→ Bullet: Brief

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -v- HARWYN INDUSTRIES CORPORATION, HARVEY R. SIEGEL, IRVING L. GARTENBERG, ACADEMIC DEVELOPMENT CORPORATION, HYMAN TEMKIN, JAMES W. FEENEY, XANADU PROPERTIES, INC., RAMON N. D'ONOFRIO, JKM INDUSTRIES, J. KEVIN MURPHY, MOTEL TRAILER DISTRIBUTORS, INC., STEPHEN KIRSHNER, WAYNE SLOCKBOWER, FSI CORPORATION, HAROLD C. YATES, Defendants.	70 Civil Action File No. 2693

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

-v-

HARWYN INDUSTRIES CORPORATION
HARVEY R. SIEGEL
IRVING L. GARTENBERG
ACADEMIC DEVELOPMENT CORPORATION
HYMAN TEMKIN
JAMES W. FEENEY
XANADU PROPERTIES, INC.
RAMON N. D'ONOFRIO
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J. KEVIN MURPHY
MOTEL TRAILER DISTRIBUTORS, INC.
STEPHEN KIRSHNER
WAYNE SLOCKBOWER
FSI CORPORATION
HAROLD C. YATES

Defendants.

REPLY MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF'S MOTION FOR A PRELIMINARY INJUNCTION

Respectfully submitted,

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August 31, 1970

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PRELIMINARY STATEMENT

The plaintiff Securities and Exchange Commission ("Commission") respectfully submits this Reply Memorandum of Law in response to the answering papers filed by the defendants in opposition to the plaintiff's Motion for a Preliminary Injunction.

I DEFENDANTS' CONTENTION THAT THEY HAVE NOT VIOLATED THE REGISTRATION PROVISIONS IS BASED ON A MISCONCEPTION OF THE STATUTORY PURPOSE AND ON AN ERRONEOUS CONSTRUCTION OF THE STATUTORY LANGUAGE

Defendants contend that, since Harwyn's shareholders did not pay for the spun off stock which they received, the distributions did not involve any "sales," and accordingly that there can be no violations of the registration provisions of Section 5 of the Securities Act in this case. With respect to the statutory purpose, they contend (a) that the only function of registration is to provide a prospectus to the immediate offeree of distributed shares to enable him to make an informed investment decision as to whether to buy them; (b) that it is the Exchange Act, and not Section 5 of the Securities Act, which is intended to deal with subsequent trading in the shares; and (c) since the Harwyn shareholders were not required to make an investment decision as to whether to buy the spun off stock, registration would have been a useless act.

Defendants' argument, as discussed below, rests upon a persistent refusal to recognize the existence of a factor

of overriding significance, namely, that the spin-offs were effected for no independent business purpose, but rather for the sole purpose of instantly creating publicly-held companies whose shares would be actively traded. The Commission submits, particularly in light of this factor, that defendants have adopted an unjustifiably restrictive view of the function of Securities Act registration and have misconstrued the statutory language.

A. Harwyn's Spin Offs Were the Type of Transaction Intended to Be Subject to the Registration Provisions of the Securities Act.

A recurrent theme throughout the legislative history of the Securities Act was that the investing public had incurred large losses because of sudden distributions of securities without information being concomitantly released to enable the public to make reasoned investment decisions. Securities issued by new or unknown companies would suddenly appear upon the market. Rumors would begin to circulate and

wild speculation would ensue, causing losses to uninformed investors. 1/ In enacting the Securities Act, Congress wanted to prevent this type of activity by requiring companies, especially those as to which there was little or no publicly available information, to expose themselves and their financial condition to the public when their securities were distributed into the marketplace, so that information would be publicly available to enable investors to make informed decisions.

Since the enactment of this legislation in 1933, great strides have been made in providing full disclosure to the investing public; and it has been the Securities Act registration requirement, probably more so than any other provision in the federal securities laws, which has brought about this remarkable achievement. For it is through the registration process that the Commission's staff is able, in advance of a public distribution, to examine and review

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1/ House Rep. 34 on H.R. 52, 69th Cong. 1st Sess. 1925
House Rep. 85 on H.R. 5480, 73rd Cong. 1st Sess. 1933

the detailed business and financial information about the issuer contained in the registration statement filed with the Commission, and to work out any disclosure problems involved. Moreover, as new situations arise, calling for new methods of disclosure, the staff is able to deal with such matters in its review of registration statements and to work out the proper method of disclosure.

The registration requirements, contrary to defendants' contention, not only serve to protect the immediate distributees of the registered securities but also serve a vital function in protecting subsequent purchasers and sellers in the market-place. See Section 4(3) of the Securities Act and the discussion at pp. 14-15, 25-27 of the Commission's Memorandum of Law. This is particularly true in the case of a company which is making its first public offering. Although the registration provisions apply also to offerings made by companies whose securities are already publicly traded, these provisions have their greatest impact in situations like those in the present case where a distribution converts a privately held company into one whose securities are held

by numerous public investors, and creates for the first time a trading market in those securities. In such a situation, since there may well be little or no publicly available information about the company prior to the distribution, compliance with the registration provisions opens up the previous wall of secrecy surrounding the company and provides investors, broker-dealers, investment advisers and others in the financial community with information essential to the maintenance of an honest trading market in which people can buy and sell the company's securities on the basis of informed judgments and at prices that are not determined arbitrarily.

In view of this vital role served by the registration provisions when a company makes its first public offering, the Commission submits that, except in those limited situations where overriding policy considerations dictate a contrary result, the Securities Act was intended to require registration before a company's securities make their initial entry into the public trading markets.

It is true of course, as defendants point out, that through the exemptions contained in Sections 3 and 4 of the Securities Act it is possible in certain instances for a trading market in a company's securities to develop even though the company has never been required by the Act to register its securities. But the exemptions were enacted because of overriding policy considerations which render it either unnecessary, undesirable or impracticable to require registration in certain situations. For example, the exemptions in Sections 4(1) and 4(2) are a reflection of two factors: (a) that registration is not deemed necessary when the offered shares come to rest in the hands of persons who, by virtue of their relationship to the issuer, can fend for themselves and obtain needed information without registration; and (b) that when such persons, who are not in control of the issuer, decide at a later time to resell their shares into the market, it is impracticable to require registration since they cannot compel the issuer to file a registration statement. Through these exemptions, it is possible for securities sold initially in private placements to eventually enter the market without a registration statement ever having been filed. Similarly, isolated or casual sales by a company's

controlling stockholders, each sale involving only a small amount of securities, may gradually change a company from a privately-held company into one with a significant body of shareholders; but to require registration for each isolated sale may not be appropriate, particularly when the broker who executes the transaction may have no way of knowing whether registration is required. Another situation in which stock may enter the market without registration arises under the doctrine embodied in the Commission's Rule 133, which permits the issuance of unregistered shares in certain mergers. This doctrine had its origin, however, in the 1930's when many corporate reorganizations were being consummated during the Depression, and it was thought undesirable to complicate them by applying the then unfamiliar registration requirements. Rule 133 transactions also raise problems as to the application of the civil liability provisions and the identification of persons who are underwriters. While this doctrine remains in effect today, the unregistered merger transactions which it permits are transactions which serve an independent business purpose - to unite two businesses. Moreover, in cases where the merging company is subject to the proxy provisions of the

Exchange Act, full disclosure is obtained through those provisions.

Unlike the foregoing situations, the present case involves no policy considerations which would even remotely warrant a decision excluding any of Harwyn's spin-offs from the registration requirements. Since each spin-off was brought about by the issuing subsidiary and its controlling persons, registration statements could have been filed; and unlike a gradual buildup in the number of shareholders through isolated or casual transactions, the situation here was that a privately held subsidiary having one shareholder, Harwyn, was instantaneously converted through a large-scale distribution into a publicly held company having over 500 shareholders. Most importantly, however, the Harwyn spin-offs had no independent business purpose; their sole function was to create publicly-held companies whose shares would be actively traded, and to enable defendants to derive whatever benefits might flow from such trading. 2/ Thus, defendants

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2/ Accordingly, the question whether traditional spin-offs effected for independent business purposes would require registration is not in issue in this case.

are in effect making the untenable argument that because Congress has exempted certain transactions where policy considerations render registration either unnecessary, undesirable or impracticable, this Court should add to the exempted category the Harwyn spin-offs which involve no such considerations.

B. The Statutory Language Should Be Construed To Carry Out the Statutory Purpose

Since the Harwyn spin-offs were the type of transaction intended to be subject to the registration provisions, the statutory language should be interpreted to carry out that statutory purpose unless the language clearly and unmistakably precludes such a result. Thus, the Commission is not, as defendants suggest, urging that the statutory language be ignored; rather we are relying on long-standing principles of statutory construction. See pp. 15-18 of plaintiff's Memorandum of Law.

The interpretation of the statutory language, in the present case, involves the questions of whether the defendants engaged in "sales" within the meaning of Section 5 and, if so, whether the transactions were exempt from registration under Section 4(1).

1. Defendants Sold Securities

There are two separate grounds for concluding that defendants engaged in sales within the meaning of Section 5. First, by bringing about spin-offs for the purpose of creating trading activity in the marketplace, defendants caused and became participants in the offers and sales in the trading market which took place subsequent to the spin-offs. (See pp. 24-27 of plaintiff's Memorandum of Law.) It is important to remember, in this regard, that the market sales were not simply an incidental consequence of the spin-offs and a matter of no concern to defendants. To the contrary, the creation of trading markets in which there would be continual sales was defendants' sole purpose and objective in effecting the spin-offs.

Secondly, the entire process by which the shares of each subsidiary were spun-off to create a trading market, and benefits were derived by defendants from the trading activity which took place in that market, constituted a

"disposition of . . . [securities] for value" and therefore a "sale" as defined in Section 2(3) of the Securities Act. The subsidiary and its new management obtained the benefit of a publicly held company whose shares were actively traded, and the increased market price resulting from the continual sales in the market added value to the shares held by the new management as well as to the spun-off shares held by Harwyn's insiders. See pp. 27-28a of plaintiff's Memorandum of Law. Again, as in the case of the first ground for holding that defendants engaged in sales, it is important to remember that the benefits received by defendants were not simply an incidental consequence of some trading activity which, in turn, was just an incidental consequence of the spin-offs. The trading activity and the receipt of the benefits flowing therefrom were defendants' very objective in effecting the spin-offs.

Although the securities which were spun-off consisted of shares belonging to Harwyn, all the defendants, including

the subsidiaries and their new management, caused and participated in the transactions and therefore violated Section 5. Each subsidiary whose shares were spun-off was a party - indeed, an essential party - to the agreement to effect the spin-offs: Had the subsidiary not agreed to issue a controlling block of its stock to the new management, the spin-off would not have occurred. In addition, the spin-off was effected for the subsidiary's benefit and was essential to the accomplishment of the subsidiary's objective, namely, to obtain an infusion of assets and became a publicly-held company. Similarly, the new management were also responsible for the spin-off. The spin-off, which was essential to the accomplishment of new management's objective of obtaining a publicly held company, was effected at their behest and for their benefit in order to accomplish their objective. If the new management had refrained from acquiring control of the subsidiary, the spin-off would not have occurred.

Had there been compliance with the registration provisions in this case, persons who traded in the spun off shares subsequent to the distribution to Harwyn's shareholders

would have had the benefit of the public availability of the required disclosures. For at least 90 days after the effective date of the registration statement, securities dealers effecting sales of these shares would have furnished a statutory prospectus to the purchasers; 3/ and of course, even apart from the delivery of the prospectus, all investors as well as their stockbrokers and their investment advisers, would have had the benefit of the availability of the information contained in the registration statement during and even after the 90 day period. In addition, a company which has made a registered distribution is subject to the periodic reporting provisions in Section 15(d) of the Exchange Act, 15 U.S.C. 78o(d), requiring continued disclosures by the company subsequent to the distribution.

2. Defendants' Transactions Were Not Exempt From The Registration Provisions

The exemption in Section 4(1) of the Securities Act is not applicable to the present transactions, both because they

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3/ See Section 4(3) of the Securities Act, 15 U.S.C. 77d(3).

were transactions by issuers and because they were transactions by underwriters.

Issuer Transactions

Each spin-off and the sales made in the ensuing trading market were transactions by the issuer - i.e., by the subsidiary itself. Each spin-off was simply a part of a larger transaction to which the subsidiary was an essential party and which included the issuance by the subsidiary of the block of stock which went to the new management. Particularly since the spin-off was a condition of this purchase of stock from the subsidiary, the spin-off and the issuance of the new stock were inextricably linked together, and it would be unrealistic to treat the spin-off and the stock issuance as separate transactions. Without the active participation of the subsidiary in providing the new stock, there would have been no spin-off at all.

Underwriter Transactions

Each spin-off and the sales made in the ensuing trading market were also transactions by an underwriter - Harwyn; and

there are two separate reasons why this is so. First, in effecting the spin-off Harwyn was acting on behalf and for the benefit of the subsidiary (see p.13 , supra) and therefore was an underwriter within the meaning of Section 2(11) 15 U.S.C. 77b(11), as a person who sells for an issuer in connection with a distribution. Second, Harwyn was also acting on behalf and for the benefit of the subsidiary's new management (see p.13 , supra) and therefore was an underwriter as a person who sells for the issuer's controlling persons in connection with a distribution. See S.E.C. v. Chinese Consol. Benev. Ass'n, 120 F.2d 738, 740 (2d Cir. 1941) cert. denied, 314 U.S. 618 (1942). 4/

4/ The Memorandum of Law submitted by defendants Harwyn ans Siegel, (p. 37), in urging the availability of an exemption under Section 4(1), quotes from the Commission's decision in Great Sweet Grass Oils Ltd., 37 S.E.C. 683, 690 (1957), aff'd, 256 F.2d 893 (D.C. Cir. 1958). The initial distribution in that case involved a merger and therefore was excluded from the registration requirements by Rule 133. The Commission stated that "subsequent casual sales . . . by non-controlling stockholders which follow the normal pattern of trading in the stock would be deemed exempt" from registration by virtue of Section 4(1). Defendants' reliance on the quoted material is misplaced, however, since it is obvious that the Commission was not referring to transactions like the present spin-offs in which it was the very purpose of the issuer and its controlling persons to bring about the subsequent sales.

It is important to note that each of the foregoing grounds for denying the Section 4(1) exemption - one ground relating to issuer transactions, and two relating to underwriter transactions - is alone sufficient to deny the exemption. Thus, if this Court should conclude that the transactions here involved were transactions by an issuer, it need not consider whether any of the defendants were underwriters. Similarly, if it concludes that Harwyn was an underwriter on either of the two grounds advanced, it need not consider the other ground. Nor need the Court decide whether any of the remaining defendants are underwriters; for if a transaction is not exempt, all persons who cause or participate in it are in violation of Section 5 regardless of whether they happen to be underwriters (see pp. 22-23, 36-38 of plaintiff's Memorandum of Law).

C. "DIVIDENDS" ARE NOT NECESSARILY EXEMPT FROM REGISTRATION

The defendants have repeatedly referred to the Harwyn spin-offs as "dividends" or "stock dividends." In so doing they have employed the same device that they have

unjustifiably accused the Commission of utilizing, namely a bootstrap argument to bolster their contention that the transactions complained of involve no sales of securities and are therefore exempt from registration under the Securities Act. They could have just as conveniently called the unregistered securities of the subsidiaries "exempt securities" and labeled their various NOTICES (See Exhibits C, G, J and R of Sorkin's Affidavit) as NOTICE AS TO SOURCE OF EXEMPT SECURITIES.

Their argument is based upon the assumption that "dividends," either in stock, cash or other property, and "sales" as defined in Section 2(3) of the Securities Act, are mutually exclusive. This is an incorrect assumption. Neither in Section 2(3) nor in Section 5 is there any provision declaring that dividends and sales are mutually exclusive. Indeed, the term "dividend" is not even used there. Furthermore, since the Court in the instant case is faced with the task of interpreting a federal statute, the meaning given to the term "dividend" under state law would not be determinative.

See S.E.C. v. Variable Annuity Co., 359 U.S. 65, 69 (1959).

In any event, whether or not the Harwyn spin-offs would be characterized under state law as "dividends," they clearly are not "stock dividends." While the term "dividend" has been defined in several contexts, See McKinney's Consolidated Laws of New York Annotated § § 219 - p and 350, it is well settled under New York State corporation law Business Corporation Law § 510, that a dividend of stock of another corporation is in no way a stock dividend as the term is usually employed.

> It is very clear that a dividend of the stock of other corporations is in no respect a stock dividend, as the term is usually employed; i.e. an increase of the nominal capital stock of shareholders of a company. It is precisely the same as a dividend in cash because the corporation might have sold the stock and divided the money among its shareholders. In Re Rodgers, 48 N.Y.S. 175, 178 aff'd 161 N.Y. 108; cited with approval In Re Kurz's Estate, 251 N.Y. S.2d 112, 114 (1964).

Similarly, the spin-offs of the securities of the four subsidiaries in the present case were not increases of the nominal capital stock of the shareholders of Harwyn.

This distinction between "dividends" and "stock dividends" is important because the defendants have repeatedly characterized the Commission's Securities Act Release No. 929 (July 29, 1936) as a justification for their failure to register. Their claimed reliance on this release as the "authority" that has sanctioned unregistered spin-offs for the past thirty years is based on an incorrect interpretation of the release. It should be noted that the release specifically points out that the term "sale" as defined in Section 2(3) of the Securities Act "is extremely broad in its scope. . . ." 5/ The release also points out that the party requesting the opinion "is silent as to the mechanics of the declaration and distribution. . ." of the dividend there involved. Most

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5/ The relevant part of Section 2(3) reads: The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security for value. The term "offer to sell," "offer for sale," or "offer" shall include every attempt or offer to dispose of, solicitation of an offer to buy, a security or interest in a security, for value.

importantly, however the release deals with a situation which differs from the present case in two significant respects. First, Release 929 deals with a true "stock dividend" declared in the stock of the corporation which is declaring the dividend. In that situation the company's securities may already be trading publicly on the open market, and a dividend in stock would be an increase in the capital of the corporation rather than an _initial distribution of securities of a privately-held corporation_. Compare this situation with that of the Harwyn distributions of securities of wholly-owned subsidiaries - which securities have _never_ been traded publicly and are distributed at a time when there is a total vacuum of information concerning the subsidiaries. Second, the situation dealt with in Release 929 did not involve a distribution effected for the sole purpose of creating an instant public corporation - a situation which appears to be a relatively recent phenomenon.

D. ABSENCE OF PRIOR JUDICIAL PRECEDENT DOES NOT PRECLUDE AN INTERPRETATION CARRYING OUT THE STATUTORY PURPOSE

The defendants have stressed that this action brought by the Commission raises novel questions of law and is based

on a "new concept" in the interpretation of the securities laws. They seem to argue that new interpretations must be left to the legislature and are not a proper exercise of the judicial function. This proposition not only is contrary to fundamental principles of Anglo-American jurisprudence, but would destroy the vital function of the courts to interpret statutory language through judicial decisions, applying the statutes in accordance with legislative purpose to new situations as they arise. Thus, even assuming that the Court is faced with a case of first impression in deciding whether spin-offs effected to create "instant" public corporations must be registered,". . the first litigation of . . . a /particular/ practice is a proper occasion for its outlawry if it is in fact in violation." Chasins v. Smith, Barney & Co., Inc., CCH Fed. Sec. L. Rep. par. 92, 712 at p. 99136 (2d Cir. July 7, 1970).

It is particularly appropriate, indeed essential, to interpret the securities laws on a case-by-case basis so as to carry out the statutory purpose in dealing with new situations involving the application of these laws. Such

an approach is not inconsistent with settled doctrine, for

> It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits. S.E.C. v. W.J. Howey Co., 328 U.S. 1100, 1103 (1946).

The term "sale" is a broad, non-technical term which, because it lies at the very foundation of the applicability of the Securities Act, must be construed flexibly to deal with new situations in accordance with the Congressional intent. It is just not realistic to require Congress, rather than the courts, to deal continuously with the myriad of methods, schemes and artifices employed to violate the Securities Act.

The defendants repeatedly claim that for the past thirty years the type of spin- offs involved in this case have been regarded as not requiring registration. As we have shown, however, not only are the activities complained of contrary to the statutory purpose, but the distribution of unregistered securities through spin-offs for the sole purpose of creating instant public companies appears to be a relatively recent phenomenom. Furthermore,

the defendants in this case have not been singled out by the Commission to be sued in a test case involving spin-offs. The Commission has also brought action against other persons who utilized the spin-off method prior to the July 2, 1969 release.

II CONTRARY TO DEFENDANTS' ASSERTIONS, THE FRAUD ALLEGATIONS ARE NOT DEPENDENT UPON A FINDING THAT DEFENDANTS HAVE VIOLATED THE REGISTRATION PROVISIONS OF THE SECURITIES ACT

Defendants mistakenly assert that the Commission's fraud allegations are based on the theory that, by violating the registration provisions, they automatically committed fraud violations also. To the contrary, the fraud allegations are not at all dependent on a finding that defendants violated Section 5. The fraud charges rest on two grounds, neither of which involves the registration provisions.

First, defendants made affirmatively false and misleading statements of material fact in at least two respects. (a) A release to shareholders which categorically states that the corporation being spun-off has "no assets and no liabilities" is plainly misleading in light of previous releases announcing

the acquisition of the subsidiary by new management. Is one to believe that new management is giving up privately held assets for a corporation that has no assets? Is one to believe that the subsidiaries which several weeks prior to the distribution had received an infusion of assets, now at the time of the distribution had no assets? The defendants have claimed that the NOTICE(S) AS TO SOURCE OF DIVIDENDS were understating the real worth of the subsidiaries and should therefore be "praised" for taking a more conservative position with regard to the worth of spin-off corporations. But it is just as important not to understate information conveyed to the public as it is not to overstate information. S.E.C. v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968), cert. denied sub nom. Kline v. S.E.C. 394 U.S. 976 (1969).

(b) The defendants also deceived Harwyn shareholders and other investors in the public markets by describing the spin-offs as dividends, without at the same time informing the public, including Harwyn's shareholders, that Harwyn had specifically contracted with third parties to spin-off the shares of its subsidiaries and that the spin-offs were made solely to create publicly held companies rather than for an

independent business purpose and to provide legitimate dividends to the Harwyn shareholders. The nature and purpose of the dividends were material facts because they might have affected "the desire of investors to buy, sell, or hold the company's securities." Securities and Exchange Commission v. Texas Gulf Sulphur, supra, 401 F.2d at 849. Disclosure of the background of the so-called dividends would have put investors on notice that the new controlling persons of each subsidiary were not averse to taking action artifically affecting the market for the company's securities. Such disclosure would also have put investors on notice of a motive for the new management to run the company's business in such a way as to stimulate market activity regardless of the effects on the corporation itself.

The second major ground upon which the fraud charges rest - and this ground is the heart of the fraud portion of the case - is based on the Congressional intent to secure fair and honest securities markets (see pp. 38-44 of the Commission's Memorandum of Law) and was summarized at p. 63:

> With respect to the anti-fraud provisions, particularly those under the Exchange Act, the creation of a trading market through a distribution effected for the sole purpose of creating such a market, while basic

> information about the company or the distribution is withheld, would be inconsistent with the statutory purpose of maintaining fair and honest securities markets.

See also p. 45.

The Commission's position that defendants violated the anti-fraud provisions by their action in creating trading markets while basic information about the companies and the distributions was withheld does not mean, as defendants assert, that in order to have complied with the anti-fraud provisions they would have had to furnish all the detailed information contained in a statutory prospectus. What they would have been required to do was disclose certain basic information essential to the maintenance of an honest market - information about the company's financial condition, the nature of its business, the identity and background of its management and the nature and purpose of the distribution.

Nor does the Commission's position mean that defendants should be held to have violated the anti-fraud provisions simply by having remained "totally silent." Defendants committed the violations by taking affirmative steps to create the trading markets.

III DEFENDANTS SHOULD BE PRELIMINARILY ENJOINED

The defendants, in their various answering affidavits and memoranda of law, have erroneously characterized a preliminary injunction in a Commission enforcement action as being an "extraordinary remedy" that can only be granted if there is "clear and convincing" evidence that there is a "danger" the violative activity will occur again.

The defendants, however, fail to realize that this preliminary injunction sought by the Commission is a creature of statute and therefore the burden of showing irreparable injury by clear and convincing evidence is totally irrelevant to the relief sought. Furthermore, the preliminary injunction sought by the Commission is a means by which the defendants are ordered to obey the law and not engage in further violative activity. The defendants cannot treat the Commission's action as a common law fraud action for damages.

Although the defendants have repeatedly characterized a preliminary injunction as an "extraordinary remedy," it is, in fact, no more than a " mild prophylactic." See S.E.C. v. Capital Gains Research Bureau, 375 U.S. 179, 193 (1963).

As the court stated in Capital Gains Research Bureau, supra at p. 193,

> It is not necessary in a suit for equitable or prophylatic relief to establish all the elements required in a suit for monetary damages.

Defendants' reliance as a defense on Securities Act Release 929 and Section 19(a) of the Securities Act is without merit. No further discussion is necessary concerning the applicability or relevancy of Release 929 (See POINT I subsection C of this Reply Memorandum of Law). As for Section 19(a), this section applies only to "rules and regulations of the Commission." It does not apply to or make reference to interpretive releases.

The defendants have also suggested that since they derived no benefit from their violative activities, they should not be preliminarily enjoined. Assuming, arguendo, that the defendants are correct, although the Commission argues otherwise (See Memornadum of Law, pp. 28-28(a) and POINT I subsection B of this Reply Memorandum of Law) the Court in

S.E.C. v. North American Research and Development Corporation, 424 F.2d 63, 82 expressly lays this argument to rest and goes further in stating that economic motivation is not a defense to action for violation of Section 5.

CONCLUSION

It is respectfully requested that the relief sought in the Commission's motion be granted and that this Court issue an order of preliminary injunction enjoining the defendants from further violations of the registration and anti-fraud provisions of the federal securities acts.

Respectfully submitted,

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