

COMMONWEALTH OF PENNSYLVANIA  
HOUSE OF REPRESENTATIVES  
COMMITTEE ON APPROPRIATIONS

In re: Budget Request - 1983-1984  
Securities Commission

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Verbatim report of hearing held  
in the Minority Caucus Room,  
Main Capitol Building, Harrisburg,  
Pennsylvania, on Wednesday,

February 23, 1983  
3:30 p.m.

HON. MAX PIEVSKY, CHAIRMAN  
Hon. Kurt Zwickl, Vice Chairman  
Hon. Joseph M. Hoeffel, III, Secretary  
Hon. H. William DeWeese, Chairman Subcommittee on Capital Budget  
Hon. James M. McIntyre, Chairman Subcommittee Health and Welfare  
Hon. Ralph Pratt, Chairman Subcommittee on Education

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Reported by:  
Dorothy M. Malone

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**ALSO PRESENT:**

**Michael Hershock, Executive Director**

**Paul Muench**

**Don Easton**

**Jim Stevens, Budget Office**

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**Robert M. Lam, Chairman**

**Cole Price, Commissioner**

**John Tuten, Commissioner**

**Elliott Klein, Chief Counsel**

**Nancy L. Diana, Secretary**

**Mark Cohen, Director of Enforcement**

**Philip Rutledge, Director of Corporation Division**

**Simon Dengel, Administrative Services Director**

**Ernest Cole, Director of Licensing**

**CHAIRMAN PIEVSKY:** The Appropriations Committee welcomes the Securities Commission.

(Prepared statement of Chairman Robert M. Lam, Pennsylvania Securities Commission, was as follows:)

" The Pennsylvania Securities Commission administers and enforces the following Pennsylvania statutes: The Pennsylvania Securities Act of 1972 (1972 Act) (Act No. 284 - effective January 1, 1973) and the Takeover Disclosure Law (Act No. 19 - effective March 3, 1976).

" The Commission is comprised of three Commissioners, Cole B. Price, Jr., of Cumberland County; John C. Tuten of York County; and myself of Montgomery County. The Commissioners are appointed by the Governor with the advice and consent of the Senate.

"The Commission is functionally divided into three divisions and the responsibilities of each division are summarized in this Budget Request as follows: (1) Corporation Finance (pp 22-32); (2) Enforcement (pp 33-36); and (3) Licensing (p 37).

"The function of the Commission and its staff is to regulate the sale of securities and the securities industry in Pennsylvania. The Commission's jurisdiction encompasses all securities offered and sold in Pennsylvania or to

Pennsylvania residents. The 1972 Act requires the registration of all securities offered for sale in Pennsylvania unless there is an applicable exemption. The Act provides a series of exemptions to cover situations where, because of the nature of the security or the character of the transaction, registration is not deemed to be necessary in the public interest or for the protection of investors.

" With respect to the responsibility for regulating the securities industry in Pennsylvania, the Commission maintains as its primary objective the encouragement of investor protection and confidence in the investment banking industry. In this respect, all persons who propose to act as broker-dealers agents (salesmen) or investment advisers must be licensed by the Commission prior to engaging in such activities.

" The Takeover Disclosure Law requires the filing of a registration statement or exemption notice in certain cases involving persons seeking to acquire equity securities for the purpose of changing or influencing the control of a Pennsylvania corporation or a corporation which has its principal place of business and substantial assets in Pennsylvania. The purpose of this statute is to ensure full and fair disclosure to all offerees of material information in regard to a takeover offer.

" The Commission's functions also include the investigation of alleged violations of the provisions of the above-referenced statutes along with the initiation of civil and criminal prosecutions of persons who have violated the provisions of these statutes.

" Philosophically, the Commission considers its regulatory responsibility as that of protecting the public from unfair and fraudulent practices employed in connection with the offer and sale of securities in Pennsylvania while, at the same time, encouraging the financing of legitimate business and industry in the Commonwealth.

" Legitimate capital formation activities, which are necessary for state and national economic growth and health and for new or continued job employment, are adversely affected when (1) the investing public loses confidence in the honesty and integrity of the financial markets; and (2) our supply of investment capital is misappropriated.

" It is the Commission's position that measures taken by the Commission prior to the offer and sale of securities (to insure compliance with the 1972 Act) by those entities subject to securities regulation are more cost effective to the Commonwealth and are more beneficial to the protection of the public investor than enforcement measures

which are instituted after alleged violations of the 1972 Act have occurred.

"In order for the Commission to have an effective and accountable regulatory program, this agency must have an adequate complement of professionally-trained, knowledgeable staff. This staff must be capable of acting in a responsible regulatory manner in an atmosphere of federal deregulation of the financial markets and the ever-changing array of financial products which this deregulation has spawned.

"The Commission, therefore, has included in its 1983-84 Budget Request, four program revisions to hire additional staff to facilitate capital formation and economic development (see Programs 1 and 2, pages 49-55); deter economic crime (see Program 3, pages 56-62); and insured the integrity of the securities markets (see Program 4, pages 63-71).

" As an aid to capital formation and economic development, the Commission, in adopting existing regulations and in promulgating new regulations and guidelines, gives priority to certain factors such as (a) compatibility with existing federal, state and local rules; (b) extent and scope of conditions which have arisen that justify the imposition of such requirements; and (c) economic and industry impact of such

rules. The most recent action taken by the Commission is in the area of employee and community investments in distressed businesses.

" It should be noted that the Commission views each of the requested programs to be of equal importance to the Commission and to the welfare of the citizens of the Commonwealth.

" It is recognized that the requests set forth in these four programs require the appropriation of additional funds. In addition to the justification for the programs set forth in this statement and as discussed in the programs, the Commission requests that the General Assembly now recognize that the fee revenues collected by the Commission from the securities industry should go to support the agency's securities regulatory activities.

" In fiscal year 1981-82, the Commission revised its fee schedule (as pages 5-6) which resulted in a dramatic increase in actual and projected revenues (see page 7). Fiscal year 1981-82 revenues of \$2,581,855 were 100% over 1980-81 revenues of \$1,289,972, and were 90% over the Commission's fiscal year 1981-82 budget appropriation of \$1,357,290.

" Fiscal year 1982-83 projected revenues of \$2,983,000 will be approximately 99% over the Commission's

1982-83 budget appropriation of \$1,500,000.

" Projected revenues for fiscal year 1983-84 of \$3,050,000 will exceed by 65% of the \$1,830,000 contained in this budget request.

" The chart on page 8 contains a comparison of Commission appropriations to revenues since fiscal year 1976-77.

" The Commission, in submitting its proposed fee changes, which are now included in Act 48 (Commonwealth Fee Act) also advised the administration and the legislature that, in tandem with the fee changes, the Commission is proposing to amend the Pennsylvania Securities Act of 1972 to ensure the changes to the Commission's fee schedule would result in fees being fair and equitable, to reduce by half the current waiting period before certain sales of securities can be made in Pennsylvania, and to remove certain unnecessary impediments to legitimate capital formation which currently exists.

" The Commission currently has proposed legislation designed to reduce technical burdens on certain classes of issuers registering securities under the 1972 Act, to expedite the effectiveness of certain filings with the Commission, and to make certain exemptions for the registration requirements of the 1972 Act more available to certain classes of issuers.



" The proposed amendments will in effect dramatically increase the number of filings under the private placement exemption contained in the 1972 Act and, in addition, will reduce the waiting period prior to the commencement of an offering in Pennsylvania for certain issuers, thereby requiring additional staff to timely review these offerings.

" Revision of fee schedule.

" Act 48, effective July 1, 1981, regarding Commonwealth Agency Fees ("Fee Act") contained a revised fee schedule for the Commission. In summary, the legislation provided for an increase in five Commission fees and provided for ten new fees. In addition, Section 602 of the Pennsylvania Securities Act of 1972 still retains three fees which were not revised and were not included in the Fee Act.

"Of the ten new fees, four relate to statutory exemptions from registration of securities or securities transactions which require a filing with the Commission. The Division of Corporation Finance devotes substantial time to analyzing and reviewing such exemption filings.

"As background information, during 1978-79, a comprehensive study of fees collected by the Commission was begun by the Legislative Budget and Finance Committee ("LBFC") to determine the need for legislative change to increase fee

schedules to cover a "reasonable" portion of fee-related costs.

" In its study of fees collected by the Commission, the LBFC staff focused on the following: (1) How much fee revenue is generated? (2) What activities are fee-related? (3) How much is expended by performing such activities?

"In determining specific fee rates for services performed, the Commission conducted a national survey of other state securities agencies and also considered those findings and recommendations contained in the LBFC's October 1980 "Fee Study of the PSC." The Commission's primary objective in establishing those fee rates reflected in the Fee Act was to insure that persons paying fees would pay an equitable amount based on the services being provided in order to avoid burdening the general taxpayer, who is not a major recipient of such services, with funding a significant cost of fee-related activities; and, insure the fairness of such fees and their effect on those persons who do business in Pennsylvania.

"The Commission, in submitting its fee change recommendations for inclusion in the Fee Act, pointed out that there must be some linkage between the increase of fees for certain segments of the securities industry and the enactment of certain amendments to the 1972 Act directly affecting those particular persons in order that the proposed

fees are fair and equitable and that certain unnecessary impediments to legitimate capital formation that currently exist are removed. The Commission's fee schedules contained in the Fee Act are based on a cost-analysis of services rendered, as reflected in the LBFC "Fee Study."

Following is a comparison of Commission revenues since the enactment of the Pennsylvania Securities Act of 1972:

1982-83: (Projected)	\$2,983,000	1977-78:	\$1,208,553
1981-82:	2,581,855	1976-77:	880,438
1980-81:	1,289,972	1975-76:	828,550
1979-80:	1,311,608	1974-75:	737,687
1978-79:	1,003,761	1973-74:	743,969

#### Account code structure.

During fiscal year 1981-82, the Commission staff has worked in conjunction with the Comptroller's Office in order to develop a revised account code structure for expenditures of funds in the Commission. The new account code structure was to be designed in order that expenditures for employee salaries, benefits, operating costs and similar expenditures could be recorded and compiled according to the fee with which the activity was associated. This structure will be incorporated into the Commonwealth's Centralized Accounting System to provide for computerized collection and processing of the data. The results of this information may

then be compared with the data obtained through the revised revenue code structure that was implemented July 1, 1981, simultaneously with the new and revised fees. This will reveal precisely the total costs of the various activities associated with each particular fee.

" This development will enable the Commission to regularly produce reports on fee revenues received and the fee related costs for purposes of review and analysis or for public information. Information contained in these reports may be used to determine those inequities that may exist in the fee structure. In addition, the results may be used as an objective reference for the purpose of adjusting or making recommendations concerning the adjustment of existing fees.

" The initial implementation of this new structure was July 1, 1982. Following this initial implementation, a comprehensive time study is planned in order to assess the accuracy of the information resulting from this project and to further refine the data. This project is consistent with the recommendation made by the LFBC in the October 1980 "Fee Study of the PSC."

CHAIRMAN PIEVSKY: Chairman Lam, do you want to introduce your organization?

CHAIRMAN LAM: We would be very happy to. We, of

course, are appreciative of the opportunity to be here. John Tuten all the way on my left, who is a fellow Commissioner, Cole Price, fellow Commissioner. We have Elliott Klein, our Chief Counsel; Nancy Diana, our Executive Secretary. Behind me we have Mark Cohen, who is our Director of Enforcement; we have Phil Rutledge, who's Director of our Corporate Divisions; Simon Dengel, who's our Administrative Services Director, and Ernest Cole, who is Director of Licensing, in the back. Thank you.

CHAIRMAN PIEVSKY: Michael Hershock, I believe you have some questions.

BY MR. HERSHOCK:

Q Mr. Lam, before any members want to ask you questions, there are parts of your budget that contain really substantial increases in personnel. I would just like to go through them quickly and ask you to explain why the increase is necessary for each function and then see if the members have any questions about that. The first, the total apparently is about a 32 percent increase in staff. In the Division of Corporate Finance you are seeking three of these 32 positions to accelerate the review of filings. How long does it take to review a filing now? How long should it take and what are you going to do with these three people?

A I think the way I would like to answer that if I may is, first to give you kind of an overview as to why we want to expand that department. And then secondly, to ask Phil Rutledge, the Director of our Corporation Division, an attorney with us, to explain just what they do, how they function and how this will actually specifically relate.

Really there are, I guess, three reasons why we need this expansion of personnel in this department. One is the number of filings coming into Pennsylvania, as you may have noticed from the budget request that we have presented you with, have dramatically increased over the past year, certainly over the past couple of years. What we are finding is that with the SEC taking a deregulatory process, they are leaving a lot of areas uncovered that are now falling to the states and the states have to do whatever review process is necessary. At the present time, 50 percent of the issues that are offered in Pennsylvania are not reviewed by the SEC. That means if the state doesn't do it nobody is going to do it. So our responsibilities have increased drastically during the past year. In addition to that, we have also developed a program within our department working along, as a matter of fact, with the Governor's office and certain members of the legislature where we are expediting certain filings that come to us. Particularly

those that concern themselves with distressed industry. We were very active in the A & P takeover in Philadelphia by the employees. We devoted, I can't tell you exactly how many hours, but it was ten or 15 staff hours in the attorneys' division to help them put that deal together. Some of these priority items and the additional case load has really bled us white.

The other reason, and I guess really the primary reason, is that a bill has been introduced, <sup>if it</sup> hasn't been introduced, it is about to be introduced in the Senate, which will change some of our regulatory processes. It is going to expedite filings, quicken the pace and to raise capital in Pennsylvania and also cheapen the process at the same time by allowing certain things to be done under the exemption process which still must be reviewed by us, but not requiring a full filing by the Securities Commission. By reducing the time element to expedite those offerings, we are going to need more personnel in that division.

Q It sounds like I may have asked the wrong question.  
I asked --

A How the three positions specifically --

Q I asked how long is it taking you to review a filing. You're telling me that maybe about half of them even get reviewed.

A Oh, no, no. I am saying half of the issues in Pennsylvania that are reviewed by us in one form or another and also reviewed by the SEC. The other half are not reviewed by the SEC at all. We are the only body reviewing them. That is a new phenomena. It never used to be that way. The SEC took a much stronger posture and is much more involved in many, many things.

Q How long is it taking to review a new file?

A Let me pass to Phil Rutledge, if I may for a moment. I will get to that. I was saving that for the end, but probably should have been first.

Phil, do you want to speak to that?

MR. RUTLEDGE: Thank you. We have basically two types of filings. One is a filing to claim an exemption from registration which means you have to prove certain things that that exemption is available to you.

Second is the filing for registration under the Act. The filings for exemptions are, all filings are time sensitive. Most specifically, the filings for exemptions under which most of the tax sheltered type of filings fall under. We review all those filings, especially the tax shelters and it is a timely process because the Act says it must be filed before you can offer and sell, but you can offer and sell after you file it.



We review these filings to make sure, one, the exemption is available to them. They have met all the statutory criteria. And second, that the disclosure is adequate to meet the anti-fraud provision of Section 401 of the Act. We must do this timely. That means within a day or two of receipt in our offices, we have to get on that filing, review it thoroughly and if we have comments, which we do most of the time, get back to the issuer and tell him that the Pennsylvania Securities Commission has the following comments and we move toward a resolution. So, the timing is critical, especially at the end of the year, September or December tax shelter season. Over last fiscal year, this fiscal year, we had a 31 plus percentage increase in the number of filings. So those types of exemption filings need immediate attention. The fact is we are getting so many of them we don't have enough bodies to appropriately review all of them.

BY MR. HERSHOCK: (To Mr. Rutledge)

Q That is what I'm asking. How long does it take?

A How long does it take? Depending upon the number of comments, but we generally get to the filings within, I'd say, a matter of several hours per file.

CHAIRMAN LAM: But how long does it take you on that file?

MR. RUTLEDGE: On that particular file?

MR. HERSHOCK: Till they are approved to sell stock, to issue the security?

CHAIRMAN LAM: Maybe if Phil could get -- why don't you, Elliott, go through this scenario when we get it in.

MR. HERSHOCK: I still want to know how long.

MR. LAM: We're going to tell you.

MR. KLEIN: I'm going to try to be responsive to your question. There are two types of filings that come to us. Those for formal registration and those for private placements or other exemptions. Those for formal registration generally run anywhere from four weeks to six weeks if they are simple and if they are full, complex offering to the public at large, could run several months.

In terms of the exemptions which Phil is addressing himself to, the critical thing is the timing factor. That under an exemption in most cases the Commission does not have to clear an offering in order for the securities to be sold. Yet the legislature intended that there be a review because there is a requirement that it be filed with us. Because of the time factors built in that statute that review period is telescoped down to one day in order to review a filing. Reviewing the filing could take weeks, could take days, depending

upon the complexity. The important element is that primarily we get to look at it the day that it is filed. Because in the event there is something wrong with the filing in an exemption posture, that person who is filing could go out and offer and sell those securities the day it is filed. Unless we can initially respond to it and review it the day it comes in, we are going to be left with a situation which we are now turning the matter over to enforcement, because if there is something wrong with the filing in some way the public investors are getting hurt. Then what we could have resolved in a matter of a couple of hours by asking them to hold off, don't sell this until you get this corrected, turns into long prosecutorial delays, costs and expense. So that the first element that we want to do is be sure that we can review these things, exemptions, on the days that they are filed.

Now, you have asked how long does it take to straighten out the situation when there is a problem. When there is a problem, we could spend as much as two hours or we could spend two weeks or we could spend three weeks, depending upon the complexity of what is involved. Many of the things that we are looking for in terms of the exemption filings are the track record of the individuals that are involved in this. Have they ever been subject to any administrative sanctions,

criminal proceedings. Have they made full disclosure of their past record in other activities. And when you have a problem situation, when you have what is known in the industry as bad boys, people coming in and trying to sell under an exemption with a past record of wrongdoing, it may take a long time before the disclosures are put into proper perspectives where the matter is brought to the attention of the Commission to issue a denial order.

But that is the two pronged element that is involved. One, to have enough bodies to be able to review it the day it is filed, and secondly, to have enough people to be able to, within a reasonable period of time, particularly if the deficiencies are those that can be adjusted by getting prompt comments to problems with the projections. That may be of a technical nature, problems that are related to matters of if which staff were available, in an hour or two or several days, by going back and forth with the issuer are able to resolve those particular problems. Then the offering can go forward and go forward comfortably.

But in answer to your basic question, it depends upon how serious the problems are as to how long it takes to review an exemption. A registration takes six to eight weeks for a small offering and months in cases of a large offering.

BY MR. HERSHOCK: (To Mr. Klein)

Q You are asking for three new people to accelerate this. How many are doing it now?

A We have a complement of four attorneys in the division, two legal assistants and the rest is clerical. So that would be a total of --

MR. RUTLEDGE: We only have two people, two attorneys, one full time, one part time, one legal assistant and one securities accountant doing just exemption filings.

MR. KLEIN: For exemptions alone, but in terms of the total process, the figures that I gave you was the total amount for our total responsibility in the division, including exemptions and registration.

BY MR. HERSHOCK: (To Chairman Lam)

Q The other four positions you are asking for I assume are in relation to the new Act, the bill you sent to the Senate?

A That is correct.

Q So those four positions are prospective based upon the passage of the bill?

A That is also correct. To the best of our knowledge, we feel rather confident that bill is going to be passed because everybody seems to be in favor of it, and we have had

an awful lot of agitation to get on with it.

Q What will these people be doing?

MR. KLEIN: They will come into two categories. The nature of the bill is to deregulate certain of the burden and the time delays that are involved in the offering. At the same time be certain that we haven't reduced the protection to the public investors. In that scope, what will occur will be there will be many more filings coming into the Commonwealth of Pennsylvania. In the areas of private placements, there are technical provisions in our statute that, without getting too technical on this, that present a brokerage firm who may be affiliated with a promoter of an offering or in some cases be actually part of the promotion of an offering, from selling the securities under an exemption in Pennsylvania. Anyone else can go out and sell under a private placement exemption, but not this particular class of brokers.

It is very common now in the securities industry for brokers to be involved in putting together private placements of securities, because they cannot avail themselves of the exemption right now. What is happening is that Pennsylvania investors are simply not being offered these securities because you have national brokerage firms that can sell in 50 different jurisdictions and where they are being exempted in

every jurisdiction practically but Pennsylvania. They are able to sell immediately and those private placements are then being purchased by investors in other jurisdictions. Whereas, I indicated to you before when it has to go through a registration, because of this technicality, it takes four to six weeks. So what will occur will be two different factors. One will be many more filings of securities in Pennsylvania as a result of making the exemption available. And the second factor will be because the review period will be reduced from weeks to one day, the burden will be increased upon the staff to review those filings.

There are several other deregulatory provisions that are built in there as well, which also reduces the filing time. One of the most significant relating to employee participations, which Chairman Lam referred to in the case of the A & P Co-op situation, where we are seeking to reduce the waiting period down from 30 days to 15 days in order for employees to invest in their own businesses and hopefully preserve their businesses. This will place an additional burden on the staff as well.

CHAIRMAN LAM: If I could just also add that we do anticipate that our fees which have been going up dramatically over the past year will also be impacted very positively

by this new approach.

MR HERSHOCK: You have four people you want to establish in an enforcement office in Harrisburg. You cited as the reason for that saving time and cost and delays to citizens. What are these four people going to do and what kind of money are they going to save?

CHAIRMAN LAM: Let me speak to that also, if I may. The four people that we talk about are going to constitute a third enforcement office for us in the Harrisburg area. I will ask Mark to speak on exactly who they are going to be and what they are going to do. Before I do, I would just like to add that we need additional personnel in that Department very badly. John Fedders of the SEC complained recently in a speech that his enforcement attorneys had to handle three and four cases at one time. If they had one big case, the other three cases were just neglected. Our attorneys are now handling between 30 and 35 cases apiece. So we obviously, we need additional help. We just really are not coping with the situation properly.

By having a third office it is prudent to have it in Harrisburg rather than to add in Philadelphia and Pittsburgh, because the Philadelphia and Pittsburgh people are forced to come into Harrisburg in the central area of Pennsyl-



vania to do their job, to do the research, et cetera. This will alleviate that problem. It will save us some funds and will be cost-efficient by doing it that way. We think it is productive and proper economics to beef up this Department, because every time that funds are diverted from their appropriate course, there is less seed capital in the State of Pennsylvania. Every time somebody perpetrates a fraud. If we can get on these things right away, promptly, get an injunction against the fellows who are selling stock improperly, we can stop that bleeding off of our economic well-being. Mark, would you just speak to the first part of that question.

MR. COHEN: Yes, as the Chairman indicated, we have a tremendous backlog of open investigations involving security fraud in Pennsylvania with a very, very small portion number of legal staff to prosecute these cases. In the last year or two, because of the economic climate, we are finding more and more investment scams coming out of the woodwork and robbing the citizens of this State of their investment dollars. We have found that approximately two-thirds of our active investigations are located between Harrisburg and Philadelphia. A lot of our work has to do with actually going out to the various outlying counties, interviewing the various investors in these schemes and a lot of the promoters of these schemes

are also in the outlying counties. You have to do this work face to face many times with investigators and the people involved. If you take people from Philadelphia and have them on the road between here and Philadelphia every day, you're talking about four hours of driving time. It is a complete waste of time. If we had an office staff, we only have a request for staff for just one attorney, one securities analyst, one typist and one investigator, a bare skeleton staff to open up a third district office. It would save us a tremendous amount of time in researching. We do researching with the Department of Revenue and the Corporation Bureau which is all centrally located here in Harrisburg. We have a good number of investigations that are located here. We would be able to handle our litigation in the middle district of Pennsylvania and Commonwealth Court more efficiently here in the middle district of Pennsylvania. Our basic time and travel costs will be cut down, but we desperately need more enforcement staff to handle a tremendous amount of investment frauds that we have open and investigating in Pennsylvania right now.

Many of these cases involve sophisticated white collar crime. Many of these people retain very prominent defense counsel and we just need more attorneys and more staff

to be able to just protect the investors and give them more of a sense of security in the investing market in Pennsylvania.

MR. HERSHOCK: Are all of your attorneys state employees?

MR. COHEN: Yes, they are.

CHAIRMAN LAM: I just might add, every attorney in our Department is a State employee not permitted to have private practice and I might say hired without any political, without our knowledge of any political affiliation. I am very proud of that situation.

BY MR. HERSHOCK: (To Chairman Lam)

Q Finally, you are proposing an additional four positions for the creation of a compliance program for brokers, right? What are these four positions for and what is the program you wanted to create?

A Okay, we'll speak just specifically to who they are and what they are going to do in just one second. But again, if I may just give you a short overview. The Act mandates that we monitor and inspect and review the workings of the brokerage community. We now have some 600 broker dealers in Pennsylvania and some 20,000 sales people. To the best of my knowledge, the Department has never been funded sufficiently to go into a program and has been relying entirely

on the NASDA, National Association of Securities Dealers, and the Federal FEC to carry this burden. In most states, the State Securities Commission works in concert with those two bodies and they divide up the workload and they work together reviewing the various broker dealers. Both of those agencies now are cutting back on their inspections. And many, many Pennsylvania broker dealers have never been inspected. In this documentation it does go into the details of some of the critical areas of vulnerability we are left with. We have never done any inspection ourselves unless we had an enforcement matter to contend with. We would hope to put that program into effect and the justification being for the additional expenditures is, number one, we are bringing in more money than we ever brought in before. We hope to bring in more money next year and more money the year after. We just think in order to protect, again, the investment climate, which is so critical in this State, and to keep the funds at home right here in Pennsylvania, that we got to maintain that integrity. It is kind of scary because we really don't know what is going on out there in the big world. Ernie or Nancy, I don't know which one. Ernie, do you want to speak to what you would do with those specific positions?

MR. COLE: Sure. Not wanting to repeat what Chair-

man Lam has outlined, the fact that the SEC and what material you have in front of you, they only review about 30 percent of the offices in Pennsylvania on a calendar year, broker dealers, and only about 14 percent of investment advisors. They have their investment advisors, they are short just as we are. They have them on, they get around to them once every 11 years I have been told. So we do need somebody. We needed the program that is mandated to us in the Act to set up this compliance program. It has never been funded because we never had it since '72, since it has been mandated. We have been working in concert with the SEC and the NEC. This actually is just a pilot program, four people, three examiners and one clerical.

I do visualize in the years ahead we would need 15 people.

BY MR. HERSHOCK: (To Mr. Cole)

Q So if one of your examiners visits my local stockbroker down here on Second Street what is he going to check for, what is he going to look for?

A He will be trained in a program that is contemplated, they will go through a program to be trained to do an internal audit, really do an in-house audit as well as post-registration reporting requirements and that all the people that are there are affiliated with the broker dealer that are

properly registered, all sales and all transactions are properly recorded and that notices are going out on time, transactions are timely, all post-registration requirements are timely.

Q Do not the major stock exchanges verify that kind of thing before they accept a broker?

A If they are a member of the New York Stock Exchange, for example, if their home office is in New York, yes. That will come through the regulatory agency over there. That is a requirement, but they only go to the principal office of that firm. Most of your large firms have offices in Pennsylvania as well as your mom and pop.

CHAIRMAN LAM: We have had problems in the past in the branch offices, very serious problems. We always find out about them after the fact.

BY CHAIRMAN PIEVSKY: (To Chairman Lam)

Q Is there any duplicating?

A There really, I would say this. There is no duplicating because all of these things are well coordinated. We would certainly not go in on the same people that they were going to go in on. There is complete notification of what is going on. I think I can best explain, a lot of people think you have a Securities Commission and you have the SEC, but it

is sort of the same connotation as having the State Police and the FBI. They have a different overview than we do. They look for different things. They are attracted to different kinds of problems. We are interested in what is going on in Pennsylvania. They are looking at the whole country.

MR. COLE: I might add that the SEC is looking at a giant problem on a national level. We are concerned about the mom and pop.

MS. DIANA: With respect to your comment regarding the exchanges, review of their member firms and the home offices. In many instances we have been made aware that an exchange has conducted an exam, maybe a regular exam or a special audit of one of its members for any particular purpose. Usually it is a member's home office. That member could have eight, ten offices in Pennsylvania. Depending on the type of problem the stock exchange has uncovered, more seriously not only the broker dealers financial responsibility perhaps in that cap, that kind of financial problem other than just the books and records problems, if they have zoned in on a customer abuse problem, they will alert those states that have compliance programs in place to conduct special audits of the firm's branch offices in their states. In many instances, it is because they have now spotted that perhaps the broker dealer

has hired a special vice president in charge of sales. The danger exists that the sales practices, the supervisory practices and reporting practices might have gone down. So in many states when they audit those branch offices they do indeed find hints of suggested customer abuse or potential abuse.

Pennsylvania is one of the few, I won't say the only state of its size, that does not have a compliance program in place. Historically, we have always allocated our resources to those areas which are critical, corporation finance, where I have observed the filings increasing 100%; the staff never increasing. And of course, enforcement being inundated with fraudulent schemes. Thereby the compliance program was never funded. Not because of need and I think those of you who have been on the Committee year after year have always been forthright about saying that when budget appropriations permit our priority is the establishment of a compliance program.

BY MR. HERSHOCK: (To Chairman Lam)

Q Mr. Lam, before I relinquish the microphone you just stated that you have had problems with branch offices in Pennsylvania. What kind of problems are you typically running into?

A Well, the one that was really coming to my mind was



the one that happened a number of years ago. I really should not mention names of brokerage firms. But we had a salesman in one of our smaller cities in Pennsylvania who was using abusive and fraudulent sales practices, one of the big firms. We got a complaint on it, we got into the act and all the principals from New York flew down and we had a hearing. Somebody lost their license, the money was repaid. It was a very nasty situation, but without going into minute details, it was a salesman, a practice of a salesman. It probably could have been uncovered, I am not saying we would have uncovered it with this program, but it could be uncovered with more surveillance. Somebody going in and looking over the books, making sure that the customers are suited for what they are buying, and so on.

Q Have you had problems brought to your attention in the branch offices of money not being transmitted in a timely fashion, record keeping not keeping up with trading and so forth?

A We have had numerous complaints of money not being transferred in a timely fashion. That usually goes to our enforcement division. They get in touch with the brokerage firm and they straighten the matter out. But again those things shouldn't happen at all. We are not addressing it

until after we get a complaint really.

Q You get a complaint from someone that bought stock?

A A customer, yes, sir. Didn't get my stock, didn't get my check, something like that. They held my check for two months and didn't pay me interest. These are, we don't consider these to be major complaints unless we have a chain reaction, but we do get those.

CHAIRMAN LAM: Elliott, do you want to add anything?

MR. KLEIN: Well, I just wanted to indicate that another area of concern of the branch offices is the question of adequate supervision. And one of the things that directly relates to our responsibilities to the State is the fact that the securities that are being sold in Pennsylvania have to be filed in most cases with the Pennsylvania Securities Commission and goes through a certain type of review process for protection of the investors. What we're finding out in a lot of branch offices, because of a lack of adequate supervision, is the fact that the agents that are working for the brokers are either free lancing or putting together their own deals or are putting together private placements which have never been cleared through Pennsylvania in many cases because of lack of supervision. Their employers haven't even checked close enough to see what their employees are doing. Often these are

the transactions that lead to the large amount of fraud on public investors. Sometimes a very large scale, because the investors are under the impression that this is somehow or other under the auspices of the broker dealers. In fact, it is not and therefore, again, when we talk about investors' confidence, this person is registered with XYZ brokerage firm. Can't be anything wrong with it. He goes out to the brokerage firm because the supervisor has no idea that this person is free lancing and causing a great deal of fraud and loss of investors' dollars in the Commonwealth of Pennsylvania.

MR. LAM: Might I add just one other thought? One thing I think is important to know, and some of this may be very elementary, but the state jurisdiction differs drastically from the Federal SEC. The Federal SEC is primarily concerned with anti-fraud, full disclosure at the time that the offer is made and then the after market.

Our concern primarily is before the offering is made, anti-fraud and a certain merit review. The Federal Government does not have that privilege or that responsibility. We being a uniform state have a merit review on many issues. We look at them. Our corporate division has guidelines, we look at them. They make sure that promoters are not taking an unconscionable amount of profit in th-

beginning, that there is no inside trading and things like that. If we find that, we won't let it go through. It may be sold in West Virginia, Maryland, but it won't be sold in Pennsylvania.

And escrowing of funds is another area we get into and suitability. Particularly in the tax shelter deals we have been very, very tough on that. We want to make sure that somebody is selling a tax shelter and not selling it to a guy that doesn't need it.

BY CHAIRMAN PIEVSKY: (To Chairman Lam)

Q Are you ever on the same case that the Feds are on?

A Yes, we are, and when that happens, now they refer cases to us and we refer cases to them. We have got a number of cases that we have been working in conjunction.

Q Together?

A Together and we will step aside or they will step aside at the appropriate time, a number of cases. A lot of cases we have worked and they have been in a better position to prosecute. We have a couple cases right now that the Feds are going to prosecute. But we were the ones that uncovered the case and brought it up to a certain level.

Q It solves your problem then?

A Well, it does. We would like to have all the credit but then at the same time, what is right is right.

CHAIRMAN PIEVSKY: Representative Vroon.

BY REPRESENTATIVE VROON: (To Chairman Lam)

Q Mr. Chairman, I want to ask a few elementary questions here and do it quickly. I am a corporation in Pennsylvania and I want to go public. I'm a Pennsylvania corporation and I only want to go public in Pennsylvania. I need only apply for registration with the SEC in Pennsylvania, is that correct?

A I am going to let Elliott Klein answer that, because there are no easy answers to these things. Because from what you're telling me, my answer would be yes, if you are only selling in Pennsylvania and only offering in Pennsylvania and your assets are in Pennsylvania. But he may have a question that may modify it.

MR. KLEIN: Well, basically that is correct. Assuming that the assets are in Pennsylvania and that proceeds will be used in Pennsylvania primarily, yes, that is an intrastate offering solely under our jurisdiction.

BY REPRESENTATIVE VROON: (To Mr. Klein)

Q Do you have a continuing monitor type of policy on that type of corporation?

A Yes, we do, in two different categories. We require them to file quarterly reports with respect to the amount of money that they are raising and what they have done with the proceeds of the offering in order to assure that what they have told the public they were going to do with the money they in fact used the money accordingly.

Secondly, there is a requirement for annual reports to be given certified to the security holders. Again, this is in the case of a public offering.

CHAIRMAN LAM: I might just add to that. The only thing where we would lose our control excepting for any fraud would be if you sold stock to one of the gentlemen here and then he sold the stock to somebody else in the after market. If there was out and out fraud we might get involved. Beyond that we would not. The SEC gets more involved in the after market than we do.

BY REPRESENTATIVE VROON: (To Mr. Klein)

Q If I, as a corporation, went through the process, I'm operating and some of my stockholders get very unhappy with me because I don't send out an annual report every year, could they come to you and insist that you make me issue an annual report?

A Yes, we would be able to go into court if they

wouldn't voluntarily comply and get a mandamus order from the court requiring them to provide financial statements to the investors. Fortunately, with respect to the public offerings that have been registered, we have run into few or no situations where that has taken place.

What is the general problem is more in the lap of the Enforcement Division and that is the offering of securities that have taken place immediately without registration and those shareholders want the financial statement. And in that situation, since it was not registered under our Act in the first place, there is no requirement for them to provide the financial statements, so therefore you have to turn to the Business Corporation Law which gives some relief and sometimes very little relief to the public shareholders.

Q This question, you mention merit review and I am pleased to hear that you do conduct the merit review. Now, to what extent do you conduct a merit review? For example, again I'm a Pennsylvania corporation and I only have shell, an idea up here. I am a real charlatan and I know how to fool people. I can write up a darn good prospectus and I can cook up as nice a deal as you ever heard of. Do you really dig to this thing as to the merits of the deal?

CHAIRMAN LAM: Let me just say, go to the SEC, they

will clear it as long as you make full disclosure. The SEC will clear that and in many states it will be cleared where they do not have a merit review. Most states have the merit review.

I'll let Elliott tell you what the keys are that we look at. We do have guidelines where we do have a uniform approach to this thing. We are not dealing by the seat of our pants. But he can tell you some of the key issues.

MR. KLEIN: I think the most important consideration is what is going to happen to the money. The first thing we do is we look to see how much money you need. We require in our guidelines you indicate specifically how that money is going to be spent. Without getting too technical you say you need five or six million dollars in order to do what you have to do. So we'll say to you, what is the least amount of money you need in order to start your business. Sometimes they'll say, well, two million or a million and a half or whatever else that is. So, at the starting point we require, once we determine that that is a reasonable minimum, that all of the proceeds of the offering be kept in escrow and returned to the public investors in the event you don't raise sufficient amount of money to at least do what you have to do.

That prevents during the six months or year period



you are selling securities that you're pocketing salaries, or doing nothing or just going out and selling securities, the money is wasted on travel, expenses, T and E and everything else that you might be interested in doing other than running your particular business. That will, in many ways, discourage somebody who is not for real in lay terms. That if they are raising capital, if they are forming a corporation in order to raise capital as opposed to raising capital in order to form a corporation, this is going to discourage anybody that wants a quick buck operator from going in.

The second thing is that once they determine that it is for real and that it is going to be adequately capitalized in order for them to do what they are going to do, that they have the experience and expertise, then we're involved in a merit review and that is we cannot guarantee that every offering is going to be successful. But we can guarantee a situation upon which the investors are putting in X number of dollars and taking a certain amount of risk, that they are going to share a reasonably appropriate share of the rewards if they are successful. Not a situation in which the public is putting in 90 percent of the money and is going to get ten percent of the rewards from that company later. We want to be certain that the deck is stacked fairly so that if the public is taking

a risk that the returns will be commensurate with the risks that they are taking and it doesn't wind up as a case with the SEC registration in which all the profits can essentially go to the promoters, referring to all return. There is very comprehensive guidelines that we have on it and fuller details, but that is the philosophy behind it and what is involved.

CHAIRMAN LAM: And that deals with cheap stocks, warrants and that sort of thing.

REPRESENTATIVE VROON: Now, let me change the context a little bit. I'm the same corporation, same good ideas. This time they are good ideas, but I am going to sell interstate. Do I go out to register with you and the SEC both?

CHAIRMAN LAM: Yes --

MR. KLEIN: Well --

CHAIRMAN LAM: That answer is not exactly correct. Go ahead, Elliott.

MR. KLEIN: Now you are getting into some very technical areas. Depending upon the size, the dollar amount and the people that you are going to. A year and a half ago Chairman Lam's response was categorically yes. If you had a public offering and you are going to go out and sell securities to a large number of people, you are going to have to register with the SEC. You are going to have to go through what is

almost like a mini registration. But the SEC has come up with something that really hits home in Pennsylvania. Very substantially what is called Regulation D. As a result of that has more or less dropped their responsibilities for a large amount of offerings, including offerings up to a couple million dollars involving the public at large. Now you can sell millions of dollars worth of securities in local jurisdictions without going before the Securities and Exchange Commission. It is part of their attempt to only concentrate on very major corporations, very major situations and delegate to the states greater and greater responsibilities. That is essentially what we are dealing with. What we have alluded to before is aside from all the increase in volume because of what is occurring and people attempting to raise capital in this particular climate, we are also getting a double burden because the SEC is attempting to throw back to the states greater and greater responsibility. And what would have been a quick answer to your question a year and a half ago, that would have been the SEC's problem. It is now our problem.

CHAIRMAN LAM: Just to elaborate on that, under normal circumstances what you would have to do, if you had to file with the SEC, you would file with the SEC and you would then either have to file with us or your would have to register

with us, depending on the circumstances of the issue. We, at that time, even if you're filing with the SEC and just filing with us on a notice basis, we still have the prerogative and our staff still checks over those SEC clearances, doesn't give them quite the scrutiny that we give the issues that are actually registered with us, but still checks them over. And if they find it does not meet our guidelines in one way or another, we will still stop it. An example, I am only mentioning a name because it was in the newspapers not too long ago is Walnut Leasing in Philadelphia. Walnut Leasing was a Philadelphia firm. They were on the verge of bankruptcy and they had been selling in many jurisdictions, but not in Pennsylvania. They are an SEC cleared filing. I don't know whether they still are or not but they were a year ago. And there was a big article in the paper that we wouldn't let them sell, but they are selling in New Jersey, Maryland, out of Philadelphia.

BY REPRESENTATIVE VROON: (To Mr. Klein)

Q Would you help me then to offer two million dollars worth of stock and not have anybody look at it?

A Would I -- I'm not certain I understand the approach.

Q You were telling me that maybe a two million dollar

offering wouldn't get looked at by anybody. It is interstate and it is supposed to be SEC jurisdiction.

A Oh, no, no. What will happen will be this. The SEC, as Chairman Lam indicated, when they do a registration are primarily concerned with disclosure. The states have a two-fold responsibility, disclosure and merit review and a registered offering. In the past what would happen would be filing with the SEC, going through all of their disclosure requirements in order to have a public offering, would be filed by coordination, coordinate with the SEC. The states would do a merit review. Now what is happening in this particular class of offerings is at this time only the states -- the states have total responsibility for both the disclosure and the merit review. So in essence, it falls back into the laps of the states and you still end up with the prospectus for disclosure and everything else. But the weeks and hours of review time that the SEC had been doing in the past are now the responsibilities of the states and that is the difference. Hopefully, our standards are as good if not better than the SEC. But the question, again, why we are here today is to be able to have the staffing in order to be able to review this inundation of filings that are coming about from this SEC, a throwback of their responsibility to the state jurisdiction.

Q Just a quick follow up then. Is a good part of your staff involved in this kind of work?

CHAIRMAN LAM: I would say, we have the numbers in here and I don't remember them off hand, but I would say approximately, almost half of our staff I would think is involved in what you're talking about. It is the corporation financing division and it is preventive medicine. It avoids many, many problems for us. You will notice if you look through this thing that there are a number of offerings that have come into Pennsylvania and have withdrawn and have not sold in Pennsylvania. That is why they are withdrawn. They got adverse comments from the staff, you are entitled to a hearing before the Commission. They don't bother coming in.

BY REPRESENTATIVE VROON: (To Mr. Klein)

Q So by and large you would say that there is not too much overlap in the amount of work that you do on offerings for the SEC?

A Absolutely none because where they perform a function we don't perform that function. We never do.

Q Except that once in a while you find out that they are performing the function?

A And in which case we get on the horn and we simply ask them, are you in the process of reviewing this. They have

filed this with us. There are certain things that have not been answered and we go back to the issuer and try to get the answers to those particular questions as opposed to us being duplicative and doing the same thing.

CHAIRMAN LAM: There is tremendous cooperation, tremendous cooperation.

CHAIRMAN PIEVSKY: Representative Pistella.

REPRESENTATIVE PISTELLA: Thank you, Mr. Chairman.

BY REPRESENTATIVE PISTELLA: (To Chairman Lam)

Q Mr. Chairman, my question probably falls into the area of policy, something that I noticed in the Governor's presentation Volume II of the budget this year would be a paragraph dealing with attempting to facilitate the ability of businesses to raise capital and particularly that area of employees taking over a particular company. I don't know if that dovetails into your presentation with your budget on page 3 which is the discussion I believe that Representative Vroon and Mr. Hershock had regarding the additional employees?

A Yes, I believe it does and I believe it concerns item number one. I don't know whether you have a copy of this or not. Where do we have that corresponding -- it is the accelerated review of filings under current program.

Q Covered I believe on page 51.

A Here's the document that we put out which really, we are disseminating to the public when they ask us, which articulates just how that program works.

Q May I ask for it?

A Surely.

Q With the permission of the Chairman I would like to have a copy of this for the record of the Committee.

A It is a series of interpretive opinions and regulations.

Q I would ask you if you could provide the Chairman a copy of this?

A We will see that you get them.

MS. DIANA: You want extra copies for the Committee?

REPRESENTATIVE PISTELLA: Right.

CHAIRMAN LAM: We'll see that you have them.

REPRESENTATIVE PISTELLA: Just to facilitate our getting them.

CHAIRMAN LAM: Right.

BY REPRESENTATIVE PISTELLA:

Q Could you explain very briefly some of the provisions that are contained in here that you allude to in saying you have to change certain guidelines, regulations, et cetera?

A Now, I think there may be an overlapping in that



question because we have already accomplished the aspect of it that facilitates the employee takeover. That is all done. And I am going to let Phil Rutledge speak to that if I may for just a moment to articulate how that works.

The second part of that is the change in the law which is the bill that is --

Q In the Senate.

A It is in the Senate right now. It was just introduced, that is right. I think Elliott Klein had mentioned what that was. We will just get a little capitalization so there is no confusion. Phil, why don't you first speak, if you would, as to what we did on employee takeover. Are you in a position to do that?

MR. RUTLEDGE: Okay. One is in the bill that was just introduced in the Senate and in combination with an interpretive opinion the Commission issued, which is contained in that document, which grew out of the O and L situation in Philadelphia. That the Commission, through its interpretive opinion, has determined that that type of employee takeover, through an employee workers cooperative, would be an employee benefit plan, which would make certain exemptions for registration available to them. The bill in the Senate will lower the waiting period that a plan must wait before it can go out

and solicit membership in that cooperative from 30 days to 15 days.

Now, a plan would still have to file with us for the exemption and would still have to go through a review process. This is what these particular positions would go to, expediting that review, making sure it gets a review in a short manner of time, because many of these things, time is of the essence.

CHAIRMAN LAM: And we have directed the staff, if they get one of those in, they are to drop everything else and immediately go to that and help them clear it as quickly as they can. The reason why we still have to review it, we don't want anyone taking advantage of anyone. Some promoter coming in and saying, hey, I got a great idea, I am going to make a lot of money for myself and we also want to make sure that there is full disclosure. Even though they may be employees, that they have a full understanding of what they are getting into.

MR. KLEIN: In addition to the employee issue in the package of information that we provided you, the Commission has created another regulation which expedites the ability of the people in the community to go out and invest at an earlier time period than what would be for the full registration

process. And in order to at least indicate their interest with money in escrow, pending full registration, which we found to be something so very essential that often the employees don't have sufficient capital, be able to come up with the financing that is needed. The registration process, as we have indicated to you before, sometimes takes weeks and sometimes takes months, depending on the complexities that are involved. Many times there are strong financing that would be available from outside sources, that from institutional investors would come in to support the employees taking it over, but they want to be certain there is also some equity interest by the community.

Under this proposal, which is in effect as a regulation right now, the community can put their money in escrow pending the effectiveness of the registration statement. Now, they will get a de nova chance once that registration statement comes out to review the final wording of it to make certain that they want to remain as investors. But we think that this is very essential as far as the community to be able to participate in the early timing of it per se. To preserve the jobs and preserve the industry in Pennsylvania. This is something, as a result of this regulation, that comes, as Chairman Lam indicated, under number one, we need people to expedite this type of filing and give the initial review which is something

that did not exist prior to this time.

BY REPRESENTATIVE PISTELLA: (To Chairman Lam)

Q You are not adequately covered now?

A We really are not. We are making it, we have a lot of glue and a lot of adhesive tape and things are working, but it really isn't a very satisfactory situation.

Q I know the system well. That is the reason why I raised the question regarding capital and economic development. I am interested in the area of economic development and I am sure, as you know, there are as many schools of economic development as there are people. I was wondering if in the two areas, number one, is this area in fact duplicated by any other department? The question being raised the fact that the Secretary of Community Affairs has now espoused an enterprise development concept with her budget proposal. The Department of Commerce, which has advocated a small business action center and other economic systems programs, PIDA, the revenue bond, et cetera. I was wondering if there would be some duplication or is this a situation where after the analysis has been completed by your organization, then referral will be made to another area for acquiring capital?

MR. KLEIN: Well, it is not the responsibility of the Securities Commission to deal with these proposed projects

per se. Our responsibility lies in facilitating the ability of raising capital among the employees or among the community under the security laws in the State. The alternative financing through public, through industrial development bonds, PIDA offerings or other approaches, in order to finance these activities is not within our purview. But when the public investors want to come in to shore up the community or when the employees want to come in to shore up the business for the community, then our Securities Act comes into play. What the purpose of these regulations and interpreted opinions create is circumstances upon which we are trying to expedite this so that it won't be because of any time delays that an investment opportunity, which would preserve business of the State, would not be available.

CHAIRMAN LAM: I think I can also add to that that we have worked closely with the Commerce Department and the industrial development bond and questions that have come up. We don't hesitate to stick our nose into somebody else's business a little bit to make suggestions where we think it impacts on the raising of venture capital. On the other hand, our primary responsibility is really consumer protection and really helping the industry to maintain its integrity and its image. We were happy to get into these other areas, particu-

larly if they start to impinge on us where they are doing something where we think it may be great in raising capital, but it may bilk a thousand investors. So in that case we are very outspoken in saying, hey, we understand what you are trying to do. You can't do it that way, you have got to do this, that and the other thing.

Our people have been very concerned with a lot of secondary issues which they are capable of handling and that is whether an issue affects the tax situation appropriately. I am talking about federal income taxes, et cetera. When we scrutinize something, we go over all of these inuendos very carefully to make sure the consuming public that is going to buy this stuff is really getting what they are supposed to get. And that has to do also with holding the industry. We have had a couple of those programs which really haven't been too satisfactory from a consumer standpoint.

BY REPRESENTATIVE PISTELLA: (To Chairman Lam)

Q Looking at the two narratives, I got the impression that it looks as if you are moving in two different directions, with the employee takeover on the one hand and the issue of the capital acquisition and formation on the other hand. I wonder if they cross or run parallel?

A I would think they run parallel, because all we are

doing is facilitating all of these programs to make it easier for them to do it and still protect the public. How they do it, I don't mean to be callous about it for having get involved in anything we should get involved in, but that really is their problem.

Q Your staff, once they have gone through this evaluation and analysis, do you make reference to suggestions or does your staff make reference to suggestions to implementing or using the revenue bond or PIDA?

A I think the only thing our staff has done in that direction is because when we first put out that little bulletin, we had a lot of calls coming in, can you get me money. We did tell them, the other departments, to get in touch with them. But we were not in a position ourselves to tell them just how they are going to raise that money.

REPRESENTATIVE PISTELLA: Thank you, Mr. Chairman.

REPRESENTATIVE VROON: Mr. Chairman.

CHAIRMAN PIEVSKY: Representative Vroon.

BY REPRESENTATIVE VROON: (To Mr. Klein)

Q Just a quick question on what we were talking about. Do you give the same kind of merit review to these situations that you would to an ordinary offering?

A The answer is both yes and no. With respect to

employees participation, our primary concern is disclosure to make certain -- because often in a corporation you have employees of various levels of familiarity with what is really going on with a company. We are concerned that there is sufficient information for an employee to make an intelligent investment decision.

With respect to the investment to the community at large where it is a registered offering under the statute, the statute still requires for us to put a merit review on the offering but on the circumstances upon which the offering might be made hypothetically, depending upon the suitability, who the people are in the community that might be backing the program. I think the Commission would be in a position to look at each offering individually to apply criteria that would be appropriate which regulations just went into effect and as of today's date we have not had such a filing for community investment. But technically the answer is yes, that portion would come under merit review, but the Commission has substantial discretion under the statute to create standards which would be appropriate in the context of any particular offering.

Q Would you require the issuance of a prospectus to all the employees involved?



A A disclosure document which may be called a prospectus, yes. Depending upon the circumstances, if they are offering what involved the key members of management that wanted to take over the company, the amount of disclosure would be more limited than it would be to a corporation that may have several hundred employees, which employees may be performing a wide variety of activities with the company and may be more or less familiar. But the answer is since it is an exemption, it would not come under our full prospectus guidelines and therefore the formal requirements for a three year certified financial statement and other requirements that would cause substantial delays would not necessarily be involved.

CHAIRMAN LAM: May I just add one thing yet. Phil Rutledge has suggested that I mention this. As you can see from the answers we are giving you, there are no short answers to these problems. Consequently, it takes a lot of staff time every time they get involved in something like this or in an issue and that is one of the reasons why he is hoarse and needs bodies. We rest our case on that.

BY REPRESENTATIVE VROON: (To Chairman Lam)

Q Just one more quick question, Mr. Chairman. Do you do anything at all by way of advising employees of a company that is going closing or has closed, who want to take it over

as to whether or not their chances are good chances of taking that company over and making it go?

A I think that we would not want to advise an employee as to the merits of a deal, getting into a deal or not. I know in the A & P case that we did have to do an awful lot of education in that situation. We were not hesitant to try to point them in the right direction, get a lawyer, a lawyer that knows securities stuff and we'll try to help. We took them by the hand as best we could. But I don't think we would want to bring employees in and say, gee, do you want to buy the company. Now that would be very dangerous I would think. They have got to make that decision themselves. But there are many ways they can get into these and we are happy to help them facilitate on the technical end of it.

Q Do you know a company very well that perhaps has been losing money for a number of years and finally decides to close, if their employees decide to try to take it over wouldn't you give them any kind of advice as to the chances?

MR. KLEIN: Well, to begin with, just to rephrase your question, in many situations in Pennsylvania it is not at a company that is in bad financial condition that is closing. It is something that is a corporation or division that is marginally profitable that is employing people, that

because of the big picture from a large national or voting national corporation, that they decide it is just not worth it for them pursuing this. So just to argue a little bit with the premise of the question, it is not always a negative situation that these employees are investing in.

Now in the case of where it is a marginal situation where there have been losses that have been sustained, this is where our responsibility comes in. We make certain that the disclosure document points out to them the risks that are involved. We make certain it would be tailored in a manner that would be readable and understandable by an employee in that company to be able to appreciate the risks that are involved in proceeding with that type of an investment. Under those circumstances, we hope to put them in a position where he can make an intelligent decision as to whether to invest or not.

CHAIRMAN LAM: I won't sleep tonight if I don't answer that question. I think if somebody came into us and showed us a deal and they were employees and they were thinking about buying a company and our people really let their hair down with us and said, it's a lousy deal. I don't think we would say to them it is a lousy deal. But I think we would certainly say to them you ought to talk to a good accountant, you ought

to talk to a good lawyer before you make a decision. You know, our conscience would be strong enough to do that.

CHAIRMAN PIEVSKY: Mike Hershock.

MR. HERSHOCK: Chairman Lam, there is legislation before the House now to involve the State in what is called community capitalism, in other terms EOP, employee takeover. This Committee, and the proposal would involve expenditure of State funds. Now this Committee will be holding hearings next week and the following week on economic development proposals. And during one of those hearings, I'm sorry I can't recall the precise date, during one of those hearings we will be taking testimony from a group that succeeded and a group that failed and learn what caused the failure and from the group that succeeded at Jeannette Glass what got in their way, what made it difficult for them to do it.

I would like to suggest that perhaps an observer from your Commission be present so that if questions arise at that hearing about the role of your Commission and what they want to say, I would like somebody there to answer.

CHAIRMAN LAM: All right, wonderful. We will certainly be there.

MR. HERSHOCK: Thank you.

CHAIRMAN PIEVSKY: Any further questions of the

Commission?

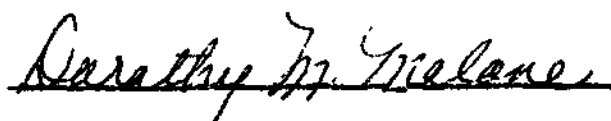
(No response)

CHAIRMAN PIEVSKY: Hearing none, then Chairman Lam  
the Appropriations Committee thanks you for your testimony.

CHAIRMAN LAM: Thank you.

(Whereupon at 4:25 P.M. the hearing was concluded.)

I hereby certify that the proceedings and evidence  
taken by me in the within matter are fully and accurately  
indicated in my notes and that this is a true and correct  
transcript of same.



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