forms N-1A, N-2 and N-3. Commission staff further estimated that the additional annual cost of including the line item per portfolio would equal $542.[120]

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118 We are permitting acquiring funds to omit a separate line item if the amount of expenses attributable to acquired funds does not exceed 0.01 percent (one basis point) of average net assets, and to include these expenses in "Other Expenses." See Instruction 3(f)(i) to Item 3 of Form N-1A; Instruction 10.a to Item 3.1 of Form N-2; Instruction 19(a) to Item 3(a) of Form N-3.

119 We also believe the costs to the acquiring fund of preparing the footnote to the line item that discloses the typical performance fee charged by hedge funds in which the acquiring fund invests will be minimal.

120 In the Proposing Release, Commission staff estimated the additional burden would equal 6 hours for an intermediate level accountant and 1 hour for a deputy general counsel to review the calculation per portfolio. See Proposing Release, supra note 4, at n.127. We did not receive any comments on these hourly estimates and continue to believe that they are appropriate. We have, however, updated our wage estimates based on current wage data for professionals in the financial services industry available at http://www.careerjournal.com/salaryhiring (last visited July 28, 2005).

One commenter, a fund of hedge funds, disagreed with our estimates and asserted that the cost to a single fund of hedge funds to make an initial calculation each year would be between $8,000 and $25,000 depending on the number of personnel involved and the need for auditor review.[121] The commenter did not specify the number or functions of the personnel involved. We agree with the commenter that a fund of hedge funds may have additional costs. We estimate that the cost of adding the new line item for a fund of hedge funds is $16,500.[122] Based on recent Commission filings, approximately 11 funds of hedge funds file initial registration statements on Form N-2 each year and their aggregate assets under management are $958.2 million. The estimated aggregate costs for these funds of hedge funds to calculate the new line item is $181,500.[123] We do not believe that the additional cost is significant given the funds of

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In order to determine who would be an intermediate level accountant in the new source, we looked at years of experience. We believe that accountants with 6 to 15 years of experience would fall within that category. The national average salary for these accountants is $89,749 (($85,483 (6-10 years of experience) + $94,015 (11-15 years of experience)) ÷ 2 = $89,749). Adjusting this salary upwards by 35% to reflect possible overhead costs and employee benefits, the staff estimates that the annual adjusted salary would be $121,161, and the cost for 6 hours of an intermediate level accountant's time would be $404 ($121,161 ÷ 1800 hours x 6 = $403.87). The staff estimates the national average salary for a deputy general counsel is $183,675. Adjusting this salary upwards by 35% to reflect possible overhead costs and employee benefits, the staff estimates that the annual adjusted salary would be $247,961, and the cost for 1 hour of a deputy general counsel's time would be $138 ($247,961 ÷ 1800 hours = $137.76). Accordingly, the staff estimates the total cost for each portfolio to calculate the amended disclosure would equal $542 ($404 + $138 = $542). We have revised the final instructions for calculating acquired funds' expenses as described above. See supra notes 77-79 and accompanying text. Although the staff believes that these modifications may provide funds with some cost savings, we have not adjusted the hour burden estimates but will review them when the collection of information requirements must be resubmitted for review and funds will have had actual experience in complying with them.

121 See Comment Letter of Man Investments, Inc. (Dec. 1, 2003).

122 Because the commenter did not explain the underlying calculations for its range of costs, the estimate is based on the average of the $8,000 to $25,000 range provided by the commenter. The cost to each fund of hedge funds may be higher or lower depending on a variety of factors, including the number of hedge funds in which the fund of hedge funds invests.

123 This calculation is based on the following: (11 x $16,500) = $181,500).

hedge funds' aggregate assets under management.[124]

On the assumption that funds of hedge funds would have to monitor current fees in order to guard against material misrepresentations in the fee table, the commenter estimated that these funds of hedge funds would face an additional monitoring cost of $15,000 or more annually. As discussed in Section III above, staff estimates that the 23 funds of hedge funds registered under Form N-2 and offering their shares on a continuous basis file updated registration statements on at least an annual basis. We estimate the additional cost to review the disclosure will be $8245 per fund of hedge funds and the total annual costs for funds of funds to update the acquired fund expenses in their prospectuses pursuant to the requirements of section 10(a)(3) of the Securities Act will be $189,635.[125]

Despite this additional cost, we continue to believe that the costs of the required disclosure are justified because the disclosure will assist a fund of hedge funds investor in making an informed investment decision as to whether the benefit of diversification provided by investing in a fund of hedge funds outweighs any layering of costs. We do not believe that other alternatives suggested by the commenter, such as simply disclosing a range of fees, would be a meaningful substitute. These alternatives would not meet our objective of improving transparency of expenses. Nor would they meet our objective to include acquired fund expenses in the total annual fund operating expenses disclosed to investors in order to provide them a more complete presentation of the aggregate direct and indirect costs of investing in a fund of funds. We continue to believe that our estimate is appropriate for Form N-2 registrants that are not

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124 The estimated cost of preparing the line item is 0.0189% of assets under management for funds of hedge funds in the aggregate ($181,500 ÷ $958.2 million).

125 See supra notes 102-104 and accompanying text. These estimates are based on the following calculations: 106.5 (hours per fund) x $77.42 (estimated hourly cost to prepare the disclosure) = $8245; $8245 x 23 (funds) = $189,635.

funds of hedge funds.

In the Proposing Release, we also estimated that including the additional item in the disclosure of portfolio company expenses on Forms N-4 and N-6 would add approximately 0.5 hours per portfolio, which based on the updated wage estimates would be an annual cost per portfolio of $34.[126] We did not receive any comments on this estimate and continue to believe that it is appropriate.

Based on Commission filings, the staff estimates that half the funds registered under Forms N-1A and N-2 (excluding funds of hedge funds) invest in other funds, all funds of hedge funds registered on Form N-2 invest in other funds, and 5 separate accounts (with 7 portfolios) registered under Form N-3 invest in other funds and will be required to make the proposed disclosure on an annual basis. For purposes of the PRA analysis, Commission staff has estimated that on an annual basis, registrants file (i) initial registration statements covering 483 portfolios and post effective amendments covering 6542 portfolios on Form N-1A, (ii) 234 initial registration statements (of which 11 are funds of hedge funds) and 38 post-effective amendments on Form N-2, and (iii) initial registration statements covering 3 portfolios and post-effective amendments covering 35 portfolios on Form N-3. In addition, Commission staff also estimates that each year, 157 separate accounts file initial registrations and 1242 separate accounts file post-effective amendments on Form N-4, and 50 separate accounts file initial registrations and 500 separate accounts file post-effective amendments on Form N-6.[127] Of the filings on Forms

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126 Commission staff estimates the cost would equal 0.5 hours for an intermediate level accountant to include the expense item in the calculation. The estimated cost is based on the following calculation: 0.5 x $67.3 = $33.7. The estimated hourly cost for an intermediate level accountant is $67 ($121,161.15 (annual cost) ÷ 1800 hours = $67.31/hour). See supra note 120.

127 Changes in estimates from the Proposing Release are due to updated PRA analyses for the relevant forms. Of the Form N-6 post-effective amendments, 150 are annual updates and 350 are additional post-effective amendments. As we said in the Proposing Release, we assume that registered funds would include the disclosure only in a post-effective amendment to the annual

N-4 and N-6, Commission staff estimates that half the separate accounts invest in portfolio companies that themselves invest in other funds. Thus, Commission staff estimates that the cost of the amendments to Forms N-1A, N-2, N-3, N-4, and N-6 to funds registering under these forms will be $2.4 million.[128]

V. CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 2(c) of the Investment Company Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation.[129] We sought, but did not receive any comment with respect to this section.

A. Rules 12d1-1, 12d1-2 and 12d1-3

Rules 12d1-1, 12d1-2 and 12d1-3 will expand the circumstances in which funds can invest in other funds without first obtaining an exemptive order from the Commission, which can be costly and time-consuming. We anticipate that the rules will promote efficiency and competition. Rule 12d1-1 permits funds to acquire shares of money market funds in the same or in a different fund group in excess of the limitations in section 12(d)(1) of the Act. This exemption allows funds, particularly small funds without a money market fund in their complex, to allocate their uninvested cash more efficiently and thereby increase competition among funds. In addition, the final rule provides additional section 17 relief for funds that execute transactions

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update. See Proposing Release, supra note 4, at n.132.

128 The estimate is based on the following calculation: (((483 + 6542)) ÷ 2) x $542) + (((223 + 38) ÷ 2) x $542 + (11 x $16,500) + (23 x $8245) + (7 separate account portfolios x $542) + (((157 + 1,242) ÷ 2) x $34) + (((50 + 150) ÷ 2) x $34) = $2,376,618. The increase in costs from the Proposing Release is due to adjustments for salary and overhead costs during the intervening period and the additional cost for funds of hedge funds to comply with the disclosure requirement.

129 15 U.S.C. 80a-2(c).

with broker-dealers affiliated with money market funds in which the acquiring funds invest. This additional relief, we believe, will allow more funds to take full advantage of the exemption provided by the rule.[130] Rule 12d1-2 permits an affiliated fund of funds to acquire limited amounts of securities issued by funds outside the same fund group and securities not issued by a fund. The rule also permits a traditional equity or bond fund to invest in funds within the same fund complex. We believe that this expansion of investment opportunities will permit funds to allocate their investments more efficiently. Rule 12d1-3 allows funds relying on section 12(d)(1)(F) of the Act to charge sales loads greater than 1½ percent provided that the aggregate sales load any investor pays does not exceed the limits established by the NASD for funds of funds. We believe this will increase competition among funds as it will provide funds with greater flexibility in structuring their sales charges. We do not believe that these exemptive rules, which provide funds with greater flexibility in their investments and provide certain funds of funds greater flexibility in structuring their sales charges, will have an adverse impact on capital formation.

B. Amendments to Forms N-1A, N-2, N-3, N-4, and N-6

The form amendments are designed to provide better transparency for fund shareholders with respect to the costs of investing in funds of funds. The enhanced disclosure requirements will provide shareholders with greater access to information regarding the indirect costs they bear when a fund in which they invest purchases shares of other funds. This information should promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds because investors may compare and choose funds based on their preferences for cost more easily. The amendments may also improve competition, as enhanced

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130 See supra notes 32-36 and accompanying text.

disclosure may prompt funds to provide improved products and services that may have a greater appeal to investors. Enhanced disclosure also may prompt acquiring funds to invest in acquired funds with lower costs. Finally, we do not believe that the amendments will have an adverse impact on capital formation. As discussed above, we believe that the amendments will benefit investors.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

We have prepared this Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 604. It relates to new rules 12d1-1, 12d1-2 and 12d1-3 under the Investment Company Act, and amendments to Forms N-1A, N-2, N-3, N-4, and N-6. The Commission prepared an Initial Regulatory Flexibility Analysis ("IRFA") in accordance with 5 U.S.C. 603, a summary of which was published in the Proposing Release.[131]

A. Need for the New Rules and Form Amendments

As described more fully in Section II of this release, we are adopting rules 12d1-1, 12d1-2 and 12d1-3 to address the ability of a registered fund to invest in shares of another fund without first having to seek Commission approval. The rules codify and expand upon a number of exemptive orders we have issued that permit funds to invest in other funds. The form amendments are a critical element of the relief we are adopting today and are designed to improve the transparency of the expenses of funds of funds by requiring that the expenses of the acquired funds be aggregated and shown as an additional expense in the fee table of the fund of funds.

B. Significant Issues Raised by Public Comment

In the IRFA for the proposed rules and form amendments, we requested comment on any

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131 See Proposing Release, supra note 4, at Section VII.

aspect of the IRFA, including the number of small entities that are likely to rely on the proposed rules and amendments and the likely impact of the proposal on small entities. We received no comments on the IRFA.

C. Small Entities Subject to the New Rules and Form Amendments

For purposes of the Regulatory Flexibility Act, a fund is a small entity if the fund, together with other funds in the same group of related funds, has net assets of $50 million or less as of the end of its most recent fiscal year.[132] The staff estimates, based upon recent Commission filings, that there are approximately 4083 active registered funds and 88 business development companies, of which approximately 175 and 65 are small entities, respectively.[133] The staff estimates that no separate account is a small entity. A fund that is a small entity, like other funds, may rely on any of the exemptive rules if the fund satisfies the rule's conditions.

The Commission expects the new rules to have little impact on small entities. Like other funds, small entities will be affected by new rules 12d1-1, 12d1-2 and 12d1-3 only if they determine to use any of the exemptions provided by the rules. Few small entities have applied for relief to engage in the activities that will be permitted under the rules. The staff anticipates that the number of funds, including small funds, that will engage in the activities permitted under the rules, will increase. Nevertheless, the staff believes that the proportion of small entities compared to the total number of funds that engage in these activities will remain small.

The Commission expects that the amendments to Forms N-1A and N-2 will have a greater impact on small entities. The amendments require each registered fund, including each

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[132] 17 CFR 270.0-10.

[133] Some or all of the funds may contain multiple series or portfolios. If a registered investment company is a small entity, the portfolios or series it contains are also small entities. The estimated number of small entities in the IRFA was based on filings with the Commission current at that time.

fund that is a small entity, that invests in any other fund to disclose the aggregate costs of investing in acquired funds. The staff estimates, based upon Commission filings, that 140 funds that file on Form N-1A, and 32 funds (of which 4 are funds of hedge funds)[134] that file on Form N-2 are small entities.[135] Commission staff also estimates that half of the funds registered under Forms N-1A and N-2 (excluding funds of hedge funds) invest in other funds, and all funds of hedge funds would be required to make the new disclosure.[136] Accordingly, we estimate that 70 funds that are small entities file on Form N-1A and 18 funds (including the 4 funds of hedge funds) that are small entities file on Form N-2 and would be required to make the new disclosure.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The new rules will not impose any mandatory reporting or recordkeeping requirements on any person and will not materially increase other compliance requirements. Rule 12d1-1 allows funds to invest in money market funds in excess of section 12(d)(1)(A) limits. The rule requires that either (i) the acquiring fund does not pay any sales charge, distribution fee or service fee (as defined by NASD Sales Charge Rule 2830(d)) on the purchase of money market fund shares, or (ii) the fund's adviser waives its fee in an amount necessary to offset any administrative fees of the money market fund.[137] This condition may reduce the cost of cash management (by reducing advisory or custodial fees relating to money market instruments) for large and small funds. In addition, under the rule, a fund that invests in an unregistered money market fund will have to "reasonably believe" that the unregistered fund (i) operates in

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134 The 4 funds of hedge funds that are small entities do not offer their shares continuously in reliance on rule 415 of the Securities Act.

135 Amendments to Forms N-3, N-4, and N-6 are not expected to impact small entities because the staff estimates that no registered separate account is a small entity.

136 This estimate is based on information in the Commission's database of Form N-SAR filings.

137 Rule 12d1-1(b)(1).

compliance with rule 2a-7, and (ii) complies with certain provisions of the Act. With respect to these conditions, we believe that if the cost of investing in a money market fund (registered or unregistered) exceeds the costs of other forms of cash management, acquiring funds, including funds that are small entities, will not take advantage of the exemption. Finally, we believe the additional section 17 relief for acquiring funds that execute transactions with broker-dealers that are affiliated solely as a result of the acquiring fund's investment in a money market fund, will allow more funds to take full advantage of the exemption provided by the rule. We believe this additional relief will be important if a small fund without a money market fund in its complex invests, in reliance upon rule 12d1-1, in a money market fund in another complex and thereby becomes affiliated with a broker-dealer affiliated with the money market fund. Without the relief from certain recordkeeping and monitoring requirements, small funds may find it potentially costly or onerous to monitor transactions with affiliated broker-dealers.[138]

Rule 12d1-2 also has no mandatory reporting, recordkeeping or other compliance requirements.[139] Rule 12d1-3 requires an unaffiliated fund of funds relying on the rule to limit aggregate distribution-related costs under the NASD Sales Charge Rule.[140] The rule provides funds greater flexibility in structuring sales loads, consistent with the approach Congress took in section 12(d)(1)(G) to prevent excessive sales loads in affiliated funds of funds, while providing shareholders greater protection by requiring that funds relying on the rule limit overall distribution fees (rather than only sales loads).

Funds that intend to rely on the rules will no longer incur the expense associated with

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138 See supra notes 32-36 and accompanying text.

139 Funds that invest in a money market fund in reliance on rule 12d1-2, however, must comply with the conditions of rule 12d1-1. See supra note 62 and accompanying text.

140 See rule 12d1-3(a); see also supra note 64 and accompanying text.

filing applications for comparable exemptive relief from sections 12(d)(1)(A), (B), (F), and (G), 17(a), 17(e)(2)(A), and 57, and rules 17d-1, 17e-1(b)(3) and 17e-1(d)(2) in connection with the fund of funds arrangement permitted by the rules. The exemptive rules may be of greater benefit to small funds for which the benefits of obtaining an order for the relief described above may not sufficiently offset the costs of filing an exemptive application.

The amendments to Forms N-1A and N-2 require registered funds to include a line item in the fee table disclosing the acquiring fund's pro rata portion of the cumulative expenses charged by funds in which the acquiring fund invests. The amendments include instructions for calculating the line item—"Acquired Fund Fees and Expenses." For purposes of the PRA, Commission staff estimated that the disclosure requirement for calculating the line item according to the instructions will add up to 7 hours per portfolio to the burden of completing Forms N-1A and N-2.[141] Commission staff also estimated that the additional cost of including the line item per portfolio would equal $542 for Forms N-1A and Form N-2 (excluding funds of hedge funds).[142] The Commission staff has further estimated, based on comments received, that a fund of hedge funds would incur $16,500 to calculate the new line item.[143] Assuming that half of all small funds and all small funds of hedge funds invest in other funds and will be required to include the additional disclosure, the Commission staff estimates that the maximum total annual cost for small entities to comply with the form amendments will be $176,026.[144]

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141 See supra notes 99-100 and accompanying text.

142 See supra note 120 and accompanying text.

143 See supra note 103 and accompanying text.

144 Based on recent Commission filings, the staff estimates that 140 funds that are small entities are registered under Form N-1A, with an average of 2.7 portfolios per registrant. Commission staff further estimates that 28 funds registered with an average of 1.0 portfolio per registrant and 4 funds of hedge funds registered under Form N-2 are small entities. The staff's estimate assumes that all funds of hedge funds and half of all other portfolios would include the proposed disclosure. The maximum cost estimate is based on the following calculation: ((140 x 2.7) + (28

E. Commission Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the new rules, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rule, or any part thereof, for small entities.

The new rules are exemptive, and compliance with them is voluntary. We therefore do not believe that special compliance, timetable, or reporting requirements or an exemption from coverage of the rules for small entities would be appropriate.

The rules do not require any reporting requirements that could be further clarified, consolidated, or simplified. Rule 12d1-1 uses performance rather than design standards to the extent it requires that acquiring funds "reasonably believe" that underlying funds are operating in compliance with rule 2a-7 and certain provisions of the Act. This standard is designed to ensure that a violation on the part of the acquired fund would not cause the acquiring fund to lose its exemption under the rule if it can demonstrate that it reasonably believed that the acquired fund was in compliance. In addition, rule 12d1-3 does not specify the sales load and distribution-related charges an acquiring or acquired fund must impose, but permits funds to determine the

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x 1.00)) ÷ 2 portfolios x \$542 = \$110,026) + (4 x \$16,500 = \$66,000) = \$176,026. The increase from the Proposing Release is due to adjustments for salary and overhead costs during the intervening period and the additional cost for funds of hedge funds to comply with the disclosure requirement. Amendments to Forms N-3, N-4 and N-6 are not expected to impact small entities because the staff estimates that no registered separate account is a small entity.

combined charges within the overall limit set by the NASD Sales Charge Rule.

With respect to the form amendments, we believe that any further clarification, consolidation, or simplification of the requirements to report expenses of acquired funds for small funds would not be consistent with the protection of investors. A different requirement, including differing compliance or reporting requirements or timetables, could compromise the intent to provide investors with cost information that will allow them to make direct comparisons to the costs of alternative fund of funds arrangements and to the costs of a more traditional fund. Performance standards also would not provide this important benefit to investors. An exemption for small entities would defeat the purposes of the amendments for the same reasons.

VII. STATUTORY AUTHORITY

The Commission is adopting rules 12d1-1, 12d1-2 and 12d1-3 under the authority set forth in sections 6(c), 12(d)(1)(J), and 38(a) of the Act (15 U.S.C. 80a-6(c), 80a-12(d)(1)(J), 80a-37(a)). The Commission is also adopting amendments to Forms N-1A, N-2, N-3, N-4, and N-6 under the authority set forth in sections 6, 7(a), 10 and 19(a) of the Securities Act (15 U.S.C. 77f, 77g(a), 77j, 77s(a)), and sections 8(b), 24(a), 30, and 38(a) of the Act (15 U.S.C. 80a-8(b), 80a-24(a), 80a-29, and 80a-37(a)).

List of Subjects

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rules and Form Amendments

For the reasons set out in the preamble, the Commission is amending Title 17, Chapter II of the Code of Federal Regulations to read as follows:

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

1. The authority citation for Part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77x-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-9, 80a-10, 10a-13, 80a-8, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

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PART 270 – RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

2. The authority citation for Part 270 is amended by revising the subauthority for § 270.12d1-1 to read as follows:

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, and 80a-39, unless otherwise noted;

* * * * *

Sections 270.12d1-1, 270.12d1-2, and 270.12d1-3 are also issued under 15 U.S.C. 80a-6(c), 80a-12(d)(1)(J), and 80a-37(a).

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3. Sections 270.12d1-1, 270.12d1-2, and 270.12d1-3 are added to read as follows:

§ 270.12d1-1 Exemptions for investments in money market funds.

(a) Exemptions for acquisition of money market fund shares. If the conditions of paragraph (b) of this section are satisfied, notwithstanding sections 12(d)(1)(A), 12(d)(1)(B), 17(a), and 57 of the Act (15 U.S.C. 80a-12(d)(1)(A), 80a-12(d)(1)(B), 80a-17(a), and 80a-56), and § 270.17d-1:

(1) An investment company ("acquiring fund") may purchase and redeem shares issued by a money market fund; and

(2) A money market fund, any principal underwriter thereof, and a broker or a dealer

may sell or otherwise dispose of shares issued by the money market fund to an acquiring fund.

(b) Conditions.

(1) Fees. The acquiring fund pays no sales charge, as defined in rule 2830(b)(8) of the Conduct Rules of the NASD ("sales charge"), or service fee, as defined in rule 2830(b)(9) of the Conduct Rules of the NASD, charged in connection with the purchase, sale, or redemption of securities issued by a money market fund ("service fee"); or the acquiring fund's investment adviser waives its advisory fee in an amount necessary to offset any sales charge or service fee.

(2) Unregistered money market funds. If the money market fund is not an investment company registered under the Act:

(i) The acquiring fund reasonably believes that the money market fund satisfies the following conditions as if it were a registered open-end investment company:

(A) Operates in compliance with § 270.2a-7;

(B) Complies with sections 17(a), (d), (e), 18, and 22(e) of the Act (15 U.S.C. 80a-17(a), (d), (e), 80a-18, and 80a-22(e));

(C) Has adopted procedures designed to ensure that it complies with sections 17(a), (d), (e), 18, and 22(e) of the Act (15 U.S.C. 80a-17(a), (d), (e), 80a-18, and 80a-22(e)), periodically reviews and updates those procedures, and maintains books and records describing those procedures;

(D) Maintains the records required by §§ 270.31a-1(b)(1), 270.31a-1(b)(2)(ii), 270.31a-1(b)(2)(iv), and 270.31a-1(b)(9); and

(E) Preserves permanently, the first two years in an easily accessible place, all books and records required to be made under paragraphs (b)(2)(i)(C) and (D) of this section, and makes those records available for examination on request by the Commission or its staff; and

(ii) The adviser to the money market fund is registered with the Commission as an investment adviser under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3).

(c) Exemption from certain monitoring and recordkeeping requirements under § 270.17e-1. Notwithstanding the requirements of §§ 270.17e-1(b)(3) and 270.17e-1(d)(2), the payment of a commission, fee, or other remuneration to a broker shall be deemed as not exceeding the usual and customary broker's commission for purposes of section 17(e)(2)(A) of the Act if:

(1) The commission, fee, or other remuneration is paid in connection with the sale of securities to or by an acquiring fund;

(2) The broker and the acquiring fund are affiliated persons because each is an affiliated person of the same money market fund; and

(3) The acquiring fund is an affiliated person of the money market fund solely because the acquiring fund owns, controls, or holds with power to vote five percent or more of the outstanding securities of the money market fund.

(d) Definitions.

(1) Investment company includes a company that would be an investment company under section 3(a) of the Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)).

(2) Money market fund means:

(i) An open-end management investment company registered under the Act that is regulated as a money market fund under § 270.2a-7; or

(ii) A company that would be an investment company under section 3(a) of the Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and

3(c)(7) of the Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)) and that:

(A) Is limited to investing in the types of securities and other investments in which a money market fund may invest under § 270.2a-7; and

(B) Undertakes to comply with all the other requirements of § 270.2a-7, except that, if the company has no board of directors, the company's investment adviser performs the duties of the board of directors.

§ 270.12d1-2 Exemptions for investment companies relying on section 12(d)(1)(G) of the Act.

(a) Exemption to acquire other securities. Notwithstanding section 12(d)(1)(G)(i)(II) of the Act (15 U.S.C. 80a-12(d)(1)(G)(i)(II)), a registered open-end investment company or a registered unit investment trust that relies on section 12(d)(1)(G) of the Act (15 U.S.C. 80a-12(d)(1)(G)) to acquire securities issued by another registered investment company that is in the same group of investment companies may acquire, in addition to Government securities and short-term paper:

(1) Securities issued by an investment company, other than securities issued by another registered investment company that is in the same group of investment companies, when the acquisition is in reliance on section 12(d)(1)(A) or 12(d)(1)(F) of the Act (15 U.S.C. 80a-12(d)(1)(A) or 80a-12(d)(1)(F));

(2) Securities (other than securities issued by an investment company); and

(3) Securities issued by a money market fund, when the acquisition is in reliance on § 270.12d1-1.

(b) Definitions. For purposes of this section, money market fund has the same meaning as in § 270.12d1-1(d)(2).

§ 270.12d1-3 Exemptions for investment companies relying on section 12(d)(1)(F) of the

Act.

(a) Exemption from sales charge limits. A registered investment company ("acquiring fund") that relies on section 12(d)(1)(F) of the Act (15 U.S.C. 80a-12(d)(1)(F)) to acquire securities issued by an investment company ("acquired fund") may offer or sell any security it issues through a principal underwriter or otherwise at a public offering price that includes a sales load of more than 1½ percent if any sales charges and service fees charged with respect to the acquiring fund's securities do not exceed the limits set forth in rule 2830 of the Conduct Rules of the NASD applicable to a fund of funds.

(b) Definitions. For purposes of this section, the terms fund of funds, sales charge, and service fee have the same meanings as in rule 2830(b) of the Conduct Rules of the NASD.

PART 274 - FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

4. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

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5. Form N-1A (referenced in §§ 239.15A and 274.11A), Item 3, is amended by adding paragraph (f) to Instruction 3 to read as follows:

Note: The text of Form N-1A does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-1A

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Item 3. Risk/Return Summary: Fee Table

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Instructions.

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3. Annual Fund Operating Expenses.

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(f)(i) If the Fund (unless it is a Feeder Fund) invests in shares of one or more Acquired Funds, add a subcaption to the "Annual Fund Operating Expenses" portion of the table directly above the subcaption titled "Total Annual Fund Operating Expenses." Title the additional subcaption: "Acquired Fund Fees and Expenses." Disclose in the subcaption fees and expenses incurred indirectly by the Fund as a result of investment in shares of one or more Acquired Funds. For purposes of this item, an "Acquired Fund" means any company in which the Fund invests or has invested during the relevant fiscal period that (A) is an investment company or (B) would be an investment company under section 3(a) of the Investment Company Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the Investment Company Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)). If a Fund uses another term in response to other requirements of this Form to refer to Acquired Funds, it may include that term in parentheses following the subcaption title. In the event the fees and expenses incurred indirectly by the Fund as a result of investment in shares of one or more Acquired Funds do not exceed 0.01 percent (one basis point) of average net assets of the Fund, the Fund may include these fees and expenses under the subcaption "Other Expenses" in lieu of this disclosure requirement.

(ii) Determine the "Acquired Fund Fees and Expenses" according to the following formula:

$$\text{AFFE} = \frac{[(F_1/FY)*AI_1*D_1]+[(F_2/FY)*AI_2*D_2]+[(F_3/FY)*AI_3*D_3] + \text{Transaction Fees} + \text{Incentive Allocations}}{\text{Average Net Assets of the Fund}}$$

Where:

AFFE = Acquired Fund fees and expenses;

$F_1, F_2, F_3, \ldots$ = Total annual operating expense ratio for each Acquired Fund;

FY = Number of days in the relevant fiscal year.

$AI_1, AI_2, AI_3, \ldots$ = Average invested balance in each Acquired Fund;

$D_1, D_2, D_3, \ldots$ = Number of days invested in each Acquired Fund; and

"Transaction Fees" = The total amount of sales loads, redemption fees, or other transaction fees paid by the Fund in connection with acquiring or disposing of shares in any Acquired Funds during the most recent fiscal year.

"Incentive Allocations" = Any allocation of capital from the Acquiring Fund to the adviser of the Acquired Fund (or its affiliate) based on a percentage of the Acquiring Fund's income, capital gains and/or appreciation in the Acquired Fund.

(iii) Calculate the average net assets of the Fund for the most recent fiscal year, as provided in Item 8(a) (see Instruction 4 to Item 8(a)).

(iv) The total annual operating expense ratio used for purposes of this calculation (F_1) is the annualized ratio of operating expenses to average net assets for the Acquired Fund's most recent fiscal period as disclosed in the Acquired Fund's most recent shareholder report. If the ratio of expenses to average net assets is not included in the most recent shareholder report or the Acquired Fund is a newly formed fund that has not provided a shareholder report, then the ratio of expenses to average net assets of the Acquired Fund is the ratio of total annual operating expenses to average annual net assets of the Acquired Fund for its most recent fiscal period as disclosed in the most recent communication from the Acquired Fund to the Fund. For purposes of this instruction: (i) Acquired Fund expenses include increases resulting from brokerage service and expense offset arrangements and reductions resulting from fee waivers or reimbursements by the Acquired Funds' investment advisers or sponsors; and (ii) Acquired Fund expenses do not include expenses (i.e., performance fees) that are incurred solely upon the realization and/or distribution of a gain. If an Acquired Fund has no operating history, include in the Acquired Funds' expenses any fees payable to the Acquired Fund's investment adviser or its affiliates stated in the Acquired Fund's registration statement, offering memorandum or other similar communication without giving effect to any performance.

(v) To determine the average invested balance (AI_1), the numerator is the sum of the amount initially invested in an Acquired Fund during the most recent fiscal year (if the investment was held at the end of the previous fiscal year, use the amount invested as of the end of the previous fiscal year) and the amounts invested in the Acquired Fund no less frequently than monthly during the period the investment is held by the Fund (if the investment was held through the end of the fiscal year, use each month-end through and including the fiscal year-end). Divide the numerator by the number of measurement points included in the calculation of the numerator (i.e., if an investment is made during the fiscal year and held for 3 succeeding months, the denominator would be 4).

(vi) A New Fund should base the Acquired Fund fees and expenses on assumptions as to the specific Acquired Funds in which the New Fund expects to invest. Disclose in a footnote to the table that Acquired Fund fees and expenses are based on estimated amounts for the current fiscal year.

(vii) The Fund may clarify in a footnote to the fee table that the total annual fund operating expenses under Item 3 do not correlate to the ratio of expenses to average net assets given in response to Item 8, which reflects the operating expenses of the Fund and does not include Acquired Fund fees and expenses.

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6. Form N-2 (referenced in §§ 239.14 and 274.11a-1), Item 3, paragraph 1, is amended by:

a. Redesignating Instruction 10 titled "Example" as Instruction 11; and

b. Adding new Instruction 10. The addition reads as follows:

Note: The text of Form N-2 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-2

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Item 3. Fee Table and Synopsis

1. * * *

Instructions:

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10. a. If the Registrant invests, or intends to invest based upon the anticipated net proceeds of the present offering, in shares of one or more "Acquired Funds," add a subcaption to the "Annual Expenses" portion of the table directly above the subcaption titled "Total Annual Expenses." Title the additional subcaption: "Acquired Fund Fees and Expenses." Disclose in the subcaption fees and expenses incurred indirectly by the Registrant as a result of investment in shares of one or more Acquired Funds. For purposes of this item, an "Acquired Fund" means any company in which the Registrant invests or intends to invest (A) that is an investment company or (B) that would be an investment company under section 3(a) of the 1940

Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)). If a Registrant uses another term in response to other requirements of this Form to refer to Acquired Funds, it may include that term in parentheses following the subcaption title. In the event the fees and expenses incurred indirectly by the Registrant as a result of investment in shares of one or more Acquired Funds do not exceed 0.01 percent (one basis point) of average net assets of the Registrant, the Registrant may include these fees and expenses under the subcaption "Other Expenses" in lieu of this disclosure requirement.

b. Determine the "Acquired Fund Fees and Expenses" according to the following formula:

$$AFFE = \frac{[(F_1/FY)*AI_1*D_1]+[(F_2/FY)*AI_2*D_2]+[(F_3/FY)*AI_3*D_3] + \text{Transaction Fees} + \text{Incentive Allocations}}{\text{Average Net Assets of the Registrant}}$$

Where:

AFFE = Acquired Fund fees and expenses;

$F_1, F_2, F_3, \ldots$ = Total annual operating expense ratio for each Acquired Fund;

FY = Number of days in the relevant fiscal year.

$AI_1, AI_2, AI_3, \ldots$ = Average invested balance in each Acquired Fund;

$D_1, D_2, D_3, \ldots$ = Number of days invested in each Acquired Fund;

"Transaction Fees" = The total amount of sales loads, redemption fees, or other transaction fees paid by the Registrant in connection with acquiring or disposing of shares in any Acquired Funds during the most recent fiscal year; and

"Incentive Allocations" = Any allocation of capital from the Acquiring Fund to the adviser of the Acquired Fund (or its affiliate) based on a percentage of the Acquiring

Fund's income, capital gains and/or appreciation in the Acquired Fund.

c. Calculate the average net assets of the Registrant for the most recent fiscal year, as provided in Item 4.1 (see Instruction 15 to Item 4.1) and include the anticipated net proceeds of the present offering.

d. The total annual operating expense ratio used for purposes of this calculation (F_1) is the annualized ratio of operating expenses to average net assets for the Acquired Fund's most recent fiscal period as disclosed in the Acquired Fund's most recent shareholder report. If the ratio of expenses to average net assets is not included in the most recent shareholder report or the Acquired Fund is a newly formed fund that has not provided a shareholder report, then the ratio of expenses to average net assets of the Acquired Fund is the ratio of total annual operating expenses to average annual net assets of the Acquired Fund for its most recent fiscal period as disclosed in the most recent communication from the Acquired Fund to the Registrant. If the Registrant has a written fee agreement with the Acquired Fund that would affect the ratio of expenses to average net assets as disclosed in the Acquired Fund's most recent shareholder report, the Registrant should determine the ratio of expenses to average net assets for the Acquired Fund's most recent fiscal period using the written fee agreement. For purposes of this instruction: (i) Acquired Fund expenses include increases resulting from brokerage service and expense offset arrangements and reductions resulting from fee waivers or reimbursements by the Acquired Funds' investment advisers or sponsors; and (ii) Acquired Fund expenses do not include any expenses (i.e., performance fees) that are calculated solely upon the realization and/or distribution of gains, or the sum of the realization and/or distribution of gains and unrealized appreciation of assets distributed in-kind. If an Acquired Fund has no operating history, include in the Acquired Funds' expenses any fees payable to the Acquired Fund's investment adviser or its affiliates stated in the Acquired Fund's registration statement, offering memorandum or other similar communication without giving effect to any performance.

e. If a Registrant has made investments in the most recent fiscal year, to determine the average invested balance (AI_1), the numerator is the sum of the amount initially invested in an Acquired Fund during the most recent fiscal year (if the investment was held at the end of the previous fiscal year, use the amount invested as of the end of the previous fiscal year) and the amounts invested in the Acquired Fund no less frequently than monthly during the period the investment is held by the Registrant (if the investment was held through the end of the fiscal year, use each month-end through and including the fiscal year-end). Divide the numerator by the number of measurement points included in the calculation of the numerator (i.e., if an investment is made during the fiscal year and held for 3 succeeding months, the denominator would be 4).

f. For investments based upon the anticipated net proceeds from the present offering, base the "Acquired Fund Fees and Expenses" on: (i) assumptions about specific funds in which the Registrant expects to invest, (ii) estimates of the amount of assets the Registrant expects to invest in each of those Acquired Funds, and (iii) an assumption that the investment was held for all of the Registrant's most recent fiscal year and was subject to the Acquired Funds' fees and expenses for that year. Disclose in a footnote to the table that Acquired Fund fees and expenses are based on estimated amounts for the current fiscal year.

g. If an Acquired Fund charges an Incentive Allocation or any other fee based on income, capital gains and/or appreciation (i.e., performance fee), the Registrant must include a footnote to the "Acquired Fund Fees and Expenses" subcaption that: (i) discloses the typical Incentive Allocation or such other fee (expressed as a percentage) to be paid to the investment advisers of the Acquired Funds (or an affiliate); (ii) discloses that Acquired Funds' fees and expenses are based on historic fees and expenses; and (iii) states that future Acquired Funds' fees and expenses may be substantially higher or lower because certain fees are based on the performance of the Acquired Funds, which may fluctuate over time.

h. If the Registrant is a Feeder Fund, reflect the aggregate expenses of the Feeder Fund and the Master Fund in the "Acquired Fund Fees and Expenses." The aggregate expenses of the Master-Feeder Fund must include the fees and expenses incurred indirectly by the Feeder Fund as a result of the Master Fund's investment in shares of one or more companies (A) that are investment companies or (B) that would be investment companies under section 3(a) of the 1940 Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)). For purposes of this instruction, a "Master-Feeder Fund" means a two-tiered arrangement in which one or more investment companies registered under the 1940 Act (each a "Feeder Fund") holds shares of a single management investment company registered under the 1940 Act (the "Master Fund") in accordance with section 12(d)(1)(E) of the 1940 Act [15 U.S.C. 80a-12(d)(1)(E)].

i. The Registrant may clarify in a footnote to the fee table that the total annual expenses item under Item 3.1 is different from the ratio of expenses to average net assets given in response to Item 4.1, which reflects the operating expenses of the Registrant and does not include Acquired Fund fees and expenses.

* * * * *

7. Form N-3 (referenced in §§ 239.17a and 274.11b), Item 3(a), is amended by:

a. In Instruction 16(a), revising the phrase in the third sentence "Instructions 18(b), 19(e) and 19(f)" to read "Instructions 18(b), 19(f), 20(e), and 20(f)";

b. Redesignating Instruction 19 titled "Example" as Instruction 20; and

c. Adding new Instruction 19.

The addition reads as follows:

Note: The text of Form N-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-3

* * * * *

Item 3. Synopsis or Highlights

(a) * * *

Instructions:

* * * * *

19. (a) If the Registrant invests in shares of one or more Acquired Funds, add a subcaption to the "Annual Expenses" portion of the table directly above the subcaption titled "Total Annual Expenses." Title the additional subcaption: "Acquired Fund Fees and Expenses." Disclose in the subcaption fees and expenses incurred indirectly by the Registrant as a result of investment in shares of one or more Acquired Funds. For purposes of this Item, an "Acquired Fund" means any company in which the Fund invests that (i) is an investment company or (ii) would be an investment company under section 3(a) of the 1940 Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)). If a Registrant uses another term in response to other requirements of this Form to refer to Acquired Funds, it may include that term in parentheses following the subcaption title. In the event the fees and expenses incurred indirectly by the Registrant as a result of investment in shares of one or more Acquired Funds do not exceed 0.01

percent (one basis point) of average net assets of the Registrant, the Registrant may include these fees and expenses under the subcaption "Other Expenses" in lieu of this disclosure requirement.

(b) Determine the "Acquired Fund Fees and Expenses" according to the following formula:

$$AFFE = \frac{[(F_1/FY)*AI_1*D_1]+[(F_2/FY)*AI_2*D_2]+[(F_3/FY)*AI_3*D_3] + \text{Transaction Fees}}{\text{Average Net Assets of the Fund}}$$

Where:

AFFE	=	Acquired Fund fees and expenses;
$F_1, F_2, F_3, \ldots$	=	Total annual operating expense ratio for each Acquired Fund;
FY	=	Number of days in the relevant fiscal year.
$AI_1, AI_2, AI_3, \ldots$	=	Average invested balance in each Acquired Fund;
$D_1, D_2, D_3, \ldots$	=	Number of days invested in each Acquired Fund; and
"Transaction Fees"	=	The total amount of sales loads, redemption fees, or other transaction fees paid by the Registrant in connection with acquiring or disposing of shares in any Acquired Funds during the most recent fiscal year.

(c) Calculate the average net assets of the Registrant for the most recent fiscal year, as provided in Item 4(a) (<u>see</u> Instruction 10 to Item 4(a)).

(d) The total annual operating expense ratio used for purposes of this calculation (F_1) is the annualized ratio of operating expenses to average net assets for the Acquired Fund's most recent fiscal period as disclosed in the Acquired Fund's most recent shareholder report. If the ratio of expenses to average net assets is not included in the most recent shareholder report or the Acquired Fund is a newly formed fund that has not provided a shareholder report, then the ratio of expenses to average net assets of the Acquired Fund is the ratio of total annual operating expenses to average annual net assets of the Acquired Fund for its most recent fiscal period as disclosed in the most recent communication from the Acquired Fund to the Registrant. For purposes of this instruction, Acquired Fund expenses include increases resulting from brokerage service and expense offset arrangements and reductions resulting from fee waivers or reimbursements by the Acquired Funds' investment advisers or sponsors.

(e) To determine the average invested balance (AI_1), the numerator is the sum of the amount initially invested in an Acquired Fund during the most recent fiscal year (if the investment was held at the end of the previous fiscal year, use the amount invested as of the end of the previous fiscal year) and the amounts invested in the Acquired Fund no less frequently than monthly during the period the investment is held by the Registrant (if the investment was held through the end of the fiscal year, use each month-end through and including the fiscal year-end). Divide the numerator by the number of measurement points included in the calculation of the numerator (i.e., if an investment is made during the fiscal year and held for 3 succeeding months, the denominator would be 4).

(f) A New Registrant should base the "Acquired Fund Fees and Expenses" on assumptions as to the specific Acquired Funds in which the New Registrant expects to invest. Disclose in a footnote to the table that Acquired Fund fees and expenses are based on estimated amounts for the current fiscal year.

(g) The Registrant may clarify in a footnote to the fee table that the total annual expenses under Item 3 are different from the ratio of expenses to average net assets given in response to Item 4, which reflects the operating expenses of the Registrant and does not include Acquired Fund fees and expenses.

* * * * *

8. Form N-4 (referenced in §§ 239.17b and 274.11c), Item 3, is amended by adding a sentence at the end of Instruction 17(a) to read as follows:

Note: The text of Form N-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-4

* * * * *

Item 3. Synopsis

* * * * *

<u>Instructions:</u>

* * * * *

17. (a) * * * If any Portfolio Company invests in shares of one or more Acquired Funds, "Total Annual [Portfolio Company] Operating Expenses" for the Portfolio Company must also include fees and expenses incurred indirectly by the Portfolio Company as a result of investment in shares of one or more Acquired Funds, calculated in accordance with Instruction 3(f) to Item 3 of Form N-1A (17 CFR 239.15A; 17 CFR 274.11A). For purposes of this paragraph, an Acquired Fund means any company in which the Portfolio Company invests that (i) is an investment company or (ii) would be an investment company under section 3(a) of the 1940 Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the 1940 Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)).

* * * * *

9. Form N-6 (referenced in §§ 239.17c and 274.11d), Item 3, is amended by adding a sentence at the end of Instruction 4(b) to read as follows:

Note: The text of Form N-6 does not, and this amendment will not, appear in the Code of

Federal Regulations.

FORM N-6

*　　*　　*　　*　　*

Item 3.　　Risk/Benefit Summary: Fee Table

*　　*　　*　　*　　*

Instructions:

*　　*　　*　　*　　*

4.　　Total Annual [Portfolio Company] Operating Expenses.

*　　*　　*　　*　　*

(b)　　*　　*　　*　　If any Portfolio Company invests in shares of one or more Acquired Funds, "Total Annual [Portfolio Company] Operating Expenses" for the Portfolio Company must also include fees and expenses incurred indirectly by the Portfolio Company as a result of investment in shares of one or more Acquired Funds, calculated in accordance with Instruction 3(f) to Item 3 of Form N-1A (17 CFR 239.15A; 17 CFR 274.11A). For purposes of this paragraph, an Acquired Fund means any company in which the Portfolio Company invests that (i) is an investment company or (ii) would be an investment company under section 3(a) of the Investment Company Act (15 U.S.C. 80a-3(a)) but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7) of the Investment Company Act (15 U.S.C. 80a-3(c)(1) and 80a-3(c)(7)).

*   *   *   *   *

By the Commission.

Nancy M. Morris
Secretary

June 20, 2006

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8714 / June 21, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54027 / June 21, 2006

INVESTMENT ADVISERS ACT OF 1940
Release No. 2524 / June 21, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12338

In the Matter of **EVAN MISSHULA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Evan Misshula ("Misshula").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial

Document 32 of 49

Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

SUMMARY

1. This proceeding concerns fraudulent conduct by Evan Misshula, the founder and manager of Sane Capital Partners, L.P. (the "Fund"), a hedge fund located in New York, New York and Greenwich, Connecticut. In 1999, Misshula created the Fund and managed the Fund through its unregistered investment adviser, Sane Capital, LLC. At its peak, the Fund, which Misshula told investors would invest primarily in technology and telecommunications stocks, had ten investors and approximately $800,000 in assets. In January 2001, Misshula developed financial difficulties in his personal life and began misappropriating Fund assets by transferring them into his personal bank account. From 2001 to 2004, Misshula materially misrepresented the performance of the Fund's investments to investors while he continued to misappropriate Fund assets. To hide his fraudulent conduct, Misshula sent investors fictitious quarterly reports showing investment gains, which bore no relation to the true condition of the Fund's investments or assets under management. By 2004, Misshula had ceased trading altogether and he had depleted the Fund's brokerage and bank accounts primarily through unauthorized transfers to his personal bank account. During the course of his fraudulent conduct, Misshula misappropriated approximately $529,000 in Fund assets. In July 2004, the Fund collapsed when Misshula was unable to meet an investor's redemption demand.

RESPONDENT

2. **Misshula**, age 39, is a resident of Greenwich, Connecticut and was the founder and manager of Sane Capital Partners, L.P. and Sane Capital, LLC. From 1999 to 2004, Misshula managed Sane Capital Partners, L.P. and Sane Capital, LLC. Misshula holds Series 7, 24 and 63 licenses. Since the collapse of Sane Capital in 2004, Misshula has worked as a Senior Risk Analyst at a registered investment adviser to a hedge fund located in Old Greenwich, Connecticut.

OTHER RELEVANT ENTITIES

3. **Sane Capital Partners, L.P.** was a limited partnership registered in the State of Delaware. Misshula founded the Fund in 1999 and from January 2000 to July 2004, the Fund was a domestic hedge fund that purportedly invested in public market securities in the technology industry.

4. **Sane Capital, LLC** was a New York limited liability company based in New York, New York and was the General Partner of, and unregistered investment adviser to, the Fund. Misshula was the principal of Sane Capital, LLC.

FACTS

A. Misshula Solicited Investors to Invest in Sane Capital Partners, L.P.

5. In 1999, Misshula gave a presentation on a new hedge fund that he was creating, Sane Capital Partners, L.P., to several partners at a law firm located in New York City (the "Law Firm"). In November 1999, a partner at the Law Firm prepared the operating agreement and articles of organization for Sane Capital, LLC, and, in January 2000, he prepared the Certificate of Limited Partnership for the Fund.

6. From November 1999 through July 2004, Misshula offered and sold the Fund's limited partnership interests to investors by telling investors that he would invest the Fund's assets in technology and telecommunications stocks. During this period, Misshula raised approximately $800,000 from investors.

7. In late 1999, Misshula solicited a personal friend ("Investor A") to invest in the Fund. Misshula told Investor A that he would be investing the Fund's assets in technology stocks, that he would manage the Fund, and that he would take as compensation a one percent management fee and 20 percent of profits. On January 5, 2000, Investor A and his wife invested $250,000 in the Fund.

8. In March 2000, four partners at the Law Firm founded a partnership ("Investor B") for the purpose of investing in the Fund. On March 31, 2000, Investor B made an initial investment of $162,500 in the Fund. In 2001 and 2002, individuals associated with Investor B made additional investments in the Fund. In total, Investor B and individuals associated with Investor B collectively invested approximately $262,500 in the Fund.

9. Four other individuals invested in the Fund, but three of them withdrew their investments before July 2004 for reasons unrelated to Misshula's misconduct. The fourth remaining investor ("Investor C") invested $20,000 in the Fund. By July 2004, Investor A, Investor B, and Investor C were the only investors remaining in the Fund.

B. Misshula Made Material Misrepresentations Concerning The Fund's Investments and Misappropriated the Fund's Assets

10. From the inception of the Fund in 1999 until January 2, 2001, Misshula traded in technology and telecommunication stocks, and sent investors quarterly investment reports that accurately depicted the Fund's returns and net asset value. In January 2001, unable to support his mounting personal expenses, Misshula began misappropriating Fund assets and depositing them into his personal bank account. To conceal his conduct from investors, Misshula began sending investors fictitious quarterly reports that failed to disclose that he had converted some of the Fund's assets to his own personal use, and falsely represented that the investors had made substantial returns on their investments. Additionally, Misshula incurred trading losses in the Fund's brokerage accounts – which he also concealed from investors. Eventually Misshula ceased trading

altogether and misappropriated the remaining assets of the Fund for his personal benefit. From January 2001 through July 2004, Misshula continued to send quarterly reports that falsely represented that the Fund's investments were receiving positive returns and that the investors' accounts were growing. Misshula also sent investors Form K-1s which showed positive returns consistent with the false quarterly reports.

11. Contrary to Misshula's representations to the investors in the quarterly reports and Form K-1s, Misshula diverted approximately $529,000 of investor funds, without the investors' authorization or knowledge, to pay his personal expenses.

12 In 2005, after the Fund's collapse, Investor A and Investor B obtained civil judgments against Misshula and Sane Capital LLC in the amounts of $486,460 and $300,000. To date, Misshula has paid $25,000 pursuant to these judgments.

VIOLATIONS

13. As a result of the conduct described above, Respondent Misshula willfully violated Section 17(a) of the Securities Act in that he, by the use of the means of instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly, in the offer or sale of securities, employed devices, schemes or artifices to defraud; obtained money or property by means of untrue statements of material fact or omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or engaged in transactions, practices or courses of business which operated or would operate as a fraud or deceit upon purchasers or prospective purchasers of such securities.

14. As a result of the conduct described above, Respondent Misshula willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that he, in connection with the purchase or sale of securities, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, employed devices, schemes or artifices to defraud; made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit.

15. As a result of the conduct described above, Respondent Misshula willfully violated Section 206(1) and 206(2) of the Advisers Act by employing devices, schemes or artifices to defraud clients or engaging in transactions, practices or courses of business that defrauded clients or prospective clients.

RESPONDENT'S COOPERATION

16. In determining to accept the Offer, the Commission considered cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Misshula's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Misshula cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act;

B. Respondent Misshula be, and hereby is barred from association with any investment adviser;

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any restitution ordered against the Respondent by any court related to the conduct that served as the basis for the Commission order; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioners Glassman & Atkins Disapproved

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 54030 / June 22, 2006

Accounting and Auditing Enforcement
Release No. 2444 / June 22, 2006

Administrative Proceeding
File No. 3-12339

In the Matter of **WALLACE G. HAISLIP,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Wallace G. Haislip ("Haislip" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. In the fall of 2000, Adelphia Communications Corporation ("Adelphia"), a cable television system owner and operator, asked Scientific-Atlanta, Inc. ("Scientific-Atlanta"), a vendor that provided digital cable set-top boxes used by Adelphia, to enter into a marketing support transaction. Following negotiations between Adelphia and Scientific-Atlanta, the parties agreed that Scientific-Atlanta would make marketing support payments for the stated purpose of helping Adelphia increase demand for digital set-top boxes provided by Scientific-Atlanta and, in return, Scientific-Atlanta would receive a corresponding increase in the price of digital set-top boxes it had supplied Adelphia in the past and was contractually obligated to supply in the future pursuant to a long-term purchase contract that had been entered into in May 2000. Adelphia did not use the marketing support payments to help increase demand for digital set-top boxes. Adelphia recorded the price increases it paid Scientific-Atlanta as capital expenditures, and recognized the marketing support payments paid by Scientific-Atlanta as a contra marketing expense, thereby artificially reducing its marketing expense and increasing Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA"). In this manner, Adelphia was able to use the transaction to reduce improperly its operating costs and increase its earnings by approximately $16.8 million in 2000 and $26.2 million in 2001.

2. Respondent, Scientific-Atlanta's CFO at the time, was the most senior finance executive responsible for approving the transaction. Respondent was not involved in documenting the transaction or signing the transaction documents.

Respondent

3. Respondent, age 56, is currently Senior Vice President, Finance and Operations for Scientific-Atlanta. From 1998 to 2003, Respondent was Senior Vice President of Finance, CFO, and Treasurer.

Relevant Entities

4. Scientific-Atlanta is a Georgia corporation, with corporate headquarters in Lawrenceville, Georgia. Scientific-Atlanta sells end-to-end networks used by programmers and cable operators and provides customer service and support for the cable television industry. At all relevant times, Scientific-Atlanta's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was publicly traded on the New York Stock Exchange.

5. Adelphia is a Delaware corporation, formerly headquartered in Coudersport, Pennsylvania. Adelphia owns, operates, and manages cable television systems and other related

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

telecommunications businesses. On March 27, 2002, Adelphia announced that it was liable for approximately $2.3 billion in debt that it had previously failed to disclose. In May 2002, certain members of the Rigas family, who controlled and held officer and director positions with Adelphia, resigned and Adelphia disclosed that it had misrepresented its financial performance for the fiscal years 2000 and 2001 by, among other things, overstating its earnings. On July 18, 2002, the Commission filed *SEC v. Adelphia Communications Corporation, et al.*, 02 Civ. 5776 (PKC) (S.D.N.Y.), alleging that widespread, multifaceted financial fraud occurred at Adelphia. On July 8, 2004, two Adelphia executives were convicted on 18 counts of securities fraud, bank fraud, and conspiracy. On May 31, 2005, the U.S. District Court for the Southern District of New York entered a consent order enjoining Adelphia from violating Section 17(a) of the Securities Act of 1933, Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, and 13a-13 under the Exchange Act.

The Year 2000 Marketing Support Agreement

6. In May 2000, Adelphia entered into a purchase agreement for digital set-top boxes with Scientific-Atlanta. The agreement, which expired on December 31, 2001, required Adelphia to purchase digital set-top boxes and transmission equipment at prices fixed by the terms of the agreement, and contained no provision regarding marketing.

7. In June 2000, Adelphia realized that its second quarter reported EBITDA would fall below analysts' expectations. Adelphia devised a plan to increase EBITDA by reducing operating costs through a marketing support agreement with Scientific-Atlanta. The business rationale for the marketing support agreement that Adelphia stated to Scientific-Atlanta was to assist Adelphia in the roll-out of its digital cable service, which was in direct competition with satellite television. The request was consistent with the cable industry's use of marketing campaigns to introduce digital service and to compete with satellite television. Pursuant to the agreement, Scientific-Atlanta would make marketing support payments to Adelphia. The transaction, however, would have no economic impact on Scientific-Atlanta's net revenue or income from the sales of set-top boxes to Adelphia because Adelphia would pay to Scientific-Atlanta an amount equal to the marketing support payments in the form of a price increase applied to each set-top box that Adelphia purchased. The parties ultimately agreed that the marketing support would average approximately $20 per set-top box. Based upon the number of boxes that Adelphia was required to purchase, the marketing support came out to approximately $16.8 million for the year 2000 and $22.4 million for the year 2001.

8. Several facts existed that, taken together, should have put Respondent on notice that it was unlikely that Adelphia was using the marketing support agreement to market Scientific-Atlanta set-top boxes. Respondent understood that the price increase was designed to ensure that there would be no impact on Scientific-Atlanta's net revenue or income. Respondent also knew that the marketing support transaction provided operating expense benefits to Adelphia. During negotiations in October 2000, Adelphia put intense pressure on Scientific-Atlanta to agree to pay marketing support of $50 per set-top box. Respondent rejected that proposal as commercially unreasonable, and the parties eventually agreed that Scientific-Atlanta would pay approximately $20 per set-top box over the life of the contract, with Adelphia paying the same amount to Scientific-Atlanta in the form of price increases applied to Adelphia's set-top orders. Adelphia

requested, and Scientific-Atlanta agreed, that the marketing support contracts apply retroactively to set-tops shipped during the period from April 2000 to December 2000. Respondent also understood that part of the rationale for the marketing support payments was that Adelphia had already incurred marketing expenses in prior quarters.

9. Pursuant to the contracts, on May 10, 2001 Adelphia paid Scientific-Atlanta $16.8 million in price increases and Scientific-Atlanta immediately returned to Adelphia $16.8 million in marketing support payments. Scientific-Atlanta did not ask for any proof of marketing before making the $16.8 million payment.

The Year 2001 Modifications To The Marketing Support Agreement

10. In June 2001, Adelphia advised Scientific-Atlanta that it would be ordering fewer set-top boxes than required by the long-term purchase agreement. Because Adelphia would be ordering fewer set-top boxes than previously agreed to by the parties, the prior price increase for the set-top boxes would not be sufficient to cover Scientific-Atlanta's marketing support payment obligation of $22.4 million for the year 2001. To ensure that Scientific-Atlanta's marketing support payment obligation equaled the amount of the overall price increase, Scientific-Atlanta agreed to expand coverage of the marketing support arrangement beyond digital set-top boxes to include price increases applied to Adelphia's purchases of digital cable transmission equipment from Scientific-Atlanta, retroactive to 2000.

11. In December 2001, Adelphia demanded an increase in the amount of marketing support for 2001 from the previously agreed $22.4 million to between $28-29 million. The parties ultimately agreed that Scientific-Atlanta would pay $26.2 million in marketing support, which covered set-tops purchased in 2001 and transmission equipment purchased between July 2000 and December 31, 2001.

12. In late 2001, at Respondent's direction, Scientific-Atlanta repeatedly asked Adelphia for documentation of the marketing that had been done using the marketing support payments. Adelphia failed to deliver to Scientific-Atlanta any documentation of credible marketing activity by Adelphia. Notwithstanding the lack of credible evidence of marketing done, Respondent approved the payment of $26.2 million for 2001.

Adelphia Misused The Marketing Support Transaction
To Artificially Decrease Marketing Expenses And Increase EBITDA

13. In internal journal entries, Scientific-Atlanta recorded the price increases as an increase in revenue and the marketing support payments to Adelphia as contra-revenue. The net result was no change in the revenue line item reported in Scientific-Atlanta's publicly-filed income statement.

14. Adelphia, however, recorded the marketing support payments as a contra-expense to marketing costs. This accounting treatment lowered the amount of recorded marketing expenses and, in turn, artificially inflated Adelphia's EBITDA. Adelphia recorded the price increases paid to Scientific-Atlanta as capital expenditures, which are depreciated over time and, as such, have no impact on EBITDA and a minimal impact on earnings. In total, over seven quarters from April

2000 through December 2001, Adelphia recorded improperly approximately $43 million in marketing support payments as reductions in current operating expenses, with the intended effect of inflating improperly its reported EBITDA by $43 million over that period. Adelphia's accounting treatment violated Generally Accepted Accounting Principles ("GAAP") because it improperly reflected the transaction as having substance when in fact Adelphia did not make the necessary marketing expenditures.

15. On March 27, 2002, approximately one month after Scientific-Atlanta paid Adelphia $26.2 million for marketing support, Adelphia announced that the company was liable for $2.3 billion in off-balance sheet liabilities. On June 10, 2002, Adelphia filed a Form 8-K with the Commission, making downward revisions of its 2000 and 2001 reported EBITDA, citing improper accounting of marketing support agreements with two unnamed vendors (one of which was Scientific-Atlanta). Adelphia stated that properly accounting for the marketing support agreements would reduce EBITDA by approximately $54 million in 2001 and $37 million in 2000, of which $26.2 million and $16.8 million, respectively, is attributable to the transactions with Scientific-Atlanta.

Legal Conclusions

16. The Exchange Act and Exchange Act rules require every issuer of registered securities to file reports with the Commission that accurately reflect the issuer's financial performance and provide other true and accurate information to the public.

17. Adelphia violated Section 13(a) and Rules 13a-1, 13a-13, and 12b-20 by filing with the Commission a Form 10-Q for each of the quarters from the fourth quarter of 2000 through the fourth quarter of 2001, and a Form 10-K for the year ended December 31, 2000, each containing materially false and misleading earnings in the financial statements for each reporting period.

18. Adelphia violated Sections 13(b)(2)(A) and 13(b)(2)(B) by improperly recording the marketing support payments as a contra-expense to Adelphia's marketing costs, and by recording as capital expenditures the payments owed by Adelphia to Scientific-Atlanta under the price increase provisions of the marketing support agreement. Certain officers of Adelphia knowingly falsified, and caused others to falsify, Adelphia's books, records and accounts, including the fraudulent journal entries of the price increases and marketing support payments. In doing so, each of them knowingly circumvented the internal accounting controls that existed at Adelphia.

19. Section 21C of the Exchange Act provides that the Commission may issue a cease-and-desist order against a person who is "a cause of [another person's] violation, due to an act or omission the person knew or should have known would contribute to such violation."[2] Based on

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[2] Where the primary violations underlying a finding that a person is "a cause of" violations do not themselves require a finding of scienter, the standard of liability for being "a cause of" such violations under Section 21C of the Exchange Act is negligence. *See KPMG LLP v. SEC*, 289 F. 3d 109, 112 (DC Cir. 2002).

the conduct described above, Respondent was a cause of Adelphia's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioners Glassman & Atkins Disapproved

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 54031 / June 22, 2006

Accounting and Auditing Enforcement
Release No. 2445 / June 22, 2006

Administrative Proceeding
File No. 3-12340

In the Matter of **JULIAN W. EIDSON,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Julian W. Eidson ("Eidson" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. In the fall of 2000, Adelphia Communications Corporation ("Adelphia"), a cable television system owner and operator, asked Scientific-Atlanta, Inc. ("Scientific-Atlanta"), a vendor that provided digital cable set-top boxes used by Adelphia, to enter into a marketing support transaction. Following negotiations between Adelphia and Scientific-Atlanta, the parties agreed that Scientific-Atlanta would make marketing support payments for the stated purpose of helping Adelphia increase demand for digital set-top boxes provided by Scientific-Atlanta and, in return, Scientific-Atlanta would receive a corresponding increase in the price of digital set-top boxes it had supplied Adelphia in the past and was contractually obligated to supply in the future pursuant to a long-term purchase contract that had been entered into in May 2000. Adelphia did not use the marketing support payments to help increase demand for digital set-top boxes. Adelphia recorded the price increases it paid Scientific-Atlanta as capital expenditures, and recognized the marketing support payments paid by Scientific-Atlanta as a contra marketing expense, thereby artificially reducing its marketing expense and increasing Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA"). In this manner, Adelphia was able to use the transaction to reduce improperly its operating costs and increase its earnings by approximately $16.8 million in 2000 and $26.2 million in 2001.

2. Respondent, Scientific-Atlanta's principal accounting officer at the time, was one of the senior executives responsible for approving the form of the transaction and was the senior executive responsible for approving Scientific-Atlanta's accounting for the transaction. Respondent did not negotiate the terms of the transaction or review the transaction documents.

Respondent

3. Respondent, age 65, was Vice President, Controller, and Principal Accounting Officer of Scientific-Atlanta from at least 2000 to 2003.

Relevant Entities

4. Scientific-Atlanta is a Georgia corporation, with corporate headquarters in Lawrenceville, Georgia. Scientific-Atlanta sells end-to-end networks used by programmers and cable operators and provides customer service and support for the cable television industry. At all relevant times, Scientific-Atlanta's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was publicly traded on the New York Stock Exchange.

5. Adelphia is a Delaware corporation, formerly headquartered in Coudersport, Pennsylvania. Adelphia owns, operates, and manages cable television systems and other related

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

telecommunications businesses. On March 27, 2002, Adelphia announced that it was liable for approximately $2.3 billion in debt that it had previously failed to disclose. In May 2002, certain members of the Rigas family, who controlled and held officer and director positions with Adelphia, resigned and Adelphia disclosed that it had misrepresented its financial performance for the fiscal years 2000 and 2001 by, among other things, overstating its earnings. On July 18, 2002, the Commission filed *SEC v. Adelphia Communications Corporation, et al.*, 02 Civ. 5776 (PKC) (S.D.N.Y.), alleging that widespread, multifaceted financial fraud occurred at Adelphia. On July 8, 2004, two Adelphia executives were convicted on 18 counts of securities fraud, bank fraud, and conspiracy. On May 31, 2005, the U.S. District Court for the Southern District of New York entered a consent order enjoining Adelphia from violating Section 17(a) of the Securities Act of 1933, Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, and 13a-13 under the Exchange Act.

The Year 2000 Marketing Support Agreement

6. In May 2000, Adelphia entered into a long-term purchase agreement for digital set-top boxes with Scientific-Atlanta. The agreement, which expired on December 31, 2001, required Adelphia to purchase digital set-top boxes and transmission equipment at prices fixed by the terms of the agreement, and contained no provision regarding marketing.

7. In June 2000, Adelphia realized that its second quarter reported EBITDA would fall below analysts' expectations. Adelphia devised a plan to increase EBITDA by reducing operating costs through a marketing support agreement with Scientific-Atlanta. The business rationale for the marketing support agreement that Adelphia stated to Scientific-Atlanta was to assist Adelphia in the roll-out of its digital cable service, which was in direct competition with satellite television. The request was consistent with the cable industry's use of marketing campaigns to introduce digital service and to compete with satellite television. Pursuant to the agreement, Scientific-Atlanta would make marketing support payments to Adelphia. The transaction, however, would have no economic impact on Scientific-Atlanta's net revenue or income from the sales of set-top boxes to Adelphia because Adelphia would pay to Scientific-Atlanta an amount equal to the marketing support payments in the form of a price increase applied to each set-top box that Adelphia purchased. The parties ultimately agreed that the marketing support would average approximately $20 per set-top box. Based upon the number of boxes that Adelphia was required to purchase, the marketing support came out to approximately $16.8 million for the year 2000 and $22.4 million for the year 2001.

8. Several facts existed that, taken together, should have put Respondent on notice that it was unlikely that Adelphia was using the marketing support agreement to market Scientific-Atlanta set-top boxes. Respondent understood that the price increase was designed to ensure that there would be no impact on Scientific-Atlanta's net revenue or income. As Principal Accounting Officer, Respondent took steps to ensure that Scientific-Atlanta would not record any additional revenue as a result of the price increase; instead, Scientific-Atlanta would record both the effect of the price increase and the corresponding marketing support payments in revenue, resulting in no net change in Scientific-Atlanta's revenue from its sales to Adelphia. Respondent also understood that the marketing support transaction would likely be used to provide operating expense benefits to Adelphia. Adelphia demanded, and Scientific-Atlanta agreed, that the marketing support

contracts apply retroactively to set-tops shipped during the period from April 2000 to December 2000.

The Year 2001 Modifications To The Marketing Support Agreement

9. In June 2001, Adelphia advised Scientific-Atlanta that it would be ordering fewer set-top boxes than required by the long-term purchase agreement. Because Adelphia would be ordering fewer set-top boxes than previously agreed to by the parties, the prior price increase for the set-top boxes would not be sufficient to cover Scientific-Atlanta's marketing support payment obligation of $22.4 million for the year 2001. To ensure that Scientific-Atlanta's marketing support payment obligation equaled the amount of the overall price increase, Scientific-Atlanta agreed to expand coverage of the marketing support arrangement beyond digital set-top boxes to include price increases applied to Adelphia's purchases of digital cable transmission equipment from Scientific-Atlanta, retroactive to 2000.

10. In December 2001, Adelphia demanded an increase in the amount of marketing support for 2001 from the previously agreed $22.4 million to between $28-29 million. The parties ultimately agreed that Scientific-Atlanta would pay $26.2 million in marketing support, which covered set-tops purchased in 2001 and transmission equipment purchased between July 2000 and December 31, 2001.

Respondent Approved Marketing Support Payments Without Any Documentation Of Marketing Done By Adelphia

11. On or about May 10, 2001, Respondent approved the first marketing support check request in the amount of $16.8 million. Respondent did not confirm that actual marketing was being done prior to approving the check request.

12. In late 2001, Respondent recommended that the CFO approve payment of $26.2 million in marketing support for 2001. Respondent did not confirm that actual marketing was being done prior to recommending approval of that payment. The CFO approved the payment, based in significant part on Respondent's recommendation.

Adelphia Misused The Marketing Support Transaction To Artificially Decrease Marketing Expenses And Increase EBITDA

13. In internal journal entries, Scientific-Atlanta recorded the price increases as an increase in revenue and the marketing support payments to Adelphia as contra-revenue. The net result was no change in the revenue line item reported in Scientific-Atlanta's publicly-filed income statement.

14. Adelphia, however, recorded the marketing support payments as a contra-expense to marketing costs. This accounting treatment lowered the amount of recorded marketing expenses and, in turn, artificially inflated Adelphia's EBITDA. Adelphia recorded the price increases paid to Scientific-Atlanta as capital expenditures, which are depreciated over time and, as such, have no impact on EBITDA and a minimal impact on earnings. In total, over seven quarters from April 2000 through December 2001, Adelphia recorded improperly approximately $43 million in

marketing support payments as reductions in current operating expenses, with the intended effect of inflating improperly its reported EBITDA by $43 million over that period. Adelphia's accounting treatment violated Generally Accepted Accounting Principles ("GAAP") because it improperly reflected the transaction as having substance when Adelphia did not make the necessary marketing expenditures.

15. On March 27, 2002, approximately one month after Scientific-Atlanta paid Adelphia $26.2 million for marketing support, Adelphia announced that the company was liable for $2.3 billion in off-balance sheet liabilities. On June 10, 2002, Adelphia filed a Form 8-K with the Commission, making downward revisions of its 2000 and 2001 reported EBITDA, citing improper accounting of marketing support agreements with two unnamed vendors (one of which was Scientific-Atlanta). Adelphia stated that properly accounting for the marketing support agreements would reduce EBITDA by approximately $54 million in 2001 and $37 million in 2000, of which $26.2 million and $16.8 million, respectively, is attributable to the transactions with Scientific-Atlanta.

Legal Conclusions

16. The Exchange Act and Exchange Act rules require every issuer of registered securities to file reports with the Commission that accurately reflect the issuer's financial performance and provide other true and accurate information to the public.

17. Adelphia violated Section 13(a) and Rules 13a-1, 13a-13 and 12b-20 by filing with the Commission a Form 10-Q for each of the quarters from the fourth quarter of 2000 through the fourth quarter of 2001, and a Form 10-K for the year ended December 31, 2000, each containing materially false and misleading earnings in the financial statements for each reporting period.

18. Adelphia violated Sections 13(b)(2)(A) and 13(b)(2)(B) by improperly recording the marketing support payments as a contra-expense to Adelphia's marketing costs, and by recording as capital expenditures the payments owed by Adelphia to Scientific-Atlanta under the price increase provisions of the marketing support agreement. Certain officers of Adelphia knowingly falsified, and caused others to falsify, Adelphia's books, records and accounts, including the fraudulent journal entries of the price increases and marketing support payments. In doing so, each of them knowingly circumvented the internal accounting controls that existed at Adelphia.

19. Section 21C of the Exchange Act provides that the Commission may issue a cease-and-desist order against a person who is "a cause of [another person's] violation, due to an act or omission the person knew or should have known would contribute to such violation."[2] Based on the conduct described above, Respondent was a cause of Adelphia's violations of Sections 13(a),

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[2] Where the primary violations underlying a finding that a person is "a cause of" violations do not themselves require a finding of scienter, the standard of liability for being "a cause of" such violations under Section 21C of the Exchange Act is negligence. *See KPMG LLP v. SEC*, 289 F. 3d 109, 112 (DC Cir. 2002).

13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2525 / June 22, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12341

In the Matter of	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940
WEISS RESEARCH, INC., MARTIN WEISS, AND LAWRENCE EDELSON	
Respondents.	

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Weiss Research, Inc., and pursuant to Sections 203(f) and 203(k) of the Advisers Act against Martin Weiss and Lawrence Edelson ("Edelson") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted individual Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

A. Respondents

1. Weiss Research, Inc. is a privately-held Florida corporation headquartered in Jupiter, Florida. Weiss Research publishes a number of newsletters that provide general commentary about the securities markets. Weiss Research also publishes "premium services" newsletters that, in addition to providing market commentary, recommend specific securities transactions. Weiss Research is not registered as an investment adviser with either the Commission or any state securities regulator. Weiss Research was registered with the Commission as an investment adviser pursuant to Section 203(a) of the Advisers Act until it withdrew its registration in 1997 according to publicly available records.

2. Martin Weiss, age 58, is a resident of Palm Beach Gardens, Florida. He owns and controls Weiss Research through a corporate entity. Martin Weiss drafted or reviewed many of Weiss Research's advertisements for its publications.

3. Lawrence Edelson ("Edelson"), age 50, is a resident of Palm Beach Gardens, Florida. He was employed by Weiss Research from 1996 to January 31, 2003, when he became an independent contractor for Weiss Research. Edelson continues to provide copywriting and editorial services to Weiss Research.

B. Facts

<u>Weiss Research's Activities</u>

4. Weiss Research is a newsletter publisher that, since approximately the mid-1990s, has published a number of "premium services" newsletters that provide subscribers with specific advice on the purchase or sale of securities. Subscribers to these newsletters receive, in addition to periodic analyses of economic trends and business developments, frequent facsimiles or e-mails recommending the purchase or sale of specific investments. These facsimiles and e-mails, which Weiss Research characterizes as "simple, plain-English, – sell-this-buy-that – signals," often only identify the investment and provide verbatim trading language for the subscribers to recite to their brokers. Weiss Research sends trading instructions to its premium services subscribers only when it purports to see an investment opportunity arise. Weiss Research charges its subscribers between $1,000 and $5,000 for annual subscriptions to its premium services. From 2000 to 2004, Weiss Research had a total of approximately 10,000 subscribers to its premium services newsletters.

5. Weiss Research offers several different premium services publications, each of which reflects a different investment strategy. Some focus on stock investments, while others focus on options trading. Currently, Weiss Research offers approximately ten different premium services, including Stock Options Alert, Larry's Gold Trader, Gold Trader Hotline, Index Options Hotline, and Stock Market Dogs and Darlings.

6. Between at least September 2001 and December 31, 2004 (the "relevant time period"), Weiss Research helped potential subscribers choose the premium service that was best

for them. For example, during a portion of the relevant period, Weiss Research provided a questionnaire on its website which inquired about topics such as the subscriber's age, income, cash holdings, assets, tax status, investment experience, and objectives. After potential subscribers completed the questionnaire, Weiss Research's website responded with an automated evaluation of the subscriber's risk profile along with a recommendation of whether Weiss Research's premium services would be appropriate for that subscriber. Weiss Research also had customer service representatives available to answer questions regarding premium services. In addition to this tool, during the relevant time period, Weiss Research's advertisements claimed that subscribers would not only receive trading recommendations, but also private telephone numbers and e-mail addresses for contacting Martin Weiss and Edelson directly.

7. Starting in approximately September 2001 and through March 31, 2005, Weiss Research enabled its premium services subscribers to engage in "auto-trading." Auto-trading was an arrangement in which premium services subscribers requested that Weiss Research send trading instructions directly to their broker-dealers for automatic execution. Weiss Research provided its premium services subscribers with a list of brokerage firms that were willing to enter into auto-trading agreements. Weiss Research received no commissions or fees from the auto-trading broker-dealers or additional fees from auto-trading subscribers. Weiss Research estimates that 25% of its premium services subscribers utilized auto-trading.

8. Subscribers who wished to participate in auto-trading generally opened accounts at and executed auto-trading agreements with one of the broker-dealers from the Weiss Research list. Under the auto-trading agreements, premium services subscribers directed their broker-dealers to execute automatically all transactions recommended in the Weiss Research premium service newsletters without the need for any further instruction or pre-approval from the subscribers.

9. During the relevant time period, Weiss Research advised its premium services subscribers to execute every recommended trade and to avoid altering the trading instructions in order to receive the greatest benefit from Weiss Research's strategies. According to Weiss Research, auto-trading "eliminate[d] the need for subscribers to manually review and communicate orders to their broker."

10. Weiss Research worked with certain of the auto-trading broker-dealers for purposes of record keeping and customer service. For example, Weiss Research requested and received from some of the auto-trading broker-dealers copies of trade confirmations with customers' names and account numbers redacted to verify the prices at which its subscribers' orders were filled. Further, Weiss Research requested and occasionally received from the broker-dealers the names of their auto-trading customers to verify that only paying subscribers were receiving its trading recommendations.

11. Almost all of Weiss Research's auto-trading subscribers opened accounts with broker-dealers from the list Weiss Research provided and used those broker-dealers primarily for Weiss Research-recommended trades. As of at least December 31, 2003, Weiss Research's auto-trading subscribers had more than $30,000,000 in assets in their auto-trading brokerage accounts. Weiss Research stopped facilitating auto-trading for new subscribers on December 31, 2004, and for all subscribers on April 1, 2005.

Weiss Research's Selective Statements About Profitability

12. During the relevant time period, Weiss Research disseminated advertisements prepared by Martin Weiss, Edelson, and others that gave examples of the profits those subscribers who followed the recommendations in Weiss Research's premium services newsletters could earn. These solicitations were designed to attract new subscribers to Weiss Research's premium services and persuade existing subscribers to subscribe to additional premium services. These advertisements, however, selectively highlighted profitable trades, omitted specific references to unprofitable trades, and presented an unrealistic picture of Weiss Research's investment success.

13. Weiss Research, in promotional materials prepared by Martin Weiss, Edelson, and others, sometimes used selective, outdated, and/or hypothetical examples of specific returns that subscribers might have realized on individual trades had they followed Weiss Research's recommendations, without advising that the overall return was or might not be profitable. For example, Weiss Research, in promotional materials disseminated until July 2003, claimed that subscribers "who followed our recommendations scooped up 400% profits," and also "bagged profits like 400% ... 39% ... 217% ... 100% ... 374% ... 66% ... 171% ... 222%." In other advertisements, Edelson told potential subscribers, "I cannot guarantee profits. This is a speculative service for your speculative money. But as you can see from the penny gold shares I'm eyeing right now, it's not an understatement when I say you could make back the cost of the subscription fee 30...40...even 50 times over." Because this publication carried a maximum subscription rate of $5,000 per year, this claim indicated that subscribers could profit by as much as $250,000 by following Weiss Research's recommendations.

14. The overall performance of Weiss Research's premium services did not support these profit claims. In fact, during the relevant time period, many subscribers who followed each Weiss Research trading recommendation – as Weiss Research encouraged its subscribers to do – experienced overall returns that were substantially lower than Weiss Research's profit examples and most actually lost money. Although Weiss Research disclosed to subscribers that losses are possible, it did not include information on specific losing trades or disclose that, for the most part, its premium services newsletters had not been profitable for subscribers.

15. Weiss Research maintained internal performance records which noted every trade Weiss Research recommended and the hypothetical profit or loss an investor would have experienced if he or she had followed Weiss Research's recommendations. Weiss Research did not make these performance records available to subscribers or potential subscribers. These performance records demonstrate that, during the relevant time period, subscribers to most of Weiss Research's premium services, who followed Weiss Research's recommendations without deviation, would have lost money. Subscribers to the few profitable services would have realized overall gains that were well below the profits from individual trades represented in Weiss Research's advertisements.

16. For one of its premium services, Weiss Research also made claims in 2004 about its overall trading strategy that were inconsistent with actual results. In its "Operating Manual" provided to new subscribers, Weiss Research claimed that its "proprietary SIX-STEP option selection process has a proven track record of finding the best profit opportunities in up AND down markets." In reality, this particular premium service had generated an overall loss for subscribers since its inception.

17. Weiss Research's selective use of profitable trades and omission of information about losing trades in its advertisements created an impression that subscribers to its premium services would consistently realize large profits overall if they followed Weiss Research's recommendations.

Weiss Research's Claims About Edelson's Involvement

18. Weiss Research, in advertisements and other materials prepared or reviewed by Martin Weiss and Edelson, represented to existing and potential premium services subscribers that they would receive expert trading advice from Edelson and advertised his decades of experience and "uncanny" ability to pick profitable trades. In reality, Edelson was not actually involved in selecting the specific recommendations during a portion of the relevant time period. The recommended trades were selected without Edelson's knowledge by other Weiss Research employees with little or no specific experience in the particular markets at issue.

19. Weiss Research's claims about the profitability and performance history of its premium services publications, and Edelson's involvement in the trading recommendations of certain publications, were significant factors in subscribers' decisions to purchase Weiss Research's premium service publications.

C. Legal Discussion

Weiss Research Operated as an "Investment Adviser"

20. Section 202(a)(11) of the Advisers Act defines "investment adviser" as any person who, for compensation, engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. However, under Section 202(a)(11)(D) of the Advisers Act, "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation" is not considered an investment adviser. Under Lowe v. SEC, 472 U.S. 181, 209 (1985), the publications of any person relying on the publishers' exclusion may not be "personal communications masquerading in the clothing of newspapers, news magazines, or financial publications." The exclusion applies so long as the communications between the newsletter and its subscribers remain "entirely impersonal and do not develop into the kind of fiduciary, person-to-person relationships that ... are characteristic of investment advisers-client relationships." Id. at 210. Factors that may be relevant to whether a newsletter may rely on the publishers' exclusion include the existence of authority over the funds of subscribers; decision-making authority to handle subscribers' portfolios or accounts; or individualized, investment-related interactions with subscribers. Id. at 210 n.57.

21. From at least September 2001 to April 1, 2005, for a fee of up to $5,000 per year, Weiss Research was engaged in the business of advising others as to the buying and selling of securities in response to market activity. Accordingly, Weiss Research met the definition of an investment adviser under Section 202(a)(11) of the Advisers Act.

22. Weiss Research's auto-trading program did not qualify for the publishers' exclusion set forth in Section 202(a)(11)(D) of the Advisers Act. Unlike a typical newsletter, Weiss Research engaged in personalized communications with its subscribers regarding investment advice and effectively had investment discretion to purchase and sell securities on behalf of its

auto-trading subscribers. These factors preclude Weiss Research from relying on the publishers' exclusion found in Section 202(a)(11)(D) of the Advisers Act. See Lowe, 472 U.S. at 210 n.57.

D. Violations

Weiss Research Failed to Register with the Commission as an Investment Adviser

23. Section 203(a) of the Advisers Act makes it unlawful for an investment adviser, absent certain exemptions and prohibitions for small investment advisers, "to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser" unless registered with the Commission. All investment advisers with $30,000,000 or more in assets under management must be registered with the Commission pursuant to Section 203A of the Advisers Act and Rule 203A-1(a) thereunder. A violation of Section 203(a) does not require a showing of scienter. SEC v. Wall Street Transcript Corp., 422 F.2d 1371, 1376 (2d Cir.), cert. denied, 398 U.S. 958 (1970).

24. As discussed above, Weiss Research met the definition of an "investment adviser" and could not avail itself of the publishers' exclusion with respect to those premium service subscribers who utilized auto-trading. Moreover, Weiss Research effectively had investment discretion over the auto-traded accounts, which held at least $30,000,000 as of December 31, 2003. As such, Weiss Research was required to be registered with the Commission as an investment adviser. By failing to register, Weiss Research willfully[1] violated Section 203(a) of the Advisers Act. Martin Weiss, as the owner and president of Weiss Research, willfully aided and abetted, and caused, that violation.

Violations of Sections 206(2), 206(4) of the Advisers Act and Rules 206(4)-1(a)(2) and (5) Thereunder

25. Section 206 of the Advisers Act requires investment advisers to exercise the utmost good faith in dealings with clients or prospective clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients or prospective clients. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963). Violations of Sections 206(2) and 206(4) of the Advisers Act do not require a showing of scienter. SEC v. Steadman, 967 F.2d 636 (D.C. Cir. 1992). Weiss Research, in advertisements and other materials drafted by Martin Weiss and Edelson, (a) made claims about the profitability and past performance of its premium service publications that were inconsistent with the premium services' overall performance; and (b) made false statements that mischaracterized Edelson's involvement in selecting the recommended investments. Accordingly, Weiss Research willfully violated, and Martin Weiss and Edelson willfully aided and abetted and caused Weiss Research's violations of, Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.

26. Further, Weiss Research referred to past specific recommendations in its advertisements without providing a complete list of all recommendations it made within the previous one-year period. Weiss Research therefore willfully violated, and Martin Weiss and Edelson willfully aided and abetted and caused Weiss Research's violations of, Rule 206(4)-1(a)(2) under the Advisers Act, which makes it unlawful for an advertisement by an investment

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[1] "Willfully" as used in this Order means intentionally committing the act which constitutes the violation. See Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

adviser to refer to any past specific recommendations without providing a complete list of all recommendations made within one year. Rule 206(4)-1 applies to "any investment adviser registered or required to be registered under section 203" of the Advisers Act. See Advisers Act Rule 206(4)-1(a). See also Rules Implementing Amendments to the Investment Advisers Act of 1940, Advisers Act Release No. 1633 at 80 (May 15, 1997).

Weiss Research's Remedial Efforts

27. Weiss Research has taken the following voluntary remedial actions:

A. Ceased facilitating auto-trading for all subscribers and undertakes not to resume facilitating auto-trading unless it registers as an investment adviser with the Commission, or, if appropriate, a state securities regulator; and

B. Made available to current and potential subscribers the performance histories for each premium service; and

C. Established an internal compliance department to review marketing materials and procedures; and

D. Established internal procedures for monitoring the accuracy and performance of trading recommendations.

28. In determining whether to accept the Offers, the Commission has considered the remedial acts undertaken by Weiss Research, including those set forth in Paragraph 27, above, and the cooperation the Respondents afforded the Commission staff.

Undertakings

29. Weiss Research undertakes to continue and maintain the remedial efforts described in Paragraph 27, above.

30. In determining whether to accept the Offers, the Commission has considered the undertakings in Paragraph 29, above.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Weiss Research, Martin Weiss, and Edelson's Offers.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(k) of the Advisers Act, Respondent Weiss Research cease and desist from committing or causing any violations and any future violations of Sections 203(a), 206(2), and 206(4) of the Advisers Act, and Rules 206(4)-1(a)(2) and (5) thereunder;

B. Pursuant to Section 203(k) of the Advisers Act, Respondent Martin Weiss cease and desist from committing or causing any violations and any future violations of

Sections 203(a), 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-1(a)(2) and (5) thereunder;

C. Pursuant to Section 203(k) of the Advisers Act, Respondent Edelson cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act, and Rules 206(4)-1(a)(2) and (5) thereunder;

D. Respondent Weiss Research shall comply with the undertakings specified in Paragraph 27 above.

E. Respondent Weiss Research shall, within twenty (20) days of the entry of this Order, pay disgorgement and prejudgment interest in the total amount of $1,641,141.00 and a civil money penalty in the amount of $350,000.00 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies Weiss Research as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Glenn Gordon, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131;

F. Respondent Martin Weiss shall, within twenty (20) days of the entry of this Order, pay disgorgement in the amount of $1.00 and a civil money penalty in the amount of $100,000.00 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies Martin Weiss as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Glenn Gordon, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131;

G. Respondent Edelson shall, within twenty (20) days of the entry of this Order, pay disgorgement in the amount of $1.00 and a civil money penalty in the amount of $75,000.00 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies Edelson as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Glenn Gordon, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131;

H. Such civil money penalties contained in Paragraphs E, F, and G, above, may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002 ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that they shall not, after offset or reduction in any Related Investor Action based on Respondents' payment of disgorgement in this action, argue that they are entitled to, nor shall they further benefit by offset or reduction of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioner Glassman
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54049 / June 27, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2448 / June 27, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12344

In the Matter of **DOUGLAS R. BAUER,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Douglas R. Bauer ("Bauer" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Respondent

Douglas R. Bauer, age 44, of St. Petersburg, Florida, is the chief financial officer, secretary, and treasurer of PowerLinx, Inc. ("PowerLinx"). He joined PowerLinx's management team in early 2001 and shortly thereafter became chief financial officer.

Other Relevant Entity

PowerLinx is a Nevada corporation based in St. Petersburg, Florida. The company, formerly known as SeaView Video Technology, Inc., manufactures security video cameras, underwater cameras, and accessories. PowerLinx's stock is quoted on the OTC Bulletin Board under the symbol "PWNX."

Summary

Bauer joined PowerLinx's management team in early 2001. Prior to Bauer's arrival, PowerLinx had fraudulently recognized nearly ninety percent of its reported revenues during fiscal year 2000 based on fictitious sales.[2] During his initial review of the company's financial records, Bauer concluded that PowerLinx had materially overstated revenues and accounts receivable during 2000. In April 2001, largely at Bauer's impetus, PowerLinx restated its second- and third-quarter revenues as part of its fiscal year 2000 annual report on Form 10-K. In April 2002, PowerLinx again restated its financial statements, in its 2001 annual report on Form 10-K, to write down improperly recorded deferred tax assets. At the time of that restatement, Bauer was aware of material information that should have been disclosed, but did not cause that information to be included in the restatement. Accordingly, Bauer was a cause of PowerLinx's violations of Section 15(d) of the Exchange Act and Rules 15d-1 and 12b-20 thereunder with regard to its April 2002 restatement.

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1 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

2 In a related action, PowerLinx and two of its former officers and directors, George S. Bernardich III and James R. Cox, have consented to the entry of final judgments enjoining them from violating the antifraud, periodic reporting, and recordkeeping provisions and imposing various sanctions. *See Securities and Exchange Commission v. PowerLinx, Inc., et al.*, Civ. Action No. 1172 (D.D.C. filed June 27, 2006).

Background

PowerLinx's Improper Revenue Recognition

From 1999 through 2001 (the "relevant period"), PowerLinx's business consisted of manufacturing and selling underwater video cameras and accessories, and it sold and shipped its products directly to consumers, primarily at boat shows.[3] During fiscal year 2000, PowerLinx utilized a sales program known as "dealer floor plans," which were, in essence, consignment arrangements whereby dealers agreed to display PowerLinx's underwater camera products without actually purchasing them (*i.e.*, without accepting title and the risks and rewards of ownership). In a departure from both Generally Accepted Accounting Principles ("GAAP") and the company's stated revenue recognition policy, which provided for recognition "at the time of product shipment," PowerLinx recorded revenues from dealer orders placed pursuant to the dealer floor plans before any cameras were shipped to dealers or sold by the dealer-consignees to consumers.[4] Most of the cameras in question were not shipped, or even manufactured, during the relevant period. However, even if PowerLinx had shipped the cameras on time, the company could not have recognized revenue on those shipments in accordance with GAAP because the cameras would have been shipped pursuant to consignment arrangements.

PowerLinx's dealer floor plan program for underwater cameras continued until September 2000, when the company began soliciting orders for its new SecureView video surveillance product, which was still under development at that time. As the terms of the dealer floor plan agreement made clear,[5] dealers who submitted orders to participate in SecureView dealer floor plans merely were agreeing to display cameras on PowerLinx's behalf, but were not purchasing the cameras. Consequently, the dealer floor plan orders that PowerLinx received did not reflect actual demand for the company's products. From September through at least December 2000, PowerLinx devoted virtually all of its marketing and sales efforts toward generating dealer floor plan orders

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[3] In late 1999, PowerLinx began developing a video surveillance product known as "SecureView," which used a "camera in a light bulb" technology to transmit video signals through electrical wiring to a television monitor. During the relevant period, PowerLinx only produced approximately two dozen functioning SecureView cameras, primarily prototypes for testing purposes.

[4] Under GAAP, revenue recognition is inappropriate on products delivered pursuant to a consignment arrangement, but not yet sold by the consignee, because the consignor retains the risks and rewards of ownership of the product and title has not passed to the consignee. *See* Statements of Financial Accounting Standards ("SFAS") 48, *Revenue Recognition When Right of Return Exists*; Statement of Position ("SOP") 97-2, *Software Revenue Recognition*, ¶ 25; Statements of Financial Accounting Concepts ("SFAC") 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, ¶¶ 83-84. Financial statements filed as part of an issuer's periodic reports under Sections 13(a) and 15(d) of the Exchange Act must be prepared in accordance with GAAP. *See* Regulation S-X §§ 210.4-01, 210.1-01(a)(2).

[5] The consignment agreement that PowerLinx used in connection with its SecureView dealer floor plan offered dealers the following terms: "ZERO down...ZERO interest...ZERO risk." The consignment agreement further provided that "[t]he Goods shipped shall remain [PowerLinx]'s property until sold to Consignee's customers," and also that the "Consignee shall make payment to [PowerLinx] for Goods sold as soon as practical after the sale of each unit on consignment."

for SecureView cameras. As it had done with the underwater camera dealer floor plans, PowerLinx improperly recorded the SecureView orders as sales prior to shipping any cameras and before dealers had sold any cameras to customers. In fact, PowerLinx only manufactured approximately two dozen prototype SecureViews in all of 2000 and did not produce commercially viable models until May 2001 or later.

PowerLinx's 2000 Annual Report and Restatement

Bauer joined PowerLinx's management team in early 2001. During his initial review of the company's financial records, Bauer concluded that PowerLinx had materially overstated revenues and accounts receivable during 2000. Bauer immediately conveyed his findings to other members of PowerLinx's senior management. In April 2001, PowerLinx filed its annual report on Form 10-K for fiscal year 2000. In that report, PowerLinx restated its financial results for the second and third quarters of 2000, but failed to disclose that its accounting errors stemmed from having improperly recorded consignment (or dealer floor plan) orders as revenue.

In addition, PowerLinx asserted in its Form 10-K that "[a]ggressive selling efforts [had] achieved approximately *$9 million in SecureView product orders from independent retailers and individual customers*." (Emphasis added.) This purported $9 million SecureView backlog was also discussed in a December 2000 press release, in which PowerLinx stated, "[t]he Company will roll into 2001 with a backlog of orders totaling over $9 million." In fact, the "orders" comprising the purported $9 million backlog were consignment orders and not actual product sales. By representing its dealer floor plan orders as "product orders from independent retailers and individual customers," PowerLinx created the impression that there was actual demand for SecureView cameras and that such demand would translate into future revenue as soon as PowerLinx could begin filling the orders. In fact, there was little, if any, demand for SecureView cameras at the time PowerLinx filed its Form 10-K. As PowerLinx's senior accounting officer, Bauer had a role in preparing PowerLinx's annual report for fiscal year 2000 and was aware of this disclosure concerning the $9 million order backlog.

Bauer Was a Cause of PowerLinx's Issuance of a Restatement in 2002 That Omitted Material Facts Regarding the Improper Recording of a Deferred Tax Asset

Under GAAP, a company may record a deferred tax asset based on a reasonable expectation that current net tax operating losses will, in future years, offset expected future profits, thereby reducing the company's future income tax liability.[6] However, GAAP requires that the deferred tax asset be reduced by a "valuation allowance" to account for the possibility that the company will fail to be profitable as expected.

PowerLinx improperly recorded on its fiscal year 2000 balance sheet a deferred tax asset of $1,439,322 without any valuation allowance. The tax asset was material, representing almost forty percent of PowerLinx's total assets of $3,841,944. PowerLinx also recorded deferred tax

6 *See* SFAS 109, *Accounting for Income Taxes.*

assets of $180,613, $72,907, and $44,921, respectively, in its financial statements for the first three quarters of 2000.

PowerLinx did not have a proper basis for recording the deferred tax assets. The company had accumulated significant losses in 2000 and had no historical operating basis from which to conclude that it would be profitable in future years. Underwater camera sales had declined significantly and the company had devoted most of its resources to developing its SecureView product. The sole basis for PowerLinx's "expectation" of future profitability was the purported $9 million backlog of SecureView orders, which management assumed would generate taxable income; however, this purported backlog, which predated Bauer's hiring, did not reflect actual demand for SecureView cameras and, consequently, was not a reasonable or reliable indicator of future profitability.

In late 2001, Bauer determined that virtually all of the orders comprising the purported $9 million backlog contained consignment terms and, therefore, were unlikely to produce taxable income. In April 2002, after hiring a new audit firm, PowerLinx restated its 2000 financial results, reducing the value of the deferred tax asset on its balance sheet from $1,439,322 to zero. In its restatement, PowerLinx explained that the action was necessary because "projections of future taxable income d[id] not rise to the 'more likely than not' criteria established in Financial Accounting Standard No. 109." However, PowerLinx failed to disclose the material underlying reason for the restatement, which was, as Bauer himself had concluded in an internal memorandum, that "[i]n no cases did these orders [comprising the backlog] constitute firm, contracted future business" and, for that reason, they should not have been relied upon as evidence of future taxable income.

Although Bauer had become aware, after PowerLinx had filed its fiscal year 2000 annual report, that the purported backlog consisted of orders for consignment arrangements (rather than orders to purchase product), he failed to ensure that PowerLinx disclosed this information as part of the 2002 restatement. As chief financial officer, Bauer should have caused PowerLinx to disclose that the sole basis for having recorded the deferred tax asset, the purported $9 million order backlog, had been determined to be invalid, but he failed to do so.

Legal Analysis

As a result of the conduct described above, PowerLinx violated, among other provisions, Section 15(d) of the Exchange Act and Rules 15d-1 and 12b-20 thereunder, which require Exchange Act reporting companies to file accurate annual reports on Forms 10-K and include in such reports material information necessary to ensure that statements in the reports are not misleading. In April 2002, PowerLinx filed an annual report with the Commission that omitted material facts.

As a further result of the conduct described above, Bauer was a cause of PowerLinx's violations of Section 15(d) of the Exchange Act and Rules 15d-1 and 12b-20 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that Respondent Bauer cease and desist from causing any violations and any future violations of Sections 15(d) of the Exchange Act and Rules 15d-1 and 12b-20 promulgated thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54054 / June 28, 2006

Admin. Proc. File No. 3-7370

In the Matter of

SALIM B. LEWIS

ORDER GRANTING PETITION TO VACATE ADMINISTRATIVE BAR ORDER

On August 13, 1990, the Commission entered an order barring Salim B. Lewis from association with any broker, dealer, investment company, investment adviser, or municipal securities dealer (the "Bar Order"). Lewis consented to the Bar Order. The Bar Order contained the findings that 1) Lewis had pled guilty in 1989 to violating antifraud, recordkeeping, and margin requirements of the federal securities laws and 2) Lewis had been permanently enjoined in 1990 by a federal district court from violating those requirements. 1/

On January 20, 2001, the President of the United States granted Lewis a full and unconditional pardon for his criminal conviction. Lewis filed a motion with the Commission on September 9, 2004, seeking to vacate the bar order in light of his pardon. On June 10, 2005, we denied Lewis's request to vacate the Bar Order in its entirety "because the order rest[ed] on the injunction entered with Lewis's consent as well as his criminal conviction." 2/

In our June 10, 2005 order, we noted that Lewis could seek to have his injunction vacated, and that "the bar based on the injunction entered against Lewis would be vacated on Lewis's application if the district court vacated Lewis's injunction." 3/ Lewis filed a motion with the federal district court on December 30, 2005, seeking to have his injunction vacated. On March 29, 2006, the court vacated the injunction in its entirety.

1/ Salim B. Lewis, Securities Exchange Act Rel. No. 28333 (Aug. 13, 1990), 46 SEC Docket 1733.

2/ Salim B. Lewis, Exchange Act Rel. No. 51817 (June 10, 2005), 85 SEC Docket 2472. We nonetheless vacated the portion of the bar order prohibiting Lewis from association with any investment company, investment adviser, or municipal securities dealer. Id.

3/ Id. at 2480.

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On March 30, 2006, Lewis filed a motion with the Commission seeking to vacate the Bar Order. The Division of Enforcement "supports a grant of relief" "[b]ecause the conviction was the subject of a Presidential pardon and the injunction has now been vacated." Under the unique circumstances of this case, and despite the underlying conduct engaged in by Lewis, the Commission believes it is necessary to set aside the remainder of Lewis's Bar Order. 4/

Accordingly, IT IS ORDERED that the petition of Salim B. Lewis to vacate the bar order entered against him on August 13, 1990, be, and it hereby is, granted; and it is further

ORDERED that the order be, and it hereby is, vacated.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

4/ In our June 10, 2005 order, we stated that the Bar Order survived the pardon because "the order relied, by virtue of the injunction, on the underlying conduct rather than simply the fact of conviction." Id. at 2479 n.25. We retain the view that "[p]rofessional discipline based on underlying conduct rather than the fact of conviction survives a pardon." Id. at 2477 n.21. In light of the district court's decision to vacate the injunction following the presidential pardon, however, we have determined to vacate the bar.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54048 / June 27, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2447 / June 27, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12343

In the Matter of **ACCOUNTING CONSULTANTS, INC., and** **CAROL L. MCATEE, CPA,** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Accounting Consultants, Inc., and Carol L. McAtee, CPA (collectively, "Respondents"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the

1 Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

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purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[2] that:

Respondents

Carol L. McAtee ("McAtee"), age 43, of St. Petersburg, Florida, is a certified public accountant duly licensed in Florida. She is the sole owner of Accounting Consultants, Inc., and was responsible for the year-end audits and quarterly reviews of PowerLinx, Inc.'s financial statements from June 1999 until November 2001.

Accounting Consultants, Inc. ("Accounting Consultants"), is a Florida corporation located in St. Petersburg, Florida. Accounting Consultants was PowerLinx's independent auditor for its fiscal years ended December 1999 and 2000.

Other Relevant Entity

PowerLinx, Inc. ("PowerLinx"), is a Nevada corporation based in St. Petersburg, Florida. The company, which was known as SeaView Video Technology, Inc. during the relevant period, manufactures security video cameras, underwater cameras, and accessories. PowerLinx is a reporting public company pursuant to Section 15(d) of the Exchange Act and is quoted on the OTC Bulletin Board under the symbol "PWNX."

Summary

During the first three quarters of 2000, PowerLinx improperly recognized nearly ninety percent of its reported revenues from fictitious sales. The company initiated consignment arrangements with numerous third-party dealers and recorded the consignment order amounts as revenue before any products were actually shipped to dealers or sold to consumers pursuant to the consignment terms. PowerLinx publicized its false revenues in almost-weekly press releases and in three consecutive quarterly reports on Form 10-Q filed with the Commission. In April 2001, following a management change, PowerLinx restated its second- and third-quarter revenues as part of its 2000 annual report on Form 10-K. However, PowerLinx's restatement was incomplete and

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[2] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

misleading, and the financial statements included in its annual report contained other material instances of improper accounting.

Respondents performed quarterly reviews and a year-end audit of PowerLinx's fiscal year 2000 financial statements, but failed to conduct their review and audit procedures in accordance with Generally Accepted Auditing Standards ("GAAS"). Accordingly, Respondents were a cause of PowerLinx's violations of Section 15(d) of the Exchange Act and Rules 15d-1, 15d-13, and 12b-20 thereunder, and also engaged in improper professional conduct within the meaning of Rule 102(e) of the Commission's Rules of Practice.

PowerLinx's Improper Revenue Recognition

From 1999 through 2001 (the "relevant period"), PowerLinx's business consisted of manufacturing and selling underwater video cameras and accessories, and it sold and shipped its products directly to consumers, mostly at boat shows.[3] During the first three quarters of fiscal year 2000, PowerLinx fraudulently recognized nearly ninety percent of its reported revenues based on fictitious sales of its cameras. Most of the cameras in question were neither manufactured nor shipped during the relevant period.

As part of its fraudulent scheme, PowerLinx utilized a sales program known as "dealer floor plans," which were consignment arrangements whereby dealers agreed to display PowerLinx's camera products without actually purchasing them (*i.e.*, without accepting title and the risks/rewards of ownership). PowerLinx recorded dealer floor plan order amounts as sales – specifically, as accounts receivable – before any cameras were manufactured, shipped to the dealers, or sold to customers. However, even if PowerLinx had shipped the cameras on time, the company could not have recognized revenue on those shipments in accordance with Generally Accepted Accounting Principles ("GAAP") because the cameras would have been shipped pursuant to consignment arrangements.[4]

PowerLinx publicly announced its fictitious "revenues" in press releases issued on an almost-weekly basis, often accompanying those figures with unsubstantiated and materially misleading revenue forecasts. PowerLinx never revealed, in its press releases or otherwise, that its

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3 In late 1999, PowerLinx began developing a video surveillance product known as "SecureView," which used a "camera in a light bulb" technology to transmit video signals through electrical wiring to a television monitor. During the relevant period, PowerLinx only produced approximately two dozen functioning SecureView cameras, primarily prototypes for testing purposes.

4 Under GAAP, revenue recognition is inappropriate on products delivered pursuant to a consignment arrangement because the consignor retains the risks and rewards of ownership of the product and title has not passed to the consignee. *See* Statement of Financial Accounting Standards ("SFAS") 48, *Revenue Recognition When Right of Return Exists*; Statement of Position ("SOP") 97-2, *Software Revenue Recognition*, ¶ 25; Statement of Financial Accounting Concepts ("SFAC") 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, ¶¶ 83-84; SEC Staff Accounting Bulletin ("SAB") 101, *Revenue Recognition*. Financial statements filed as part of an issuer's periodic reports under Sections 13(a) and 15(d) of the Exchange Act must be prepared in accordance with GAAP. *See* Regulation S-X §§ 210.4-01, 210.1-01(a)(2).

fast-growing "revenues" derived from dealer floor plans or consignment arrangements. In addition, PowerLinx materially overstated its year-to-date revenues for the first three quarters of fiscal year 2000 by $232,705 (124 percent), $1,220,972 (410 percent), and $2,315,638 (1,546 percent), respectively. The company also reported net income ranging from $280,000 to $420,000 in those quarters, when it should have been reporting substantial losses.

In late February 2001, PowerLinx hired a new accounting officer who, while preparing for the fiscal year 2000 audit, determined that PowerLinx had materially overstated revenues and accounts receivable during 2000. In April 2001, in its 2000 annual report on Form 10-K, PowerLinx restated its financial results for the second and third quarters and amended its corresponding quarterly filings.

Respondents' Fiscal Year 2000 Quarterly Reviews

Respondents performed reviews of PowerLinx's quarterly financial statements during fiscal year 2000, but their reviews failed to comply with GAAS. Pursuant to GAAS, reviewers of public company interim financial statements are required to perform inquiries and analytical procedures to obtain a basis for reporting whether material modifications are necessary for the financial information to conform with GAAP.[5]

As part of their first-, second-, and third-quarter 2000 reviews, Respondents failed to exercise heightened skepticism and perform sufficient inquiries and procedures to understand the basis for PowerLinx's accounts receivable and revenue balances. Respondents should have made appropriate inquiries to obtain an understanding of how PowerLinx's accounting practices, business activities, and internal controls may have changed since Respondents' most recent audit in March 2000, and to understand the impact of those changes on PowerLinx's reporting. Such inquiries were particularly necessary in light of the sudden and material increases in PowerLinx's accounts receivable since Respondents' most recent audit.[6] When Respondents had completed their audit of PowerLinx's 1999 annual financial statements, PowerLinx had not been extending credit or financing to customers and did not report any trade-based accounts receivable. PowerLinx's 1999 annual report explicitly stated that the company "required all sales [to] be conducted on a cash basis."[7] However, PowerLinx's balance sheet for the quarter ended March 31, 2000 showed that the company's accounts receivable had increased from zero to approximately $232,705, which represented fifty-five percent of PowerLinx's total reported revenue of $421,068. PowerLinx's second- and third-quarter accounts receivables also showed similar dramatic increases. Despite these trends, Respondents failed to ensure that PowerLinx understood and was properly applying the accounting principles for extensions of credit. Moreover, although Respondents knew that PowerLinx was selling cameras to dealers, they did not ask PowerLinx about the terms of those dealer arrangements.

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5 *See* Codification of Statements on Auditing Standards ("AU") § 722.09 (current version at AU § 722.07).

6 *See* AU § 722.13(a), (f) (current version at AU § 722.11).

7 SeaView Underwater Research, Inc., 1999 Annual Report on Form 10-K, at 7 (filed March 30, 2000).

Respondents also failed to perform sufficient analytical procedures during their quarterly reviews to check PowerLinx's purported accounts receivable and revenue balances against certain other elements of PowerLinx's financial statements.[8] Respondents relied on information contained in PowerLinx's draft Forms 10-Q, but should have performed additional analytical procedures to determine whether PowerLinx's cash flow, inventory, and accounts payable balances correlated with the company's purported sales.

Finally, as part of their reviews, Respondents also requested that PowerLinx provide a listing of current accounts receivable balances, but PowerLinx failed to provide such information. Respondents should have questioned PowerLinx's failure to respond, particularly in light of the rapid growth of the company's accounts receivable during 2000.

Respondents' Fiscal Year 2000 Audit

Respondents issued an audit report containing an unqualified opinion on PowerLinx's fiscal 2000 financial statements, which included PowerLinx's restatement of accounts receivable and revenue. As described below, Respondents' audit failed to comply with GAAS in several material respects and contributed to PowerLinx's issuance of an inaccurate annual report on Form 10-K.

Accounts Receivable and Revenue

In April 2001, PowerLinx restated its financial results for the second and third quarters as part of its Form 10-K for fiscal year 2000. However, even after the restatement, PowerLinx's year-end 2000 accounts receivable balances and revenue amounts continued to be materially overstated due to revenues that were improperly recognized from consignment transactions. In addition, as for the second- and third-quarter accounts receivable and revenues that it did restate, PowerLinx failed to disclose that these restated amounts were the result of PowerLinx's practice of improperly recording consignment orders as revenue.

Respondents' audit procedures were insufficient to ensure that PowerLinx's year-end 2000 accounts receivable and revenue balances were fairly presented in accordance with GAAP.[9] Respondents sent accounts receivable confirmation letters to seven of PowerLinx's purported dealers, but received no responses from those dealers and failed to perform adequate alternate procedures as required by GAAS.

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8 *See* AU § 722.13(b) (current version at AU § 722.16).

9 *See* AU § 330.31-.32.

Issuance of Convertible Debentures

During the first quarter of 2000, PowerLinx issued convertible debentures, raising cash proceeds of over $2.5 million. The debentures entitled the holder to an eight percent return and, at the holder's option, were convertible at any time into restricted common stock at prices ranging from $.50 to $8.00 per share. At that time, those conversion prices represented a substantial discount (at least eighty percent, on average) to the prevailing price of PowerLinx's stock traded on the OTC Bulletin Board.

Under GAAP, when a company issues convertible debentures that can be converted to the issuer's securities at a deep discount to the current market price, the issuer must account for the discount as an expense.[10] PowerLinx failed to account for the discount as an expense – a material error in the company's income statement. In addition, PowerLinx failed to keep adequate records documenting the precise discount it had given to each debenture holder.

Respondents' audit of the convertible debentures departed from GAAS. Respondents did not obtain sufficient competent evidential matter concerning the terms of the debentures, and, as a consequence, they were unable to apply audit procedures to determine reasonably the amounts of the discounts provided to PowerLinx's debenture holders.[11] Respondents improperly relied on management's representations about the discounts as a basis for issuing an unqualified audit report.

Recording of a Deferred Tax Asset

Under GAAP, a company may record a deferred tax asset based on its reasonable expectation that current net tax operating losses will, in future years, offset expected future profits, thereby reducing the company's future income tax liability.[12] GAAP requires that the deferred tax asset be reduced by a "valuation allowance" to account for any likelihood that the company will fail to be profitable as expected.

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10 *See* Emerging Issues Task Force Consensus ("EITF") 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios.*

11 GAAS requires that an auditor obtain sufficient competent evidential matter through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion on the subject financial statements. *See* AU § 326.01.

12 *See* SFAS 109, *Accounting for Income Taxes*. The specific value of a deferred tax asset is determined by multiplying a company's annual net loss by its estimated tax rate. For example, if a company has a $1 million net loss in year one, and anticipates future net profits of $1 million in year two, then, at a marginal tax rate of thirty-six percent, the value of its deferred tax asset would be $360,000. Thus, the current loss would save the company from paying $360,000 in future income taxes on the $1 million in expected profits.

PowerLinx improperly recorded on its fiscal year 2000 balance sheet a deferred tax asset of $1,439,322 with no valuation allowance. This amount was material, representing approximately thirty-eight percent of PowerLinx's $3,841,944 in total assets.[13]

PowerLinx lacked a legitimate basis for recording the deferred tax assets. The company had accumulated significant losses in 2000 and had no historical operating basis from which to conclude that it would be profitable in future years. Underwater camera sales had declined significantly, and the company had devoted most of its resources to developing its SecureView product. The sole basis for PowerLinx's "expectation" of future profitability was a purported $9 million backlog of dealer orders for its new security video product, which the company's new management team assumed would generate taxable income. However, that purported backlog was unsupported and, as management later determined, unlikely to be realized. The purported backlog consisted primarily of orders with consignment terms, not orders to purchase cameras, and thus was not reflective of actual demand for PowerLinx's products.

Respondents approved of PowerLinx's recording of the deferred tax asset based on oral representations from management that PowerLinx expected to be profitable and would soon realize taxable income from the $9 million backlog. However, Respondents should have reviewed supporting documentation and tested whether PowerLinx had a reasonable expectation of profitability prior to issuing their audit report. Respondents also should have verified the existence of the $9 million backlog or the terms of the orders that purportedly comprised the backlog.

In late 2001, PowerLinx's new management determined that the orders comprising the purported $9 million backlog were unlikely to be realized. In April 2002, after hiring a new audit firm, PowerLinx restated its 2000 financial results, reducing the value of the deferred tax asset on its balance sheet from $1,439,322 to zero.

Accounting for an Investment

On July 12, 2000, PowerLinx exchanged 150,000 restricted common shares for a twenty percent voting interest in Golden Springs, LLC ("Golden Springs"), owner and operator of a spa and mineral spring located in Florida.[14] PowerLinx materially overstated the value of this partnership interest in its third-quarter and year-end financial statements for fiscal year 2000.

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13 PowerLinx also recorded deferred tax assets of $180,613, $72,907, and $44,921, respectively, in its financial statements for the first three quarters of 2000.

14 This transaction was facilitated by PowerLinx's issuance of 150,000 shares to Golden Springs with the agreement that PowerLinx's former chief executive officer and president, Richard L. McBride ("McBride"), would promptly replace the shares with his personal holdings. Upon replacement of the shares by McBride, the common shares were immediately cancelled by PowerLinx. This did not, however, affect PowerLinx's obligation to properly account for the investment on its books and records. GAAP provides that when a corporation implicitly benefits from transactions made on its behalf by a principal stockholder, the corporation should account for the transaction. *See* AICPA Accounting Interpretation 25, *Accounting for Stock Issued to Employees: Accounting Interpretations of APB Opinion No. 25*; SAB 79, *Accounting for Expenses or Liabilities paid by Principal Stockholder(s).*

Under GAAP, consideration received for the issuance of equity instruments is accounted for based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.[15] Additionally, if the fair value of restricted stock serves as the basis for measuring the consideration received, such a valuation should be determined in good faith and also reflect a discount from the market price of unrestricted securities of the same class.[16] GAAP also requires that the equity method of accounting be employed by an investor whose investment gives it the ability to exercise significant influence over operating and financial policies of an investee.[17] Pursuant to the equity method, the carrying amount of an investment is periodically adjusted to recognize the investor's share of the investee's earnings or losses. The amount of the adjustment is also recorded in the investor's income statement. Because PowerLinx held a twenty percent interest in Golden Springs's voting stock and exercised significant influence, PowerLinx was required to apply the equity method after determining the initial carrying value.

PowerLinx determined that the fair value of the restricted shares issued was the more reliable measure in establishing the initial carrying value of the investment. PowerLinx recorded the initial carrying value of the restricted shares at approximately $1 million, which was the same amount that Golden Springs had recorded on its balance sheet for the third quarter of fiscal year 2000. While this value represented a discount of approximately forty-seven percent from PowerLinx's stock price of $12.88 on July 12, 2000 (the closing date of the transaction), the discount departed from the higher discount rate applied to contemporaneous sales of restricted stock by PowerLinx to other third parties. In addition, the $12.88 per share price of PowerLinx's freely-tradable stock was inherently inflated as a result of the company's contemporaneous fraudulent conduct.

Respondents' audit of the Golden Springs investment was deficient for several reasons. First, in valuing the 150,000 restricted shares that Golden Springs received in this transaction, PowerLinx was required under GAAP to apply a good faith discount to the reported price of its stock on the OTC Bulletin Board. In determining the appropriate discount to apply to the 150,000 restricted shares, PowerLinx should have looked to contemporaneous sales of restricted stock by the company to third parties. There were many such sales of restricted stock during the first and second quarters of fiscal year 2000. As Respondents were aware, during these periods PowerLinx had sold debentures that were convertible to restricted shares, and had valued the underlying restricted shares at an eighty percent discount, on average, to the prevailing market price. However, despite the availability of such contemporaneous valuations of restricted stock, Respondents failed to require that PowerLinx apply a similar eighty percent discount as a benchmark for assessing PowerLinx's valuation of the restricted stock.

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15 *See* SFAS 123, *Accounting for Stock-Based Compensation*, ¶ 8.

16 *See* SEC Codification of Financial Reporting Policies 404.04, *"Restricted" Securities*.

17 *See* Accounting Principles Board Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*.

Second, in corroborating PowerLinx's valuation of its interest in Golden Springs, Respondents relied on an oral representation from PowerLinx's management that Golden Springs's real estate, based on a purported appraisal, was worth approximately $6.5 million and that, as a result, PowerLinx's twenty percent interest was worth $1.3 million. After comparing the purported $1.3 million "appraised" amount with the carrying amount reflected in PowerLinx's third-quarter financial statements (approximately $1 million), Respondents concluded that the carrying amount was appropriate, if not conservative. Respondents' reliance on management's oral representation, without reviewing the appraisal or ascertaining its basis, was a departure from GAAS.[18]

Finally, Respondents failed to consider that PowerLinx's valuation of Golden Springs was based on an inflated stock price ($12.88 per share at the closing date of the transaction) as a result of the company's materially overstated revenue and receivables. By the time of Respondents' 2000 year-end audit, PowerLinx's stock price had declined to less than $2 per share on public reports suggesting that PowerLinx had engaged in improper revenue recognition.

In its 2001 Form 10-K, PowerLinx disclosed that the initial carrying value of its interest in Golden Springs had been reduced from approximately $1 million to $146,000. After adjusting this revised carrying value for PowerLinx's share of Golden Springs's losses in fiscal year 2000 under the equity method of accounting, the carrying amount of the investment was restated to $8,618 as of December 31, 2000.

Departures from Generally Accepted Auditing Standards

Commission regulations require that audits of public company financial statements be conducted in accordance with GAAS. *See* Regulation S-X § 210.2-02(b). Under GAAS, an auditor must be proficient in accounting (AU § 210) and exercise due professional care while conducting an audit and in preparing the audit report. (AU § 230.01). Under AU § 230.04, "due professional care concerns what the independent auditor does and how well he does it." AU § 326.01 requires an auditor to obtain sufficient competent evidential matter through inspection, observation, inquiries and confirmations to afford a reasonable basis for an opinion on the subject financial statements. Similarly, an auditor is required to maintain an attitude of professional skepticism (AU § 230.07) and cannot simply rely on management representations (AU § 333.02). When an auditor relies on the work of a specialist, GAAS requires that the auditor evaluate the qualifications, independence, work, and findings of the specialist. (AU § 336.08-.09.) As set forth above, Respondents' audit of PowerLinx's financial statements for the fiscal year ended December 31, 2000 failed to comply with GAAS. Respondents also issued an audit report containing an unqualified opinion and a representation that the audit was conducted in accordance with GAAS, when such was not the case, in departure from AU § 508.07.

In addition, Respondents' quarterly reviews of PowerLinx's financial statements for fiscal year 2000 failed to comply with AU § 722.09, which requires the reviewer of public company interim financial statements to perform inquiries and analytical procedures (AU §§ 722.13-.19) to

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18 AU § 336 requires an auditor relying on a specialist to confirm that the specialist is competent and objective, and to gain an understanding of the basis of the appraisal.

obtain a basis for reporting whether material modifications are necessary for the financial information to conform with GAAP.

Reporting Violations

Section 15(d) of the Exchange Act and Rules 15d-1, 15d-13, and 12b-20 thereunder require issuers reporting pursuant to Section 15(d) of the Exchange Act to file accurate periodic reports on Forms 10-K and 10-Q. Such reports must be accurate and not misleading.

PowerLinx violated Section 15(d) of the Exchange Act and Rules 15d-1, 15d-13, and 12b-20 thereunder by filing false and misleading annual and quarterly reports with the Commission for fiscal year 2000.

As a result of the conduct described above, Respondents were a cause of PowerLinx's violations of Section 15(d) of the Exchange Act and Rules 15d-1, 15d-13, and 12b-20 thereunder by failing to conduct their quarterly reviews and year-end audit for fiscal year 2000 in accordance with GAAS.

Improper Professional Conduct

Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person, or deny such person, temporarily or permanently, the privilege of appearing or practicing before the Commission, if it finds that such person has engaged in improper professional conduct. *See* Rule 102(e)(1)(ii) (now codified in 15 U.S.C. § 78d-3(a)(2)).[19]

As described above, Respondents engaged in improper professional conduct within the meaning of Rule 102(e)(1) by failing, in repeated instances, to comply with GAAS in performing their quarterly reviews and fiscal year 2000 audit of PowerLinx's financial statements.

IV.

Based on the foregoing, the Commission finds that Respondents were a cause of PowerLinx's violations of Section 15(d) of the Exchange Act and Rules 15d-1, 15d-13, and 12b-20 promulgated thereunder.

Based on the foregoing, the Commission finds that Respondents engaged in improper professional conduct within the meaning of Rule 102(e)(1) of the Commission's Rules of Practice.

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[19] For accountants, the rule defines improper professional conduct to mean either: "[i]ntentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards," a "single instance of highly unreasonable conduct that results in a violation of applicable professional standards," or "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." *See* Rule 102(e)(1)(iv).

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Accounting Consultants and McAtee shall cease and desist from causing any violations and any future violations of Section 15(d) of the Exchange Act and Rules 15d-1, 15d-13, and 12b-20 promulgated thereunder;

B. Accounting Consultants and McAtee are denied the privilege of appearing or practicing before the Commission as accountants.

C. After two (2) years from the date of this order, Accounting Consultants and McAtee may request that the Commission consider their reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondents' work in their practice before the Commission will be reviewed either by the independent audit committee of the public company for which they work or in some other acceptable manner, as long as they practice before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Accounting Consultants, or the public accounting firm with which McAtee is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) McAtee, or the public accounting firm with which she is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in McAtee's or the firm's quality control system that would indicate that McAtee will not receive appropriate supervision;

(c) Respondents have resolved all disciplinary issues with the Board, and have complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondents acknowledge their responsibility, as long as Respondents appear or practice before the Commission as independent accountants, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Respondents to resume appearing or practicing before the Commission provided that Respondents' state CPA licenses are current and they have resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondents' character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Nazareth
Not Participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 54047 / June 27, 2006

Investment Advisers Act of 1940
Release No. 2526 / June 27, 2006

Administrative Proceeding
File No. 3-12342

In the Matter Of **MORGAN STANLEY & CO. INCORPORATED and MORGAN STANLEY DW INC.,** **Respondents.**	**ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 15(b)(4) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING CEASE-AND-DESIST ORDERS, PENALTIES, AND OTHER RELIEF**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), be and hereby are instituted against Morgan Stanley & Co. Incorporated ("MS & Co.") and Morgan Stanley DW Inc. ("MSDW") (collectively, "Morgan Stanley" or "Respondents").

II.

In anticipation of the institution of these proceedings, the Respondents have submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, the Respondents, without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and over the subject matter of these proceedings, consent to the entry of this Order Instituting Proceedings Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934, and Sections 203(e) and 203(k) of the

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Investment Advisers Act of 1940, Making Findings, and Imposing Cease-and-Desist Orders, Penalties, And Other Relief ("Order").

III.

On the basis of this Order and the Respondents' Offer, the Commission finds that:

A. RESPONDENTS

1. **Morgan Stanley & Co. Incorporated** is a Delaware corporation with its principal place of business in New York, New York. MS & Co. is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, and is a member of self-regulatory organizations, including the NASD and New York Stock Exchange. MS & Co. is also a registered investment adviser pursuant to Section 203(c) of the Advisers Act. MS & Co. engages in a nationwide securities business.

2. **Morgan Stanley DW Inc.** is a Delaware corporation with its principal place of business in New York, New York. MSDW is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, and is a member of self-regulatory organizations, including the NASD and the New York Stock Exchange. MSDW is also a registered investment adviser pursuant to Section 203(c) of the Advisers Act. MSDW engages in a nationwide securities business.

B. SUMMARY

MS & Co. and MSDW, like all registered broker-dealers and investment advisers, are required by the securities laws to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of their business, to prevent the misuse of material nonpublic information by them and any person associated with them. Given the extensive financial businesses conducted by MS & Co. and MSDW, certain categories of employees are regularly in possession of material nonpublic information or in contact with employees who are in possession of such information pertaining to Morgan Stanley's clients. Morgan Stanley has certain policies and procedures designed to prevent misuse of material nonpublic information. Among other things, Morgan Stanley maintains a "Watch List" of companies about whom Morgan Stanley is in possession of material nonpublic information. Morgan Stanley is required by its policies to conduct surveillance of trading by its employees, certain people related to its employees, and the firm for its own account, in the securities of Watch List companies to determine if those trades were made improperly with the benefit of material nonpublic information.

Despite the legal requirements to do so, Morgan Stanley, for years, failed to maintain and enforce adequate written policies and procedures to prevent the misuse of material nonpublic information by Morgan Stanley or persons associated with it. Due to a systemic breakdown in this critical compliance function, Morgan Stanley failed to conduct any surveillance of a massive number of accounts and securities. Moreover, Morgan Stanley's written policies failed to provide adequate guidance to Morgan Stanley personnel charged with conducting surveillance, and there were inadequate controls in place with respect to certain aspects of Watch List maintenance.

Morgan Stanley's specific failures included:

- From at least 2000 to 2004, Morgan Stanley failed to conduct any Watch List surveillance of hundreds of thousands of employee and employee-related accounts to determine whether securities in those accounts had been purchased or sold on the basis of material nonpublic information.

- From at least 1999 to 2003, Morgan Stanley failed to conduct any daily Watch List surveillance of trading in *any* accounts with respect to some or all of the securities of approximately 3,000 issuers that had been placed on the firm's Watch List specifically so that trading in those securities would be monitored.

- From as early as 1997 until as late as 2005, Morgan Stanley failed to conduct any surveillance of trading in approximately 900 employee accounts held outside of Morgan Stanley and approximately 30,000 employee accounts held at Morgan Stanley that the firm failed to identify as held by employees.

- From at least 2001 until 2004, Morgan Stanley failed to conduct any of the surveillance required by its policies of certain types of securities traded in MSDW and MS & Co. accounts, including certain derivative securities, single stock futures, and equity options pertaining to issuers that Morgan Stanley had placed on its Watch List.

- From at least 2000 to October 2004, Morgan Stanley failed to conduct surveillance of certain Watch List securities traded in certain employee and employee-related accounts held at MSDW due to failures in the firm's systems for identifying and matching certain internal securities identifiers.

- From at least 1997 to 2006, Morgan Stanley's written policies pertaining to Watch List surveillance were inadequate because they failed to provide clear guidance regarding the manner in which surveillance was to be conducted.

- For years, Morgan Stanley failed to adequately maintain and implement its written policies and procedures with respect to maintaining the Watch List. In implementing its policies for placing companies on the Watch List, Morgan Stanley failed to put in place adequate controls to ensure that the steps involved in the process were completed consistently and correctly, so that all appropriate securities were placed on the Watch List.

All of the items set forth above were discovered following the commencement of an investigation by the Commission staff. As a result of these systemic failures, Morgan Stanley may have failed to detect illegal insider trading by the firm, its employees, or people related to its employees.

C. BACKGROUND

Morgan Stanley, the parent company,[1] is a global financial services firm that employs more than 53,000 people worldwide and does business through various subsidiaries, including MS & Co. and MSDW. As noted, MS & Co. and MSDW are both registered broker-dealers and registered investment advisers. As such, they are required by law to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of their business, to prevent the misuse of material nonpublic information by them and any person associated with them.

MS & Co. employed between approximately 11,000-12,000 people during the relevant period of time and conducted various securities businesses. MS & Co.'s employees are part of Morgan Stanley, the parent company's, "Institutional Securities Group." That group includes the investment banking business, which includes securities underwriting and distribution services and financial advisory services, including advice on mergers and acquisitions, restructurings and other transactions. In the course of conducting these businesses, various MS & Co. employees have regular occasion to come into possession of material nonpublic information or into contact with that information or other employees who have, or have access to, such information. The Institutional Securities Group also includes other securities businesses, including, among others, sales, trading, financing and market-making activities.

MSDW employed between approximately 20,000-29,000 people during the relevant period of time and also engaged in various securities businesses. MSDW employees are predominantly associated with the parent company's "Individual Investor Group." This business segment includes comprehensive brokerage, investment and financial services and operates in the United States through representatives located in approximately 525 retail locations. Although the vast majority of MSDW's employees in the retail brokerage operations do not routinely come into possession of material nonpublic information, certain MSDW employees are in physical proximity with MS & Co. and other Morgan Stanley employees who are more routinely in contact with such information. Although Morgan Stanley, the parent company, makes an effort to separate employees who have material nonpublic information from those that do not, in some office locations investment banking employees and Individual Investor Group employees may work in the same office building. In addition, these employees may share common areas such as cafeterias.

As required by the securities laws, MS & Co. and MSDW had certain policies and procedures, including surveillance processes, designed to prevent and detect the misuse of material nonpublic information. Those processes suffered, however, from systemic failures that resulted in Morgan Stanley omitting large numbers of accounts and securities from the surveillance process.

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[1] "Morgan Stanley" unless specifically referred to as the "parent company" refers collectively to MS & Co. and MSDW.

1. Watch List Maintenance And Surveillance

Morgan Stanley maintains a "Watch List" to assist in monitoring the use of certain confidential information within the firm and to help identify securities trades that may have been made while the trader was in possession of material nonpublic information. According to Morgan Stanley's written policies, the "Watch List is one of the firm's primary tools in safeguarding against the misuse of material nonpublic information." An issuer is added to the Watch List when Morgan Stanley "is, or may reasonably be expected to be, in possession of material nonpublic information regarding that issuer." The Watch List is exclusively maintained and monitored by the Control Group, a unit of the firm's Compliance Department that is responsible for monitoring the dissemination and use of material nonpublic information within the firm. It is the Control Group's responsibility to conduct surveillance of certain trading that occurs in Watch List securities. The Control Group is required by Morgan Stanley policies to monitor firm proprietary trading, employees trading in their own accounts, employee-related trading, and trading by certain employees who have been given discretion to make investment decisions and trade on behalf of their clients.[2] Under Morgan Stanley's procedures, in the event that the Control Group identifies problematic trades, it is responsible for investigating the nature of the trades and referring the conduct to the legal department if illegal trading activity is suspected. Although the legal department, in theory, would cause a trade to be broken if Morgan Stanley determined the trade was made improperly while the trader was in possession of material nonpublic information, the Control Group is not aware of any instance of insider trading since the 1997 merger between Morgan Stanley and Dean Witter Reynolds.

2. Surveillance Failures

From at least 1999 and continuing for years, the Control Group failed to conduct required surveillance of trading in Watch List securities with respect to certain categories of accounts at the company. In addition, the Control Group failed to conduct Watch List surveillance across all accounts for a certain number of securities.

a. <u>Accounts Not Surveilled</u>

Morgan Stanley failed to conduct surveillance of trading in large segments of its employee and employee-related accounts over extended periods of time. Some of the failures arose from the Morgan Stanley and Dean Witter Reynolds merger in 1997. Following the merger, the MSDW broker-dealer utilized an alphanumeric coding system to identify employee and employee-related accounts held with that broker-dealer. Accounts coded with a "1" were employee accounts and those with a "2" were employee-related. "MOR" coded accounts were those associated with employees of the legacy Morgan Stanley company. "DWR" coded accounts were those associated with employees of the legacy Dean Witter company. Under Morgan Stanley's policies, the Control Group was required to conduct surveillance of all employee and employee-related accounts for trading in Watch List securities.

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[2] "Employee-related" trading refers to trading by family members of Morgan Stanley employees who hold accounts at Morgan Stanley, as required by Morgan Stanley policy. According to Morgan Stanley's surveillance policies, securities trades made by employees in the firm's Private Wealth Management division who exercise discretion on behalf of clients to make trading and investment decisions are also monitored against the Watch List.

i. "DWR 1, DWR 2" Failure – 251,000 accounts. From at least mid-2000 until April 2004, in contravention of Morgan Stanley's written policies, the firm failed to conduct any surveillance of approximately 251,000[3] employee and employee-related accounts (those coded DWR 1 and DWR 2) for trading in Watch List securities.[4] The Control Group had previously reviewed two separate surveillance reports that captured trading in these accounts. The failure occurred after the Control Group changed its practices and ceased reviewing one of the reports because the Control Group apparently believed that all of the necessary data was contained in the second report. The Control Group was incorrect, however, because the second report was designed to capture trading in only a subset of the necessary accounts.[5] Control Group personnel failed to detect this error and failed ever to notice that they were no longer capturing trading in hundreds of thousands of accounts.

ii. Mislabeled Accounts – 183,082 accounts. From at least early 2001 until April 2004, Morgan Stanley also failed to conduct any surveillance of approximately 183,082 accounts that were not correctly coded.[6] Due to an apparent oversight in the account coding process, these accounts were coded "1" or "2" but lacked the alphabetic "MOR" or "DWR" designation or, in some instances, were coded with a different alphabetic designation. These accounts were all employee or employee-related accounts that should have been, but were not, subject to surveillance.

iii. Employee Accounts Held Outside Morgan Stanley. From as early as 1997 until May 2004, at least 900 accounts held outside of Morgan Stanley by employees of Morgan Stanley were not subject to any surveillance by the Control Group.[7] Despite the firm's policy that the Control Group should receive duplicate confirms and/or account statements to enable review of trading in those outside accounts, certain compliance units within Morgan Stanley failed to forward on to the Control Group the information about trading in these outside accounts. As a result, until 2004, Morgan Stanley did not know that it was not conducting any Watch List surveillance of these accounts.[8]

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3 For a portion of these accounts, Morgan Stanley determined that there were no security transactions at all during the relevant period. Consequently, no trading in Watch List securities was overlooked in those accounts during the relevant period. Specifically, 73,274 of the DWR 1 and DWR 2 accounts were inactive during the relevant period.

4 An additional 2,828 accounts coded MOR 1 or 2 were omitted from surveillance during this time frame; 665 of those accounts were inactive during the relevant period.

5 This subset generally included the accounts of employees most commonly in possession of material nonpublic information.

6 Of this total, 85,601 accounts were inactive during the relevant period.

7 The approximately 900 accounts were identified by Morgan Stanley as of a particular point in time; the total historical number of accounts that were not subject to surveillance is not known.

8 In addition, within the Investment Management Division, for eleven outside employee accounts, Morgan Stanley as a whole (as distinct from the Control Group alone) was not aware of the existence of these accounts until it completed an internal review of employees' compliance with the firm's policies regarding outside accounts. Information about trading in those accounts also was not forwarded to the Control Group for surveillance purposes. Morgan Stanley Investment Management employs an annual certification process in an effort to identify all such outside accounts and to ensure that they are subject to surveillance; the eleven accounts were identified as a result of the annual certification process.

iv. Employee Accounts Not Identified As Such. Since the Morgan Stanley-Dean Witter merger in 1997 until May 2005, employees of MSDW were able to open certain accounts that were designated as corporate trust or other types of accounts. Although the accounts were controlled by employees or those related to the employees, and therefore should have been subject to surveillance, they were not designated as employee or employee-related in the account-opening process and were not reviewed during this entire time period. As a result, there are at least 1,500 accounts that should have been monitored by Morgan Stanley because they were employee or employee-related accounts but were not designated as such. Following the discovery of this problem, Morgan Stanley identified an additional 29,367 non-business accounts held at MSDW that were in fact employee or employee-related accounts that were not properly coded as such and were not subject to surveillance. In addition, Morgan Stanley discovered during the third and fourth quarters of 2004 that at least 85 employee accounts held at the MS & Co. broker-dealer were not correctly labeled as such due to ministerial error. These accounts were also not subject to any surveillance.

b. Certain Watch List Securities Not Surveilled

Morgan Stanley also failed to conduct any daily Watch List surveillance of trading with respect to some or all of the securities of approximately 3,000 issuers that were placed on the Watch List from at least 1999 until 2003.

Beginning in 1999, Morgan Stanley used a Lotus Notes database system for Watch List maintenance. To place a company on the Watch List, the Control Group would identify the securities of the issuer and their associated CUSIPs and enter them into the Lotus Notes system. Separately, the Control Group analysts then entered those CUSIPs into a mainframe system which generates the Watch List surveillance reports that are reviewed by the Control Group. Failure to add the correct CUSIP in the mainframe system resulted in the exclusion of the security from the Watch List surveillance reports that were reviewed daily by the Control Group in connection with the Watch List surveillance process.

As a result of an SEC investigation pertaining to the surveillance conducted by the Control Group with respect to a particular Watch List company, Morgan Stanley discovered that the securities for that company had not been entered into the mainframe system, and therefore, that any employee, employee-related and Morgan Stanley proprietary trading in the securities of that company would not have appeared on the daily Watch List surveillance reports reviewed by the Control Group. Morgan Stanley determined, at that point, that this was not an isolated incident and was, in fact, a widespread, multi-year problem. Morgan Stanley determined ultimately that some or all of the securities of approximately 3,000 issuers – although placed on the Watch List precisely so that trading in those securities could be monitored by the Control Group – had not been subject to daily Watch List surveillance due to the failure of the Control Group to place the securities into the mainframe system. Morgan Stanley is in the process of conducting, retrospectively, the required surveillance of the trading in these Watch List securities.

c. **Classes Of Securities Not Surveilled**

In addition to the broad omissions with respect to classes of accounts and Watch List securities that were not subject to any surveillance, Morgan Stanley also had particular failures with respect to certain types of securities that should have been subject to review and surveillance, but were not. For example, employee, employee-related and firm proprietary trading in single stock futures of issuers whose other securities were on the Watch List were not captured as part of Watch List surveillance for several years. In addition, although Morgan Stanley was required by its written policies to review options trading as part of its Watch List Surveillance, Morgan Stanley failed to review equity options trading activity in all MSDW employee and employee-related accounts from approximately October 2000 until October 2004, which included all trades in equity options related to any Watch List issuer. Morgan Stanley also failed to conduct surveillance with respect to a number of listed and "over the counter" derivative securities that were related to securities of issuers on the Watch List. These derivative securities were not included in the Watch List surveillance reports for years.

In addition to the above omissions, Morgan Stanley's Watch List surveillance reports were also incomplete due to problems in the logic utilized by the software to generate the surveillance reports. Specifically, the reports did not contain all of the correct securities related to the issuers on the Watch List because Morgan Stanley's system for generating the reports failed to match correctly certain internal security identifiers of securities held in employee and employee-related accounts at MSDW against MS & Co.'s common database of security identifiers of issuers on the Watch List. As a result, employee or employee-related trades in the incorrectly matched securities were not subject to surveillance. Separately, due to certain coding problems, additional securities with certain alphabetic qualifiers were excluded from Watch List surveillance.

D. DEFICIENCIES IN CONTROL GROUP POLICIES AND PROCEDURES

Morgan Stanley's written policies and procedures were inadequate to prevent the misuse of material nonpublic information and did not provide adequate guidance to the Control Group with respect to Watch List surveillance. In addition, there were failures in controls with respect to maintaining the Watch List itself.

1. The Control Group's Written Policies Failed To Provide Clear Guidance With Respect To Conducting Surveillance.

Each day, a Control Group analyst responsible for Watch List surveillance reviewed trades listed on the Watch List surveillance reports to determine whether any trades were suspicious, and therefore warranted further investigation. This is a critical step in surveillance because if the analyst at that point did not identify a trade as suspicious, it would not be flagged for subsequent additional review by the Control Group.[9] According to Morgan Stanley's written policies, including the

[9] There are certain circumstances in which other additional review was possible. First, certain of Morgan Stanley's business units, including those that are most commonly in possession of material nonpublic information, utilized a pre-clearance process whereby an employee would have to seek clearance before conducting certain securities

"Control Group Surveillance Manual," in conducting this surveillance, the analyst is supposed to review firm proprietary, employee and employee-related trades in Watch List securities, as well as trading by certain employees who have discretion over trading in their clients' accounts. The Manual stated that the "first step in conducting an effective review of the trading in Watch List securities is to understand the reason the issuer's securities are on the Watch List." This is necessary in order for the analyst to be able to identify the type of trade someone who might be misusing material nonpublic information would be expected to make. For example, the Manual stated that if Morgan Stanley has placed a company on the Watch List because the issuer is a target of an acquisition or merger, the trading activity to be aware of is, among other things, the "[p]urchase of stock" or the "[o]pening purchase of call options."

In addition to the context of the trading activity, the Control Group Surveillance Manual contained a section that provided guidance for reviewing "Employee Trading." That section stated that "[e]ach employee trade in a Watch List security is reviewed." The section also stated that, "[i]n reviewing employee trading in Watch List securities, the following information should be considered:" This statement is followed in the Manual by a list of factors for the Control Group to consider in conducting surveillance, including (1) what department the employee works in, (2) whether the trade is made to initiate or close out a position, and (3) how the trade in question compares to the employee's trading history – including whether the security has been traded before, the number of shares traded, the dollar amount invested, the holding period pattern, and whether the trade is in a security in an industry or of a type that the employee usually trades in.

Given the complexity of the process of seeking to determine, in the context of Morgan Stanley's various securities business, whether a given employee or employee-related trade in a Watch List security may have been made improperly with the benefit of material nonpublic information, providing only a list of factors without any specific guidance regarding how or when they should be considered was inadequate written guidance. In practice, Control Group analysts did not consider all of the factors listed in the written policy when reviewing employee trading in Watch List securities. Ultimately, in the absence of sufficient guidance in Morgan Stanley's written policies and procedures, it was left to the discretion of the individual analyst conducting surveillance to determine which factors, if any, to consider in the context of reviewing a particular trade.

2. Failures In Controls Regarding Watch List Maintenance

Morgan Stanley's process for placing an issuer on the Watch List suffered from inadequate controls. There are two steps in the process: (1) employees in the relevant Morgan Stanley business units are expected to notify the Control Group that they have or anticipate receiving material, nonpublic information pertaining to an issuer, and (2) the Control Group analyst determines whether the information is material and, if so, places the securities of the relevant issuer(s) on the Watch List.

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trading. As a result, some trades that appeared on the daily Watch List surveillance reports would have been separately reviewed as part of the pre-clearance process. In addition, the Control Group reviewed a report designed to ensure that the pre-clearance process operated correctly. Accordingly, a subset of Watch List trades, those subject to the pre-clearance process, would receive this additional review. In addition, a given Watch List trade could be reviewed again separate from the daily review process by the Control Group if it was captured as part of a "Front Running" Surveillance report that the Control Group utilized when a Watch List security was moved to Morgan Stanley's Restricted List.

This process was not sufficiently maintained or enforced because it lacked certain controls in its implementation. First, there was no system of accountability to review that these steps were properly followed. Although employees were required under Morgan Stanley's Code of Conduct and certain other policies to notify the Control Group immediately with respect to developments that may affect the Watch List, Morgan Stanley lacked an adequate process for checking to ensure that all material transactions were reported to the Control Group. If employees failed to notify the Control Group of a material transaction or the fact that they possessed material nonpublic information regarding an issuer, the securities of the relevant issuer may have never made it onto the Watch List. Consequently, no Watch List surveillance would be conducted of trading in those securities.[10]

Second, historically, the Control Group analyst had sole discretion in determining whether a given transaction was material. Although the computer system default for transactions reported to the Control Group was to deem the transaction "material," if the analyst determined it was not, no Watch List coverage was initiated. (Morgan Stanley has since changed its procedures to include a review of all materiality determinations.) In addition, historically, the Control Group would not necessarily track the fact that it had been notified of a potentially material transaction if the analyst determined it was not material. Now, the procedures have been changed to track all notifications to the Control Group of a potentially material transaction, whether or not the transaction results in an issuer being placed on the Watch List.

E. LEGAL DISCUSSION

Section 15(f) of the Exchange Act requires brokers and dealers registered with the Commission to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse in violation of the Exchange Act, or the rules or regulations thereunder, of material nonpublic information by such broker or dealer or any person associated with such broker or dealer. Section 204A of the Advisers Act requires certain investment advisers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the misuse in violation of the Advisers Act or the Exchange Act, or the rules or regulations thereunder, of material nonpublic information by such investment adviser or any person associated with such investment adviser.

As described above, Morgan Stanley failed to maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of Morgan Stanley's business, to prevent misuse, in violation of the federal securities laws, of material nonpublic information by Morgan Stanley or any person associated with it. Although Morgan Stanley had written policies requiring that it conduct surveillance of trading in Watch List securities, Morgan Stanley failed to maintain and enforce those policies to the extent that it failed to conduct any surveillance with respect to hundreds of thousands of employee and employee-related accounts during a multi-year

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[10] In certain circumstances, limited trading could still be subject to surveillance. Specifically, if a transaction caused an issuer to be placed on Morgan Stanley's Restricted List, a different company list maintained by the Control Group, the Control Group would typically perform "Front Running" surveillance. This surveillance captured certain trading for the two weeks prior to the placement of the company on the Restricted List and would capture trades that would have been reviewed on the daily Watch List surveillance reports for that two week period.

period. In addition, failures in the Control Group's procedures caused the Control Group not to review trading in any accounts with respect to some or all of the securities of approximately 3,000 issuers that were placed on the Watch List. These failures went virtually undetected and uncorrected by the Respondents for several years until the Respondents began to closely analyze their procedures in response to a Commission investigation. Moreover, certain of the written policies that Morgan Stanley had were inadequate because they failed to provide clear guidance with respect to aspects of Watch List surveillance.

The Commission has consistently made clear that broker-dealers and investment advisers must take seriously their responsibilities to design and enforce sufficiently robust policies and procedures to prevent the misuse of material nonpublic information. *See, e.g, In re Goldman, Sachs & Co.*, Exch. Act. Rel. No. 48436; Admin. Proceeding No. 3-11240 (September 4, 2003) (finding violations of Section 15(f)); *In re Gintel Asset Management, Inc., et al.*, Exch. Act Rel. No. 46798; Admin. Proceeding No. 3-10930 (November 8, 2002) (finding violations of Sections 15(f) and 204A); *In re DePrince, Race & Zollo, Inc., et al.*, Adv. Act Rel. No. 2035; Admin. Proceeding No. 3-10798 (June 12, 2002) (finding violations of Section 204A); *In re Guy P. Wyser-Pratte et al.*, Exch. Act Rel. No. 44283; Adv. Act Rel. No. 1943 (May 9, 2001) (finding violations of Section 15(f) and Section 204A); *In re Gabelli & Co., Inc. and Gamco Investors, Inc.*, Exch. Act Rel. No. 35057 (December 8, 1994) (finding violations of Section 15(f) and Section 204A). Taking into consideration the extensive trading and investment activities of the Respondents as broker-dealers and investment advisers, their policies and procedures were not reasonably designed to prevent the misuse of material nonpublic information and were not adequately maintained and enforced. The Respondents therefore willfully violated Section 15(f) of the Exchange Act and Section 204A of the Advisers Act.[11]

IV.

MS & Co. and MSDW have undertaken to:

A. Retain, within thirty (30) days of the issuance of this Order, at Respondents' expense, a qualified independent consultant (the "Consultant"), not unacceptable to the Commission staff, to (1) conduct a comprehensive review of Respondents' policies, practices and procedures relating to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act to determine the adequacy of such policies, practices and procedures and to prepare a Report, referenced below, reviewing the adequacy of the Respondents' current policies, practices, and procedures and making recommendations regarding how the Respondents should modify or supplement the policies, practices, and procedures to prevent the misuse of material nonpublic information in compliance with Section 15(f) and Section 204A; and (2) conduct a comprehensive review of Respondents' proposed methodologies and procedures for its Retrospective Surveillance Process, described below, to determine the adequacy of such methodologies and procedures, and to prepare a Report of the Consultant's findings on whether Respondents' proposed methodologies and procedures for their

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[11] "Willfully" as used in this Order means intentionally committing the act which constitutes the violation. *See Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

Retrospective Surveillance Process are reasonably designed to identify trades that occurred during the relevant period that were in violation of Respondents' policies against trading on the basis of material nonpublic information. Respondents shall provide a copy of the engagement letter detailing the Consultant's responsibilities to Richard W. Grime, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC, 20549-4631;

B. Cooperate fully with the Consultant, including providing the Consultant with access to its files, books, records, and personnel as reasonably requested for the above-mentioned reviews, and obtaining the cooperation of its employees or other persons under its control;

C. Require the Consultant to report to the Commission staff on his/her activities as the staff shall request;

D. Permit the Consultant to engage such assistance, clerical, legal or expert, as necessary and at reasonable cost, to carry out his/her activities, and the cost, if any, of such assistance shall be borne exclusively by Respondents;

E. Require the Consultant to complete his/her review of Respondents' policies, practices, and procedures relating to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act, and prepare, within one hundred and fifty (150) days of the issuance of this Order, unless otherwise extended by the staff for good cause, a written Report evaluating the adequacy of Respondents' policies, practices, and procedures relating to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act and making any recommendations about modifications thereto or additional or supplemental procedures deemed necessary to remedy any deficiencies described in the Report. The Consultant shall provide the Report simultaneously to both the Commission staff (at the address set forth above) and Respondents. Respondents shall afford the Consultant the option to seek an extension of time, for good cause shown, to submit the Report by making a written request to the staff at the address set forth above, a copy of which the Consultant shall provide to Respondents;

F. Within one hundred and twenty (120) days of Respondents' receipt of the Report, adopt and implement all recommendations set forth in the Report; provided, however, that as to any recommendation that Respondents consider to be, in whole or in part, unduly burdensome or impractical, Respondents may submit in writing to the Consultant and the staff (at the address set forth above), within sixty (60) days of receiving the Report, an alternative policy, practice, or procedure designed to achieve the same objective or purpose. Respondents and the Consultant shall then attempt in good faith to reach an agreement relating to each recommendation that Respondents consider to be unduly burdensome or impractical and the Consultant shall reasonably evaluate any alternative policy, practice, or procedure proposed by Respondents. Such discussion and evaluation by Respondents and the Consultant shall conclude within ninety (90) days after Respondents' receipt of the Report, whether or not Respondents and the Consultant have reached an agreement. Within fourteen (14) days after the conclusion of the discussion and evaluation by Respondents and the Consultant, Respondents shall require that the Consultant inform Respondents and the staff (at the address set forth above) of his/her final determination concerning any recommendation that Respondents consider to be unduly burdensome or impractical. Respondents shall abide by the determinations of the Consultant and, within sixty (60) days after final agreement between

Respondents and the Consultant or final determination by the Consultant, whichever occurs first, Respondents shall adopt and implement all of the recommendations that the Consultant deems appropriate;

G. Within fourteen (14) days of Respondents' adoption of all of the recommendations that the Consultant deems appropriate, Respondents shall certify in writing to the Consultant and the staff (at the address set forth above) that Respondents have adopted and implemented all of the Consultant's recommendations and that Respondents have established policies, practices, and procedures pursuant to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act that are consistent with this Order. Within sixty (60) days of the issuance of this Order, submit a written report (the "Retrospective Surveillance Methodology") simultaneously to the Consultant and the Commission staff (at the address set forth above) documenting the methodologies and procedures that Respondents propose to adopt and implement to complete a retrospective surveillance of trading in all accounts and all securities that should have been but were not surveilled by Respondents over the four (4) years prior to the date of the issuance of this Order (the "Retrospective Surveillance Process") to ascertain whether any trading has occurred in such accounts or securities in violation of Respondents' policies against trading on the basis of material nonpublic information; Require the Consultant to complete his/her review of Respondents' methodologies and procedures contained in the Retrospective Surveillance Methodology, and prepare, within thirty (30) days of the Consultant's receipt of the Retrospective Surveillance Methodology, unless otherwise extended by the staff for good cause, a written report (the "Retrospective Surveillance Methodology Review") evaluating the adequacy of Respondents' methodologies and procedures relating to Retrospective Surveillance and making any recommendations about modifications thereto or additional or supplemental methodologies or procedures deemed necessary to remedy any deficiencies described in the Retrospective Surveillance Methodology Review. The Consultant shall provide the Retrospective Surveillance Methodology Review simultaneously to both the Commission staff (at the address set forth above) and Respondents. Respondents shall afford the Consultant the option to seek an extension of time, for good cause shown, to submit the Retrospective Surveillance Methodology Review by making a written request to the staff at the address set forth above, a copy of which the Consultant shall provide to Respondents;

H. Within thirty (30) days of Respondents' receipt of the Retrospective Surveillance Methodology Review, adopt and initiate the implementation of all of the recommendations set forth therein; provided, however, that as to any recommendation that Respondents consider to be, in whole or in part, unduly burdensome or impractical, Respondents may submit in writing to the Consultant and the staff (at the address set forth above), within thirty (30) days of receiving the Retrospective Surveillance Methodology Review, an alternative methodology or procedure designed to achieve the same objective or purpose. Respondents and the Consultant shall then attempt in good faith to reach an agreement relating to each recommendation that Respondents consider to be unduly burdensome or impractical and the Consultant shall reasonably evaluate any alternative methodology or procedure proposed by Respondents. Such discussion and evaluation by Respondents and the Consultant shall conclude within sixty (60) days after Respondents' receipt of the Retrospective Surveillance Methodology Review, whether or not Respondents and the Consultant have reached an agreement. Within fourteen (14) days after the conclusion of the discussion and evaluation by Respondents and the Consultant, Respondents shall require that the Consultant inform Respondents and the staff (at the address set forth above) of his/her final determination concerning any recommendation that Respondents consider to be unduly burdensome or impractical. Respondents shall abide by the determinations of the Consultant and, within thirty (30) days after final agreement between Respondents and the Consultant or final determination by the Consultant, whichever occurs first, Respondents shall adopt and initiate the implementation of all of the recommendations that the Consultant deems appropriate;

I. Within eighteen (18) months of Respondents' adoption of all of the recommendations that the Consultant deems appropriate, unless otherwise extended by the staff of the Commission for good cause shown, Respondents shall complete the Retrospective Surveillance Process in accordance with the Consultant's final recommendations. Within thirty (30) days of their completion of the Retrospective Surveillance Process, Respondents shall provide a written report (the "Retrospective Surveillance Report") simultaneously to the Commission's staff (at the address set forth above) and the Consultant certifying that Respondents have completed the Retrospective Surveillance Process in accordance with the Consultant's final recommendations, and providing the findings of the Retrospective Surveillance Process, provided, however, that Respondents shall provide promptly (but in any event within ten days) to the Commission staff information discovered during the completion of the Retrospective Surveillance Process tending to show that trading in violation of Respondents' policies against misuse of material nonpublic information occurred;

J. Respondents may apply to the Commission's staff for an extension of the deadlines described above before their expiration, and upon a showing of good cause by Respondents, the Commission's staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate;

K. To ensure the independence of the Consultant, Respondents shall not have the authority to terminate the Consultant without prior written approval of the Commission's staff, and shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates;

L. Respondents shall require the Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in the performance of his/her duties under this Order shall not, without the prior written consent of the Commission's staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such, for the period of the engagement and for a period of two years after the engagement;

M. Respondents agree to certify in writing to the staff (at the address set forth above), in the second year following the issuance of this Order, that Respondents have established and continue to maintain policies, practices, and procedures pursuant to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act that are consistent with this Order.

V.

In determining to accept the Offer, the Commission considered remedial actions taken by the Respondents and the cooperation they afforded the Commission staff. Once the initial problems in surveillance were discovered, Respondents conducted a review of their surveillance processes and began to take steps to correct the identified deficiencies. Respondents also cooperated with the staff in its investigation and timely reported their findings as additional surveillance issues were identified.

VI.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Respondents and to impose the sanctions agreed to in Respondents' Offer.

Accordingly, IT IS HEREBY ORDERED that:

A. Pursuant to Section 15(b)(4) of the Exchange Act and Section 203(e)(5) of the Advisers Act, MS & Co. and MSDW be, and hereby are, censured;

B. Pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, MS & Co. and MSDW shall cease and desist from committing or causing any violations and any future violations, of Section 15(f) of the Exchange Act and Section 204A of the Advisers Act;

C. Within ten days of the issuance of this Order, MS & Co. and MSDW shall pay a civil money penalty in the aggregate amount of $10,000,000 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (4) submitted under cover letter that identifies Morgan Stanley & Co. Incorporated and Morgan Stanley DW Inc. as Respondents in these proceedings, and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Richard W. Grime, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-4631; and

D. MS & Co. and MSDW shall comply with the undertakings enumerated in Section IV above.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8717 / June 28, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54062 / June 28, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2453 / June 28, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12347

In the Matter of **Walco International, Inc. and** **James C. Robison,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (the "Securities Act") and Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act") against Walco International, Inc. ("Walco") and James C. Robison.

II.

In anticipation of the institution of these proceedings, Walco and Robison have submitted an Offer of Settlement ("Offer") that the Commission has determined to accept.[1] Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Walco and Robison admit the Commission's jurisdiction over them and over the subject matter of these proceedings, Walco and Robison consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of

[1] Simultaneously with this proceeding, the Commission has filed the following settled action in which Robison is a party: SEC v. Virbac Corp., et al., Civil Action No. 4-06CV-453-A, U.S.D.C. N.D. Tex (hereafter, "the parallel civil action").

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1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Order.

III.
FINDINGS

The Commission makes the following findings[2]:

A. RESPONDENTS

Walco, based in Westlake, Texas, is the largest food animal health products distributor in North America, with over $600 million in annual revenues.

Robison, age 49, has served as chairman, CEO, and president of Walco since May 1997.

B. RELATED PARTIES

Virbac Corporation ("Virbac" or the "Company"), a Delaware corporation headquartered in Fort Worth, Texas, is the result of the March 1999 acquisition of Agri-Nutrition Group Limited ("AGNU"), a publicly held company, by Virbac Inc., a wholly owned subsidiary of Virbac S.A., a French veterinary pharmaceutical manufacturer. Virbac's common stock is registered with the Commission under Section 12(g) of the Exchange Act and trades in the Pink Sheets under the symbol "VBAC" since it was delisted from the NASDAQ National Market on January 23, 2004 for Virbac's failure to file timely its periodic reports.

Thomas L. Bell, age 45, served as president and CEO of Virbac from April 1999, as well as a director from May 2002, until he resigned effective January 27, 2004.

Joseph A. Rougraff, age 46, and a CPA licensed in the state of Indiana, served as vice president, CFO, and corporate secretary of Virbac from May 2000 until he resigned effective January 27, 2004.

Douglas A. Hubert, age 38, joined Virbac in March 1991 as a sales territory manager and served as vice president of the Veterinary Division from April 2000 until his resignation in January 2005.

C. FACTS

1. Background

Shortly after the March 1999 merger of Virbac, Inc. with AGNU, Bell was named Virbac's CEO. Primarily through the introduction of new products, Virbac's revenues grew from

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[2] The findings herein are made pursuant to Respondents' Offer and are not binding on any other person or entity in these or any other proceedings.

$44 million in 1999 to $64 million in 2002. From January 2000 through September 2002, Bell, in press releases and conference calls, consistently expressed confidence that the Company would achieve its strategic goal of more than doubling revenues to $100 million by 2004. Together with Rougraff, Bell touted positive earnings results in press releases, investor presentations, and conference calls which they attributed primarily to successful product launches. Virbac's Veterinary Division, the largest of its three reportable segments, which accounted for approximately 50% of Virbac's consolidated revenue, was portrayed as the principal driver of the Company's growth and success.

Virbac's stock price rose in response to the Company's favorable operating results and Bell and Rougraff's upbeat statements—from $1.125 on March 5, 1999 to $8.35 on November 12, 2003. The November 12 price peak immediately preceded Virbac's announcement of delay in filing its third quarter 2003 Form 10-Q. Within two weeks of this announcement, Virbac confirmed it would be restating its financial statements. Virbac's stock price tumbled—from $8.35 per share on November 12, 2003, when Virbac disclosed delays in filing its Form 10-Q, to $2.70 on February 20, 2004, when Virbac disclosed the Commission's investigation.

2. Elements of the Scheme

To foster the illusion of rapid revenue and earnings growth, Virbac orchestrated a multi-pronged scheme to manipulate Virbac's financial statements. The scheme involved, among other things: 1) accelerating revenue recognition on shipments of product that exceeded distributors' current demands (i.e., Virbac's "loading" cycle); 2) recognizing revenue on sham transactions; 3) failing to cut off sales at fiscal period-end; and 4) deferring expenses, principally by manipulating reserves and accruals.

Bell and Hubert were able to convince two distributors, one of which was Walco, to assist in the activity.[3] Walco's primary motivation for assisting Virbac was its ambition to gain Virbac's warehousing and shipping outsourcing business.

3. Walco and Robison's Participation in the Revenue Inflation and Expense Deferral Scheme

In early 1999, Virbac began "loading" its distributors to meet Bell's sales and income targets and to fulfill its mission statement: double-digit earnings growth through successful product launches. Virbac relied heavily upon Walco and another distributor to execute its loading strategy, granting whatever concessions were necessary to make "sales" in excess of distributors' current requirements. In some instances, Virbac offered unusually long payment terms—often 180 days or more instead of a more typical 30 days—or even consignment terms to distributors. On other occasions, various volume discounts and rebates were given to induce large purchases. In many cases, Virbac promised distributors that they could simply return large quantities of product for full credit, or exchange it for replacement product, at a later date. These terms were rarely

[3] The two distributors accounted for 90% of the invoices that Virbac used to inflate its revenue.

reflected in Walco's purchase orders to Virbac. Through these distributor enticements, Virbac improperly recorded revenue in violation of Generally Accepted Accounting Principles ("GAAP").[4]

Virbac's most excessive loading involved new product launches, such as Preventic Plus (flea and tick collar), Iverhart Plus (heartworm medication), and its generic ivermectin pour-on products (cattle de-wormers). During 2001, Virbac entered into development, license, and supply agreements whereby it granted Walco, and two other distributors, exclusive distribution rights to its pour-on product line.[5] In the third quarter of 2001, Virbac recognized $900,000 of revenue from Walco's "purchase" of pour-on which it should not have recognized at that time because it was a consignment sale. Despite this fact, Walco furthered Virbac's activity by submitting a purchase order that disguised this consignment as a sale with fixed payment terms.

At the end of 2001, with Virbac facing a revenue shortfall, Bell convinced Robison to have Walco purchase another $800,000 of pour-on products. Walco's additional purchase of this product was unusual in a number of ways. First, Walco had not sold any of the $900,000 of pour-on shipped at the end of September 2001. Walco, at Bell's request, sent a purchase order with 120-day payment terms while simultaneously entering into an undisclosed side agreement with Bell pursuant to which payments were not required until Walco sold the product. In addition, both Virbac and Walco knew that Walco was contractually unable to sell Virbac's pour-on products, which have a limited shelf life, until it terminated an exclusive distribution agreement with another manufacturer, which did not occur until the second quarter of 2002.

In addition to improperly accelerating revenue recognition on actual transactions, Virbac improperly recognized revenue on sham transactions fabricated by Virbac management. At the end of the fourth quarter of 2002, Bell conceived and implemented a scheme to inflate Virbac's revenue by shipping $560,000 of Iverhart Plus to Paragon Logistics ("Paragon"), a division of Walco. The transaction was falsely documented in Virbac's books and records, as well as in Walco's purchase order, as a sale to Walco. Bell separately negotiated an arrangement with Robison whereby Virbac would have Paragon ship the product to other customers and Virbac would pay Paragon a logistics fee for warehousing and freight costs. By accepting the shipment and improperly documenting the purchase order, Walco and Robison assisted Bell in inflating Virbac's revenue. The Virbac scheme failed; ultimately, the entire shipment expired, no replacement product was shipped, and Virbac was forced to issue a credit to Walco for the entire invoice amount. Bell admitted that not all the terms of the Paragon transaction had been finalized by December 31, 2002. Hubert admitted that Bell's determination to recognize revenue on this "half-baked" transaction was ill-advised because no customer was obligated to purchase the product that Virbac had stuffed into a "logistics"

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[4] GAAP requires the following criteria for revenue recognition: 1) persuasive evidence that an arrangement exists; 2) delivery has occurred or services have been rendered; 3) the seller's price to the buyer is fixed or determinable; and 4) collectibility is reasonably assured. *See, e.g.,* Statement of Financial Accounting Standards No. 48 ("FAS 48"); Statements of Financial Accounting Concepts Nos. 2 and 5 ("SFAC 2" and "SFAC 5"); and Accounting Research Bulletin No. 43 ("ARB 43").

[5] Prior to the introduction of the pour-on product line, Virbac focused exclusively on the pet and small companion animal market. Virbac's pour-on products, and its subsequent introduction of other products, marked Virbac's entry into the large animal market. The products are applied externally on cattle—hence the name "pour-on."

warehouse. By including this sale in its books and records, Bell was able to achieve Virbac's operating income target for 2002, but not its revenue target.

IV.
VIOLATIONS

Based on the foregoing, the Commission finds that:

A. Walco caused Virbac's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder, and also caused Bell, Rougraff, and Hubert's violations of Section 13(b)(5) of the Exchange Act, and Rule 13b2-1 thereunder; and

B. Robison caused Virbac's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder, and also caused Bell, Rougraff, and Hubert's violations of Section 13(b)(5) of the Exchange Act, and Rule 13b2-1 thereunder.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents' Offer.[6]

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that:

A. Respondent Walco cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13, and 13b2-1 thereunder; and

B. Respondent Robison cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 13(b)(5) of the Exchange Act, and Rule 13b2-1 thereunder, and from causing any violation and any future violation of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1 and13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

6 Robison has agreed to pay a $50,000 civil penalty, in connection with the parallel civil action.

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8716 / June 28, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54061 / June 28, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2451 / June 28, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12346

In the Matter of **Vedco, Inc. and Craig S. Campbell,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (the "Securities Act") and Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act") against Vedco, Inc. ("Vedco") and Craig S. Campbell.

II.

In anticipation of the institution of these proceedings, Vedco and Campbell have submitted an Offer of Settlement ("Offer") that the Commission has determined to accept.[1] Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Vedco and Campbell admit the Commission's jurisdiction over them and over the subject matter of these proceedings, Vedco and Campbell consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of

[1] Simultaneously with this proceeding, the Commission has filed the following settled action in which Campbell is a party: SEC v. Virbac Corp., et al., Civil Action No. 4-06CV-453-A, U.S.D.C. N.D. Tex. (hereafter, "the parallel civil action").

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1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Order.

III.
FINDINGS

The Commission makes the following findings:[2]

A. RESPONDENTS

Vedco, a privately owned veterinary buying group based in St. Joseph, Missouri, with approximately $114 million in annual sales, accounted for 18% and 12% of Virbac Corporation's ("Virbac" or the "Company") net revenues in 2002 and 2001, respectively.[3]

Campbell, age 52, is the general manager of Vedco and is Virbac's principal Vedco contact.

B. RELATED PARTIES

Virbac, a Delaware corporation headquartered in Fort Worth, Texas, is the result of the March 1999 acquisition of Agri-Nutrition Group Limited ("AGNU"), a publicly held company, by Virbac Inc., a wholly owned subsidiary of Virbac S.A., a French veterinary pharmaceutical manufacturer. Virbac's common stock is registered with the Commission under Section 12(g) of the Exchange Act and trades in the Pink Sheets under the symbol "VBAC" since it was delisted from the NASDAQ National Market on January 23, 2004 for Virbac's failure to file timely its periodic reports.

Thomas L. Bell, age 45, served as president and CEO of Virbac from April 1999, as well as a director from May 2002, until he resigned effective January 27, 2004.

Joseph A. Rougraff, age 46, and a CPA licensed in the state of Indiana, served as vice president, CFO, and corporate secretary of Virbac from May 2000 until he resigned effective January 27, 2004.

Douglas A. Hubert, age 38, joined Virbac in March 1991 as a sales territory manager and served as vice president of the Veterinary Division from April 2000 until his resignation in January 2005.

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[2] The findings herein are made pursuant to Respondents' Offer and are not binding on any other person or entity in these or any other proceedings.

[3] During the relevant time period, Vedco was owned by nine veterinary supply companies that use Vedco to achieve economies of scale when purchasing products.

C. FACTS

1. Background

Shortly after the March 1999 merger of Virbac, Inc. with AGNU, Bell was named Virbac's CEO. Primarily through the introduction of new products, Virbac's revenues grew from \$44 million in 1999 to \$64 million in 2002. From January 2000 through September 2002, Bell, in press releases and conference calls, consistently expressed confidence that the Company would achieve its strategic goal of more than doubling revenues to \$100 million by 2004. Together with Rougraff, Bell touted positive earnings results in press releases, investor presentations, and conference calls which they attributed primarily to successful product launches. Virbac's Veterinary Division, the largest of its three reportable segments, which accounted for approximately 50% of Virbac's consolidated revenue, was portrayed as the principal driver of the Company's growth and success.

Virbac's stock price rose in response to the Company's favorable operating results and Bell and Rougraff's upbeat statements—from \$1.125 on March 5, 1999 to \$8.35 on November 12, 2003. The November 12 price peak immediately preceded Virbac's announcement of delay in filing its third quarter 2003 Form 10-Q. Within two weeks of this announcement, Virbac confirmed it would be restating its financial statements. Virbac's stock price tumbled—from \$8.35 per share on November 12, 2003, when Virbac disclosed delays in filing its Form 10-Q, to \$2.70 on February 20, 2004, when Virbac disclosed the Commission's investigation.

2. Elements of the Scheme

To foster the illusion of rapid revenue and earnings growth, Virbac orchestrated a multi-pronged scheme to manipulate Virbac's financial statements. The scheme involved, among other things: 1) accelerating revenue recognition on shipments of product that exceeded distributors' current demands (i.e., Virbac's "loading" cycle); 2) recognizing revenue on sham transactions; 3) failing to cut off sales at fiscal period-end; and 4) deferring expenses, principally by manipulating reserves and accruals.

Bell and Hubert were able to convince Vedco to assist in the scheme.[4] Virbac was one of Vedco's top five suppliers. In order to maintain that relationship, Campbell consented to the transactions requested by Bell and Hubert. Vedco did not derive any direct benefit from its participation in the scheme.

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4 Vedco accounted for 60% of the invoices that Virbac used to inflate its revenue.

3. Vedco and Campbell's Participation in the Revenue Inflation and Expense Deferral Scheme

a. Virbac's "Loading" Strategy

In early 1999, Virbac began a loading strategy with its distributors to meet Bell's sales and income targets and to fulfill its mission statement: double-digit earnings growth through successful product launches. Virbac relied heavily upon Vedco and another distributor to execute its loading strategy, granting whatever concessions were necessary to make "sales" in excess of distributors' current requirements. In some instances, Virbac offered very long payment terms—often 180 days or more instead of a more typical 30 days—or even consignment terms to Vedco. On other occasions, various volume discounts and rebates were given to induce large purchases. In many cases, Virbac promised Vedco that it could simply return large quantities of product for full credit, or exchange it for replacement product, at a later date. These return or exchange terms were rarely reflected in Vedco's purchase orders to Virbac. Through these distributor enticements, Virbac improperly recorded revenue in violation of Generally Accepted Accounting Principles ("GAAP").[5]

Virbac's most excessive loading strategy involved new product launches, such as Preventic Plus (flea and tick collar), Iverhart Plus (heartworm medication), and its generic ivermectin pour-on products (cattle de-wormers). Additionally, Virbac used product launches to accelerate revenue through a scheme in which Vedco was asked to purchase an existing product with the understanding it could be exchanged for a newly launched product when available. For example, Virbac pushed Preventic in the fourth quarter of 2000 in advance of the Preventic Plus launch, and pushed Preventic Plus and other products in the second and third quarters of 2001 in advance of the Iverhart Plus launch. In none of these instances did Vedco's purchase orders reflect the true nature of the transactions.

After initial Preventic Plus sales lagged behind its projections, Virbac created the appearance of a successful product launch by pushing Preventic Plus to Vedco to meet Virbac's second and third quarter 2001 sales and earnings targets. For example, Hubert requested that Campbell issue a Vedco purchase order for "half of his first order of Iverhart Plus in Preventic Plus," with the inducement that the product "could be kept on a trailer until needed." Contrary to their previous practices, Campbell acceded to Hubert's request for the purchase order and caused Vedco to issue a $351,000 purchase order for Preventic Plus after Hubert granted unusually extended payment terms of 150 days, versus the normal 30 days. Virbac paid for 102 days of storage fees until Campbell, at Hubert's insistence, finally accepted delivery of the collars. Contrary to FAS 48, Virbac recognized revenue, without regard to expected returns, when it invoiced Vedco on September 29, 2001.

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[5] GAAP requires the following criteria for revenue recognition: 1) persuasive evidence that an arrangement exists; 2) delivery has occurred or services have been rendered; 3) the seller's price to the buyer is fixed or determinable; and 4) collectibility is reasonably assured. *See, e.g.,* Statement of Financial Accounting Standards No. 48 ("FAS 48"); Statements of Financial Accounting Concepts Nos. 2 and 5 ("SFAC 2" and "SFAC 5"); and Accounting Research Bulletin No. 43 ("ARB 43").

When the Vedco $351,000 invoice became due on February 26, 2002, Rougraff and Bell were aware of, or approved, one or more due date extensions, totaling more than a year, through February 28, 2003, in lieu of requiring payment. Vedco viewed this shipment as a consignment, and ultimately paid only $41,000 for collars it actually sold. The balance of the shipment expired in Vedco's warehouse, and Virbac was forced to issue Vedco a $308,000 credit in the fourth quarter of 2003. Virbac should not have included the $351,000 in revenue for the third quarter of 2001, because payment was contingent upon resale by Vedco and because it was probable that the collars would be returned or replaced after they expired. *See* FAS 48. This transaction resulted in a 3% overstatement of actual third quarter 2001 revenues.

In early 2001, Virbac heralded Iverhart Plus as a high-growth opportunity. Due to regulatory delays, however, Virbac did not have the necessary approvals to ship Iverhart Plus until the fourth quarter of 2001. Approximately $600,000 of Iverhart Plus was shipped to Vedco in the fourth quarter of 2001 with the explicit agreement, approved by Bell and documented in an e-mail between Hubert and Campbell, that any unsold product could be returned in 90 days for full credit.

In an effort to meet Virbac's revenue and earnings targets, Hubert convinced Campbell at the end of the first quarter of 2002 to issue a purchase order for $1.6 million of Iverhart Plus—all of Virbac's available inventory. Hubert reiterated to Campbell, with Bell's concurrence, that any expired product would be replaced at no cost to Vedco. Although payment terms were stated as 90 days on the invoice, Vedco had no obligation to pay unless, and until, it sold the product.

Because Virbac shipped all remaining Iverhart Plus inventory to Vedco, it had no available inventory to fill other customers' orders at the beginning of the second quarter of 2002. To remedy this problem, Hubert, Bell, and Rougraff decided, with the assistance of Campbell, to ship product from Vedco to other Virbac customers. As a result, Virbac improperly recognized revenue from a second shipment of the same product—from Vedco to another distributor—and sidestepped reversal of the first "sale" to Vedco by shipping "replacement" product at no cost to Vedco. Campbell and Hubert had agreed to this unusual arrangement during the first quarter of 2002. Hubert informed Campbell that he did not want to issue a credit for the Iverhart Plus because it might present a problem with Virbac's auditors. Although Vedco made some payments on Iverhart Plus sales throughout 2002, Virbac was forced to issue $857,000 of credits to Vedco in the fourth quarter of 2003 for the remainder of this product, which had expired. Virbac further inflated reported earnings by not recording a reserve for anticipated returns of Iverhart Plus.

In its May 2, 2002 earnings release, Virbac announced record revenue and operating income results for the first quarter of 2002. In the release, Bell stated that the Veterinary Division's sales "jumped 72% year-over-year, marked by early impressive sales for newcomers Iverhart Plus and Preventic Plus." Virbac's restated revenues included a $1.6 million adjustment (due to an 11% overstatement of actual first quarter 2002 sales) to reduce first quarter 2002 Iverhart Plus revenues.

At the end of the second quarter of 2002, Campbell again agreed to issue a Vedco purchase order for $598,000 of Iverhart Plus, even though Vedco had not sold $1.4 million of the $1.6

million of Iverhart Plus it acquired in the prior quarter. Again, Campbell viewed Vedco's obligation to pay as contingent upon resale, despite Vedco's issuance of a purchase order reflecting fixed payment terms. Vedco was unable to sell any of the product. Virbac recorded a mere $64,000 reserve for returns of Iverhart Plus at the end of the second quarter of 2002; however, Virbac's management knew that anticipated returns would be higher as a result of the high percentage of inventory at Vedco that would become unmarketable within 90 days and require replacement due to expiration dates. Vedco ultimately made no payments on the second quarter 2002 shipment and Virbac was forced to issue a credit to Vedco for the entire $598,000 invoice amount in the fourth quarter of 2003.

b. Fraudulent Bill-and-Hold Sale

Virbac improperly recognized $775,000 of revenue related to the pour-on invoiced to Vedco on December 28, 2001. The transactions were documented as valid bill-and-hold sales.[6] The sales, however, did not comply with the bill-and-hold criteria spelled out in GAAP for two reasons: 1) Virbac, rather than Vedco, initiated the transactions and 2) they lacked fixed delivery dates. Virbac's auditors were misled into believing that all bill-and-hold criteria had been met as of the date of the transaction. When Virbac's auditors requested third-party confirmation, Campbell approved a subordinate's signing and returning the confirmation, even though Campbell knew, or should have known, that some of the representations were false.

c. Vedco Assisted Virbac in Manipulating Reserves and Accruals

In addition to overstating revenues, Virbac's management also manipulated expenses such as reserves, accruals, and sales credits, and their associated books and records, to maintain the illusion that Virbac was meeting internal and external sales and earnings forecasts. For example, although Virbac emphasized to its distributors that expired product could be returned for full credit or replacement product, Virbac resisted issuing credits in order to lessen the negative impact on its reported earnings. Instead, it promised, but often failed, to ship replacement product. The full extent of expiring or expired product, especially Iverhart Plus, was concealed in schedules provided by Virbac to its auditors for testing the reasonableness of its accruals.

For example, Vedco and Campbell participated in Iverhart Plus reserve manipulation during the fourth quarter of 2002. To avoid increasing Virbac's accrual, Hubert, with the knowledge and consent of Campbell, caused Virbac to invoice Vedco for $258,000 of product previously shipped to Vedco at no cost as replacement for expired product. Hubert explained to Campbell in January 2003 that he needed this "favor" to help Virbac avoid increasing its Iverhart Plus replacement reserve. Vedco paid the invoice, but was issued a credit for the full amount by Virbac. As a result of this subterfuge, Virbac achieved two positive outcomes. First, Virbac was able to disguise as

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6 SFAC 5 states that revenue should not be recognized until the seller has substantially accomplished what it must do pursuant to the terms of the agreement, which usually occurs upon delivery. A bill-and-hold sale is an exception in that revenue is recognized prior to delivery. *See also*, SAB 101 which lists specific criteria for bill-and-hold sales.

revenue from a new sale what should have been recognized as an expense. More significantly, however, Virbac was able to mask the true percentage of expired product, which in turn understated Virbac's estimated liability for replacement product.

IV.
VIOLATIONS

Based on the foregoing, the Commission finds that:

A. Vedco caused Virbac's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder, and also caused Bell, Rougraff, and Hubert's violations of Section 13(b)(5) of the Exchange Act, and Rules 13b2-1 and 13b2-2 thereunder; and

B. Campbell caused Virbac's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder, and also caused Bell, Rougraff, and Hubert's violations of Section 13(b)(5) of the Exchange Act, and Rules 13b2-1 and 13b2-2 thereunder.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents' Offer.[7]

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that:

A. Respondent Vedco cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13, 13b2-1, and 13b2-2 thereunder; and

B. Respondent Campbell cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 13(b)(5) of the Exchange Act, and Rules 13b2-1, and 13b2-2 thereunder, and from causing any violation and any future violation of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1 and13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

[7] Campbell has agreed to pay a $50,000 civil penalty in connection with the parallel civil action.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 54054 / June 28, 2006

Admin. Proc. File No. 3-7370

In the Matter of

SALIM B. LEWIS

ORDER GRANTING PETITION TO VACATE ADMINISTRATIVE BAR ORDER

On August 13, 1990, the Commission entered an order barring Salim B. Lewis from association with any broker, dealer, investment company, investment adviser, or municipal securities dealer (the "Bar Order"). Lewis consented to the Bar Order. The Bar Order contained the findings that 1) Lewis had pled guilty in 1989 to violating antifraud, recordkeeping, and margin requirements of the federal securities laws and 2) Lewis had been permanently enjoined in 1990 by a federal district court from violating those requirements. 1/

On January 20, 2001, the President of the United States granted Lewis a full and unconditional pardon for his criminal conviction. Lewis filed a motion with the Commission on September 9, 2004, seeking to vacate the bar order in light of his pardon. On June 10, 2005, we denied Lewis's request to vacate the Bar Order in its entirety "because the order rest[ed] on the injunction entered with Lewis's consent as well as his criminal conviction." 2/

In our June 10, 2005 order, we noted that Lewis could seek to have his injunction vacated, and that "the bar based on the injunction entered against Lewis would be vacated on Lewis's application if the district court vacated Lewis's injunction." 3/ Lewis filed a motion with the federal district court on December 30, 2005, seeking to have his injunction vacated. On March 29, 2006, the court vacated the injunction in its entirety.

1/ Salim B. Lewis, Securities Exchange Act Rel. No. 28333 (Aug. 13, 1990), 46 SEC Docket 1733.

2/ Salim B. Lewis, Exchange Act Rel. No. 51817 (June 10, 2005), 85 SEC Docket 2472. We nonetheless vacated the portion of the bar order prohibiting Lewis from association with any investment company, investment adviser, or municipal securities dealer. Id.

3/ Id. at 2480.

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On March 30, 2006, Lewis filed a motion with the Commission seeking to vacate the Bar Order. The Division of Enforcement "supports a grant of relief" "[b]ecause the conviction was the subject of a Presidential pardon and the injunction has now been vacated." Under the unique circumstances of this case, and despite the underlying conduct engaged in by Lewis, the Commission believes it is necessary to set aside the remainder of Lewis's Bar Order. 4/

Accordingly, IT IS ORDERED that the petition of Salim B. Lewis to vacate the bar order entered against him on August 13, 1990, be, and it hereby is, granted; and it is further

ORDERED that the order be, and it hereby is, vacated.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

4/ In our June 10, 2005 order, we stated that the Bar Order survived the pardon because "the order relied, by virtue of the injunction, on the underlying conduct rather than simply the fact of conviction." Id. at 2479 n.25. We retain the view that "[p]rofessional discipline based on underlying conduct rather than the fact of conviction survives a pardon." Id. at 2477 n.21. In light of the district court's decision to vacate the injunction following the presidential pardon, however, we have determined to vacate the bar.

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8715 / June 28, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54057 / June 28, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2449 / June 28, 2006

ADMINISTRATIVE PROCEEDING
FILE NO. 3-12345

In the Matter of **RAYTHEON COMPANY,** **DANIEL P. BURNHAM, and** **ALDO R. SERVELLO,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Raytheon Company ("Raytheon" or the "company"), Daniel P. Burnham ("Burnham"), and Aldo R. Servello ("Servello") [collectively, "Respondents"].

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.[1]

[1] In a separate civil action filed simultaneously with this proceeding, Raytheon, Burnham, and Servello each separately consented to the entry of a judgment by the U.S. District Court for the District of Columbia pursuant to Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act ordering them to pay civil penalties of

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III.

On the basis of this Order and Respondents' Offers, the Commission finds that:[2]

A. RESPONDENTS

Raytheon is a Delaware corporation, headquartered in Waltham, Massachusetts. The company is an industry leader in defense, government electronics, space technology, and business and special mission aircraft. Between 1997 and 2001, Raytheon reported between $13 billion and $20 billion in net sales revenue annually and employed between 75,000 to 120,000 individuals. During this time period and continuing through today, Raytheon's securities have been registered with the Commission pursuant to Section 12(b) of the Securities Act and listed on the New York, Chicago, and Pacific Exchanges.

Burnham, age 59, became Raytheon's President and Chief Operating Officer in July 1998. He served as Raytheon's Chief Executive Officer from December 1998 through July 2003 and as Chairman from August 1999 until January 2004.

Servello, age 50, held several senior positions in RAC's financial organization between July 1998 to July 2001, including Controller, Acting CFO, and Deputy CFO. Since July 2001, Servello has been employed at other divisions of Raytheon.

B. SUMMARY

Between 1997 and 2001, Raytheon and certain members of its senior management made false and misleading disclosures and used improper accounting practices that operated as a fraud by masking the declining results and deteriorating business of Raytheon Aircraft Company ("RAC") and inaccurately reporting the company's operating results on both a segmented and consolidated basis. As set forth below, certain of these disclosures and accounting practices were undertaken by or with the knowledge of senior company officers, including Burnham and Servello.

From 1997 through 1999, Raytheon prematurely recognized revenue on RAC's sale of unfinished aircraft through improper "bill and hold" transactions. As a result, the company materially overstated RAC's net sales by approximately $80 million at year-end 1997 and $110 million at year-end 1998, which led to 13 percent overstatements of the subsidiary's annual operating income in both of these periods. These errors enabled both Raytheon and RAC to meet certain internal and external earnings targets. Although Raytheon did restate for these material errors at year-end 1999, the company misleadingly attributed the restatement to

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$12 million, $100,000, and $15,000 and disgorgement of $1.00, $875,000 plus pre-judgment interest of $263,344.37, and $15,000 plus pre-judgment interest of $4,628.28, respectively. *SEC v. Raytheon Co., et al.*, Civil Action No. 06 CV 1182 (GK).

[2] The findings herein are made pursuant to Respondents' Offers and are not binding on any other person or entity in this or any other proceeding.

additional "clarification" supposedly provided by "new guidance" on revenue recognition recently issued by the Commission in Staff Accounting Bulletin No. 101 ("SAB 101") instead of the improper accounting practices that had occurred at RAC prior to that time.

In addition, between 1997 and 2001, Raytheon failed to fully and accurately disclose known risks, trends, uncertainties, and other information concerning the deteriorating state of RAC's commuter aircraft business and the negative impact this decline was having on asset values associated with RAC's line of nineteen-seat, turboprop aircraft (the "commuters" or the "1900s") and, thus, on the company's (including RAC's) results of operations. Raytheon also engaged in several improper accounting practices that delayed and mischaracterized known losses associated with RAC's commuter line during this time period.

As Raytheon's CEO, Burnham failed to make or ensure the timely, accurate, and full disclosure of these material trends and uncertainties in the company's public filings during 2000 and 2001, failed to take sufficient steps to ensure that Raytheon properly accounted for the company's on- and off-balance sheet commuter assets during this time period, and did not ensure that the company maintained an adequate system of internal accounting controls related to these assets. As RAC's Deputy CFO and Controller, Servello failed to ensure that Raytheon properly accounted for the company's on- and off-balance sheet commuter assets during 2000, and he failed to ensure that Raytheon maintained an adequate system of internal accounting controls at RAC related to the proper recording of these assets.

Had Raytheon properly accounted for its commuter assets, the company would have reported material reductions in RAC's reported operating income of at least $34 million, $22 million, and $21 million at year-end 1998, 1999, and 2000, respectively, which represented 13 percent of the subsidiary's reported annual operating income in each of these periods. Moreover, RAC's operating results would have been further reduced by at least $67 million (41 percent) at year-end 2000 had Burnham, Servello, and others in senior Raytheon and RAC management timely and appropriately recognized losses inherent in a planned "soft landing" of the commuter aircraft line. Furthermore, at this time, internal company documents and other information indicate that these senior executives expected commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing," and a charge of $67 million to $240 million would have reduced Raytheon's 2000 profit before taxes by at least 8 to 27 percent. Burnham and other senior Raytheon officers, however, caused Raytheon to improperly take this charge in the third quarter of 2001, when the company wrote down its on- and off-balance sheet commuter assets by $693 million after the terrorist attacks of September 11th. Given the charge that the company should have taken at year-end 2000, Raytheon's third quarter 2001 commuter loss provision was materially overstated by at least 10 to 53 percent.

C. FACTS

In the early 1990s, Raytheon was a diversified, multi-national conglomerate, which operated in the defense, electronics, engineering and construction, major appliances and aircraft businesses. The company formed RAC in 1994 through the combination of Beech Aircraft and Raytheon Corporate Jets, and the wholly-owned Raytheon subsidiary has been reported as a separate segment in all of the company's public filings since that time. RAC manufactures, markets, and services business jets, turboprops, and piston-powered aircraft for the world's commercial, fractional ownership, and military aircraft markets. Due to the cyclical nature of these markets, RAC often experienced fluctuating results. For example, between 1997 and 2001, RAC generated between $2.3 billion and $3.2 billion in net sales revenue for the company annually, accounting for 13 to 19 percent of Raytheon's consolidated sales revenues.

In 1997, Raytheon completed two multi-billion dollar defense acquisitions in an effort to streamline its operations and solidify its position as one of the nation's largest military contractors. These acquisitions led to a doubling of Raytheon's long-term debt load (increasing it to over $8 billion) and a substantial lowering of Raytheon's credit rating. In an effort to reduce the burden of its debt expense on earnings and cash flows, Raytheon began to divest many of its "non-core" commercial units, using the cash generated by these sales to pay down debt it incurred as a result of its defense acquisitions. RAC was ultimately targeted for divestiture as part of this plan.

1. Raytheon's Improper Bill and Hold Aircraft Sales

Between 1997 and 1999, RAC prematurely recognized revenue on improper "bill and hold" aircraft sales (also known as "green sales" or "financial deliveries") that did not comply with generally accepted accounting principles ("GAAP").

In particular, every quarter and more prevalently at the end of the fiscal year, members of senior RAC management held "executive review sessions," in which they identified unfinished planes in the production process that could be "pulled forward" for a "financial delivery" to "bridge" certain "gaps" or "shortfalls" in RAC's performance targets. It was inappropriate to recognize revenue on these sales because the aircraft were not complete and ready for shipment, the seller (RAC) and not the purchaser had requested the bill and hold sale, and significant incentives were being given to customers in order to induce them to accept a "sale" before quarter- or year-end, all of which disqualified the aircraft for sales treatment under GAAP.

In 1997, RAC's green sales resulted in an $80 million overstatement of the subsidiary's net sales, which artificially inflated RAC's quarterly operating income by between 13 and 28 percent, the subsidiary's annual operating income by 13 percent, and Raytheon's annual earnings by 7 cents per share. Raytheon did not disclose RAC's non-GAAP bill and hold practices in any of its 1997 Forms 10-Q or its Form 10-K, which each noted RAC's "record sales" and "record operating income." In January 1998, the company filed a Form S-3 registration statement and subsequent prospectus supplements for a $3 billion shelf registration and takedown of securities. These filings made no mention of RAC's improper bill and hold accounting and also incorporated by reference Raytheon's prior misleading periodic reports as well as all future periodic reports that Raytheon would file with the Commission.

In 1998, RAC's bill and hold sales inflated the segment's quarterly operating income by 20 and 100 percent in the second and fourth quarters, respectively, and RAC's annual operating income by 13 percent. Raytheon, however, did not disclose RAC's bill and hold practices in its 1998 SEC filings but again described RAC's "record" sales and operating income and "increased" aircraft shipments. In December 1998, Raytheon was aware that RAC had only been able to achieve its year-end sales and profit goals through "significant green sales" activity, which increased the company's fourth quarter earnings by 8 cents per share. As a result, Raytheon met analyst expectations that quarter. Raytheon's 1998 Form 10-K, however, stated that "Revenue from aircraft sales are generally recognized at the time of shipment," omitting a description of RAC's non-GAAP bill and hold accounting practices.

In 1999, RAC's improper bill and hold sales practices led to material misstatements of the subsidiary's operating income in the first, second, and third quarters. Raytheon again made no disclosure of these practices. In July 1999, the company filed another Form S-3 registration statement and subsequent prospectus supplements related to its $3 billion shelf registration and takedown of securities. These filings made no mention of RAC's improper bill and hold accounting practices and also incorporated by reference Raytheon's prior misleading periodic reports as well as all future filings made by the company.

At year-end 1999, Raytheon restated its prior financial results to correct the improper bill and hold accounting that had occurred prior to that time, which indicated that the company had materially misstated RAC's reported quarterly and annual operating income in the nine Forms 10-Q, and two Forms 10-K that the company had filed during fiscal years 1997, 1998, and 1999. The company, however, improperly attributed the restatement to additional "clarification" supposedly provided by "new guidance" on revenue recognition set forth in SAB 101, which had been issued by the Commission in December 1999, instead of the improper accounting practices that had occurred at RAC with the knowledge and involvement of senior management prior to that time.

2. Raytheon's Improper Accounting and Disclosures for Its Commuter Business

Between 1997 and 2001, Raytheon also deferred substantial losses related to RAC's line of commuter aircraft. These planes were typically used by small, thinly capitalized airlines to transport passengers along regional or local routes. These carriers were generally seen as significant credit risks, were thus frequently unable to obtain independent financing for their aircraft purchases, and typically lacked sufficient cash on hand to make outright purchases of RAC's commuter aircraft.

As a result, RAC rarely sold its new or used 1900s for cash. Instead, over 90 percent of RAC's sales were financed by the subsidiary's captive finance company, Raytheon Aircraft Credit Corporation ("RACC"), which offered below-market interest rates and other favorable terms to customers in order to increase demand for the 1900s. These terms were not favorable to the company and contributed to its increasing debt burden. RAC also regularly took used commuter aircraft (model 1900Bs and 1900Cs) in trade for the purchase of newer planes (model 1900Ds) which left RAC with a supply of used 1900s in inventory.

RACC sold most of its aircraft receivables, including commuter financing receivables, into a revolving credit facility funded by an outside bank syndicate, which removed the debt associated with these financed sales from the company's balance sheet. Under the terms of the credit facility agreement, Raytheon was obligated to re-purchase certain delinquent and defaulted receivables, and the level of recourse to Raytheon averaged between 75 to 100 percent depending upon the type of financing. RACC also renegotiated and restructured many of the payment arrangements it had with certain RAC customers in order to keep these customers from becoming overly delinquent or otherwise defaulting on their notes.

a. Between 1997 and 1998, Raytheon saw a declining commuter market

During the late 1990s, RAC began to experience softening demand for its commuter aircraft due to, among other things, shifting consumer preferences, increased government regulation of nineteen-seat aircraft, increased competition in the used aircraft market, and the introduction of regional jets. These and other factors combined to place downward pressure on the sales prices, lease rates, and asset values of these planes. Thus, in 1997, RAC began for the first time to place used 1900s with customers on operating leases and substantially ceased outright sales of used 1900s for cash.

In addition, many of the used commuters that RAC received as returns, repossessions, and trade-ins required significant refurbishment before RAC could re-market them. These refurbishment costs were capitalized as part of the aircraft's book value, which led to "[h]igher book values" that "can and do exceed fair market value." In response, RAC adopted a policy of depreciating the used commuter aircraft on an accelerated basis during the life of their leases to "bring down values" to amounts that were more likely to be recovered in later cash sales. By so doing, RAC improperly deferred and re-characterized losses associated with high commuter book values as ordinary depreciation.

In April 1998, Raytheon's internal audit department identified that the capitalization of RAC's refurbishment costs was leading to inflated book values for the commuter aircraft. Although senior RAC management agreed to establish limits on the carrying values of used 1900Cs at $3.4 million to $3.7 million, by year-end 1999, more than twenty 1900Cs in inventory had book values of more than $4 million per plane net of specific reserves.

By late 1998, Raytheon was aware of potential risks, uncertainties, and adverse trends in RAC's commuter business. For example, in October 1998, a RAC sales plan noted that the "US market continues to be soft for this size [of] aircraft." In December 1998, an internal Raytheon analyst wrote that "[t]he 19-seat turboprop market is in trouble" and described several factors that were "clearly putting the viability of the 1900D in doubt." Later that month, after being informed that "the market for the 1900D appears to be in decline" and "continuing 1900D financing is probably RAC's major financial exposure," Burnham, who had just become Raytheon's CEO, observed that "clearly, the 1900D is a worry" and asked senior RAC management "how solid is our build/sell forecast?" Burnham further authorized a series of external studies into the future market demand for commuters and an internal financial analysis of the risks associated with these aircraft.

b. Raytheon's improper accounting and disclosures in 1997 and 1998

Raytheon made no meaningful disclosures of the known risks, trends, and uncertainties associated with the deteriorating state of RAC's commuter business, such as the softening demand for commuters, the increasing trend in returns and repossessions, and the movement in RAC's commuter placement program away from sales and to begin offering leases, in any of the company's SEC filings from 1997 through 1998.

Raytheon also engaged in improper accounting for RAC's commuter business that served to offset the negative effects that the declining commuter market was having on asset values for the 1900s during this time period. For example, Raytheon transferred $15 million in "corporate reserves" to RAC at year-end 1997, which RAC initially used to "off-set" potential exposures associated with over-valued 1900s. The company did not properly disclose or account for these reserves, however, which represented 7 percent of RAC's reported annual operating income that year. Although this $15 million charge should have been taken to ordinary operating income, Raytheon reported it as a "special charge" reflecting the write down of unidentified "non-current assets" at RAC. In addition, instead of using the charge to write down the non-current commuter assets held for lease, RAC ultimately used this reserve to absorb losses incurred in subsequent periods when aircraft were refurbished.

Furthermore, during 1997 and the first three quarters of 1998, Raytheon was aware that RAC had not implemented and was not complying with FAS 125 (the new guidance for off-balance sheet accounting that became effective on January 1, 1997). However, in its 1997 Form 10-K, the company stated that it had adopted this standard in 1997 and that this purported adoption "did not have a material effect on the company's financial position or results of operations." In 1998, Raytheon continued to be aware that "management ha[d] yet to record the sale of receivables in full accordance with FAS 125" and that "[t]he SEC has recently raised concerns about registrants' reporting under FAS 125." Yet, it was not until the fourth quarter of 1998 that RAC began to implement FAS 125. However, RAC based its FAS 125 calculations on incomplete and inaccurate data and also improperly measured its recourse liability obligations on the receivables sold into the credit facility. As a result, for 1998, Raytheon reported additional operating income of $18 million on the sale of commuter receivables to the credit facility instead of a $9 million loss. Proper FAS 125 accounting would have reduced RAC's reported annual operating income by $27 million (11 percent) at year-end.

RAC also established reserves for commuter losses equal to any FAS 125 gains that were recognized on the sale of commuter receivables. This practice of making perfectly off-setting adjustments left no trace on RAC's reported earnings. As a result, Raytheon's reported financial statements did not accurately reflect the accounting impact of declining commuter values. For example, in the fourth quarter of 1998, Raytheon recorded a $6.5 million gain on the sale of commuter receivables, which was offset by an equal $6.5 million reserve for commuters. No documentation supported the amount of the $6.5 million loss provision, and the amount reserved corresponded to nothing other than the amount of the recorded gain. At the time, the improper $6.5 million adjustment amounted to nearly 8 percent of the subsidiary's fourth quarter 1998 operating income of $82 million.

c. In 1999, Raytheon deferred significant commuter losses

Due to unrelated difficulties in its defense businesses and engineering and construction unit, Raytheon announced an unexpected $640 million charge during 1999, which caused the price of the company's stock to fall 44 percent in one day. The charge in 1999 also led to a downgrading of the company's bond and credit ratings, and Raytheon continued with its strategy to pay down its debt by divesting certain "non-core" commercial units. RAC was one of the segments targeted for divestiture as part of this strategy.

Throughout 1999, Raytheon and certain senior officers (including Burnham) were made aware of potential negative and adverse trends, uncertainties, and risks related to RAC's commuter business. In April 1999, an outside consultant informed Raytheon that the commuter market was "at a turning point," that other "[c]arriers have begun to flood the market with…used 19-seat airplanes," that "lease rates for used 19-seat aircraft [we]re declining," that the "[d]ownward pressure on lease rates w[ould] grow as the surplus of 19-seat aircraft expands," and that "[a]dditional lease rate pressures could impact the company's asset values and re-marketing efforts." Burnham was briefed on this situation and management's views of it.

Also in April 1999, a senior Raytheon financial officer was informed that these "surplus" aircraft and "lower lease rates could drive declining asset values and represent a potential material write down" of the commuter assets. This officer was further informed that there was an "obvious" need for a "material write-down" of RAC's commuter assets, that these losses were "large and growing," that RAC was engaging in "misleading financial reporting," and that the situation was "as bad as [one executive had ever] seen."

In May 1999, an internal Raytheon study forecasted that RAC's commuter portfolio would generate an estimated $95 million in losses due to "[t]he lack of portfolio equity, poor customer credit and payment behavior, high loan-to-value ratios, and the modest level of reserves" established for these assets. That same study identified a "worst case scenario" that could generate $200 million in additional losses depending upon the impact of the "upcoming introduction" of regional jets. Burnham was briefed on this situation and management's views of it.

In June 1999, a senior Raytheon financial officer was advised that there was an estimated exposure of $300 million to $500 million in marking the RACC portfolio to market.

Also in June 1999, Burnham and other senior Raytheon officers received a "response" from RAC to the April and May 1999 external and internal studies. This response set forth the view of RAC management that there was greater demand for new commuter aircraft than forecast by the company's outside consultant. RAC's response also advised that it was "a corporate decision" whether to "build reserves" on the commuters, but this would occur "at the expense of current period profits." RAC's response instead proposed addressing the $95 million commuter exposure identified in May 1999 through "third party, no recourse notes," which would provide an estimated $93 million "improvement." These sales did not materialize, however. Yet, reserves were not adequately increased.

In July 1999, in connection with an attempt to securitize all of RAC's aircraft receivables, the company's investment bankers informed Raytheon that the commuter portfolio should be valued "at a material discount to its current book value," that "actual collateral values may be substantially lower than loan balances," and that "[p]ortfolio policies may be masking problems from being recognized."

In August 1999, as part of an initial consideration to divest RAC, Burnham and other senior Raytheon finance executives were informed that there was "approximately $250 Million - $350 Million risk in [the] $2.4 Billion loan/lease portfolio," and the "risk is likely to approach the high end of this range over time" since "about 40% of loan/lease payments are delinquent" and "business cycle downturn may also drive up defaults [and] reduce residual values of used aircraft."

In the Fall of 1999, after the initial effort to divest RAC failed, Raytheon attempted to sell RAC's portfolio of aircraft receivables (including its commuter receivables) to an outside finance company. The finance company, however, informed Raytheon that it would not purchase any of the commuter loans due to concerns over their high loan-to-value ratios and high concentrations in certain customers. The finance company also provided Raytheon with an independent valuation analysis of the 1900s, which stated that the commuter industry was experiencing a "distinct reduction in sales activity" and a "downturn" in leasing activity over the past year. This report also listed estimated market values for the 1900s that were below their book values.

At year-end 1999, Burnham and others in senior Raytheon and RAC management were informed that the company's outside auditors had a "continued concern about commuter portfolio exposure" and, if there is "any slip," the commuter inventory "balance will balloon." In addition, following a number of production and accounting problems that arose at RAC as part of the year-end close, the subsidiary's CEO stepped down from his executive position, and Burnham traveled to the subsidiary to make it clear that RAC personnel had to improve their processes to prevent similar issues from occurring in the future.

Thereafter, in early 2000, RAC's newly-installed CEO instructed his staff to critically examine the subsidiary's operations, and Servello took the lead role in identifying issues to be examined. As part of this review, Servello and other RAC personnel identified a potential $220 million exposure related to the commuter assets on and off the balance sheet. This estimate was calculated by comparing "[p]rices which could be readily obtainable in today's market" to commuter book values. The market values used in the analysis averaged from $500,000 to $1 million below the commuter book values. However, the company did not write down its commuter assets or adequately increase its commuter reserves at that time. Instead, based on overly optimistic internal analyses prepared by RAC executives, the company concluded that no "event of impairment" had occurred.

In January 2000, Raytheon had issued an earnings advisory for the fourth quarter of 1999 and the full year 2000 because of aircraft production delays at RAC, a restatement due to RAC's improper bill and hold accounting, higher interest expenses, a higher effective tax rate, and other unfavorable results. Following this announcement, Raytheon's stock price fell approximately 17 percent in one day. And, by March 2000, it was reported that Raytheon's bond and credit ratings might be further downgraded "[i]f corrective actions do not lead to material long-term improvements in overall performance and its balance sheet, or if material new operating problems emerge…."

d. Raytheon's improper accounting and disclosures in 1999

Raytheon did not make adequate disclosures of the negative and adverse trends, uncertainties, risks, and other information related to RAC's commuter aircraft or the subsidiary's commuter business in the company's SEC filings from 1999. Raytheon's 1999 Form 10-K did refer to "commuter valuation costs" as one of five factors affecting RAC's "decline in operating income as a percent of sales in 1999," but this disclosure failed to provide adequate information concerning the known material and adverse risks, uncertainties, and trends posed by the commuters.

In addition, the forward-looking statements in Raytheon's 1999 Form 10-K stated that "the effect of market conditions, particularly as it affects the general aviation market, the impact of competing products and pricing, [and] the impact on recourse obligations of RAC due to changes in the collateral value of financed aircraft" were among the many "factors that could cause actual results to differ," but did not mention "commuter" aircraft by name or provide adequate information about the negative trends, uncertainties, and risks concerning the commuters that were known to management at the time. Likewise, another set of forward-looking statements in Raytheon's 1999 Form 10-K stated that "continued market acceptance of, and government regulations affecting, 19-seat turboprop commuter aircraft" could affect RAC's future results of operations, but Raytheon did not disclose the significant information it had about the declining commuter market and the exposures facing the company.

These forward-looking statements were inconsistent with disclosures in the footnotes to the company's 1999 financial statements, which misleadingly stated that "the Company does not expect to incur any material losses against the net book value of the long-term receivables" because "it is the Company's policy to have the aircraft serve as collateral for the commuter airline receivables;" that "any liability arising from these transactions will not have a material effect on the Company's financial position, liquidity, or results of operations" given Raytheon's experience to date with resale activities and pricing and the Company's plan to continue production into the foreseeable future; and that "[t]hese financial instruments are recorded at estimated fair value. No material gain or loss resulted from the sales of receivables." As Raytheon was aware, the fair value of the commuter aircraft serving as collateral for the corresponding receivables was declining given the deteriorating market conditions for these planes. Yet, the company was not adequately increasing its reserves for these anticipated short falls, causing significant potential future liability under its recourse provisions to the revolving credit facility.

In addition, contrary to the company's footnote disclosures, during 1999, RAC continued its incorrect practice of using FAS 125 gains on commuter receivables sold into the credit facility to set up equally off-setting commuter loss reserves. As a result, Raytheon's reported financial statements did not accurately reflect the accounting impact of declining commuter values.

For example, in the third quarter of 1999, RAC increased its "cushion" for commuter losses by roughly $11 million given the improper FAS 125 gains it recognized on the sale of commuter receivables into the credit facility. RAC, however, subsequently reduced that increase by roughly $7 million in the fourth quarter of 1999 that offset a significant FAS 125 loss caused by a reduction in Raytheon's credit rating. These adjustments represented approximately 17 and 19 percent of the subsidiary's reported operating income/loss in the third and fourth quarters of 1999, respectively.

Also, RAC still had not properly applied FAS 125 to its off-balance sheet commuter receivables during 1999. As a result, RAC's reported annual operating income should have been reduced by at least $21 million (13 percent) at year-end.

e. In 2000, Raytheon remained aware that the commuter market continued to deteriorate

In 2000, a variety of internal and external sources continued to inform Raytheon and RAC executives that the market for 1900s was in substantial decline. These sources further indicated that there were actual material commuter losses at RAC and that the potential losses associated with the 1900 line were in the hundreds of millions of dollars.

In January 2000, Burnham, Servello, and other senior Raytheon and RAC officers learned that the company's strategic planning department viewed RAC as having a substantial negative economic value due in large part to $240 million in negative value and exposure associated with RAC's off-balance sheet commuter and general aviation receivables.

In February 2000, an outside consultant reported to Raytheon that there would be "[c]ontinued downward pressure on turboprop lease rates due to falling demand for new units and a growing supply of used capacity" and that "demand for new [commuters] will average 7 to 12 sales annually," well below what RAC was planning to manufacture that year.

In March 2000, auditors with a major public accounting firm that had been retained to perform a review of RAC's "used commuter program exposures" informed certain members of senior Raytheon and RAC management (including Servello) that "the Company's largest exposure in the [commuter] portfolio is with potential returned aircraft" and that "the book values of certain aircraft in the portfolio exceed the current market values." In particular, these auditors identified a $115 million "shortfall" associated with RAC's 1900Cs that were on and off the balance sheet. The auditors also noted that RAC personnel were "rejecting cash offers on commuter aircraft because of the income statement repercussions . . . [implying that] the carrying amounts of commuter airplanes exceed their fair market values." The auditors further noted that RAC only wrote down used commuter asset values "when the Company enters into a new finance/lease transaction." The auditors also reported that RAC lacked formal and documented policies and practices concerning the accounting for commuter aircraft, commuter loan restructurings, the creation of commuter valuation reserves, and the monitoring of customer accounts and collections.

In April 2000, Raytheon's internal audit department prepared a report for members of senior Raytheon and RAC management (including Servello) on the work that had been undertaken at the request of RAC's new CEO, as set forth above. Although the report concluded that no impairment of the commuters had occurred, it did inform management that there was an "[u]ndetermined but likely to be significant" exposure related to the used commuter assets since "[t]he book values and refurbishment costs on used aircraft may exceed fair market value of cash sales...." The internal audit report further stated that there was another "undetermined" exposure associated with the subsidiary's commuter bad debt reserve since the "[v]aluation and review of assets [wa]s not performed timely or regularly." In addition, the internal audit report warned that there was "[n]o active collection effort" against delinquent commuter customers and the "non-performing segment" of the commuter portfolio was "increasing." The report also stated that management should "closely monitor this portfolio as changes will impact the accuracy of assumptions.... [A]ctions which might impair used commuters further include...change[s] in selling strategies and lease terms...large returns of aircraft which cannot be absorbed into lease market…[and an] overt decision not to support the line (such as pulling back significantly on new production).”

In the months that followed, senior RAC executives tracked on a quarterly basis an estimated $220 million “net exposure” in the commuter portfolio given existing reserve levels, and these analyses were provided to others in senior RAC management, including Servello.

In June 2000, a RAC commuter marketing plan noted that loan values for 1900s continued to be “significantly above fair market values” by upwards of $1.3 million per aircraft. Shortly thereafter, a draft sales plan warned RAC personnel to “[m]anage used commuter reserves cautiously and avoid an accounting event.”

In July 2000, auditors with the same major public accounting firm that had previously analyzed RAC’s “used commuter program exposures” prepared a report for the company that analyzed Raytheon’s off-balance sheet commuter receivables. This report highlighted significant problems related to the commuters, including high levels of delinquencies and repossessions and “between $10 million and $200 million of collateral exposure” that was not reflected by RAC’s accounting and restructuring methodologies, such as the practice of recognizing losses only upon a new sale or lease of the aircraft instead of upon return or repossession.

Between April and July 2000, Raytheon’s outside investment bankers provided the company with a series of valuation analyses for the commuter receivables in connection with the company’s efforts to sell RAC and/or its portfolio of commuter financing receivables to an outside buyer. These analyses indicated that a sale of RACC’s portfolio of commuter receivables might generate losses of between $63 million and $622 million on a secured basis, depending on the underlying assumptions, and that the value of discounted cash flows on the portfolio was between $200 million and $273 million lower than the total loan balances, depending upon the underlying assumptions. Given his involvement in the effort to divest RAC and/or its commuter line, Burnham was aware that no buyer expressed a real interest in acquiring the commuter business in whole or in part.

In the Summer of 2000, a senior RAC executive told Burnham and a senior corporate financial officer of his significant concern about a problem with the commuters in the “half a billion dollar” range based on his view of the number of idle aircraft that were then in inventory and the substantial number of commuter returns that were forecasted at year-end. Ultimately, Raytheon addressed this problem by transferring pension income to RAC to gradually build up commuter reserves.

i. Raytheon’s undisclosed transfers of pension income

In the third quarter of 2000, Raytheon began to allocate $14 million in surplus pension income to RAC each quarter, which was generated by an over-funded pension plan that had been retained when Raytheon divested another business unit. As Raytheon’s CEO, Burnham was informed of and approved the transfers. Servello and others were aware that the surplus pension-related income was “to be used to help supplement reserves that we [at RAC] had on our books…. [W]e applied it to the booked reserves as a general reserve increase….” In November 2000, senior RAC executives were told to “[a]nticipate that the $14M per quarter coming from the 'over[-]funded pension income is available indefinitely.'" Thereafter, RAC personnel projected that they would continue to receive $14 million in pension-related income per quarter through at least 2004, which would enable the subsidiary to build up nearly $260 million in commuter reserves.

These surplus pension transfers were not disclosed in the company's SEC filings because management viewed them as immaterial. They, in fact, represented 24 to 353 percent of RAC's reported quarterly operating income between the third quarter of 2000 and the second quarter of 2001; eliminated the comparability of the segment's current results with prior periods; represented 17 percent of RAC's reported annual operating income in 2000; and failed to disclose a three-year decline in the segment's annual operating income from $227 million in 1998, to $163 million in 1999, to $136 million in 2000 (absent the pension income).

ii. Raytheon's improper "pooling" of commuter aircraft

In the fourth quarter of 2000, at the direction of a senior corporate financial officer and others, RAC personnel (including Servello) instituted an improper "pooling" analysis when testing RAC's on-balance sheet commuter assets for impairment under FAS 121. This approach pooled aircraft on an aggregate basis, not on a plane-by-plane basis as required by GAAP, which enabled the company to use $45.7 million in "cushions" associated with low-book-value aircraft to off-set losses associated with higher-book-value aircraft. Raytheon then used these "benefits" to lower the book values of its used 1900Bs and 1900Cs in small amounts at year-end 2000, and the company made no disclosure of the aircraft's declining value.

In addition, even though the company's "pooling" analysis suggested that RAC did not need reserves on the 1900s that were held for sale, the company kept $26.4 million in commuter reserves on RAC's books and continued to transfer $14 million in excess pension-related income to the subsidiary each quarter on a going forward basis for continued increases to a "general commuter reserve," which indicated that the anticipated losses associated with the 1900s were greater than the current level of reserves that had been established at RAC.

iii. Raytheon's "soft landing" plan for the commuters

By late 2000, Burnham and other senior Raytheon and RAC officers were aware that "[m]arket forces ha[d] created a non-performing asset problem" with the 1900s. Specifically, contemporaneous internal company documents show that, at December 31, 2000, RAC's inventory of used commuters had increased to over 100 airplanes due to an exceptionally high number of commuter returns and repossessions at year-end, and RAC expected significant commuter returns in the years ahead.

During January 2001, in response to a perceived "market shift" concerning the commuters, RAC drafted a new "1900 Business Plan" intended to "steer[] to a 'soft landing' in 4 years" by (i) further reducing the build rate for new 1900Ds to one plane per month (the minimum production rate that the subsidiary could sustain without incurring an operating loss); (ii) moving away from RAC's historic commuter financing and leasing strategies to instead "sell 1900B[s and] 1900Cs for cash" at prices that were "well below" existing book values; and (iii) building up RAC's commuter reserves by at least an additional $240 million through the continued allocation of surplus pension-related income to facilitate such sales.

The new "reduced cash sale prices" were approved by senior Raytheon management (including Burnham and senior corporate financial officers) in early January 2001, and the plan projected that the revised "cash sale" values for the commuters would create at least $60 million in anticipated losses in 2001 alone. These losses, however, were going to be charged against the reserves that were being built up at RAC through the transfers of surplus pension-related income and, thus, would not be reflected in Raytheon's reported financial statements.

Servello and others at the company were also aware of the strategy to move to "cash sales," including the effort to "maximiz[e] conversion of 1900Cs for cash" and use "gross margin generated by additional [commuter sales] to fund more sales." Consistent with the company's new commuter business plan, by February 2001, RAC's commuter sales force was instructed that "the operating lease program they had relied upon [in] the previous few years to place used commuters was gone.... In its place were new lower cash prices on 1900Cs and 1900Ds plus an emphasis on cargo sales."

f. Raytheon's inadequate disclosures in 2000

Raytheon did not make adequate disclosures of the negative, adverse, and material trends, uncertainties, risks, and other information described above related to RAC's commuter operations and the subsidiary's commuter line in the company's SEC filings for 2000. Raytheon also did not disclose in its SEC filings the transfer of surplus pension income to RAC or the improper testing of RAC's on-balance sheet commuter assets on a "pooled" basis. In addition, Raytheon did not disclose the "soft landing" plan for RAC's commuter line, including the decision to emphasize cash sales at prices that were "well below" book values to address a perceived "market shift" in the commuter business.

Although Raytheon's Forms 10-Q for the second and third quarter of 2000 did cite "pricing pressure on commuter aircraft" as one of the factors affecting RAC's operating income, these disclosures did not adequately describe the substantial negative information concerning the commuters that was known to management at the time. Similarly, Raytheon disclosed in its third quarter 2000 Form 10-Q that "a downturn in demand could have a material adverse effect on the company's financial position or results of operations" and in its 2000 Form 10-K that the company would "continue to...watch for any indications of a downturn in demand for RAC's aircraft," but these disclosures incorrectly suggested that management was not yet aware of any such downturn in the commuter aircraft market or its severity.

Raytheon also made disclosures concerning the effect of overall market conditions in the forward-looking statements of the company's SEC filings for 2000 that did not provide adequate information concerning the deteriorating state of the commuter aircraft market and the negative effect that this decline was having on RAC and commuter asset values. For example, in its 2000 Form 10-K, Raytheon included the forward-looking statement that the company's "operating results may vary significantly over time for a variety of reasons, many of which are outside of our control," such as "the impact on recourse obligations at Raytheon Aircraft due to changes in the collateral value of financed aircraft...[and] general economic conditions, particularly the cyclical nature of the general aviation...market[] in which we participate." These disclosures made no mention of "commuter" aircraft by name and did not reflect that the company was aware of significant losses related to RAC's commuter assets and anticipating that these losses would continue to grow in the future.

In addition, Raytheon disclosed in other forward-looking statements in the company's annual report that some of the "[i]mportant factors that could cause actual results to differ" were "the effect of market conditions, particularly in relation to the general aviation and commuter aircraft markets; [and] the impact on recourse obligations of Raytheon Aircraft due to changes in the collateral values of financed aircraft, particularly commuter aircraft," These statements were contrary to other disclosures in the footnotes to the company's 2000 financial statements, which misleadingly stated that the company had a secure line of commuter financing receivables, that any liability resulting from the sale of commuter receivables into the revolving credit facility "will not have a material effect on the Company's financial position, or results of operations" given Raytheon's "experience to date with resale activities and pricing and the Company's plan to continue production into the foreseeable future," and that "[n]o material gain or loss resulted from the sales of receivables in 2000, 1999, or 1998." These disclosures did not reflect a move to cash sales of commuter aircraft at prices that were well below book value, a significant reduction in the 1900D build rate, actual material commuter losses at RAC, and potential losses associated with the 1900 line in the hundreds of millions of dollars.

As Raytheon's CEO, Burnham reviewed and approved the inaccurate filings and disclosures set forth above.

g. Raytheon's improper accounting in 2000

From the early 1990s and throughout 2000, RAC used an improper reserve practice known as the "Min/Max" analysis, which was a non-GAAP practice of considering RAC's reserves in the aggregate and, thus, used over-accruals in some reserves to cover short-falls in others. RAC's process of maintaining excess reserves in some areas because they off-set short-falls in reserves in other areas was not disclosed by Raytheon, was inconsistent with GAAP, and led to the keeping of inaccurate books, records, and accounts at the RAC segment. For example, between 1998 and 2000, RAC's excess reserves related to its parts business and general aviation aircraft, which were used to off-set under-accruals in other areas, such as those related to commuter receivables, totaled as much as $19.6 million and represented as much as 61 percent of the subsidiary's total reserves.

In addition, as set forth above, the establishment of $56 million in additional commuter reserves through the transfer of surplus pension income to RAC between the third quarter of 2000 and the second quarter of 2001 was inconsistent with GAAP. No adequate contemporaneous documentation supported the amount of these commuter loss provisions, and the amount reserved corresponded only to the amount of the surplus pension income available. As Raytheon's CEO, Burnham was informed of and approved these surplus pension-related transfers. As RAC's Deputy CFO and Controller, Servello was also aware of these transfers and their use to increase commuter reserves.

In 2000, Raytheon's outside auditors also informed members of senior Raytheon and RAC management (including Servello) that it was "not appropriate" to pool commuter aircraft when testing for impairment under FAS 121 because they "d[id] not represent a large pool of homogenous assets." The auditors, therefore, posted a $12 million audit adjustment, which represented the supposed "benefit" that the company obtained through pooling. Raytheon, with the knowledge of its auditors, did not book the adjustment because it was considered to be immaterial to the company's consolidated financial results. As Raytheon's CEO, Burnham was aware of this decision. The $12 million audit entry, however, represented approximately 7 percent of RAC's reported operating income for 2000 and, thus, was material to the financial results reported for that segment.

In 2000, Raytheon's outside auditors further informed senior Raytheon and RAC executives (including Servello) that RAC "ha[d] not appropriately accounted for the gain or loss on notes sold to [the revolving credit facility]" or properly measured other components of the FAS 125 calculation and, thus, offered to sell RAC an improved FAS 125 model. However, RAC took no substantive steps to comply with FAS 125 during the calendar year. Instead, senior members of the Raytheon and RAC financial organizations "resist[ed]" the purchase of the new model, and, at year-end 2000, the outside auditors were still raising the issue of RAC's failure to comply with FAS 125 with Raytheon. While the company did adopt the new FAS 125 model advocated by its auditors before filing its 2000 Form 10-K, this model also failed to comply with GAAP. Because much of the data serving as the inputs for this model was incomplete and inaccurate, the new FAS 125 model materially misestimated the amount of RAC's various off-balance sheet assets and liabilities. Also, the new FAS 125 model calculated a $22 million overstatement related to prior period FAS 125 gains, but Raytheon did not make this audit entry because it was deemed immaterial to the company's consolidated financial results. As Raytheon's CEO, Burnham was aware of the decision not to book this proposed adjustment. Such a charge, however, would have reduced RAC's reported annual operating income for 2000 by 13 percent (from $164 million to $142 million) and, thus, was material to the segment.

Finally, had senior Raytheon and RAC management timely recognized losses inherent in their planned "soft landing" of the commuter aircraft line, the company would have been required to take a charge of at least $67 million at year-end 2000, and contemporaneous internal company documents and other information indicate that Burnham, Servello, and other senior Raytheon and RAC officers were expecting commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing." A charge of $67 million to $240 million at year-end 2000 would have reduced RAC's reported annual operating income by at least 41 to 146 percent and Raytheon's 2000 profit before taxes by at least 8 to 27 percent.

h. In 2001, Raytheon continued to be aware of the ongoing decline in the commuter market and wrote down these assets after September 11, 2001

Throughout 2001, senior Raytheon executives continued to be aware of the ongoing decline of the commuter market and how this decline was creating serious operational issues at RAC, including substantial actual and anticipated losses associated with the 1900s on and off the company's balance sheet.

i. The first and second quarters of 2001

In addition to moving to a cash sales strategy for the 1900s at prices that were significantly below the carrying value of the aircraft, in early 2001, Raytheon attempted to purchase risk insurance for the cash flows associated with the 1900D notes receivable in the company's off-balance sheet commuter portfolio. During these discussions, the insurer informed Raytheon that an independent appraiser had determined that the company was over-valuing these assets by roughly $220 million (approximately 20 percent above their actual market value).

In addition, during the first quarter of 2001, a senior corporate financial officer had the lead RAC auditor removed from the engagement due to that partner's unwillingness to "ignore SEC and GAAP errors" at the officer's insistence and the partner's requests for consults on various accounting issues with his firm's national office, which were resulting in adverse accounting treatments for the company.

By April 2001, Raytheon was aware that RAC had not sold any used commuters for cash under the "soft landing" plan during the first quarter and that recent offers for used 1900Cs were "in the $1.2M range," which was "far below" the initial "cash sale" estimates of $2.2 million approved by management as part of the "soft landing." Raytheon was further aware that "each cash order looks like it will require a great deal of focus and effort to get the ball over the goal line. Simply put, it's harder to sell for cash, but...we knew this 'going in.'" In response to this statement, one senior Raytheon executive explained that $1.5 million was a "more realistic" price for these used aircraft and further emphasized the need to "raise cash" on these sales.

In June 2001, a RAC sales forecast informed a senior Raytheon financial officer and others that "[a] clear trend exists that prices will have to continue to be lowered to move inventory.... In order to get more cash sales in Q4, the price will have to be lowered to between $1.1 - $1.5 MM. This could create accounting issues." Senior Raytheon financial officers were also informed that it would be necessary to "discount heavily" and offer 1900Cs at between $1.1 million to $1.5 million in order to make sales for cash. These officers were further informed that RAC's 2001 sales forecast was "contingent" upon these values. These transactions, however, were blocked by a senior corporate financial officer and others in the financial organization because "these deals could cause a write down of the entire portfolio and, as a result, we need to sell the airplanes at a higher value." As set forth in internal company documents, "[w]e cannot afford to change NRVs [the Net Realizable Values of the aircraft] below $2,500,000" due to the income statement repercussions for the company. "Price integrity issues and limited reserves prevent us from lowering prices to meet a large portion of the market. Market pricing will require additional reserves."

In July 2001, the company's investment bankers provided Raytheon with an update of earlier analyses of the company's commuter portfolio. This analysis indicated that, at the close of the second quarter, there was at least $113 million to $198 million in losses associated with the on- and off-balance sheet commuters given the difference between their book and assumed collateral values. This analysis also indicated that the value of the discounted cash flows from the on- and off-balance sheet commuters were $431 million to $528 million below their total book values.

In August 2001, Raytheon convened a "commuter summit" at the company's corporate headquarters to discuss the state of the commuter market and the negative effect this decline was having on RAC's commuter business. At this meeting, an outside consultant informed senior Raytheon and RAC management that "[c]ompetitive market pressures are intense. Critically, they are not anticipated to ease anytime soon.... Turboprop aircraft orders have stagnated at best.... Only a handful of companies still operate 19-seat turboprops.... The prognosis for U.S. 19-seat operators is not very good...." Downward pricing pressure is not anticipated to ease as the number of surplus 20 to 35 seat turboprop aircraft grows, making them more attractive as 19-seat replacements.... With turboprop aircraft demand falling and supply raising, pricing must reflect basic market conditions not internal benchmarks."

At this "commuter summit," another outside consultant reported that estimates of fair market value for the commuters were, on average, $2 million below book value for the 1900Cs and $1.3 million below book value for the 1900Ds. At the time, the company had over 130 1900Cs and nearly 320 1900Ds on and off the balance sheet, making for an estimated exposure of approximately $676 million.

ii. Raytheon's improper disclosures in the first and second quarters of 2001

Despite the substantial information that Raytheon possessed concerning the decline in RAC's commuter aircraft business and the erosion of commuter asset values, the company's first quarter 2001 Form 10-Q did not adequately disclose these adverse views of and developments in RAC's commuter operations, including management's decision to move from a leasing to a cash sales strategy for used commuters. Instead, Raytheon's disclosures in this filing discussed only "commercial" aircraft in general, which covered several other product lines in addition to the commuters. Because these and other disclosures covered all of RAC's "new and used" commercial aircraft, the company did not make adequate disclosure of the negative risks and trends related to the commuters that were known to senior management at the time.

Raytheon's second quarter 2001 Form 10-Q, which was filed one week after the August 2001 commuter summit, also did not adequately disclose the negative risks and trends associated with the company's commuter aircraft. For example, Raytheon only disclosed that RAC's second quarter 2001 "[o]perating income was down primarily due to the lower sales volume and margin pressure on T-6A, Beechjet, and used aircraft due to the current market environment. During 2001, RAC experienced softness in orders for new and used commercial aircraft. The Company remains concerned about the market outlook at RAC. During the second quarter of 2001, RAC responded to a softening market by announcing workforce reductions and adjustments in production rates." These disclosures made no specific mention of "commuter" aircraft and failed to adequately disclose the negative risks and trends concerning the commuters that were known to senior management at the time.

The only disclosure specifically referencing "commuters" in Raytheon's second quarter 2001 filing concerned "[t]he aging on RAC's commuter customer financing receivables [which] has deteriorated over the past year. Non-performance on these loans and leases, in the aggregate, could have a material adverse effect on the Company's liquidity." At this time, senior Raytheon officers had been informed that there were hundreds of millions of dollars of actual and potential losses associated with these receivables based on the analyses that the company's investment bankers had performed and the other information the company had received. Thus, Raytheon failed to adequately disclose the significant declines in the commuter market, recent restructuring of several commuter customers to keep them from defaulting on their notes payable, and the substantial financial repercussions that would follow given the company's recourse obligations to the bank facility.

In both its first and second quarter 2001 filings, Raytheon also made inadequate disclosures about the potential effect of market conditions in its forward-looking statements. In particular, in both Forms 10-Q, Raytheon stated that of the many "[i]mportant factors that could cause actual results to differ" were "the effect of market conditions, particularly in relation to the general aviation and commuter aircraft markets; [and] the impact of recourse obligations of Raytheon Aircraft due to changes in the collateral values of financed aircraft, particularly commuter aircraft." These disclosures, however, failed to provide investors with sufficient information concerning the negative trends and risks associated with the commuters that were known by management at the time. The inclusion of these disclosures in the company's forward-looking statements gave the inaccurate impression that Raytheon was not presently facing any risks associated with its on- and off-balance sheet commuter assets during these time periods.

iii. Raytheon's equity offering

In early 2001, Raytheon turned to the equity markets to raise capital to pay down its debt. In April and May 2001, Raytheon filed a Form S-3 and prospectus supplements in connection with its $3 billion shelf registration and takedown of equity securities. These filings contained materially misleading statements and omissions concerning the commuters because:

> Raytheon's Form S-3 incorporated prior filings by reference and thus repeated the misleading statements from those periodic reports. In addition, Raytheon did not disclose the material and adverse trends and uncertainties that were known to management at the time concerning the commuters. The company's Form S-3 also incorporated by reference "any future filings made by us...until we sell all of the securities." As alleged below, these future filings were also misleading.
>
> In addition, in the forward-looking statements, Raytheon made disclosures about "regional aircraft" and "price pressures within the market" but did not specifically reference commuters by name. Similarly, Raytheon disclosed that "a decline in demand in the market for our aircraft, would have an adverse effect, which may be material, on our financial results," but did not describe the declining commuter market or RAC's deteriorating commuter business. Likewise, in other forward-looking statements, Raytheon disclosed that "[t]he value of our securities may fluctuate as a result of considerations that are difficult to forecast, such as...the impact on recourse obligations at Raytheon Aircraft Company due to changes in the collateral value of financed aircraft...and general economic conditions, particularly the cyclical nature of the general aviation and other commercial markets in which we participate." Raytheon, however, did not specifically mention the known risks posed by the deteriorating state of the

commuter market, RAC's growing inventory of used commuter aircraft, or the over-valued commuter financing receivables that were off the company's balance sheet.

As Raytheon's CEO, Burnham reviewed and approved the inaccurate filings and disclosures set forth above.

iv. Raytheon's improper accounting and disclosures in the third quarter of 2001 and at year-end

Although Raytheon was aware that its on- and off-balance sheet commuter assets were over-valued by hundreds of millions of dollars as of August 31, 2001, it was not until after the terrorist attacks on September 11th that the company began the process of a write down. However, much of the information which management used to estimate fair value for the commuters was "from three weeks earlier or four weeks earlier, in August of 2001.... [N]one of the publicly available data [used in the write-down analysis] were post-September 11th." Senior Raytheon financial officers also considered offers that RAC had received from commuter customers during "the most recent year," even though these officers had previously refused to sell planes for these prices in July 2001 since "these deals could cause a write down of the entire portfolio...." Also, a post-September 11th "top down, market study" upon which Burnham and a senior Raytheon financial officer relied to support the final charge estimated that there was $400 million to $500 million in pre-existing exposure on the commuters as of July 2001. This amount represented roughly 60 to 70 percent of the $693 million charge that was ultimately taken by the company. As the Vice President of Investor Relations informed senior management near completion of the write down, a survey of buy- and sell-side analysts prior to the upcoming earnings call indicated that "defense companies get a free pass this quarter" given recent events. These analysts were further "expecting a $400-500 million charge" on the commuters, and they would be "irritated" with the company "if we do not take this opportunity to adjust these values."

Thus, in the third quarter of 2001, Raytheon stated that it had taken a $693 million loss provision related to RAC's commuter aircraft as "a result of continued weakness in the commuter aircraft market and the impact of the events of September 11, 2001." This misleading statement was repeated in substance in the company's 2001 Form 10-K. Given the charge that the company should have taken at year-end 2000 to properly account for RAC's on- and off-balance sheet commuter assets and the $240 million in commuter reserves that the company planned to build to cover anticipated losses, the $693 million commuter loss provision that Raytheon took in the third quarter of 2001 was materially overstated by at least 10 to 53 percent.

Raytheon also did not disclose that its third quarter 2001 commuter loss provision was largely determined by implementing for the first time a market-based measure of portfolio loss under FAS 140, the successor to FAS 125. Contrary to its public disclosures, the company had previously been calculating its recourse liability obligations on the commuter receivables sold into the credit facility through a pooled, probable loss analysis. In addition, Raytheon did not disclose that certain "excess" non-commuter reserves, such as those related to RAC's parts business and general aviation aircraft, which had previously been used in the Min/Max analysis to off-set under-accruals on the commuters, were not written off in the third quarter of 2001. Instead, these reserves were retained by the company for their original, specified purposes, indicating that they should not have been used to off-set deficiencies in the commuter reserves in prior periods.

As Raytheon's CEO, Burnham reviewed and approved the inaccurate filings and disclosures described above.

3. The Impact of Raytheon's Improper Accounting and Disclosure Practices

As a result of the improper disclosure and accounting practices described above, Raytheon filed at least fifteen quarterly reports, five annual reports, and four registration statements and prospectus supplements that contained materially false and misleading disclosures and financial statements.

D. LEGAL ANALYSIS

Section 17(a)(2) of the Securities Act prohibits a person from obtaining money or property by means of any untrue statement of a material fact or any misleading omission of material fact in the offer or sale of securities. *See* 15 U.S.C. § 77q(a)(2). Section 17(a)(3) of the Securities Act prohibits a person from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities. *See* 15 U.S.C. § 77q(a)(3). Information is material where there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). Establishing a violation of Sections 17(a)(2) and (3) does not require a showing of scienter. *See Aaron v. SEC*, 446 U.S. 680, 701-02 (1980).

Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 require issuers with securities registered under Section 12 to file annual, quarterly, and other reports with the Commission. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Rule 12b-20 further requires the inclusion of any additional material information that is necessary to make required statements, in light of the circumstances under which they were made, not misleading. Information regarding the financial condition of a company is presumptively material. *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985). No showing of scienter is necessary to establish a violation of Section 13(a) or Rules 12b-20, 13a-1, and 13a-13. *See, e.g., Savoy*, 587 F.2d at 1167. Additionally, Item 303 of Regulation S-K requires registrants to disclose "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material ... unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii). The failure to comply with Regulation S-K constitutes a violation of Section 13(a) of the Exchange Act.

Raytheon violated Sections 17(a)(2) and (3) of the Securities Act and Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1 and 13a-13 thereunder. As described above, between 1997 and 2001, Raytheon filed false and misleading periodic reports with the Commission that contained inadequate disclosures and inaccurate financial statements, which materially misstated the company's and RAC's results of operations. Between 1997 and late 1999, Raytheon failed to disclose the improper bill and hold accounting practices that were occurring at RAC, including that such transactions did not comply with GAAP and were resulting in material overstatements of the subsidiary's reported operating results. Between 1997 and 2001, contrary to Item 303 of Regulation S-K, Raytheon failed to fully disclose in its periodic reports material trends and uncertainties associated with the deteriorating state of RAC's commuter aircraft business. Raytheon also failed to make full and complete disclosure concerning its implementation of and compliance with FAS 125, its establishment of $15 million in commuter reserves at year-end 1997, and the company's practice in 1998 and 1999 of creating reserves at RAC that were equal to any FAS 125 gains recognized on the sale of commuter receivables. In 2000 and 2001, Raytheon failed to disclose the deteriorating commuter aircraft market, RAC's declining commuter business, the increasing number of commuter returns, the quarterly transfers of "surplus" pension-related income to RAC, the non-GAAP "pooling" analysis used to test commuter aircraft for impairment, and the components of the "soft landing" plan, such as the reduced cash sale prices for used commuter aircraft and the substantial reduction of the production rate for new 1900Ds. Finally, Raytheon filed at least four registration statements and prospectus supplements between 1997 and 2001, which incorporated by reference the inadequate disclosures and inaccurate financial statements contained in the periodic reports identified above.

Burnham violated Sections 17(a)(2) and (3) of the Securities Act and caused certain of Raytheon's violations of Section 13(a) of the Exchange Act as well as Rules 12b-20, 13a-1, and 13a-13 thereunder, through conduct in 2000 and 2001. As described above, as Raytheon's CEO, Burnham (i) failed to make or ensure full, accurate, and adequate disclosure of the known trends and uncertainties associated with the company's commuter line in Raytheon's public filings for 2000 and 2001, such as the deteriorating state of RAC's commuter business and the various means that the company was taking to address this problem; (ii) failed to ensure that Raytheon properly accounted for the resulting commuter losses that were known and anticipated by management during 2000 and 2001, which led to material misstatements of the company's reported results on both a segment on consolidated basis; and (iii) through such conduct, caused Raytheon's filing of at least six quarterly reports, two annual reports on Forms 10-Q and 10-K, and two sets of registration statements and prospectus supplements for May 2001 and October 2001 offerings that contained inadequate disclosures and inaccurate financial statements.

Servello caused certain of Raytheon's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. As a result of the actions described above, as RAC's Deputy CFO and Controller during 2000, Servello knew or should have known that RAC was not properly accounting for its commuter assets and the mounting losses associated with them. During this time, Servello was also aware that RAC's financial results were flowing through to the company's publicly filed quarterly and annual reports.

Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Section 13(b)(2)(B) of the Exchange Act requires such registrants to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain the accountability of assets. Rule 13b2-1 prohibits the falsification of any book, record, or account subject to Section 13(b)(2)(A). No showing of scienter is necessary to establish violations of these provisions. *See SEC v. McNulty*, No. 94 CIV. 7114 (MBM), 1996 WL 422259, at *7 (S.D.N.Y. July 29, 1996).

Raytheon violated Section 13(b)(2)(A) and (B) of the Exchange Act and Rule 13b2-1 thereunder through the conduct described above. Between 1997 and late 1999, Raytheon and RAC kept materially inaccurate books, records and accounts, and failed to maintain adequate internal controls related to RAC's bill and hold practices during this four-year time period. Between 1997 and 2001, Raytheon kept materially inaccurate books, records and accounts concerning RAC's commuter aircraft that (i) did not maintain individual commuter loss and liability accounts at levels that were consistent with available evidence concerning these contingencies or management's knowledge about the declining value of these assets; (ii) did not record repossessed or returned commuter aircraft at their fair market value; (iii) through improper "pooling" analysis, impermissibly grouped non-homogenous collections of used commuter aircraft for assessment of net realizable value in 2000 and 2001, so that individual units were not reduced to the lower of cost or market; (iv) did not timely or properly record in accordance with GAAP the assets and liabilities associated with its off balance sheet portfolio of commuter financing receivables between 1997 and mid-2001; (v) used reserves established for the commuter assets between 1997 and 2001 in contravention of GAAP; and (vi) established additional commuter reserves at RAC in 2000 and 2001 through the use of "surplus" pension-related income in a manner that was inconsistent with GAAP, and (vii) did not properly reflect losses inherent in a planned "soft landing" of the commuter line. Finally, between 1997 and 2001, Raytheon failed to maintain an adequate system of internal accounting controls related to the proper measurement and recording of commuter asset values and reserve levels, the testing of commuter assets for recoverability and impairment, and the estimation of their fair value for purposes of measuring impairments and loss contingencies.

Burnham caused certain of Raytheon's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder. As described above, during 2000 and 2001, he failed to ensure that the company's commuter assets and liabilities were properly recorded in the company's books and records. He also failed to design and maintain an adequate system of internal controls to ensure that the company properly measured its commuter assets and liabilities.

Servello caused certain of Raytheon's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder. As RAC's Deputy CFO and Controller during 2000, he failed to ensure that the subsidiary's commuter assets and liabilities were properly accounted for in the company's books and records. He also failed to design and maintain an adequate system of internal controls to ensure that Raytheon was properly measuring its commuter assets and liabilities.

Based on the foregoing, the Commission finds that: (i) Raytheon violated Sections 17(a)(2) and (3) of the Securities Act and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder; (ii) Burnham violated Sections 17(a)(2) and (3) of the Securities Act, and caused certain of Raytheon's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act as well as Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder; and (iii) Servello caused certain of Raytheon's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

A. Respondent Raytheon cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act, Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13, and 13b2-1 thereunder;

B. Respondent Burnham cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13, and 13b2-1 thereunder; and

C. Respondent Servello cease and desist from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-13, and 13b2-1 thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54068 / June 29, 2006

INVESTMENT ADVISERS ACT OF 1940
Release No. 2527 / June 29, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12348

In the Matter of **WENDY FELDMAN PURNER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Wendy Feldman Purner ("Respondent" or "Purner").

II.

In anticipation of the institution of these proceedings, Purner has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings and the findings contained in Section III.2. below, which is admitted, Purner consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Purner, age 41, is a resident of Los Angeles, California. From April 1998 to August 2000, Purner was a registered representative associated with a broker-dealer and investment adviser registered with the Commission ("Broker"). From September 2000 through late 2001, Purner operated San Diego Asset Management, Inc. ("SDAM"), an unregistered investment adviser. Purner held a Series 7 license while she was associated with Broker but she allowed that license to lapse after she left Broker. In February 2003, Purner was permanently barred by the National Association of Securities Dealers ("NASD") from associating with any NASD member.

2. On June 27, 2006, a final judgment was entered by consent against Purner, permanently enjoining her from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled, Securities and Exchange Commission v. Wendy Feldman Purner, Civil Action Number 06-cv-01148, in the United States District Court for the District of Columbia.

3. The Commission's complaint alleged, among other things, that:

a. During the period from July 1998 through late 2001, Purner breached the trust of her brokerage customers and investment advisory clients and engaged in fraud when she misappropriated approximately $4,145,000 from her customers at Broker and her clients while associated with SDAM.

b. While associated with Broker and SDAM, Purner received money from her customers and clients to invest and manage. Purner told her customers and clients that she would invest their money in various investment vehicles, including commercial paper, investment partnerships, and common stock. However, Purner did not invest her customers' and clients' money, but rather took it for herself or used it to conceal her withdrawals from the accounts of other customers and clients.

c. Purner concealed her fraud at Broker by creating and mailing false account statements to her customers that described non-existent investments and contained inflated account balances.

d. At SDAM, Purner made materially false oral representations to her clients regarding the nature and value of their investments in order to conceal her misappropriation of the funds that they entrusted to her.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Purner's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Purner be, and hereby is barred from association with any broker, dealer, or investment adviser;

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and the reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8718 / June 30, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54075 / June 30, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2454 / June 30, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12350

In the Matter of Information Architects Corporation, William Overhulser and Michael Clark, Respondents.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Information Architects Corporation ("IACH" or "company"), William Overhulser ("Overhulser") and Michael Clark ("Clark") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, which Respondents admit, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

A. Respondents

1. IACH is a North Carolina corporation with its principal executive office located in Fort Lauderdale, Florida. IACH, a company that provides employment screening and background investigation services, has a class of securities registered with the Commission under Section 12(g) of the Exchange Act and that trade on the Over-the-Counter Bulletin Board.

2. Overhulser, 38, is the former Chief Operating Officer ("COO") and a director of IACH. Overhulser has no known disciplinary history.

3. Clark, 30, is the former president of IACH. Clark has no known disciplinary history.

B. Background

4. On April 6, 2004, IACH filed a Form S-8 regarding the issuance of 14.6 million shares of IACH stock to various consultants, who were contracted to perform services through December 31, 2004. IACH's Form S-8 incorporated by reference subsequent filings of IACH until such time as a post-effective amendment to the S-8 is filed disclosing that all securities offered have been sold or which de-registers all securities that remain unsold. No such amendment was filed during the time period relevant to the events described herein. Therefore, the Form S-8 incorporated the filings described below.

5. On April 22, 2004, IACH filed with the Commission a Form 10-KSB for the year ended December 31, 2003. The Form 10-KSB was signed and certified by Clark, as IACH's president. IACH relied on a non-employee management consultant, Marvin Winick, to prepare and then file the company's public reports. Prior to filing, Winick was to provide draft reports for review by IACH's officers and directors, including Clark and Overhulser. Winick prepared the Form 10-KSB for IACH and included in the filing a Report of Independent Certified Public Accountants dated April 15, 2004, and auditor's consent letter, purportedly signed by an Oklahoma City-based accounting firm ("accounting firm"). In addition, IACH's Form 10-KSB noted that, on August 31, 2003, the company retained the accounting firm to replace its prior auditor, who had resigned.

6. On May 14, 2004, August 16, 2004 and November 18, 2004, IACH filed Forms 10-QSB for the quarterly periods ended March 31, 2004, June 30, 2004 and September 30, 2004, respectively. All of IACH's 2004 quarterly filings were signed and certified by Clark, as president, and Overhulser, as COO. Each filing contains a balance sheet comparing the financial results for the current quarter with those for the year ended December 31, 2003 and designating the 2003 period as "audited."

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[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

7. In October 2004, the managing partner ("auditor") of the accounting firm learned that IACH's Form 10-KSB contained an audit report purportedly issued by the accounting firm. In fact, that accounting firm had neither audited IACH nor provided IACH with an audit report. The auditor immediately confronted Winick about the fictitious audit report. Winick admitted to the auditor that he had included the putative audit report in IACH's Commission filing. The auditor then told Winick to remove the sham report from the filing; Winick assured the auditor that he would take care of it.

8. In a letter dated October 19, 2004, the accounting firm notified IACH and Winick that the firm had not performed the audit referenced in the 2003 Form 10-KSB and demanded that the firm's name be removed as IACH's auditor of record. Until February 2005, IACH took no steps to advise the investing public, in a Form 8-K, press release or by any other means, that the accounting firm performed no audit of its financial statements.

C. Legal Standards

9. Sections 17(a)(2) and 17(a)(3) of the Securities Act proscribe certain fraudulent conduct in the offer and sale of securities. Specifically, Section 17(a)(2) makes it unlawful, in the offer or sale of any securities, for any person to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Similarly, Section 17(a)(3) makes it unlawful, in the offer or sale of any securities, to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon the purchaser. *Scienter* is not required to establish a violation of Section 17(a)(2) or (3). In this case, IACH's Form S-8, described above, was a continuing offer of the sale of securities throughout the relevant time period.

10. Sections 13(a) and Rules 13a-1 and 13a-13 thereunder require issuers with a class of securities registered under Section 12 of the Exchange Act to file with the Commission annual and periodic reports, and Rule 12b-20 of the Exchange Act requires that periodic reports contain all information necessary to ensure that the statements made in them are not materially misleading. It is implicit in these requirements that the information in the reports be accurate. *See SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979).

11. Section 13(b)(2)(A) of the Exchange Act requires issuers to make and keep books, records, and accounts that, in reasonable detail, accurately reflect transactions and asset dispositions, and Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in accordance with Generally Accepted Accounting Principles.

12. Rule 13b2-1 (promulgated under Section 13(b)(2)(A) of the Exchange Act) prohibits any person from, directly or indirectly, falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

13. Exchange Act Rule 13a-14 requires principal executives and financial officers to certify in quarterly and annual Commission filings that, among other things, they have read the filing; that it does not contain any untrue statements, or omissions, of material facts; that the filing fairly presents the financial condition and results of operations and cash flows of the issuer; and that they have disclosed to the audit committee and auditors all significant deficiencies of internal controls of the company. Rule 13a-14 further requires certifying officers to certify that they have, among other things, reviewed the issuers' internal controls.

D. Conclusions

14. As a result of the conduct described above, IACH violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

15. As a result of the conduct described above, Overhulser violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Rules 13a-14 and 13b2-1 of the Exchange Act, and caused IACH's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

16. As a result of the conduct described above, Clark violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Rules 13a-14 and 13b2-1 of the Exchange Act, and caused IACH's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanction agreed to in Respondents' Offer.

Accordingly, it is hereby ORDERED that:

Respondent IACH cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

Respondent Overhulser cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13a-14 and 13b2-1 of the Exchange Act, and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

Respondent Clark cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13a-14 and 13b2-1 of the Exchange Act, and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54072 / June 30, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12349

In the Matter of GIZMO COMPANY, SMART WORLD UNITED INC., AND URBAN ENTERTAINMENT CONCEPTS INTERNATIONAL, INC., Respondents.	ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Gizmo Company, Smart World United Inc., and Urban Entertainment Concepts International, Inc. (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

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A. Respondents

1. Gizmo Company ("Gizmo") (CIK 1142806) is a "blank check" Nevada corporation formed in 2001 with its last known headquarters in Thornhill, Ontario. Gizmo has a class of securities registered with the Commission under Section 12(g) of the Exchange Act. Gizmo is delinquent in its periodic filings, having last filed a periodic report for the period ending March 31, 2003. Gizmo reported assets of $0, liabilities of $545, and a net loss of $1,545, for the three months ended March 31, 2003. Gizmo's securities are not quoted on any U.S. stock exchange.

2. Smart World United Inc. ("Smart World") (CIK 1124402) is a Nevada corporation with its last known headquarters in Thornhill, Ontario, formed to engage in internet related businesses. Smart World has a class of securities registered with the Commission under Section 12(g) of the Exchange Act. Smart World is delinquent in its periodic filings, having last filed a periodic report for the period ended August 31, 2004. Smart World reported assets of $0, liabilities of $3,545, and a net loss of $0, for the year ended August 31, 2004. Smart World's securities are not quoted on any U.S. stock exchange.

3. Urban Entertainment Concepts International, Inc. ("Urban Entertainment") (CIK 1136944) is a Nevada corporation with its last known headquarters in Thornhill, Ontario, formed to develop and engage in a café/marche business. Urban Entertainment has a class of securities registered with the Commission under Section 12(g) of the Exchange Act. Urban Entertainment is delinquent in its periodic filings, having last filed a periodic report for the period ending September 30, 2001. Urban Entertainment reported assets of $545, liabilities of $545, and a net loss of $25,950, for the nine months ended September 30, 2001. Urban Entertainment's securities are not quoted on any U.S. stock exchange.

B. Delinquent Periodic Filings

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act to file periodic and other reports with the Commission. Based on each Respondent's failure to file the required periodic reports, each of the Respondents has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means of instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

In view of the foregoing, the Commission finds that it is necessary and appropriate for the protection of investors to impose the sanction specified in Respondents' Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of securities of Gizmo Company, Smart World United Inc., and Urban Entertainment Concepts International, Inc. registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8719 / June 30, 2006

SECURITIES EXCHANGE ACT OF 1934
Release No. 54076 / June 30, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2455 / June 30, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12351

In the Matter of **Greentech USA, Inc. and** **Roland L. Breton,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Greentech USA, Inc. ("Greentech" or "company") and Roland L. Breton ("Breton") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, which Respondents admit, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

A. Respondents

1. Greentech is a Florida corporation headquartered in Fort Lauderdale, Florida. During the time period relevant here, Greentech, a company engaged in the sale, marketing and rental of portable trade show displays, had a class of securities registered with the Commission under Section 12(g) of the Exchange Act that were traded on the Over-the-Counter Bulletin Board.

2. Roland L. Breton is the president, CEO and a director of Greentech. Breton has no known disciplinary history and is not an officer or director of any other publicly traded company.

B. Background

3. On October 14, 2003, Greentech filed a Form S-8 regarding the issuance of 15.6 million shares to several consultants for various services. Greentech's Form S-8 incorporated by reference subsequent filings of Greentech until such time as a post-effective amendment to the S-8 is filed disclosing that all securities offered have been sold or which de-registers all securities that remain unsold. No such amendment was filed during the time period relevant to the events described herein. Therefore, the Form S-8 incorporated the filings described below.

4. On April 16, 2004, Greentech filed with the Commission a Form 10-KSB for the year ended December 31, 2003. The Form 10-KSB was signed and certified by Breton, as Greentech's CEO and principal accounting and financial officer. Greentech relied on a non-employee management consultant, Marvin Winick, to prepare and then file the company's public reports. Prior to filing, Winick was to provide draft reports for review by Breton. Winick prepared the Form 10-KSB for Greentech and included in the filing an audit report, dated April 15, 2004, purportedly provided by an Oklahoma City-based accounting firm ("accounting firm") and auditor's consent letter, purportedly signed by the accounting firm. In addition, Greentech's Form 10-KSB noted that, on December 1, 2003, the company retained the accounting firm to replace its prior auditor, who had resigned.

5. On May 19, 2004, August 19, 2004 and November 26, 2004, Greentech filed Forms 10-QSB for the quarterly periods ended March 31, 2004, June 30, 2004 and September 30, 2004, respectively. All of Greentech's 2004 quarterly filings were signed and certified by Breton, as CEO and principal financial and accounting officer. Each filing contains a balance sheet comparing the financial results for the current quarter with those for the year ended December 31, 2003 and designating the 2003 period as "audited."

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[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

6. In October 2004, the managing partner ("auditor") of the accounting firm learned that Greentech's Form 10-KSB contained the accounting firm's purported audit report. In fact, the accounting firm neither audited Greentech nor provided Greentech with an audit report. The auditor immediately confronted Winick about the fictitious audit report. Winick admitted to the auditor that he had included the accounting firm's audit report in Greentech's Commission filing. The auditor then told Winick to remove the sham report from the filing; Winick assured the auditor that he would take care of it.

7. In a letter dated October 19, 2004, the accounting firm notified Greentech and Winick that the firm had not performed the audit referenced in the 2003 Form 10-KSB and demanded that the firm's name be removed as Greentech's auditor of record. Greentech took no steps until February 2005 to advise the investing public, in a Form 8-K, press release or by any other means, that the accounting firm performed no audit of its financial statements.

C. Legal Standards

8. Sections 17(a)(2) and 17(a)(3) of the Securities Act proscribe certain fraudulent conduct in the offer and sale of securities. Specifically, Section 17(a)(2) makes it unlawful, in the offer or sale of any securities, for any person to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Similarly, Section 17(a)(3) makes it unlawful, in the offer or sale of any securities, to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon the purchaser. *Scienter* is not required to establish a violation of Section 17(a)(2) or (3). In this case, Greentech's Form S-8, described above, was a continuing offer of the sale of securities throughout the relevant time period.

9. Sections 13(a) and Rules 13a-1 and 13a-13 thereunder require issuers with a class of securities registered under Section 12 of the Exchange Act to file with the Commission annual and periodic reports, and Rule 12b-20 of the Exchange Act requires that periodic reports contain all information necessary to ensure that the statements made in them are not materially misleading. It is implicit in these requirements that the information in the reports be accurate. *See SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979).

10. Section 13(b)(2)(A) of the Exchange Act requires issuers to make and keep books, records, and accounts that, in reasonable detail, accurately reflect transactions and asset dispositions, and Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in accordance with Generally Accepted Accounting Principles.

11. Rule 13b2-1 (promulgated under Section 13(b)(2)(A) of the Exchange Act) prohibits any person from, directly or indirectly, falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

12. Exchange Act Rule 13a-14 requires principal executives and financial officers to certify in quarterly and annual Commission filings that, among other things, they have read the filing; that it does not contain any untrue statements, or omissions, of material facts; that the filing fairly presents the financial condition and results of operations and cash flows of the issuer; and that they have disclosed to the audit committee and auditors all significant deficiencies of internal controls of the company. Rule 13a-14 further requires certifying officers to certify that they have, among other things, reviewed the issuers' internal controls.

D. Conclusions

13. As a result of the conduct described above, Greentech violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

14. As a result of the conduct described above, Breton violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13a-14 and 13b2-1 of the Exchange Act, and caused Greentech's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanction agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

Respondent Greentech cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

Respondent Breton cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Rules 13a-14 and 13b2-1 of the Exchange Act, and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54085; File No. 10-131)

June 30, 2006

Order Modifying a Condition to Operation as a National Securities Exchange of the Nasdaq Stock Market LLC

I. Introduction

On January 13, 2006, the Securities and Exchange Commission ("Commission") granted registration of the Nasdaq Stock Market LLC ("Nasdaq Exchange") as a national securities exchange.[1] At the same time, the Commission conditioned the Nasdaq Exchange's operation as an exchange on the satisfaction of six specific requirements. The Commission is modifying in this Order the condition requiring the NASD to represent to the Commission that it no longer needs to control the Nasdaq Stock Market, Inc. ("Nasdaq"), the Nasdaq Exchange's parent company, through the Preferred D share because the NASD can fulfill through other means its obligations with respect to non-Nasdaq exchange listed securities under Section 15A(b)(11) of the Securities Exchange Act of 1934 ("Exchange Act"),[2] Rules 602 and 603 of Regulation NMS,[3] and the national market system plans in which it participates (the "Control Share Condition "). This condition reflected the Nasdaq Exchange's intent to begin trading at the same time Nasdaq UTP Plan Securities and CTA Plan Securities.[4]

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1 See Exchange Act Release No. 53128, 71 FR 3550 (January 23, 2006) ("Nasdaq Exchange Order").

2 15 U.S.C. 78o-3(b)(11).

3 17 CFR 242.602 and 603.

4 Transactions are reported pursuant to two national market system plans: Nasdaq-listed securities are reported to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an

The Nasdaq Exchange would now prefer to commence trading Nasdaq UTP Plan Securities and CTA Plan Securities in two separate phases. Accordingly, by letter dated March 31, 2006, the Nasdaq Exchange requested that the Commission modify the Control Share Condition to allow it to begin operating as an exchange with regard to Nasdaq UTP Plan Securities before the Control Share Condition is satisfied.[5] As discussed further below, the Commission is granting the Nasdaq Exchange's request. Until the Control Share Condition is satisfied, however, the NASD must retain control of Nasdaq through the Preferred D share, and Nasdaq must continue to perform obligations under the NASD's Plan of Allocation and Delegation of Functions by NASD to Subsidiaries ("Delegation Plan") with respect to CTA Plan Securities. Satisfaction of the condition would continue to be a prerequisite to the Nasdaq Exchange trading CTA Plan Securities.

II. Discussion

As discussed in the Nasdaq Exchange Order,[6] the NASD plans to remain a member of the Intermarket Trading System ("ITS Plan") for the purpose of providing access to over-the-counter ("OTC") quotes in CTA Plan Securities communicated by its members through NASD facilities and to provide its members access to exchanges' quotes in such securities. The Control Share Condition is necessary because the NASD

Unlisted Trading Privileges Basis ("Nasdaq UTP Plan Securities"); securities listed on other national securities exchanges are reported to the Consolidated Transaction Association Plan ("CTA Plan Securities"). Approximately 40 securities are dually-listed on Nasdaq and the New York Stock Exchange LLC. Transactions in these securities are reported to the CTA Plan and thus are CTA Plan Securities.

5 See letter to Nancy M. Morris, Secretary, Commission, from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, dated March 31, 2006.

6 See Nasdaq Exchange Order, supra note 1.

and its members currently comply with their obligations under the ITS Plan through the NASD's Nasdaq Market Center facility.

In addition, with respect to CTA Plan Securities, NASD facilities owned by Nasdaq currently are the NASD's only means available to fulfill its obligations under Exchange Act Rules 602 and 603,[7] the CTA Plan, CQ Plan, and Section 15A(b)(11) of the Exchange Act.[8] Therefore, the NASD must have the means to satisfy these obligations prior to relinquishing control of Nasdaq.

The Nasdaq Exchange represented that the technology solutions to allow the NASD to fulfill its obligations with respect to CTA Plan Securities through means that would not involve a delegation of regulatory authority to Nasdaq are not completed.[9] In addition, the Nasdaq Exchange represented that many of its prospective members have indicated that a phased-in approach to the Nasdaq Exchange's operation would be preferable. Specifically, according to the Nasdaq Exchange, these firms believe that a single-day transition would entail unnecessary costs and administrative burdens and pose transition risks that could be mitigated through a phased approach.

The Commission believes that a phased-in implementation of the operation of the Nasdaq Exchange is consistent with the Exchange Act and may allow for a more smooth transition. Accordingly, the Commission believes that it is necessary or appropriate in the public interest, consistent with the protection of investors and consistent with the requirements of Exchange Act, and the rules and regulations thereunder applicable to

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7 17 CFR 242.602 and 603.

8 15 U.S.C. 78o-3(b)(11).

9 The Commission notes that the NASD operates the Alternative Display Facility ("ADF"), which currently collects quotes and trades for Nasdaq UTP Plan Securities, but not for CTA Plan Securities.

Nasdaq Exchange to modify the Control Share Condition to the Nasdaq Exchange Order as follows:

First, the requirement that the NASD represent that "control of Nasdaq through the Preferred D share is no longer necessary because the NASD can fulfill through other means its obligations with respect to [CTA Plan Securities] under Section 15A(b)(11) of the Exchange Act,[10] Rules 602 and 603 of Regulation NMS,[11] and the national market system plans in which the NASD participates" is modified so as to be a condition only with respect to the Nasdaq Exchange commencing to trade CTA Plan Securities. This will allow the Nasdaq Exchange to begin operations as a national securities exchange solely for Nasdaq UTP Plan securities before the Control Share Condition is satisfied.

Second, the Control Share Condition is modified to permit the Nasdaq Exchange to commence trading Nasdaq UTP Plan Securities once Nasdaq is no longer delegated regulatory authority under the Delegation Plan with respect to such securities. The modification of the Control Share Condition described above means that the Nasdaq Exchange would commence trading in Nasdaq UTP Plan Securities while the NASD controls Nasdaq. The Commission believes, however, that it would be inappropriate for the Nasdaq Exchange to commence trading in Nasdaq UTP Plan Securities while its parent company continued to be delegated regulatory authority by the NASD with respect to the same activities. Accordingly, the Commission would have to approve an amendment to the NASD's Delegation Plan to reflect that Nasdaq would no longer be delegated regulatory authority with regard to Nasdaq UTP Securities prior to the Nasdaq Exchange commencing to trade Nasdaq UTP Plan Securities.

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10 15 U.S.C. 78o-3(b)(11).

11 17 CFR 242.602 and 603.

III. Modification of Conditions to Operation

The Commission notes that all of the other conditions set forth in the Nasdaq Exchange Order remain and must be satisfied before the Nasdaq Exchange can begin operations as an exchange.

The Commission hereby replaces the Control Share Condition to operation of the Nasdaq Exchange as a national securities exchange as follows:

B. The NASD's Ability to Fulfill its Statutory and Regulatory Obligations.

(1) With respect to the Nasdaq Exchange commencing to trade securities reported pursuant to the Nasdaq UTP Plan, the NASD's Delegation Plan is amended to eliminate Nasdaq's exercise of regulatory authority with respect to such securities.

(2) With respect only to the Nasdaq Exchange commencing to trade securities reported pursuant to the CTA Plan, the NASD must represent to the Commission that control of Nasdaq through the Preferred D share is no longer necessary because the NASD can fulfill through other means its obligations with respect to securities reported to the CTA Plan under Section 15A(b)(11) of the Exchange Act, Rules 602 and 603 of Regulation NMS, and the national market system plans in which the NASD participates.

IV. Conclusion

IT IS ORDERED that the Control Share Condition to operation for the Nasdaq Exchange is modified as described herein.

By the Commission.

J. Lynn Taylor
Assistant Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54084; File No. SR-NASD-2005-087)

June 30, 2006

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Relating to Amendments to the NASD's Rules Following the Nasdaq Exchange's Operation as a National Securities Exchange for Nasdaq UTP Plan Securities

I. Introduction

On July 11, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend various NASD rules to reflect the Nasdaq Stock Market, Inc.'s ("Nasdaq") separation from the NASD following the commencement of operations of the Nasdaq Stock Market LLC ("Nasdaq Exchange") as a national securities exchange.

Prior to 2000, Nasdaq was wholly-owned by the NASD. The NASD currently retains voting control of Nasdaq through an outstanding share of Nasdaq Series D preferred stock.[3] The NASD and Nasdaq began restructuring their relationship in 2000

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 The share of Series D preferred stock gives the NASD the right to cast one more than one-half of all votes entitled to be cast at an election by all holders of capital stock of Nasdaq. When Nasdaq ceases to operate pursuant to the NASD's Plan of Allocation and Delegation of Functions by NASD to Subsidiaries (the "Delegation Plan"), the Series D preferred share will expire automatically. See Securities Exchange Act Release No. 53022 (December 23, 2005), 70 FR 77433 (December 30, 2005). To reflect this change, the NASD will file a proposed rule change to revise the Delegation Plan to remove references to Nasdaq as a subsidiary of the NASD. Because this change to the Delegation Plan would terminate the NASD's control under the Series D preferred share, the NASD

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with the goal of completely separating Nasdaq from the NASD. As part of this restructuring, Nasdaq filed with the Commission an application to register one of its subsidiaries, the Nasdaq Exchange, as a national securities exchange.[4]

The Commission approved the Nasdaq's Exchange's registration as a national securities exchange on January 13, 2006.[5] In the Nasdaq Exchange Order, the Commission conditioned the Nasdaq Exchange's operation as a national securities exchange on the satisfaction of certain enumerated requirements. The Nasdaq Exchange Order and the conditions therein reflected the Nasdaq Exchange's intentions to begin operations as a national securities exchange for CTA Plan Securities as well as securities listed on Nasdaq and reported to the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("Nasdaq UTP Plan Securities").

The Commission modified the conditions set forth in the Nasdaq Exchange Order on June 30, 2006, to allow the Nasdaq Exchange to operate as a national securities

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cannot file this proposed rule change until it can represent to the Commission that its control of Nasdaq is no longer necessary because the NASD can fulfill through other means its obligations with respect to securities reported to the Consolidated Transaction Association Plan ("CTA Plan Securities"). See Order Modifying Nasdaq Exchange Conditions, infra note 6.

4 In connection with the Nasdaq Exchange registration, Nasdaq became a holding company with the Nasdaq Exchange as its wholly-owned subsidiary.

5 See Securities Exchange Act Release No. 53128, 71 FR 3350 (January 23, 2006) ("Nasdaq Exchange Order").

exchange solely with respect to Nasdaq UTP Plan Securities.[6] During this period, the NASD will continue to control Nasdaq through the Series D preferred share and Nasdaq will continue to perform obligations under the Delegation Plan with respect to CTA Plan Securities. Accordingly, the NASD filed Amendment No. 1 to modify the proposed rule change to reflect the Nasdaq Exchange's operational plan.

II. NASD Proposal

In the proposed rule change, the NASD proposed to: (1) delete certain NASD rules that pertain to the operation of the Nasdaq Exchange and thus reflect Nasdaq's separation from the NASD;[7] (2) modify certain NASD rules to clarify the NASD's continued regulation of the over-the-counter ("OTC") market upon the Nasdaq Exchange's operation as an exchange;[8] (2) amend the NASD's Order Audit Trail System ("OATS") to reflect the use of OATS by Nasdaq Exchange members;[9] (3) make technical and clarifying changes to the rules governing the NASD's Alternative Display Facility ("ADF");[10] and (4) establish rules governing the NASD's proposed new trade reporting facility ("Trade Reporting Facility").[11]

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6 See Securities Exchange Act Release No. 54085 (June 30, 2006) ("Order Modifying Nasdaq Exchange Conditions").

7 See infra note 44 and accompanying section.

8 See infra notes 46-53 and accompanying text.

9 See infra note 55 and accompanying text.

10 See infra notes 77-84 and accompanying section.

11 See infra notes 85-101 and accompanying text.

The proposed rule change was published for comment in the Federal Register on July 22, 2005.[12] The Commission received 14 comment letters from 12 commenters regarding the proposal.[13] On November 23, 2005, and May 3, 2006, the NASD submitted responses to the comment letters.[14]

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12 See Securities Exchange Act Release No. 52049 (July 15, 2005), 70 FR 42398 (July 22, 2005).

13 See letters to Jonathan G. Katz, Secretary, Commission, from Mary Yeager, Assistant Secretary, New York Stock Exchange, Inc. ("NYSE"), dated August 12, 2005 ("NYSE Letter I") and November 10, 2005 ("NYSE Letter II"); Edward S. Knight, Executive Vice President and General Counsel, Nasdaq, dated October 13, 2005 ("Nasdaq Letter"); John Boese, Vice President and Chief Regulatory Officer, Boston Stock Exchange, Inc. ("BSE"), dated November 4, 2005 ("BSE Letter"); and Kevin J.P. O'Hara, Chief Administrative Officer and General Counsel, Archipelago Holdings, Inc. ("Archipelago"), dated November 10, 2005 ("Archipelago Letter"); letters to The Honorable Christopher Cox, Chairman, Commission, from Bart J. Ward, Chief Executive Officer, Ward & Company, dated February 10, 2006 ("Ward Letter"); John A. Thain, Chief Executive Officer, NYSE Group, Inc., dated April 27, 2006 ("NYSE Letter III"). See also letters to The Honorable Christopher Cox, Chairman, Commission, from The Honorable Geoff Davis, U.S. House of Representatives, dated February 9, 2006 ("Davis Letter"); The Honorable Melissa L. Bean, U.S. House of Representatives, dated January 16, 2006 ("Bean Letter"); The Honorable Edolphus Towns, U.S. House of Representatives, dated January 12, 2006 ("Towns Letter"); The Honorable Michael E. Capuano, U.S. House of Representatives, dated January 3, 2006 ("Capuano Letter"); The Honorable Patrick T. McHenry, U.S. House of Representatives, dated December 22, 2005 ("McHenry Letter"); The Honorable Jim Gerlach, U.S. House of Representatives, dated December 14, 2005 ("Gerlach Letter"); and The Honorable Richard H. Baker, Chairman, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, U.S. House of Representatives, dated December 13, 2005 ("Baker Letter"). The comment letters are available in the Commission's Public Reference Room and on the Commission's Internet Web site (http://www.sec.gov). The Commission notes that the Archipelago Letter and NYSE Letter II also were submitted as comment letters in response to the Nasdaq Exchange's application to register as a national securities exchange.

14 See letter to Jonathan G. Katz, Secretary, Commission, from Barbara Z. McSweeney, Senior Vice President and Corporate Secretary, NASD, dated November 23, 2005 ("NASD Response Letter I"); letter to the Honorable Christopher Cox, Chairman, Commission from Robert R. Glauber, Chairman and Chief Executive Officer, NASD, dated May 2, 2006 ("NASD Response Letter II").

The NASD filed Amendment No. 1 to the proposal on June 15, 2006. In addition to making several technical corrections and conforming changes,[15] the NASD proposes in Amendment No. 1 to revise its proposal to: (1) amend the Delegation Plan to retain the delegation to Nasdaq of obligations with respect to CTA Plan Securities, while eliminating Nasdaq's regulatory authority with respect to Nasdaq UTP Plan Securities;[16] (2) amend the Nasdaq Bylaws to reflect changes that were approved in the Nasdaq Exchange Order;[17] (3) retain amended versions of the rules governing Nasdaq's BRUT and INET trading systems;[18] (4) provide that members may continue to quote and trade CTA Plan Securities and participate in the Intermarket Trading System ("ITS") through an NASD facility by retaining in the NASD's rules revised versions of relevant rules;[19] (5) revise an existing NASD rule to make clear that certain securities that will be listed on the Nasdaq Exchange will continue to be treated as CTA Plan Securities;[20] and (6) delete

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15 For example, the NASD proposes to: (1) revise NASD Rule 5100, "Short Sale Rule," to indicate that the NASD's Short Sale Rule will continue to operate as a pilot program; (2) retain the NASD Rule 9700 Series, "Procedures on Grievances Concerning the Automated Systems" for appeals of OTC Bulletin Board eligibility determinations and retain NASD Rule 11890, "Clearly Erroneous Transactions," and IM-11890-1 and IM-11890-2; (3) make additional technical changes to the ADF Rules; (4) incorporate NASD rules that have been approved since the NASD filed the proposal; (5) clarify the termination provision in the Trade Reporting Facility LLC agreement to correctly reflect that Nasdaq is not registered as a self-regulatory organization ("SRO"); and (6) retain references to Nasdaq in NASD's Delegation Plan, bylaws and rules to reflect that Nasdaq remains a controlled subsidiary.

16 See infra notes 40-41 and accompanying text.

17 See infra note 42 and accompanying text.

18 See infra notes 72-74 and accompanying text.

19 See infra notes 58-70 and accompanying text.

20 See infra note 57 and accompanying text.

from NASD Rule 6120 a provision allowing a national securities exchange that trades Nasdaq securities on an unlisted trading privileges basis ("UTP Exchange") to participate in the Trade Reporting Facility. In addition, the NASD has requested that this proposal become effective only when the Nasdaq Exchange begins operations as a national securities exchange for Nasdaq UTP Plan Securities.

Finally, in Amendment No. 1, the NASD also proposed to renumber NASD Rule 6440(i) as NASD Rule 5110, "Transactions Related to Initial Public Offerings" and to extend its application to transactions in Nasdaq UTP Plan Securities.

After careful consideration and for the reasons discussed below, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the NASD, and, in particular, with the requirements of Sections 15A(b)(2), (6), and (11) of the Exchange Act.[21] Section 15A(b)(2) of the Exchange Act requires a registered national securities association to be so organized and have the capacity to be able to carry out the purposes of the Exchange Act. Section 15A(b)(6) of the Exchange Act requires that the rules of a registered national securities association be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, to remove impediments to and protect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

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21 15 U.S.C. 78o-3(b)(2), (6), and (11). In approving the proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

Section 15A(b)(11) of the Exchange Act requires that the rules of a registered national securities association be designed to produce fair and informative quotations, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting, distributing, and publishing quotations.

In addition, the Commission is publishing notice to solicit comments on, and is simultaneously approving, on an accelerated basis, Amendment No. 1. Many of the changes proposed in Amendment No. 1 reflect the new implementation strategy for the Nasdaq Exchange and are necessary for the NASD to fulfill its obligations under the Exchange Act with regard to CTA Plan Securities.

Specifically, the NASD proposes to retain its rules that govern its members' quoting, trading, and transaction reporting of CTA Plan Securities and its ITS rules related to the NASD's and its members' compliance with the requirements of the ITS Plan. In this regard, in Amendment No. 1, the NASD proposes to retain the portions of the NASD's Rule 4700 Series relating to the NASD's participation in the ITS Plan. The NASD also proposes to amend the Rule 4700 Series to delete rules that relate to the operation of the Nasdaq Market Center trading system, while retaining the current rules that relate to the operation of the SuperIntermarket functionality, which facilitates NASD members' compliance with the ITS Plan. In addition, the NASD proposes to retain its Rule 6300 Series and Rule 5200 Series, which, among other things, allow NASD members to enter quotations in CTA Plan Securities by registering as Consolidated Quote System ("CQS") market makers and as ITS/Computer Assisted Execution System ("ITS/CAES") market makers. Finally, the NASD proposes to retain its 6400 Series, which governs the reporting of transactions in CTA Plan Securities that do not occur in the SuperIntermarket. The retention of these rules, with changes that reflect the Nasdaq Exchange's operation as an exchange for Nasdaq UTP Plan Securities, maintains the current framework for OTC trading of CTA Plan Securities. Accordingly, the Commission finds good cause to accelerate approval of these changes.

To reflect the new implementation strategy of the Nasdaq Exchange, in Amendment No. 1, the NASD proposes to retain in the NASD's rules the Nasdaq By-Laws and, rather than remove all references to Nasdaq in the Delegation Plan, to only eliminate Nasdaq's responsibility under the Delegation Plan with respect to Nasdaq UTP Plan Securities. By retaining references to Nasdaq in the Delegation Plan, the NASD retains control over Nasdaq pursuant to the Series D preferred share.[22] The Commission finds good cause to accelerate approval of these changes to the Delegation Plan because they allow Nasdaq to continue to perform the same functions it does today regarding CTA Plan Securities and appropriately limit Nasdaq's delegated authority once it begins operations as a national securities exchange so that it will not be delegated responsibility regarding OTC activities in Nasdaq UTP Plan Securities. Further, these changes ensure that the NASD retains control over Nasdaq so that the NASD will have the means by which to fulfill its obligations through the use of Nasdaq systems with regard to CTA Plan Securities.

In addition, the NASD proposes, in Amendment No. 1, to retain the rules that govern executions of CTA Plan Securities on BRUT and INET. The Commission finds good cause to accelerate approval of these changes because these systems must continue

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22 See supra note 3.

to operate pursuant to NASD rules until the Nasdaq Exchange begins trading CTA Plan Securities.

Finally, the NASD proposes to amend NASD Rule 4400 relating to securities that are dually listed on the NYSE and the Nasdaq Exchange. The revised rule, which reflects language currently found in NASD IM-4400, makes clear that these dually listed securities will continue to be treated as CTA Plan Securities under the NASD's rules and applicable national market system plans. The Commission finds good cause to accelerate approval of this change because it will ensure that these securities are handled in the same manner as they are today.

In Amendment No. 1, the NASD proposes to renumber NASD Rule 6440(i) as NASD Rule 5110 and to extend its application to Nasdaq UTP Plan Securities. This rule prohibits members from executing transactions in securities that are subject to an initial public offering until such security has opened for trading on the listing exchange, which is indicated by the dissemination of an opening transaction by the listing exchange via the Consolidated Tape.[23] The Commission finds good cause to accelerate approval of extending this rule to Nasdaq UTP Plan Securities because it will result in uniform regulation of securities that are subject to an initial public offering.

In Amendment No. 1, the NASD also proposes to retain the NASD Rule 9700 Series, relating to grievances concerning automated systems, and NASD Rule 11890, relating to clearly erroneous transactions. Because the NASD will continue to operate the

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23 The Commission notes that the NASD committed to file a proposed rule change to amend this rule to reflect that transactions in Nasdaq UTP Plan Securities are reported to the Nasdaq UTP Plan. Telephone call between Kelly Riley, Assistant Director, Division of Market Regulation ("Division), Commission and Lisa Horrigan, Assistant General Counsel, NASD on June 28, 2006.

OTC Bulletin Board ("OTCBB"), it must retain the NASD Rule 9700 Series, which governs the review of requests for OTCBB eligibility determinations. Accordingly, the Commission finds good cause to accelerate approval of NASD's proposal to retain this rule. The Commission notes that the NASD only proposed to eliminate reference to a Nasdaq committee that is currently required in the NASD Rule 9700 Series. The NASD replaced the Nasdaq committee with an NASD committee designated by the Board that must be comprised of at least 50% non-industry committee members. The current Nasdaq committee requires at least five non-industry members on its committee that may consist of between 8 and 18 members. The Commission finds good cause to accelerate approval of this change because it reflects the NASD's responsibility over the OTCBB.

The NASD also proposes to retain amended paragraph (a) of Rule 11890 so that its application will be limited to transactions in CTA Plan Securities. The NASD originally proposed to delete this rule, which provides Nasdaq with authority to review any transaction arising from the use of any execution or communication system owned or operated by Nasdaq. After the Nasdaq Exchange commences operations as an exchange for Nasdaq UTP Plan Securities, the only communication systems of the NASD that will be covered by Rule 11890(a) will be the SuperIntermarket, BRUT, and INET. Accordingly, the Commission finds good cause to accelerate approval of this change that limits Nasdaq's authority under this rule to CTA Plan Securities.

With regard to the Trade Reporting Facility, the NASD proposes in Amendment No. 1 to delete the provision in NASD Rule 6120 that would have allowed a UTP Exchange to participate in the Trade Reporting Facility. This provision is unnecessary because a UTP Exchange would not require a means for reporting internalized trades.

Accordingly, the Commission finds good cause to accelerate the deletion of this provision. The NASD also proposes to amend the termination provision of the Trade Reporting Facility LLC agreement to reflect that Nasdaq is not a registered SRO. The Commission finds good cause to accelerate approval of this change because the agreement, as amended, accurately reflects Nasdaq's status.

In Amendment No. 1, the NASD also proposes several technical changes. For example, the NASD proposes to indicate that its Short Sale Rule is a pilot. In addition, the NASD proposes to incorporate rule changes that have been approved or have otherwise become effective since it filed its proposed rule change. The Commission finds good cause to accelerate approval of these changes so that the proposal accurately reflects the NASD's current rules.

Finally, the NASD proposes that its proposed rule change become effective upon the operation of the Nasdaq Exchange as an exchange for Nasdaq UTP Plan Securities. The Commission finds good cause to accelerate approval of this proposal because the NASD must retain its current rules until such time as the Nadsaq Exchange begins operation for Nasdaq UTP Plan Securities in order to continue to fulfill its obligations under the Exchange Act.

For the reasons discussed above, the Commission finds good cause for approving Amendment No. 1 to the proposal prior to the 30th day after the date of publication of notice of filing thereof in the Federal Register. Accordingly, the Commission finds that it is consistent with Sections 15A(b)(6) and 19(b)(2) of the Exchange Act[24] to approve Amendment No. 1 on an accelerated basis.

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[24] 15 U.S.C. 78o-3(b)(6) and 15 U.S.C. 78s(b)(2).

III. Discussion

A. The NASD's Obligations Under the Exchange Act and Commission Rules

The NASD is a registered national securities association and SRO. One of its statutory obligations as a registered national securities association is to supervise the activities of its members that occur otherwise than on an exchange. In particular, Section 15A(b)(11) of the Exchange Act requires the NASD to have rules that govern the "form and content of quotations relating to securities sold otherwise than on a national securities exchange . . . ."[25] These rules also must be designed to produce fair and informative quotations and to promote orderly procedures for collecting, distributing, and publishing quotations.[26] Rule 602 of Regulation NMS also requires the NASD to collect bids, offers, quotation sizes, and aggregate quotation sizes from those members who are responsible broker or dealers.[27] The NASD must then make available to vendors, at all times when last sale information is reported, information about the best bids, best offers, and quotation sizes communicated otherwise than on an exchange by its members that act as OTC market makers, and their identity.

Rule 601 of Regulation NMS[28] requires the NASD to file a transaction reporting plan regarding transactions in listed equity and Nasdaq securities that are executed by its members otherwise than on a national securities exchange.[29] Under Rule 603 of

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25 15 U.S.C. 78o-3(b)(11).

26 Id.

27 17 CFR 242.602.

28 17 CFR 242.601.

29 Under Rule 601(b) of Regulation NMS, broker-dealers are prohibited from executing a transaction otherwise than on a national securities exchange unless there is an effective transaction reporting plan. New NASD Rule 5000 requires

Regulation NMS,[30] national securities exchanges and national securities associations act jointly pursuant to an effective national market system plan to disseminate consolidated information, including a national best bid and offer, and quotations for and transactions in NMS stocks.

The means by which the NASD complies with these requirements today is through operation of its Nasdaq facility[31] and the ADF,[32] and by participating in the Consolidated Quotation System Plan ("CQ Plan") and CTA Plan for CTA Plan Securities, and the Nasdaq UTP Plan for Nasdaq UTP Plan Securities.

NASD members to report transactions in exchange-listed securities effected otherwise than on an exchange to the NASD.

30 17 CFR 242.603.

31 Nasdaq systems collect quotations and transaction reports from NASD members, including registered market makers and electronic communication networks ("ECNs"), for both Nasdaq UTP Plan Securities and CTA Plan Securities. The quotations and transaction reports in Nasdaq UTP Plan Securities are reported by Nasdaq systems to the Nasdaq UTP Plan, pursuant to the NASD's participation in the plan for dissemination to vendors. The quotations and transaction reports in CTA Plan Securities are reported by Nasdaq systems to the CQ and CTA Plans, pursuant to the NASD's participation in these plans for dissemination to vendors.

32 See Securities Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002) (File No. SR-NASD-2002-97) (order approving the ADF on a pilot basis). See also Securities Exchange Act Release No. 53699 (April 21, 2006), 71 FR 25271 (April 28, 2006) (notice of filing and immediate effectiveness of File No. SR-NASD-2006-050) (extending the ADF pilot program through January 26, 2007). The ADF was developed to provide NASD members with an alternative to the Nasdaq systems for the reporting of quotations and transaction reports in Nasdaq UTP Plan Securities. These quotations and trade reports are provided to the Nasdaq UTP Plan for dissemination to vendors.

The NASD proposes to continue to operate the ADF for the collection of quotes and transaction reports in Nasdaq UTP Plan Securities.[33] In addition, the NASD's rules will continue to provide for the collection of quotes and transaction reports in CTA Plan Securities.[34] Nasdaq systems, however, are currently the exclusive means by which NASD members enter quotations and report trades in CTA Plan Securities. Under the proposal, as amended, the NASD will continue, via its delegation to Nasdaq, to use Nasdaq systems for collecting quotations and transaction reports in CTA Plan Securities.

Finally, Rule 608 of Regulation NMS requires the NASD to comply with and enforce compliance with the terms of each national market system plan of which it is a sponsor or participant.[35] In addition to the CQ Plan, CTA Plan and Nasdaq UTP Plan, the NASD is a member of the ITS Plan. The ITS Plan contains the rules pursuant to which ITS Participants interact and contains a trade-through rule.[36] Accordingly, most OTC transactions in CTA Plan Securities regulated by the NASD are subject to the requirements of the ITS Plan. The NASD expects to remain a member of the ITS Plan for the purpose of providing access to OTC quotations communicated by its members

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33 See NASD Rule 4000A Series and Rule 5000 Series. As discussed more fully below, transaction reports for Nasdaq UTP Plan Securities also may be submitted to the new Trade Reporting Facility.

34 See NASD Rules 4000 Series, 4700 Series, 5000 Series, 5200 Series, 6300 Series, and 6400 Series.

35 17 CFR 242.608(c).

36 In June 2005, the Commission adopted Regulation NMS, which included the new Rule 611. 17 CFR 242.611. This rule requires a trading center to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs of protected quotations in NMS stocks. Rule 611 became effective on August 29, 2005; compliance with this rule has been extended to a series of five dates beginning on October 16, 2006. See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 100 (May 24, 2006).

through NASD facilities and to provide its members with access to exchanges' quotations.

Current NASD rules reflect the NASD's participation in the ITS Plan.[37] In Amendment No. 1, the NASD also proposes to retain the rules that allow its members to enter quotations in CTA Plan Securities by registering as CQS market makers[38] and ITS/CAES market makers.[39] Accordingly, as discussed further below, the Commission finds that these rules, as amended, are consistent with Section 15A(b)(11) of the Exchange Act and the Commission also believes that these changes should enable the NASD to satisfy its obligation under Rule 602 of Regulation NMS.

B. Changes to the NASD's Governing Documents

The proposal, as amended, revises the Delegation Plan to eliminate Nasdaq's responsibility for operating the OTC market for Nasdaq UTP Plan Securities, while continuing to delegate to Nasdaq the responsibility for operating the OTC market for CTA Plan Securities.[40] This change to the Delegation Plan will accurately reflect the

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37 See NASD Rule 5200 Series and 4700 Series.

38 See NASD Rule 6320.

39 See NASD Rule 5220.

40 Among other things, the Delegation Plan, as amended, delegates to Nasdaq the responsibility for: (1) operating the OTC market for CTA Plan Securities and the automated systems supporting it; (2) providing and maintaining a telecommunications network infrastructure linking market participants for the efficient processing and handling of quotations, orders, transaction reports, and comparisons of transactions in the OTC market for CTA Plan Securities; (3) developing and adopting rules applicable to the collection, processing, and dissemination of quotation and transaction information for securities traded in the OTC market for CTA Plan Securities; (4) developing and adopting other rules and policies for the OTC market for CTA Plan Securities; and (5) establishing standards for participation in the OTC market for CTA Plan Securities. See Delegation Plan, Section III, A.1.

scope of the delegation to Nasdaq after the Nasdaq Exchange begins to operate as a national securities exchange for Nasdaq UTP Plan Securities and will ensure that the NASD continues to have the ability to fulfill its obligations with respect to CTA Plan Securities, as described above. Further, eliminating Nasdaq's delegation of regulatory authority with regard to Nasdaq UTP Plan Securities satisfies one of the conditions for the Nasdaq Exchange to begin trading Nasdaq UTP Plan Securities.[41]

Because Nasdaq will continue to be controlled by the NASD when the Nasdaq Exchange begins to operate as a national securities exchange for Nasdaq UTP Plan Securities, the proposal retains Nasdaq's By-Laws in the NASD's rules.[42] The Nasdaq By-Laws that the NASD proposes to retain in its rules reflect changes made to the Nasdaq By-Laws as part of the Nasdaq Exchange application and that were approved by the Commission in the Nasdaq Exchange Order.[43] The Commission finds that these changes are consistent with the Exchange Act because they ensure that Nasdaq's By-Laws are accurately reflected in the NASD's rules, while also ensuring that Nasdaq's governing documents reflect its status as a parent company of a SRO.[44]

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41 See Order Modifying Nasdaq Exchange Conditions, supra, note 6.

42 See Amendment No. 1.

43 See supra, note 5.

44 In Amendment No. 1, the NASD also proposes to retain the references to Nasdaq in the By-Laws of NASD Dispute Resolution, NASD Regulation, and the NASD to reflect that Nasdaq will continue to be controlled by the NASD when the Nasdaq Exchange begins to operate as an exchange for Nasdaq UTP Plan Securities.

C. Deleted Rules

The NASD also proposes to delete several rules in their entirety because the NASD will no longer require them after the Nasdaq Exchange commences operation as a national securities exchange for Nasdaq UTP Plan Securities. In this regard, the NASD proposes to delete in their entirety NASD Rules 2870 through 2885, relating to the listing and trading of Nasdaq index options. Similarly, the NASD proposes to delete NASD Rules 2852 and 2854 relating, respectively, to reporting requirements and trading halts or suspensions for index warrants listed on Nasdaq and reported to the Nasdaq UTP Plan.

In addition, the NASD proposes to delete from NASD Rules 2841, 2850, and 2851 provisions relating to index warrants listed on Nasdaq, while retaining provisions in those rules relating to index warrant trading in the OTC market. Similarly, the NASD proposes to delete provisions in NASD Rule 2860 relating to standardized options displayed on Nasdaq, and to retain provisions relating to options trading in the OTC market.

Because the NASD will not list or trade index options or list warrants after the Nasdaq Exchange commences operations as a national securities exchange, the NASD will no longer require these rules. Accordingly, the Commission finds that it is consistent with Section 15A(b)(6) of the Exchange Act for the NASD to delete from its rules provisions governing the listing and trading of index options and warrants listed on Nasdaq.

The NASD also proposes to delete the NASD Rule 6800 Series relating to the Mutual Fund Quotation Service because the Nasdaq Exchange will operate this service. Finally, the NASD proposes to delete the NASD Rule 5100 Series, "Nasdaq International

Service Rules," to reflect the expiration of the Nasdaq International Service pilot program.[45]

Because the Nasdaq Exchange, rather than the NASD, will operate the Mutual Fund Quotation Service, the Commission finds that the deletion of the Mutual Fund Quotation Service rules from the NASD's rules is consistent with Section 15A(b)(6) of the Exchange Act. Similarly, the Commission finds that the NASD's deletion of the Nasdaq International Service pilot program rules, which reflects the expiration of the pilot program, is consistent with Section 15A(b)(6) of the Exchange Act.

D. OTC Reporting Facility

The NASD proposes to establish the OTC Reporting Facility. NASD members will use this facility to report trades in PORTAL Securities,[46] OTC Equity Securities,[47] and Direct Participation Program ("DPP") Securities.[48] Currently, the NASD uses Nasdaq systems to accept these trade reports. According to the NASD, it plans to enter into a contract with Nasdaq so that the NASD may continue to use Nasdaq's Automated

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45 The Nasdaq International Service pilot program was most recently extended through October 9, 2003. See Securities Exchange Act Release No. 46589 (October 2, 2002), 67 FR 63001 (October 9, 2002) (notice of filing and order granting accelerated approval of File No. SR-NASD-2002-130).

46 See NASD Rule 6732.

47 See NASD Rule 6600 Series.

48 See NASD Rule 6900 Series.

Confirmation Transaction Service ("ACT")[49] as its facility to collect these transaction reports.[50]

1. PORTAL Securities

The current NASD Rule 5300 Series provides qualification and transaction reporting requirements relating to PORTAL Securities, which are foreign and domestic securities that are eligible for resale under Rule 144A under the Securities Act of 1933. The NASD proposes to delete from the NASD Rule 5300 Series rules relating to the qualification requirements for, or designation of, PORTAL Securities, a function that the Nasdaq Exchange will perform.[51] The new NASD Rule 6700 Series will govern transaction reporting in PORTAL Securities and other requirements applicable to the trading of PORTAL Securities.[52] Because these changes will more accurately reflect the NASD's proposed activities with regard to PORTAL Securities after the Nasdaq Exchange begins to operate as an exchange for Nasdaq UTP Plan Securities, the Commission finds them consistent with Section 15A(b)(5) of the Exchange Act.

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49 In 2004, Nasdaq generally discontinued its use of the term "ACT" and replaced it with the term "Nasdaq Market Center" or "service." See Securities Exchange Act Release No. 50074 (July 23, 2004), 69 FR 45866 (July 30, 2004) (notice of filing and immediate effectiveness of File No. SR-NASD-2004-076). To be consistent with the commenters to this proposal, this order also will use the term "ACT."

50 See Amendment No. 1.

51 See Nasdaq Exchange Rule 6500 Series.

52 Specifically, the new NASD Rule 6700 Series incorporates existing NASD Rules 5330, "Requirements Applicable to Members of the Association," 5331, "Limitations on Transactions in PORTAL Securities," 5332, "Reporting Debt and Equity Transactions in PORTAL Securities," 5340, "Arbitration," and 5350, "Rules of the Association."

2. OTC Equity Securities

The NASD proposes to combine its current NASD Rule 6600 and 6700 Series into a single NASD Rule 6600 Series, which will govern reporting requirements for certain quotations and transactions in OTC Equity Securities.[53] The NASD's rules define OTC Equity Securities as any equity security not traded on an exchange and certain exchange-listed securities that do not qualify for real-time trade reporting. Because these changes will maintain the regulatory requirements for trading and reporting transactions in OTC Equity Securities, the Commission believes that they are consistent with Section 15A(b)(6) of the Exchange Act.

3. DPP Securities

The NASD Rule 6900 Series governs the trade reporting of off-exchange secondary market transactions in DPP Securities. The NASD proposes to amend these rules to reflect that such transactions will be reported to the NASD's OTC Reporting Facility rather than the Nasdaq Market Center. The Commission finds these changes consistent with the Exchange Act because the substantive requirements of the NASD Rule 6900 Series will remain unchanged.

E. NASD Rule 9700 Series and 11890 Series

In the original proposal, the NASD proposed to delete in its entirety the NASD Rule 9700 Series, "Procedures on Grievances Concerning the Automated Systems." Because the NASD Rule 9700 Series governs the review of requests for OTCBB eligibility determinations under NASD Rule 6530, "OTCBB-Eligible Securities," the

53 The NASD also proposes to make minor changes designed to reflect Nasdaq's separation from the NASD and to identify the NASD as the operator of the OTCBB.

NASD proposes in Amendment No. 1 to retain a revised version of the NASD Rule 9700 Series. The NASD Rule 9700 Series, as amended, replaces references to Nasdaq, the Nasdaq Listing and Review Hearing Council, and systems owned by Nasdaq with references to, respectively, the NASD, a committee designated by the NASD's Board of Governors, and NASD systems. Because these changes to the NASD Rule 9700 Series provide for the continued availability of existing procedures for reviewing OTCBB eligibility determinations, the Commission finds that they are consistent with Section 15A(b)(6) of the Exchange Act.

In addition, Amendment No. 1 revises NASD Rule 9740, "Consideration of Applications," to permit applicants seeking redress pursuant to the NASD Rule 9700 Series to be heard telephonically by a hearing panel, as well as in person. The Commission believes that this change is consistent with Section 15A(b)(6) of the Exchange Act because it will provide additional flexibility for applicants seeking redress under the NASD Rule 9700 Series.

In its original proposal, the NASD proposed to delete NASD Rule 11890, "Clearly Erroneous Transactions," in its entirety. In Amendment No. 1, the NASD proposes to retain a modified version of NASD Rule 11890. NASD Rule 11890(a), "Authority to review Transactions Pursuant to Complaint of Market Participant," currently provides Nasdaq with the authority to review any transaction arising from the use of any execution or communication system owned or operated by Nasdaq. Because Nasdaq will no longer operate an execution or communication system for the NASD for Nasdaq UTP Plan Securities pursuant to the Delegation Plan after the Nasdaq Exchange begins to operate as an exchange for Nasdaq UTP Plan Securities, the NASD is amending

NASD Rule 11890(a) to eliminate Nasdaq's authority under the rule to review complaints regarding transactions in Nasdaq UTP Plan Securities. NASD Rule 11890(a) will continue to provide Nasdaq with authority to review complaints regarding transactions in CTA Plan Securities arising from the use of an execution or communication system owned or operated by Nasdaq.[54] For the same reason, NASD Rule 11890(b)(1), as amended, will continue to allow Nasdaq to review, on its own motion, any transaction in a CTA Plan Security in the event of extraordinary market conditions or a disruption or malfunction in the use or operation of any quotation, execution, communication, or trade reporting system owned or operated by Nasdaq, while eliminating this authority with respect to Nasdaq UTP Plan Securities. The Commission finds that these changes are consistent with Section 15A of the Exchange Act because Nasdaq will no longer operate, or be delegated authority with respect to, an NASD execution facility for Nasdaq UTP Plan Securities after the Nasdaq Exchange begins to operate as an exchange for Nasdaq UTP Plan Securities.

In addition, the NASD proposes to amend NASD Rule 11890(b)(2) to allow it to review, on its own motion, any transaction in a Nasdaq UTP Plan Security or an OTC Equity Security in the event of extraordinary market conditions or a disruption or malfunction in the use or operation of any quotation, communication, or trade reporting system owned or operated by the NASD. Thus, NASD Rule 11890(b)(2), as amended, will allow the NASD to declare clearly erroneous transactions in Nasdaq UTP Plan Securities reported to the ADF or to the Trade Reporting Facility. The NASD believes

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54 As noted above, Nasdaq will continue to operate the SuperIntermarket pursuant to a delegation from the NASD after the Nasdaq Exchange begins to operate as an exchange for Nasdaq UTP Plan securities.

that this authority may be appropriate in very limited circumstances, for example, when an extraordinary event occurs and multiple SROs are canceling or modifying trades.

The Commission finds that NASD Rule 11890(b)(2), as amended, is consistent with Section 15A of the Exchange Act because the expansion of the NASD's authority under NASD Rule 11890(b)(2) replaces authority previously delegated to Nasdaq and should facilitate the fair and efficient resolution of disputes involving clearly erroneous transactions in Nasdaq UTP Plan Securities and OTC Equity Securities.

F. OATS

The NASD proposes to revise its OATS rules regarding orders routed to non-members, including the Nasdaq Exchange, to ensure that the audit trail for transactions executed on the Nasdaq Exchange continues in the same manner as it does today, when transactions are executed on Nasdaq systems that are NASD facilities. Specifically, the NASD proposes that orders routed to non-members, which includes national securities exchanges, be identified with a routed order identifier or other unique identifier required by the non-member receiving the order, and to indicate the national securities exchange or registered securities association to which the order is transmitted.[55] In addition, the NASD proposes to clarify existing requirements by providing that members are permitted to use a routed order identifier that is different from the order identifier used for origination purposes and that a member transmitting an order to another member must provide the routed order identifier to the member receiving the order. The Commission finds that the proposed changes are consistent with Section 15A(b)(2) of the Exchange

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55 See NASD Rule 6954(c)(6).

Act[56] in that they are designed to ensure that the NASD and the Nasdaq Exchange can conduct surveillance and investigations of their members for potential violations of NASD rules, Nasdaq Exchange rules, and the federal securities laws.

G. OTC Trading of CTA Plan Securities

1. Dually Listed Securities

The NASD proposes to eliminate current NASD Rule 4400 and to modify NASD IM-Rule 4400, which will become its new Rule 4400. New NASD Rule 4400 describes the treatment of securities that are dually listed on the Nasdaq Exchange and the NYSE. Specifically, the rule indicates that such dually listed securities will continue to be subject to the CQ and CTA Plans and will continue to be treated as CTA Plan Securities under the NASD's rules.[57] The Commission finds that new NASD Rule 4400 is consistent with Section 15A of the Act because it clarifies that the NASD will treat these securities in the same manner as it does today.

2. SuperIntermarket Facility

Through its delegation to Nasdaq under the Delegation Plan, the NASD will continue to use technology owned by Nasdaq, i.e., the SuperIntermarket, as its facility to collect OTC quotes and transaction reports in CTA Plan Securities. In addition, the

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56 15 U.S.C. 78o-3(b)(2).

57 Among other things, new NASD Rule 4400 indicates the NASD will continue to send all quotes and transaction reports in dually listed securities to the processor for the CTA Plan while such securities continue to trade through the facilities of the NASD. In addition, the rule notes that market makers in dually listed securities will retain all of the obligations imposed by the NASD Rule 5200, 6300, and 6400 Series regarding quoting, trading, and transaction reporting of CQS securities, and that the NASD will continue to honor the trade halt authority of the primary market under the CQ and CTA Plans.

SuperIntermarket will continue to permit NASD members quoting in the facility to participate in ITS and satisfy the NASD's obligations under the ITS Plan.[58]

a. Quotations

In Amendment No. 1, the NASD proposes to retain its rules that allow its members to register as CQS market makers[59] and ITS/CAES market makers.[60] These rules are essential to the NASD's ability to fulfill its statutory[61] and regulatory obligations,[62] and to NASD members' ability to fulfill their regulatory obligation to submit their OTC quotations to the NASD.[63] The NASD must collect quotations in subject securities that OTC market makers communicate otherwise than on an exchange.[64] NASD rules currently provide that members that communicate quotations off an exchange in CTA Plan Securities must register as CQS market makers and ITS/CAES market makers.[65] The NASD has only proposed minor changes to the rules

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58 See supra notes 25-39 and accompanying text.

59 See NASD Rule 6300 Series. NASD members that submit quotes in CQS securities must be registered as CQS market makers. See NASD Rule 6320(a). CQS market makers must also register as ITS/CAES market makers. See NASD Rule 6320(e). See also NASD Rule 5210(e).

60 See NASD Rule 5200 Series. NASD members that participate in ITS must register as ITS/CAES market makers. See NASD Rule 5220. ITS/CAES market makers must also register as CQS market makers. See NASD Rule 5220(a). See also NASD Rule 6320(e).

61 15 U.S.C. 78o-3(b)(11). See supra notes 25-39 and accompanying text.

62 See Rule 602(a) under the Exchange Act, 17 CFR 242.602(a).

63 See Rule 602(b) of Regulation NMS under the Exchange Act, 17 CFR 242.602(b).

64 See Rule 602 of Regulation NMS under the Exchange Act, 17 CFR 242.602.

65 See NASD Rules 6320(a) and 5210(e). An NASD member that does not communicate quotations off an exchange, but that executes a transaction in a CTA Plan Security off an exchange, may report its transaction to the NASD through ACT, which Nasdaq will operate for the NASD under the Delegation Plan.

for CQS market makers and ITS/CAES market makers, including replacing references to the Nasdaq Market Center with references to Nasdaq. The NASD also proposes to adopt NASD Rule 6431, "Trading Halts," to provide a trading halt rule for CTA Plan Securities.[66]

The Commission finds that the NASD's proposal to retain, with minor clarifying changes, its rules governing CQS and ITS/CAES market makers is consistent with Section 15A of the Exchange Act because it will allow the NASD to continue to fulfill its statutory and regulatory obligations,[67] and allow NASD members to continue to fulfill their regulatory obligation to submit their OTC quotations to the NASD.[68] In addition, the Commission finds that the proposal to adopt NASD Rule 6431 is consistent with Section 15A of the Exchange Act because it could help the NASD to maintain a fair and orderly market.

b. Executions

As noted above, the NASD will remain a member of the ITS Plan. As such, the NASD is required to comply with, and enforce compliance by its members with, the provisions of the ITS Plan.[69] Currently, the NASD uses its Nasdaq SuperIntermarket facility to provide its members with access to ITS participant exchanges and to provide

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66 NASD Rule 4120 currently contains Nasdaq's authority to halt OTC trading of Nasdaq UTP Plan Securities and CTA Plan Securities. The proposal revises NASD Rule 4120 and renumbers it as NASD Rule 4633, "Trading Halts," which now relates solely to the Trade Reporting Facility. .New NASD Rule 6431, which includes the same provisions as NASD Rule 4633, applies to CTA Plan Securities.

67 See supra notes 61 and 62.

68 See note 63, supra, and accompanying text.

69 See Rule 608(c) of Regulation NMS under the Exchange Act, 17 CFR 242.608(c).

ITS participant exchanges with access to ITS/CAES market makers' quotations. The NASD proposes to continue to use the SuperIntermarket system as its facility for these purposes through its delegation to Nasdaq.

In Amendment No. 1, the NASD proposes to retain certain parts of its Rule 4700 Series that relate to the SuperIntermarket, and to eliminate from the 4700 Series those rules that pertain to the trading of Nasdaq UTP Plan Securities on the Nasdaq Market Center. The Commission finds that these changes are consistent with the requirements of the Exchange Act because they will permit the NASD and its members to continue to participate in ITS as they do today.[70] The Commission also finds that the elimination of rules that pertain to the trading of Nasdaq UTP Plan Securities is consistent with the Exchange Act because the NASD will no longer be operating an execution facility for Nasdaq UTP Plan Securities.

c. Transaction Reporting

Members effecting trades in CTA Plan Securities off an exchange, yet outside of the SuperIntermarket facility, will continue, as they do today, to submit trade reports to ACT. Nasdaq will have delegated responsibility under the Delegation Plan to operate ACT for the NASD for this purpose. Accordingly, the NASD proposes to retain its 6400 Series, "Reporting Transactions in Listed Securities," with minor changes, including replacing references to the Nasdaq Market Center with references to Nasdaq.[71]

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70 See Securities Exchange Act Release No. 49349 (March 2, 2004), 69 FR 10775 (March 8, 2004) (order approving the use of SuperMontage for trading ITS securities). The Commission notes that required participation in the ITS Plan is of limited duration. See supra note 36.

71 As described more fully above, the NASD also proposes to adopt NASD Rule 6431, relating to trading halts for CTA Plan Securities.

The Commission finds that these changes are consistent with the Exchange Act. With respect to CTA Plan Securities, the only means currently available to the NASD to fulfill its statutory and regulatory obligations is through NASD facilities owned by Nasdaq. The Commission believes that the NASD Rule 6400 Series, as amended, will enable the NASD to continue to satisfy its obligations under Rules 601 and 603 of Regulation NMS and the CTA Plan to collect its members' transaction reports for OTC trades of CTA Plan Securities.

3. BRUT and INET Rules

Because the Nasdaq Exchange will not commence trading in CTA Plan Securities at this time, any trading of these securities that occurs in BRUT and INET would occur over-the-counter. Accordingly, the NASD has proposed in Amendment No. 1 to retain its current rules that govern the operation of the BRUT[72] and INET[73] systems with regard to CTA Plan Securities. These trading platforms will continue to be facilities of the NASD for CTA Plan Securities that are operated by Nasdaq pursuant to the Delegation Plan. The NASD has proposed to make some changes to these rules to reflect that NASD members may not use these systems to execute OTC trades in Nasdaq UTP Plan Securities.[74] The Commission finds that these changes are consistent with the Exchange Act because they clarify and appropriately limit the use of these systems by NASD

72 See NASD Rule 4900 Series.

73 See NASD Rule 4950 Series.

74 Once the Nasdaq Exchange begins operations as a national securities exchange in Nasdaq UTP Plan Securities, transactions in Nasdaq UTP Plan Securities that occur in Brut and INET will be Nasdaq Exchange trades subject to the Nasdaq Exchange's rules and regulatory jurisdiction.

members after the Nasdaq Exchange begins to operate an exchange for Nasdaq UTP Plan Securities.

H. OTC Trading of Nasdaq UTP Plan Securities

1. NASD Rule 5110

The NASD proposes to renumber NASD Rule 6440(i) as NASD Rule 5110, "Transactions Related to Initial Public Offerings," which prohibits a member from executing, directly or indirectly, a transaction otherwise than on an exchange in a security subject to an initial public offering until the security has first opened for trading on the national securities exchange listing the security, as indicated by the dissemination, via the Consolidated Tape, of an opening transaction in the security by the listing exchange. In addition, the NASD proposes to extend its application to transactions in Nasdaq UTP Plan Securities. New NASD Rule 5110 is substantially the same as current NASD Rule 6440(i).[75] The Commission finds that new NASD Rule 5110 is consistent with the Exchange Act because it is substantially the same as current NASD Rule 6440(i). In addition, the Commission believes that the application of NASD Rule 5110 to Nasdaq UTP Plan Securities, as well as CTA Plan Securities, after the Nasdaq Exchange begins to operate as a national securities exchange is consistent with the Exchange Act because it will provide consistent treatment for all exchange-traded securities.[76]

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75 NASD Rule 6440(i) prohibits members from executing, directly or indirectly, an OTC transaction in a security subject to an initial public offering until the security has first opened for trading on the national securities exchange listing the security, as indicated by the dissemination, via the Consolidated Tape, of an opening transaction in the security by the listing exchange.

76 See supra note 23.

2. Changes to the ADF Rules

The ADF is an NASD facility for members to quote and report off-exchange trades in Nasdaq UTP Plan Securities. NASD members that use the ADF must comply with the NASD Rule 4000A Series, "NASD Alternative Display Facility," and the NASD Rule 6000A Series, "NASD ADF Systems and Programs."

The NASD proposes to make the following changes to its ADF rules. First, the NASD proposes to clarify that the following ADF rules apply to Registered Reporting ECNs as well as Registered Reporting ADF Market Makers: NASD Rules 4613A(b), relating to firm quote requirements, and 4613A(c), requiring quotations to be reasonably related to the prevailing market; NASD Rule 4617A, relating to normal business hours; NASD Rule 4618A, relating to clearance and settlement requirements; and NASD Rules 4621A and 4622A, relating to the NASD's ability to suspend or terminate quotations or ADF services. The Commission finds that these changes are consistent with Section 15A(b)(6) of the Exchange Act[77] because they will apply ADF rules consistently to Registered Reporting ADF Market Makers and Registered Reporting ECNs.

Second, the NASD proposes to revise NASD Rule 4632A, "Transactions Reported by Members," to incorporate the trade reporting requirements currently set forth in NASD Rule 5430, "Transaction Reporting," which is being deleted. The NASD proposes to delete the NASD Rule 5400 Series, "Nasdaq Stock Market and Alternative Display Facility Trade Reporting." NASD Rule 5410 states that the NASD will operate two facilities for collecting trade reports, the Nasdaq Stock Market and the ADF, and

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77 15 U.S.C. 78o-3(b)(6).

notes that the NASD Rule 5400 Series establishes rules governing which member must report a trade and whether the trade must be reported to the Nasdaq Market Center or to the ADF. The provisions in the NASD Rule 5400 Series relating to the reporting of transactions to the Nasdaq Market Center will be no longer relevant after the Nasdaq Exchange commences operations as a national securities exchange for Nasdaq UTP Plan Securities and, accordingly, the NASD proposes to delete these provisions. Therefore, the Commission finds that elimination of these rules is consistent with the Exchange Act.

The NASD proposes to relocate the provisions in the NASD Rule 5400 Series relating to the ADF to NASD Rules 4630A, "Reporting Transactions in ADF-Eligible Securities," and 4632A, "Transactions Reported by Members," which will govern the reporting of transactions in ADF-eligible securities through the NASD's Trade Reporting and Comparison System ("TRACS"). The Commission believes that the proposal to move the NASD Rule 5400 Series to the ADF rule series should clarify the applicability of the NASD's rules and, therefore the Commission finds that these changes are consistent with Section 15A(b)(6) of the Exchange Act.[78] The Commission believes that this change will help to consolidate the ADF's trade reporting requirements while substantially preserving the current requirements of NASD Rule 5430.

Third, the NASD proposes to make the ADF's trade reporting requirements more consistent with the trade reporting rules that apply to Nasdaq systems. For example, the NASD proposes to require that the execution time in hours, minutes, and seconds based on Eastern Time in military format be included in all ADF trade reports,[79] to add certain

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78 Id.

79 See NASD Rules 4632A(c)(2)(I) and 4632A(d)(2)(D). These changes were proposed in Amendment No. 1.

trade report modifiers,[80] and to establish provisions relating to the reporting of cancelled trades.[81] The NASD also proposes to clarify that all applicable trade modifiers must be included in "as/of" trades.[82] In addition, the NASD proposes to add to NASD Rule 4632A a provision stating that a pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade.[83] The Commission finds that these changes, which currently apply to Nasdaq trade reports, are consistent with Section 15A(b)(6) of the Exchange Act in that they are designed to protect investors and the public interest by helping to ensure the timeliness and accuracy of the transaction reports submitted to the ADF.

Fourth, the NASD proposes to revise NASD Rule 4120A to provide that it will halt trading in an ADF-eligible security in the OTC market when there is extraordinary market activity in a security that is likely to have a material effect on the market for the security and the NASD determines, or determines after consultation with a national securities exchange trading the security, that the activity is caused by the misuse or malfunction of an NASD or exchange quotation, communication, reporting, or execution system. The Commission believes that this authority may help the NASD to maintain a fair and orderly market. In addition, the Commission notes that current NASD Rule 4120(a)(6) provides the NASD with comparable trading halt authority.

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80 See NASD Rule 4632A(a)(7), (8), and (9).

81 See NASD Rule 4632A(m). This was proposed in Amendment No. 1.

82 See NASD Rule 4632A(a)(10).

83 See NASD Rule 4632A(a)(6).

Finally, the NASD proposes to eliminate the availability of passive market making on the ADF and therefore is deleting ADF rules that relate to passive market making.[84] According to the NASD, passive market making rules for the ADF are unnecessary because only Registered Reporting ECNs participate in the ADF. The NASD notes that if a market maker were, in the future, to quote in the ADF and participate in a secondary offering of a security, the ADF market maker would be required to stop quoting in the ADF in order to comply with Regulation M. The Commission finds that these changes are consistent with the Exchange Act because these rules are not used currently and Rule 103 of Regulation M does not require the NASD to make passive market making available in the ADF.

3. The Trade Reporting Facility

The NASD proposes to establish a new facility, the Trade Reporting Facility, which will provide NASD members with another facility, in addition to the ADF,[85] for reporting transactions in Nasdaq UTP Plan Securities executed otherwise than on an exchange.[86] The Trade Reporting Facility will allow NASD members that currently internalize customer orders through the Nasdaq Stock Market facility of the NASD to

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84 See NASD Rule 4619A.

85 As noted above, the ADF currently accepts quotes and transaction reports only for Nasdaq UTP Plan Securities.

86 See NASD Rule 4000 Series. See also NASD Rule 5000. New NASD Rule 4000 would permit NASD members to report transactions in Nasdaq UTP Plan Securities executed otherwise than on an exchange to the NASD through the new Trade Reporting Facility. Members also may report transactions in Nasdaq UTP Plan Securities to the ADF. These transaction reports will then be reported to the Nasdaq UTP Plan for dissemination pursuant to the NASD's participation in this Plan. The Commission finds that this proposed change is consistent with Rule 601 under Regulation NMS. See also NASD Rule 4100.

continue to internalize such orders pursuant to NASD rules and to report trades to the new Trade Reporting Facility of the NASD.

The Trade Reporting Facility will be operated by the Trade Reporting Facility LLC ("TRF LLC"), which is owned by the NASD and Nasdaq. The TRF LLC proposes to contract with the Nasdaq Exchange to use its technology, i.e., ACT, to accept OTC trade reports from NASD members in Nasdaq UTP Plan Securities. Accordingly, this proposal is intended to maintain the status quo with respect to the technology used by NASD members to report OTC transactions in Nasdaq UTP Plan Securities. Further, the NASD proposes to maintain its current rules for accepting transaction reports in Nasdaq UTP Plan Securities. By keeping its current rules, NASD members will be able to continue to choose between two facilities, the Trade Reporting Facility and the ADF, for submitting transaction reports for OTC trades in Nasdaq UTP Plan Securities.[87]

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87 The NASD represents that it will have an integrated audit trail and integrated surveillance facilities for members reporting trades on both the ADF and the Trade Reporting Facility. See Amendment No. 1. The Commission believes that an integrated audit trail and integrated surveillance capabilities are important to the NASD's ability to conduct effective surveillance of OTC trading in Nasdaq UTP Plan Securities when transactions in those securities can be reported to both the ADF and the Trade Reporting Facility.

The NASD proposes that its new Rule 4000 Series[88] and Rule 6100 Series,[89] which contain clearing and comparison rules, will govern the reporting of trades to its Trade Reporting Facility. Specifically, the NASD proposes to combine in the new NASD Rule 4630 Series the trade reporting requirements in the current NASD Rule 4630, 4640, and 4650 Series (Nasdaq National Market securities, Nasdaq Capital Market securities, and Nasdaq convertible debt securities, respectively). The Commission believes that the new NASD Rule 4630 Series retains the requirements and general organization of the NASD's current trade reporting rules. In addition, the NASD represents that it intends to interpret and apply the trade reporting rules of the Trade Reporting Facility in the same manner in which it interprets and applies its current trade reporting rules.

The Commission finds that the NASD's rules governing the reporting of trades to the Trade Reporting Facility are consistent with the Exchange Act. The NASD's proposal is designed to allow the NASD and its members to continue to fulfill their obligations under the Commission's rules and the national market system plans with regard to Nasdaq UTP Plan Securities. The Commission also believes that the establishment of the Trade Reporting Facility is consistent with the Congressional finding

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88 The proposal deletes from the current NASD Rule 4000 Series rules that relate to Nasdaq, including listing standards, trading rules for the Nasdaq National Market Center, and Nasdaq market maker registration requirements. The proposal retains an amended version of the NASD Rule 4700 Series, which will govern ITS/CAES members' use of the SuperIntermarket.

89 The current NASD Rules 6100 Series, which is being deleted, contains rules for the reporting of trades that are executed on the Nasdaq Market Center and ACES. The Commission believes that it is consistent with the Exchange Act to eliminate the NASD Rule 6100 Series because these rules relate solely to the Nasdaq systems that will no longer be NASD facilities after the Nasdaq Exchange begins to trade Nasdaq UTP Plan Securities.

in Section 11A(a)(1)(C)(iii) of the Exchange Act that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability of information with respect to transactions in securities.

a. TRF LLC

As noted above, the NASD and Nasdaq will jointly own the TRF LLC, which will operate the Trade Reporting Facility. The NASD has filed the limited liability company agreement ("LLC Agreement") for the TRF LLC as part of the current proposal.[90] The LLC Agreement makes clear that the NASD will have sole regulatory responsibility for the activities of NASD members related to the facility operated by the TRF LLC. The LLC Agreement identifies the NASD as the "SRO Member" of the LLC and provides the NASD with certain rights that are intended to preserve its regulatory authority and control. Specifically, pursuant to the LLC Agreement, the NASD must consent before certain "Major Actions" with respect to the TRF LLC are effective. The LLC Agreement defines a "Major Action" as: (1) approving pricing decisions that are subject to the Commission filing process; (2) approving contracts between the TRF LLC and Nasdaq; (3) approving director compensation; (4) selling, licensing, leasing, or otherwise transferring material assets used in the operation of the TRF LLC outside the ordinary course of business with an aggregate value in excess of $3 million; (5) approving or undertaking a merger or other reorganization of the TRF LLC with another entity; (6) entering into any partnership, joint venture, or other similar joint business undertaking; (7) making any fundamental change in the market structure of the TRF LLC; (8)

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90 The Commission notes that any changes to the LLC Agreement that are stated policies, practices, or interpretations of the NASD, as defined in Rule 19b-4 under the Exchange Act, must be filed with the Commission pursuant to Section 19(b) of the Exchange Act and Rule 19b-4 thereunder.

voluntary or involuntary dissolution of the TRF LLC other than termination as provided for in the LLC Agreement;[91] (9) conversion of the TRF LLC to any other type of entity; (10) expanding or modifying the business, which would result in a material change in the business of the TRF LLC; (11) changing the number of directors or composition of the TRF LLC Board; and (12) adopting or amending policies regarding access and credit matters affecting the TRF LLC.[92]

Nasdaq will be primarily responsible for the management of the TRF LLC's business affairs to the extent that those activities are not inconsistent with the regulatory and oversight functions of the NASD. All profits and losses from the TRF LLC will be allocated to Nasdaq.[93]

Although the TRF LLC itself will not carry out any regulatory functions, all of its activities must be conducted in a manner that is consistent with the Exchange Act. In this regard, under Section 9(d) of the LLC Agreement, each member of the TRF LLC agrees to comply with the federal securities laws and rules and regulations thereunder and to cooperate with the Commission pursuant to its regulatory authority and the provisions of

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91 As set forth in Section 20 of the LLC Agreement, two years after the effective date of the LLC Agreement, either the NASD or Nasdaq may dissolve the TRF LLC by providing the other with prior written notice of at least one year (unless such notice is revoked). If the NASD provides the notice of dissolution, the NASD and Nasdaq will negotiate in good faith to: (i) allow Nasdaq to continue to operate the TRF LLC or the business of the TRF LLC under the NASD's SRO registration; (ii) restructure the TRF LLC so that Nasdaq can operate the TRF LLC or its business under its SRO registration or that of any of its affiliates, as the case may be; or (iii) sell the TRF LLC or its business to the NASD based on a valuation of the TRF LLC's business and assets as set forth in the LLC Agreement, and consideration for the sale may include a contract for Nasdaq to provide services to the NASD relating to the operation of the TRF LLC and the business of the TRF LLC.

92 See Section 10(e) of the LLC Agreement.

93 See Section 15 of the LLC Agreement.

the LLC Agreement. Section 10(b) of the LLC Agreement imposes similar obligations on each director of the TRF LLC. Under Section 10(b), each director agrees to comply with the federal securities laws and the rules and regulations thereunder and to cooperate with the Commission and the NASD in carrying out their regulatory authority and the provisions of the LLC Agreement. In addition, Section 10(b) states that each director agrees that in discharging his or her responsibilities as a member of the TRF LLC Board, each director will take into consideration whether his or her actions as a director would cause the TRF LLC or either member to engage in conduct that would be inconsistent with the purposes of the Exchange Act.

The Commission believes that these provisions reinforce the notion that the TRF LLC, as the operator of an NASD facility, is not solely a commercial enterprise; it is an integral part of an SRO registered pursuant to the Exchange Act and, as such, is subject to obligations imposed by the Exchange Act. The Commission underscores that these obligations endure so long as the TRF LLC operates an NASD facility.

The LLC Agreement includes additional provisions that make special accommodations for the NASD as the SRO responsible for the NASD facilities operated by the TRF LLC. For example, Section 10(a) of the LLC Agreement provides that the TRF LLC Board shall, at all times, include at least one director (the "SRO Member Director") designated by the NASD. Under Section 10(e) of the LLC Agreement, no "Major Action," as defined in the LLC Agreement, will be effective unless approved by consent of the SRO Member Director.[94] Section 19 of the LLC Agreement prohibits either the NASD or Nasdaq from transferring or assigning its interest in the TRF LLC

94 See supra text accompanying notes 90-92.

except to an affiliate, as defined in the LLC Agreement, and the NASD may transfer its interest only to an affiliate that has proper authority to perform the self-regulatory responsibilities of the NASD.

The Commission believes that the provisions described above will allow the NASD to carry out its self-regulatory responsibilities with respect to its facilities operated by the TRF LLC. Moreover, the Commission believes that the limits in Section 19 of the LLC Agreement on transfers of interest in the TRF LLC, together with the requirements of Section 19(b) of the Exchange Act and Rule 19b-4 thereunder, provide the Commission with sufficient authority over changes in control of the TRF LLC to enable the Commission to carry out its regulatory oversight responsibilities with respect to the NASD and its facilities.

The Commission also believes that, as highlighted by the terms of the LLC Agreement, the Commission and the NASD have sufficient regulatory jurisdiction over the controlling parties of the TRF LLC to carry out their responsibilities under the Exchange Act. In Section 17(b) of the LLC Agreement, the NASD and Nasdaq acknowledge that — to the extent directly related to the TRF LLC's activities — their books, records, premises, officers, directors, governors, agents, and employees will be deemed to be the books, records, premises, officers, directors, governors, agents, and employees of the NASD itself and its affiliates for the purposes of, and subject to oversight pursuant to, the Exchange Act. This provision will reinforce the Commission's ability to exercise its authority under Section 19(h)(4) of the Exchange Act[95] with respect

[95] 15 U.S.C. 78s(h)(4). Section 19(h)(4) of the Exchange Act authorizes the Commission, by order, to remove from office or censure any officer or director of an SRO if it finds after notice and an opportunity for hearing that such officer or

to the officers and directors of the TRF LLC because all such officers and directors—to the extent that they are acting in matters related to the TRF LLC's activities—would be deemed to be the officers and directors of the NASD itself. Furthermore, under Section 17(b) of the LLC Agreement, the records of the NASD and Nasdaq, to the extent that they are related to the TRF LLC's activities, are deemed to be records of the NASD itself and are subject to the Commission's examination authority under Section 17(b)(1) of the Exchange Act.[96]

In addition, under Section 17(c) of the LLC Agreement, the NASD and Nasdaq, and each officer, director, agent, and employee thereof, irrevocably submits to the jurisdiction of the U.S. federal courts, the Commission, and the NASD for the purpose of any suit, action, or proceeding pursuant to the U.S. federal securities laws and the rules and regulations thereunder arising from, or relating to, the TRF LLC's activities. In addition, each Member, and each officer, director, agent, and employee thereof, waives and agrees not to assert by way of motion, as a defense or otherwise, in any suit, action, or proceeding, any claim that it is not personally subject to the jurisdiction of the Commission; that the suit, action, or proceeding is an inconvenient forum; that the venue of the suit, action, or proceeding is improper; or that the subject matter of the suit, action, or proceeding may not be enforced in or by such courts or agency. Moreover, Section 17(e) of the LLC Agreement states that the TRF LLC, the NASD, and Nasdaq will cause

director has: (1) willfully violated any provision of the Exchange Act or the rules and regulations thereunder, or the rules of such SRO; (2) willfully abused his or her authority; or (3) without reasonable justification or excuse, has failed to enforce compliance with any such provision by a member or person associated with a member of the SRO.

96 15 U.S.C. 78q(b)(1).

their respective affiliates, officers, directors, governors, employees, representatives, and agents to comply with these requirements.

The Commission also believes that, even in the absence of these provisions of the LLC Agreement, under Section 20(a) of the Exchange Act,[97] any person with a controlling interest in the TRF LLC would be jointly and severally liable with and to the same extent that the TRF LLC is liable under any provisions of the Exchange Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Exchange Act[98] creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person for violation of any provision of the Exchange Act or rule thereunder. Further, Section 21C of the Exchange Act[99] authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Exchange Act through an act or omission that the person knew or should have known would contribute to the violation.

The Commission believes that, together, these provisions grant the Commission sufficient jurisdictional authority over the controlling parties and Members of the TRF LLC. Moreover, the NASD is required to enforce compliance with the provisions of the LLC Agreement because they are "rules of the association" within the meaning of Section 3(a)(27) of the Exchange Act.[100] A failure on the part of the NASD to enforce its

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97 15 U.S.C. 78t(a).

98 15 U.S.C. 78t(e).

99 15 U.S.C. 78u-3.

100 15 U.S.C. 78c(a)(27).

rules could result in a suspension or revocation of its registration pursuant to Section 19(h)(1) of the Exchange Act.[101]

4. Comments

The Commission received 13 comment letters from 12 commenters opposing the NASD's proposal to establish the TRF LLC.[102] In light of its interest in the TRF LLC, Nasdaq submitted a comment letter to address the issues raised by the NYSE.[103] In addition, because the Archipelago Letter and the NYSE Letter II also were submitted in response to the Nasdaq Exchange's application to register as a national securities exchange, Nasdaq also addressed the comments raised in those letters in its response to comments concerning its exchange application.[104] The NASD also responded to the issues raised by the commenters.[105] The principal issues raised by commenters are discussed below.

a. Trade Reporting Facility is a Facility of the NASD

Because of the affiliation between the Nasdaq Exchange and the TRF LLC, several commenters argue that the Trade Reporting Facility would not truly be a facility of the NASD, but instead would be a facility of the Nasdaq Exchange.[106] These

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101 15 U.S.C. 78s(h)(1).

102 See Archipelago Letter, BSE Letter, NYSE Letters I, II and III, Ward Letter, Davis Letter, Bean Letter, Towns Letter, Capuano Letter, McHenry Letter, Gerlach Letter, and Baker Letter, supra note 13.

103 See Nasdaq Letter, supra note 13.

104 See letter from Edward Knight, Executive Vice President and General Counsel, Nasdaq, to Jonathan G. Katz, Secretary, Commission, dated December 13, 2005 ("Nasdaq Letter II").

105 See NASD Response Letters I and II, supra note 14.

106 See Archipelago Letter, supra note 13. See also NYSE Letter I, BSE Letter, Bean Letter, Towns Letter, Gerlach Letter, supra note 13.

commenters argue that the Trade Reporting Facility is a facility of the Nasdaq Exchange because the Nasdaq Exchange's parent company controls the board of the TRF LLC, directs all business decisions, provides technology, and will reap the economic benefits of the TRF LLC. Based on the premise that the Trade Reporting Facility is a facility of the Nasdaq Exchange, these commenters believe that approval of the Trade Reporting Facility would be inconsistent with what they view as the Commission's policy that an exchange must provide an opportunity for all exchange orders to interact with each other.[107]

Several commenters also argue that the Trade Reporting Facility, as a facility of the Nasdaq Exchange, would allow an exchange to take credit and receive remuneration for trades that do not occur on that exchange, which these commenters maintain is inconsistent with current law.[108] One commenter said that allowing Nasdaq to take credit for off-exchange trades would reduce transparency and lead to a mistaken sense of an exchange's liquidity and depth of market.[109]

Commenters also argue that approval of the Trade Reporting Facility as operated by the TRF LLC will result in the proliferation of print facilities because other markets will seek to establish similar arrangements.[110] One commenter argued that this would

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107 See Bean Letter, Archipelago Letter, NYSE Letter I, BSE Letter, and Towns Letter, supra note 13. See also Ward Letter, supra note 13.

108 See Davis Letter, Bean Letter, Archipelago Letter, NYSE Letter I, BSE Letter, Towns Letter, McHenry Letter, Baker Letter, Gerlach Letter, supra note 13.

109 See Ward Letter, supra note 13.

110 See Ward Letter, Bean Letter Towns Letter, Capuano Letter, Gerlach Letter, Baker Letter, Archipelago Letter, BSE Letter, supra note 13.

result in less order interaction.[111] Several commenters also argue that providing revenue and trade information to markets that have no nexus with the actual trades may contravene the public interest.

Section 3(a)(2) of the Exchange Act[112] defines the term "facility" of an exchange to include "its premises, tangible or intangible property whether on the premises or not, any right to the use to such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service." While the Trade Reporting Facility plainly is an affiliate of Nasdaq, the Commission does not believe that the Trade Reporting Facility is a facility of the Nasdaq Exchange within the terms of the Exchange Act. Nasdaq owns the system that the TRF uses for reporting trades; however, the Trade Reporting Facility is not a service "for the purpose of effecting or reporting a transaction" on the Nasdaq Exchange. Instead, the Trade Reporting Facility is a service for the purpose of reporting transactions to the NASD. Therefore, the Commission believes that the Trade Reporting Facility is a facility of the NASD and not a facility of the Nasdaq Exchange.[113]

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111 See Archipelago Letter, supra note 13.

112 15 U.S.C. 78c(a)(2).

113 The Commission has previously approved arrangements similar to the Trade Reporting Facility in which a third party technology provider operates an SRO's facility in return for payment of related revenues. For example, the Pacific Exchange's equity trading facility was for several years operated by an unaffiliated third party – ArcaEx. See Securities Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (order approving the Archipelago Exchange as the equities trading facility of PCX Equities, Inc., a subsidiary of the Pacific Exchange, Inc.) ("ArcaEx Order"). Under the

NASD members would report trades to the Trade Reporting Facility pursuant to NASD rules. In addition, transactions reported to the Trade Reporting Facility will be disseminated with a modifier indicating that they are NASD trades, which will clearly distinguish them from transactions executed on or through the Nasdaq Exchange. Because the Trade Reporting Facility is an NASD facility, the NASD will have the responsibility under the Exchange Act to regulate its members' activities related to the Trade Reporting Facility.[114] The Commission believes that the LLC Agreement provides the NASD with sufficient authority to carry out its SRO responsibilities because the LLC Agreement provides, among other things, that the NASD will have sole regulatory responsibility for the activities of the TRF LLC, including the right to review and approve the regulatory budget, approve rule proposals relating to the activities of the TRF LLC prior to their filing with the Commission, adopt and interpret policies regarding NASD facilities, and perform real time market surveillance. In addition, under the LLC

Agreement, PCX paid the parent of ArcaEx market data revenue and transaction and listing fees. See Archipelago Holdings, Inc. Annual Report on Form 10-K for fiscal year ended December 31, 2004. In September 2005, the parent of ArcaEx – Archipelago – acquired the Pacific Exchange. Accordingly, the exchange and the facilities operator became affiliated. See Securities Exchange Act Release No. 52497 (September 22, 2005), 70 FR 56949 (September 29, 2005). Recently, the NYSE and Archipelago merged, and the Pacific Exchange was renamed NYSE Arca.

114 Similar arrangements that have been approved by the Commission provided for the same obligations with respect to such facilities. See Securities Exchange Act Release Nos. 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (order approving the Boston Options Exchange as a facility of the Boston Stock Exchange, Inc.); and Arca Ex Order, supra note 113.

Agreement no "Major Action," as defined in the LLC Agreement, may become effective without the NASD's consent.[115]

To the extent that approval of the Trade Reporting Facility results in other markets seeking to establish similar arrangements with the NASD, the Commission notes that the NASD would have to file any proposed rule change generated by such proposals pursuant to Section 19 of the Exchange Act, and the Commission would be required to determine that such proposed rule change complied with the requirements of the Exchange Act. The Commission notes, however, that the Exchange Act does not prohibit the NASD from establishing different facilities for purposes of fulfilling its regulatory obligations. Indeed, the Commission notes that the NASD currently operates two facilities for the reporting of OTC trades in Nasdaq-listed securities -- the ADF and the Nasdaq Market Center.

b. Impact on Internalization Practices

Based on the premise that the Trade Reporting Facility is a facility of the Nasdaq Exchange, commenters conclude that the Trade Reporting Facility would allow Nasdaq Exchange members to execute and report trades without regard to orders resident on the Nasdaq Exchange book and thereby increase the internalization of orders.[116] One commenter objects to NASD members' current ability to execute trades in the OTC market without interacting with other better-priced orders on exchanges.[117] Another Commenter suggests that NASD members would not be required to provide the best

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115 See supra text accompanying note 92 for the LLC Agreement's definition of "Major Action."

116 See Archipelago Letter, BSE Letter, NYSE Letter I, supra note 13.

117 See BSE Letter, supra note 13.

prices in the market.[118] Commenters also contend that approval of the NASD's Trade Reporting Facility would result in a different standard for the Nasdaq Exchange as compared to other exchanges because, unlike other exchanges, the Nasdaq Exchange would not be required to have a consolidated limit order book.[119]

As discussed above, the Commission does not believe that the Trade Reporting Facility is a facility of the Nasdaq Exchange. Moreover, the Commission does not believe that the Trade Reporting Facility will increase the internalization of orders. The Trade Reporting Facility simply preserves the ability of an NASD member, who may also be a member of the Nasdaq Exchange or another exchange, to report trades executed otherwise than on an exchange to the NASD through the Trade Reporting Facility without regard to the orders on the Nasdaq Exchange or any other exchange's consolidated limit order book. The Commission notes that the ability to report internalized trades to an NASD facility exists and is widely used today. In this regard, an NASD member today may report internalized trades to the Nasdaq facilities of the NASD without regard to the priority rules of the Nasdaq's SuperMontage system or any exchange of which it is a member. There is no reason to expect the Trade Reporting Facility to increase such practices.

Finally, the Commission notes that a broker-dealer has a legal duty to seek to obtain the best execution of customer orders.[120] This duty requires broker-dealers to

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118 See Capuano Letter, supra note 13.

119 See Archipelago Letter, BSE Letter, NYSE Letter I, supra note 13.

120 See, e.g., Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 135 F.3d 266, 269-70 (3d Cir.), cert denied, 525 U.S. 811 (1998); Certain Market Making Activities on Nasdaq, Securities Exchange Act Release No. 40900 (Jan. 11, 1999) (settled case) (citing Sinclair v. SEC, 444 F.2d 399 (2d Cir. 1971)); Arleen

execute customers' trades at the most favorable terms reasonably available under the circumstances.[121] Further, the NASD noted that its members are subject to, among other things, NASD Rule 2320, which would prohibit an NASD member from disregarding the market.[122] Accordingly, the Commission does not agree with the commenters that argued that the Trade Reporting Facility would permit NASD members to ignore disseminated quotes and their best execution obligations.[123]

c. Unfair Competition

Several commenters object to the NASD's payment to Nasdaq of the market data revenue generated by trades reported to the Trade Reporting Facility operated by the TRF LLC.[124] One commenter argues that the transfer of market data revenue from the NASD to Nasdaq through the TRF LLC is inconsistent with Section 11A of the Exchange Act

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Hughes, 27 SEC 629, 636 (1948), aff'd sub nom. Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949). See also Order Execution Obligations, Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290 (Sept. 12, 1996) and NASD Rule 2320, "Best Execution and Interpositioning."

121 Newton, 135 F.3d at 270. Newton also noted certain factors relevant to best execution--price order size, trading characteristics of the security, speed of execution, clearing costs, and the cost and difficulty of executing an order in a particular market. Id. at 270 n. 2 (citing Payment for Order Flow, Securities Exchange Act Release No. 33026 (Oct. 6, 1993), 58 FR 52934, 52937-38 (Oct. 13, 1993) (Proposed Rules)). See In re E.F. Hutton & Co. ("Manning"), Securities Exchange Act Release No. 25887 (July 6, 1988). See also Securities Exchange Act Release No. 34902 (Oct. 27, 1994), 59 FR 55006 at 55008-55009 (Nov. 6, 1994) (Payment for Order Flow Final Rules).

122 See Amendment No. 1.

123 See BSE Letter, supra note 13. See also Capuano Letter, supra note 13.

124 See NYSE Letters I, II, and III, supra note 13. See also Gerlach Letter, Ward Letter, supra note 13.

and Regulation NMS.[125] Others state that payment of market revenue would amount to a subsidy of the Nasdaq Exchange by the NASD, which would provide the Nasdaq Exchange with an unfair economic advantage over other national securities exchanges.[126] One commenter also maintains that the Nasdaq Exchange would be able to use revenue generated by off-exchange trades to defray its business and exchange surveillance expenses, thereby discriminating against other exchanges.[127]

One commenter raises competitive issues regarding the technology that will be used by the Trade Reporting Facility to collect trade reports.[128] Specifically, the commenter argues that Nasdaq's ACT is an industry utility because virtually all market participants use the system for reporting OTC trades. This commenter argues that Nasdaq's competitors should have equal access to ACT and the Trade Reporting Facility to eliminate the unfair competitive advantage the commenter believes exists due to Nasdaq's monopoly on ACT.

Section 15A(b)(9) of the Exchange Act[129] prohibits the NASD from having rules that impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission finds that the proposal does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. As the NASD and Nasdaq note, the LLC Agreement

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125 See NYSE Letters I, supra note 13.

126 See NYSE Letters I and II, Ward Letter, and Gerlach Letter, supra note 13.

127 See NYSE Letters I and II, supra note 13.

128 See NYSE Letter III, supra note 13.

129 15 U.S.C. 78o-3(b)(9)

does not preclude the NASD from entering into similar arrangements with other national securities exchanges.[130] For this reason, the Commission believes that the Trade Reporting Facility does not impose any unfair burden on competition, as required by the Exchange Act.

The NASD notes that an exchange may develop its own proprietary system for reporting trades, and the NASD represents that it is prepared to implement a trade reporting facility with any exchange based on the technology available to the exchange.[131] The NASD represents that it has, in fact, discussed trade reporting facility arrangements with a number of exchanges.[132] Because another exchange may develop a proprietary trade reporting system and enter into a similar trade reporting facility arrangement with the NASD, the Commission does not believe that the unavailability of ACT to other exchanges imposes a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission notes that the NASD bears the responsibility for overseeing the entities that report trades to the Trade Reporting Facility and for providing regulatory services to the Trade Reporting Facility. The TRF LLC will pay the NASD for these services using revenues generated by the Trade Reporting Facility. Under the LLC Agreement, Nasdaq must ensure that the TRF LLC has funds sufficient to satisfy its regulatory obligations and must guarantee the TRF LLC's payment of obligations relating to the costs associated with the NASD's performance of regulatory services for the Trade

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[130] See NASD Response Letters I and II, supra note 14 and Nasdaq Letter, supra note 13. See also Amendment No. 1.

[131] See NASD Response Letter II, supra note 14.

[132] See NASD Response Letter II, supra note 13.

Reporting Facility.[133] As the NASD states in its response to the commenters, Nasdaq bears the economic risks associated with the operation of the Trade Reporting Facility, including any losses if revenues fail to cover regulatory and other costs associated with operating the Trade Reporting Facility.[134] In light of the costs, and potential losses, that Nasdaq must bear in connection with the operation of the Trade Reporting Facility, the Commission does not believe that allocating revenues generated by the Trade Reporting Facility to Nasdaq, net of costs, would provide the Nasdaq Exchange with an unfair economic advantage over other national securities exchanges or impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. Moreover, the Commission does not believe that an agreement by the NASD under which it pays Nasdaq market data revenue in exchange for Nasdaq providing the technology and bearing other costs of operating the facility is inconsistent with Regulation NMS or the Exchange Act and the rules and regulations thereunder.

Finally, the Commission disagrees with the characterization of Nasdaq's ACT system as an industry utility. ACT is an automated system owned and operated by Nasdaq that, among other things, provides for the reporting of transactions in securities. The Exchange Act, however, does not prevent any other party, including an exchange, from developing similar technology for use as an NASD facility. Further, the Commission does not believe that the inability of competitors to use ACT for purposes of receiving compensation for trades reported by their members constitutes a denial of access under Section 19(d) of the Exchange Act. Under the proposal, all market

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[133] See LLC Agreement, Section 12.

[134] See NASD Response Letter I, supra note 14. See also LLC Agreement, Section 15 (allocating the profits and losses of the Trade Reporting Facility to Nasdaq).

participants that are members of the NASD will continue to have the ability to report internalized trades through ACT. Thus, the proposal does not prohibit or limit any person with respect to access to services offered by the NASD in violation of Section 19(d) of the Exchange Act. The Commission does not believe that Section 19(d) or any other provision of the Exchange Act requires Nasdaq to make its proprietary trade reporting system available to a competing exchange.

d. Impact on the NASD's Ability to Effectively Regulate

One commenter also questions whether the payment of market data revenue to Nasdaq would adversely impact the NASD's ability to regulate the Trade Reporting Facility or provide NASD members with reduced membership fees, or would impair the NASD's regulatory independence.[135] In particular, the commenter claims that it would compromise the NASD's regulatory integrity and neutrality as the SRO for the OTC market and would perpetuate the conflicts that the separation of the Nasdaq Exchange from the NASD was designed to ameliorate. Nasdaq asserts that it would receive the revenues associated with the TRF LLC "because it would provide the connectivity and reporting technology and bear all costs associated with the facility."[136] In addition, the LLC Agreement requires Nasdaq to ensure that the TRF LLC has funds sufficient to satisfy its regulatory obligations and to guarantee the TRF LLC's payment obligations relating to costs associated with the NASD's performance of its SRO responsibilities related to the activities of the TRF LLC.[137] This obligation is independent of the revenue associated with the TRF LLC. Therefore, the Commission does not believe that the LLC

135 See NYSE Letter I, supra note 13.

136 See Nasdaq Letter II, supra note 13.

137 See LLC Agreement Section 12.

Agreement or the TRF LLC would impair the NASD's ability to carry out its obligations under Section 15A of the Exchange Act.[138]

e. Compliance with CTA Plan and the Nasdaq UTP Plan

One commenter contends that the payment of market data revenue to the Nasdaq Exchange by the NASD would violate both the CTA and Nasdaq UTP Plans.[139] This commenter refers to its earlier comment letters regarding Nasdaq's application for exchange registration, in which the commenter opposed Nasdaq's proposed transaction reporting rules.[140] The proposed rules would have allowed the Nasdaq Exchange to report – and receive revenue for – internalized and other off-exchange trades. This commenter argued that the proposed transaction reporting rules would not comply with Section VIII(a) of the CTA Plan, which requires each participant exchange to report all trades occurring on its floor and requires the NASD to report all trades that do not take place on the floor of an exchange.[141] Similarly, the commenter maintained that the

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138 15 U.S.C. 78o-3.

139 See NYSE Letter I and attached letters, supra note 13.

140 See letters from Darla C. Stuckey, Corporate Secretary, NYSE, to Jonathan G. Katz, Secretary, Commission, dated February 15, 2002 ("NYSE February 2002 Letter"); and James E. Buck, Senior Vice President and Secretary, NYSE, to Jonathan G. Katz, Secretary, Commission, dated August 27, 2001.

141 Specifically, Section VIII(a) of the CTA Plan states that the exchange participants will each collect and report to the Processor all last sale price information to be reported by it relating to transactions in Eligible Securities taking place on its floor. Section VIII(a) states, further, that the NASD shall collect from its members all last sale price information to be included in the consolidated tape relating to transactions in Eligible Securities not taking place on the floor of an exchange and shall report all such last sale price information to the Processor in accordance with the provisions of Section VIII(b) of the CTA Plan.

proposed rules would violate Section VIII(B) of the Nasdaq UTP Plan.[142] By not complying with the terms of these plans, the commenter concludes that both Nasdaq and the NASD would violate Rule 608 of Regulation NMS,[143] which requires each SRO to comply with the terms of an effective national market system plan in which it participates and to enforce compliance with such plan by its members and persons associated with its members.[144]

As noted in the Nasdaq Exchange Order, Nasdaq amended its exchange application so that only trades executed through the systems of the Nasdaq Exchange will be reported to the Nasdaq Exchange.[145] Through its Trade Reporting Facility and related rules, the NASD, rather than Nasdaq, will report all off-exchange trades and collect transaction reports for trades reported through the Trade Reporting Facility, as required by the Nasdaq UTP Plan. Accordingly, the Commission believes that the LLC Agreement and the proposed rules of the Trade Reporting Facility are consistent with the terms of the Nasdaq UTP Plan.[146]

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142 See NYSE February 2002 Letter, supra note 140. Section VIII(B) of the Nasdaq UTP Plan states that each Participant shall be responsible to promptly collect and transmit to the Processor Transaction Reports in Eligible Securities executed in its Market. Section III(E) of the Nasdaq UTP Plan defines "Market," when used in connection with Transaction Reports, to mean the Plan Participant through whose facilities the transaction took place or was reported, or the Plan Participant to whose facilities the order was sent for execution.

143 Rule 608 of Regulation NMS was formerly Exchange Act Rule 11Aa3-1.

144 See Rule 608(c) of Regulation NMS, 17 CFR 242.608(c).

145 See Nasdaq Exchange Order, supra note 5.

146 The Commission notes that the Trade Reporting Facility will not accept trade reports for CTA Plan Securities and, thus, the NASD will not report such trades to the CTA Plan through the Trade Reporting Facility. Accordingly, the Trade Reporting Facility and the TRF LLC will not receive CTA Plan revenue.

f. Consistency with Market Data Revenue Allocation Formula

One commenter states that the TRF LLC proposal is inconsistent with the objectives of the market data revenue allocation rules adopted by the Commission in conjunction with Regulation NMS.[147] According to this commenter, the new market data revenue allocation rules were intended to decrease incentives to engage in sham trades, wash sales, and tape shredding.

In addition to modifying Exchange Act rules governing the display and distribution of market data, the Commission amended the CTA Plan, the CQ Plan, and the Nasdaq UTP Plan (each a "Plan" and, collectively, the "Plans") to incorporate a new net income allocation formula into each Plan.[148] The amendments to each of the Plans incorporated a broad-based measure of the contribution of an SRO's quotes and trades to the consolidated data stream.

The Commission does not believe that the TRF LLC is inconsistent with the objectives of the new Plan formulas, which included reducing the incentives for distortive behavior, such as sham trades, wash sales, and tape shredding. The TRF LLC does not alter the new Plan formulas. Further, the NASD's proposed Trade Reporting Facility rules do not appear to create any incentives for distortive behavior.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

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147 See NYSE Letter II, supra note 13.

148 See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (adopting Regulation NMS).

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-NASD-2005-087 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-NASD-2005-087. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File No. SR-NASD-2005-087 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[149] that the proposed rule change (SR-NASD-2005-087), as amended, is approved.

By the Commission.

J. Lynn Taylor
Assistant Secretary

By: J. Lynn Taylor
Assistant Secretary

149 15 U.S.C. 78s(b)(2).