

U.S. Trade Representative or the Chairman of the Section 301 Committee upon a showing of good cause and for reasons of equity and the public interest.

§ 2006.11 Consultations before making recommendations.

Prior to making recommendations on what action, if any, should be taken in regard to issues raised in the petition, the U.S. Trade Representative shall obtain advice from the appropriate private sector advisory representatives unless expeditious action is required, in which case he shall seek such advice after making the recommendation. The U.S. Trade Representative may also request the views of the International Trade Commission on the probable economic impact of the proposed action.

§ 2006.12 Recommendations: Time limits.

The U.S. Trade Representative, after receiving the advice of the 301 Committee through the TPC or an appropriate subgroup, shall recommend to the President what action, if any, should be taken under Section 301 with respect to the issues raised in the petition not later than:

(a) Seven months after the date of the initiation of the investigation if the petition alleges only an export subsidy covered by the Agreement on Interpretation and Applications of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade;

(b) Eight months after the date of the initiation of the investigation if any matter covered by the Subsidies Agreement other than only an export subsidy is alleged in the petition;

(c) Thirty days after the conclusion of the dispute settlement procedure where the petition raises issues covered by a trade agreement approved under section 2(a) of the Trade Agreements Act of 1979 (other than the Subsidies Agreement);

(d) 12 months after the date of investigation initiation in cases not included under paragraphs (a), (b), or (c) of this section

§ 2006.12 Information open to public inspection.

(a) With the exception of information subject to § 2006.14, an interested person may, upon written request, inspect at the office of the Chairman of the Section 301 Committee:

(1) Any written petition, brief, or similar submission of information made pursuant to section 301.

(2) Any stenographic record of a public hearing held pursuant to section 301.

(3) Information on the nature and extent of a specific trade policy or practice of a foreign government or instrumentality with respect to particular products or services, to the extent that such information is available to the U.S. Trade Representative or other Federal agencies.

(4) Information on the rights of the United States under any trade agreement and the remedies which may be available under the agreement and under the laws of the United States.

(b) Fees will be charged for duplication of documents requested in accordance with the fee schedule and payments provisions of 15 CFR 2004.9 and 2004.10.

§ 2006.14 Information not available.

If the U.S. Trade Representative does not have, and cannot obtain from other federal agencies, information requested in writing, by any person, he shall, within 30 days after the receipt of the request—

(a) Request the information from the foreign government involved; or

(b) Decline to request the information and inform the person in writing of the reasons for the refusal.

§ 2006.15 Information exempt from public inspection.

(a) The Chairman of the Section 301 Committee shall exempt from public inspection business information submitted in confidence if he determines that such information involves trade secrets or commercial and financial information the disclosure of which is not authorized by the person furnishing such information nor required by law.

(b) A party requesting that the Chairman exempt from public inspection business information submitted in writing shall clearly mark each page "Business Confidential" at the top, and shall submit a nonconfidential summary of the confidential information. Such person shall also provide the Chairman of the Section 301 Committee with a written explanation of the reasons the material should be so classified.

(c) The Chairman may deny a request that he exempt from public inspection any particular business information if he determines that such information is not entitled to exemption under law. In the event of a denial, the party submitting the particular business information will be notified of the reasons for the denial and will be permitted to withdraw the submission.

R. Michael Gadbow,

Chairman, Section 301 Committee.

[FR Doc. 80-15930 Filed 5-22-80; 8:45 am]

BILLING CODE 3190-01-M

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

Standard To Be Applied by the Commission in Disapproving Contract Market Rules

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of Agency Interpretation.

SUMMARY: The Commodity Futures Trading Commission ("Commission") is announcing its interpretation of the standard to be applied to contract market rules submitted for Commission approval pursuant to Section 5a(12) of the Commodity Exchange Act ("Act"), 7 U.S.C. 7a(12) (1976), as amended by 92 Stat. 871 (1978), and Rule 1.41 of the Commission's regulations, 17 CFR 1.41 (1979). Under this interpretation, the Commission may disapprove contract market rules which conflict or are inconsistent with the policies, purposes and public interests embodied in the Act as well as the provisions of the Act and the Commission's regulations.

EFFECTIVE DATE: May 23, 1980.

FOR FURTHER INFORMATION CONTACT: Nancy Yanofsky, Attorney, Office of the General Counsel, Commodity Futures Trading Commission, 2033 K Street, NW., Washington, D.C. 20581, (202) 254-9880.

SUPPLEMENTARY INFORMATION: Under the Act, futures contracts may lawfully be traded only through the facilities of boards of trade—commodity exchanges—which have been designated as contract markets by the Commission.¹ In 1974, when Congress extensively amended the Act, Congress understood that contract market "self-regulation had become noticeably ineffectual" and, therefore, a strong federal regulatory umbrella was needed "to insure the efficacy of the regulatory efforts undertaken by exchanges."² It has been recognized that

"[t]he mainstay of this umbrella, Congress decided, would be the CFTC. Armed with strong regulatory powers, the CFTC was designed to guarantee 'fair practices and honesty on the exchanges' and curb 'speculative activities that periodically demoralize markets.'"³

Under section 5a(12) of the Act, contract markets must submit for Commission approval most contract market rules relating to terms and

¹ Section 4 and 4h, 7 U.S.C. 6 and 6h (1976).

² *Smith v. Groover*, 468 F. Supp. 105, 109-110 (N.D. Ill. 1979), citing H.R. Rep. No. 975, 93d Cong., 2d Sess. 48 (1974) ("1974 House Report").

³ *Id.*, quoting from 120 Cong. Rec. 30458 (1974) (remarks of Senator Herman Talmadge).

conditions in futures contracts and other trading requirements before those rules may be made effective.⁴ The Commission is authorized to approve only those contract market rules which are "not in violation of the provisions of this Act or the regulations of the Commission * * *" (Section 5a(12)). Consistent with this authority, Section 5a(12) empowers the Commission to "disapprove * * * (a contract market rule) which the Commission finds at any time is in violation of the provision of this Act or the regulations of the Commission."⁵

Among these provisions is the requirement in Section 5(g) of the Act, 7 U.S.C. 7(g), which also was added in 1974, that futures trading in a particular commodity not be "contrary to the public interest."⁶ One of the components of the public interest standard in Section 5(g) is an economic purpose test.⁷ The Committee of Conference on the 1974 amendments emphasized that Section 5(g) "would include the concept of the 'economic purposed test * * * subject to the final test of the 'public interest.'"⁸ Thus, consistent with Section 5(g), the

⁴The Commission has defined these contract market rules as "reviewable rules" in Commission Rule 1.41(a)(2), 17 CFR 1.41(a)(2) (1979). Consistent with the provisions of Section 5a(12), the Commission has also specified those operational, administrative and temporary emergency rules which need not be submitted for approval by the Commission before being placed into effect. See Commission Rules 1.41(c) and (f), 17 CFR 1.41(c) and (f) (1979).

⁵In general, rules do not violate a statutory provision in the traditional sense of the term "violate." Instead, persons violate provisions of the Act or regulations. Rules, however, may be in conflict or inconsistent with or contrary to other provisions of law. Accordingly, the Commission construes the term "violation" in Section 5a(12) to embrace rules which are in conflict or inconsistent with or contrary to the Act or the regulations of the Commission.

⁶Section 6 of the Act, 7 U.S.C. 8, makes this requirement, among others, a prerequisite to and continuing condition of a contract market's designation. For example, if the Commission found that trading in a particular futures contract was no longer in the public interest, the Commission could suspend or revoke the contract market's designation. See Section 6b, 7 U.S.C. 13a (1976).

⁷S. Rep. No. 1194, 93d Cong., 2d Sess. 36 (1974) (Report of the Committee of Conference). The Commission has advised Congress that if a proposed rule did not serve a valid economic purpose, the Commission would disapprove the rule under Section 5a(12). In connection with the 1978 amendments to Section 5a(12) of the Act, the Commission explained to the Committee of Conference that "the Commission, consistent with the requirement of Section 5(g), presently analyzes the economic purpose of proposed exchange rules, particularly as to whether they conform to commercial practices, and would disapprove those that do not serve a valid economic purpose." (Letter of August 8, 1978, from chairman William T. Bagley, for the Commission, to Senator Herman E. Talmadge and Representative Thomas S. Foley.)

⁸S. Rep. No. 1194, 93d Cong., 2d Sess. 36 (1974) (Report of Committee of Conference).

Commission has the responsibility under Section 5a(12), in determining whether a proposed rule is in violation of the provisions of the Act or Commission regulations, to consider whether the rule will be contrary to the economic purposes and other public interests embodied in the Act.

Congress has expressly defined several of the public interests to be considered by the Commission in connection with contract market rules. Section 8a(7) of the Act, as amended in 1974, 7 U.S.C. 12a(7) (1976), authorizes the Commission, after first requesting the contract market to change one of its rules, to alter or supplement the contract market's rule if the Commission determines that

"such changes are necessary or appropriate for the protection of persons producing, handling, processing or consuming any commodity traded for future delivery on such contract market, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded for future delivery on such contract market."

A contract market rule proposal which the Commission determines will hamper the protections afforded traders, for example, is thus inconsistent with the public interest test of Section 5(g) as expounded by Section 8a(7).⁹

In addition, when Congress amended the Act in 1974 it also added Section 15, 7 U.S.C. 19. Section 15 specifically directs the Commission, in considering whether to approve contract market rules, to take into account the public interests served by the antitrust laws and to endeavor to take the least anticompetitive means of achieving the objectives, policies and purposes of the Act. Section 15, therefore, contemplates that under Section 5a(12) the Commission will disapprove, or attempt to modify, a contract market rule which would have serious anticompetitive effects that are not outweighed by the policies and purposes of the Act to be served by the rule. Congress understood that the objectives of the Act would be a paramount consideration in a Commission determination whether to approve a contract market rule.

It is the view of the Commission that these provisions of the Act demonstrate that Congress did not intend to limit the Commission's authority to disapprove a contract market rule under Section 5a(12) merely to those rules which are directly contrary to a specific substantive or procedural requirement of the Act or the Commission's regulations. Rather, the Commission

⁹See also Section 3 of the Act, 7 U.S.C. 5, which sets forth basic policies and purposes of the Commodity Exchange Act.

understands its statutory responsibility to disapprove as well those contract market rules which conflict or are inconsistent with any of the policies, purposes and public interest considerations embodied in the Act and the Commission's regulations.

A more limited construction of the Commission's rule disapproval authority—whereby the Commission could disapprove only those rules which directly conflict with a provision of the Act or the Commission's regulations—would lead to a somewhat anomalous result. Under this approach, for example, the Commission would be required to approve a contract market rule which did not directly conflict with a provision of the Act even though the Commission determined that the rule would result in inadequate protection to traders, an express basis for the Commission to alter or supplement a contract market rule under Section 8a(7). Therefore, the contract market rule would be approved by the Commission and placed into effect under Section 5a(12), and the Commission could, under Section 8a(7), immediately request the contract market to alter or supplement that rule. This would create instability and uncertainty in the contract market rule approval process. Market participants and the contract markets are entitled to expect a rule approval process which will permit them generally to rely upon a rule approved by the Commission, rather than waiting to see if the rule would be amended at the Commission's direction shortly after approval had been granted.¹⁰

¹⁰Under the Commission's interpretation of Section 5a(12), Section 8a(7) could be used to alter or supplement contract market rules which have previously received Commission approval in order to cure defects in rules that operate against the interests protected by Section 8a(7). Of course, at the time that the Commission approved such rules, it would anticipate that the rules would or might reasonably be expected to comport with the public interests set forth in Section 8a(7). However, a change in market conditions may take place to which the contract market may not respond in a manner consistent with a particular interest defined in Section 8a(7). In addition, a contract market rule could be applied in a manner contrary to the Commission's expectation when it approved the rule. Or, the Commission may adopt a regulation, subsequent to its approval of a contract market rule, which conflicts with the rule. Section 8a(7) could be used in any of these circumstances. In this connection, the Commission is of the view that it is authorized to revoke a contract market rule under Section 5a(12) or to effect a revocation under Section 8a(7). Section 5a(12) authorizes the Commission to approve contract market rules and "thereafter * * * [to] disapprove * * * (any contract market rule) which the Commission finds at any time is in violation of the provisions of this Act or the regulations of the Commission." (Emphasis added). Thus, the Commission is authorized to disapprove a rule, even though that rule has previously received Commission approval, if after reviewing the operation of the rule the

Footnotes continued on next page

The Commission's interpretation of its rule disapproval authority is fully consistent with the legislative evolution of these statutory provisions. In 1968 Congress enacted Section 8a(7) of the Act, which authorized the Secretary of Agriculture to disapprove any contract market rule which "violates or will violate any of the provisions of this Act, or any of the rules, regulations or orders * * * [adopted] thereunder." See Pub. L. No. 90-258, section 23(b), 82 Stat. 26 (1968).¹¹ Congress granted this authority to the Secretary despite the vigorous protests of most contract markets.¹² The rationale for the rule disapproval authority was provided by George L. Mehren of the Department of Agriculture who stated:

It seems obvious that when there is a conflict between an exchange rule and the law, or regulations, or orders issued pursuant to authority granted by the law, the exchange rule should be revoked or so changed as to bring it into compliance.¹³

In 1974, Congress amended Section 8a(7) by removing the rule disapproval authority from that Section and placing it in Section 5a(12) and by further amending Section 8a(7) to authorize the Commission to alter or supplement contract market rules.¹⁴ The rationale for the amendments to Section 8a(7) and the enactment of Section 5a(12) was provided by Dr. Clayton Yeutter, Assistant Secretary of Agriculture, who stated that the proposed provisions

* * * would extend to the Commission even broader authority * * * to make certain that in every instance the rules protect all traders and the public and provide for orderly trading in futures contracts.¹⁵

In 1978, Congress again addressed the Commission's authority to approve or disapprove contract market rules. As amended in 1978, Section 5a(12) requires the Commission to provide notice and opportunity for public comment prior to approving contract market rules the Commission determines to be of major economic significance. The sponsor of the amendment, Representative AuCoin, stated that the amendment was necessary because the absence of a provision for public notice regarding proposed rule changes

is disturbing when one considers that the Commission is a public agency charged with insuring that the public interest is adequately served and protected in rules and regulations promulgated by the private contract markets.¹⁶

Thus, the sponsor of the 1978 amendment to Section 5a(12), understood the Commission's authority under that Section to incorporate the public interests and purposes served by the provisions of the Act and the Commission's regulations.¹⁷

The 1978 amendment to Section 5a(12) underscores the propriety of the Commission's interpretation of its contract market rule disapproval authority. The purpose of this amendment was to ensure that the Commission would receive public comments on contract market rules of major economic significance. The publication requirement evidences Congress' intent that the Commission be responsive to concerns expressed by producers, traders or other members of the public and to disapprove those rules which do not serve a valid economic purpose or are contrary to the other public interests of the Act. Thus, the Commission intends to construe its rule

disapproval authority in a manner which will ensure that all rules approved by the Commission under Section 5a(12) comport with the policies, purposes and provisions of the Act and regulations.

The Commission has received correspondence from three boards of trade concerning this interpretation of its rule disapproval authority. In essence, these exchanges disagree with the Commission's view and have asked the Commission to defer publishing its interpretation until an opportunity is provided for public comment on the interpretation.

The Commission appreciates that these boards of trade and others may not concur in the Commission's interpretation of its rule disapproval authority. In this connection, the Commission welcomes comments from all persons concerning this interpretation. Nevertheless, the Commission is announcing a general statement of its present policy concerning the rule disapproval authority vested in it under the Act. This policy does not impose any new obligations upon any entity. Congress has made plain that general statements of agency policy or interpretative rules are exempt from the requirement of notice and public comment applicable to agency rule making proceedings. See 5 U.S.C. 553(b)(A) (1976).

The Commission emphasizes that it is merely notifying the public that the Commission intends to apply this interpretation and policy to contract market rules which have been or will be submitted under Section 5a(12). Prior to disapproving a contract market rule, the Commission will provide the affected contract market and, wherever practicable, the public with notice and opportunity to comment upon the rule and the grounds the Commission may rely upon to disapprove the rule. Of course, during this comment process, the public may comment upon the Commission's interpretation of its rule disapproval authority as well as the specific application of the policy to the contract market rule at issue. The Commission believes that comment on this interpretation will be most meaningful in the context of a concrete disapproval proceeding involving a particular contract market rule.

Issued by the Commission on May 19, 1980.

Jane K. Stuckey

Secretary of the Commission, Commodity Futures Trading Commission.

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Commission finds that the rule in practice operates contrary to the policies, purposes or provisions of the Act or regulations.

¹¹ Prior to the 1974 amendments to the Act, which established the Commission, the Act was administered by the Commodity Exchange Authority within the Department of Agriculture.

¹² *Hearings Before the House Committee on Agriculture on H.R. 11930 and H.R. 12317*, 90th Cong., 1st Sess., 24-25, 89 and 111 (1967) ("1967 House Hearings"). Only one contract market supported the enactment of Section 8a(7). A representative of the Chicago Mercantile Exchange stated that "there might be a need to have some Government supervision of our rulemaking functions in order to secure a semblance of immunity from the antitrust law." 1967 House Hearings at 136. That contract market also testified that the Secretary of Agriculture's authority under Section 8a(7) should be broadened so that the disapproval could be based upon a finding that the rule is "not in the best interests of the investors and traders in cash and futures commodities." *Id.* at 136.

¹³ *Id.* at 49. In 1968 Congress also enacted Section 5a(8) which imposed a duty on contract markets to enforce those rules which had not been disapproved by the Secretary of Agriculture. See 7 U.S.C. 5a(8) (1970). Congress considered Section 5a(8) to be necessary because the contract markets had failed to enforce their own rules. S. Rep. No. 947, 90th Cong., 2d Sess., 2-3 (1968). See also 1967 House Hearings at 50 (statement of George L. Mehren).

¹⁴ See Pub. L. No. 93-463, §§ 210 and 213, 88 Stat. 1401-1402 and 1404 (1974).

¹⁵ 1974 House Report at 78. Congress amended Section 8a(7) in response to a particular problem regarding self-regulation. The House reported that allegations had been made that, in order to circumvent the statutory requirement of enforcing their rules, contract markets were reducing the number of their regulations designed to insure fair trading. 1974 House Report at 44-48. Thus, Congress empowered the Commission to change or supplement contract market rules under Section 8a(7) to assure that contract markets would have adequate rules to protect the integrity of the marketplace. See *Smith v. Groover*, 468 F. Supp. 105, 118 (N.D. Ill. 1979).

¹⁶ 124 Cong. Rec. H7312 (daily ed., July 26, 1978).

¹⁷ See also 124 Cong. Rec. H7313 (daily ed., July 26, 1978) (remarks of Representative Glickman: "in many cases the Board of Trade rules are more significant than those the Commission promulgates").

**SECURITIES AND EXCHANGE
COMMISSION**
17 CFR Part 276
[Release No. IA-721]
**Contingent Advisory Compensation
Arrangements**
AGENCY: Securities and Exchange
Commission.

ACTION: Statement of staff interpretive
position.

SUMMARY: The Commission is announcing the interpretive views of its Division of Investment Management ("staff") as to the application of the performance fee prohibitions of the Investment Advisers Act of 1940 ("Advisers Act") to investment advisory compensation arrangements which are contingent on the investment performance of the funds of advisory clients. The purpose of this release is to provide general interpretive guidance to the public regarding the application of the Advisers Act to the variety of contingent advisory compensation arrangements which have come to the staff's attention, and thereby to obviate the need for further requests for staff interpretive or no action advice concerning such compensation arrangements where the requests do not present any novel factual or interpretive issues.

EFFECTIVE DATE: May 16, 1980.

FOR FURTHER INFORMATION CONTACT:

Michael J. Eizelman, Esq., (202) 272-2079, Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: Section 205(1)¹ of the Advisers Act,² with certain exceptions, prohibits an investment adviser, unless exempt from registration pursuant to Section 203(b) of the Advisers Act,³ from entering into, extending, renewing or performing any investment advisory contract which "provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client." The staff's position, as previously articulated in a number of no action and interpretive letters, is that Section 205(1) generally prohibits an investment adviser from

being a party to any advisory contract which provides that advisory fees will be waived or refunded, in whole or in part, if a client's account does not meet a specified level of performance or which otherwise makes receipt of advisory fees contingent on the investment performance of the funds of advisory clients.⁴ In the view of the staff, the realization of "contingent" fees is dependent on a client's account achieving a specified level of capital gains or appreciation. Thus, such fees, in effect, are based on a share of capital gains or appreciation of the funds of a client within the meaning of Section 205(1), and are therefore proscribed by that section.⁵

Section 205(1) of the Advisers Act was intended "to prohibit arrangements for contingent compensation to investment advisers based on profit-sharing arrangements with clients which encourage advisers to take undue risks with the funds of clients."⁶ The concerns about undue speculation⁷ which prompted the Congress to adopt Section 205(1) are as opposite to advisory fees which are contingent upon an advisory account obtaining a certain level of performance as they are to fees which vary directly with capital gains or appreciation. For example, an investment adviser whose compensation was contingent on a discretionary account achieving a certain level of performance might be inclined to purchase for the account speculative securities, involving a high potential reward and a high risk, if the account's value was below that necessary for the adviser to earn his fee. In this regard, the Commission report which helped form the basis for the Advisers Act contained the following views of industry representatives:

¹ See, e.g., McCuen & Russell, Inc. (avail. Apr. 27, 1979); Tessco Management Corporation (avail. Apr. 24, 1979); V. L. McKenzie (avail. Sept. 29, 1975); Bruce Bennett (avail. May 10, 1973); and Robert Reinhart, Jr. (avail. Sept. 21, 1971), reprinted in [71-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶78,464.

² Section 205(1), by its express terms, applies only to compensation arrangements based upon a share of capital gains or appreciation of the funds of an advisory client. Thus, the Advisers Act does not prohibit, for example, a fee arrangement based upon the interest income (exclusive of capital gains or appreciation) derived from the funds of a client, assuming, of course, compliance with the antifraud provisions of Section 206 thereof. See, e.g., Welch & Forbes, Inc. (avail. Jan. 26, 1974).

³ H.R. Rep. No. 2639, 76th Cong., 3d Sess. 29 (1940).

⁴ *Id.* See also Hearings on S. 3580 before Subcomm. of Senate Comm. on Banking and Currency, 76th Cong., 3d Sess., pt. 1, at 252 (1940). For a discussion of the legislative history of the prohibition against profit-sharing and other contingent fee arrangements, see SEC Institutional Investor Study Report, H.R. Doc. NO. 64, 92d Cong., 1st Sess., pt. 1, 259-263 (1971).

Arrangements for contingent compensation to investment counselors, such as percentage of profits, [were] strongly condemned [by industry representatives] as inimical to the interest of the client, for . . . , aside from the 'heads I win, tails you lose' aspect of such arrangements, such a basis for compensation 'encouraged the advisor to recommend a degree of risk that the investor himself would not knowingly undertake, inasmuch as the advisor has everything to gain if he is successful and nothing to lose if he is wrong' and may have been a strong temptation to take unusual risks, to speculate or to over-trade.⁸

To the extent there is any question as to whether Section 205(1) directly prohibits contingent advisory compensation arrangements, the staff believes that such arrangements are prohibited by Section 208(d) of the Advisers Act.⁹ Section 208(d) provides, among other things, that it shall be unlawful for any person indirectly to do any act or thing which it would be unlawful to do directly under the provisions of the Advisers Act. If Section 208(d), together with Section 205(1), were not construed to prohibit contingent advisory compensation arrangements, an investment adviser who was subject to Section 205(1) could employ indirectly a compensation arrangement which was the practical equivalent of a fee structure directly proscribed by Section 205(1) and thereby frustrate the prophylactic purposes of that section. For example, rather than charging a fee which was a direct share of the capital appreciation of a client's account, and which was thus expressly prohibited by Section 205(1), a registered investment adviser might choose to approximate such a fee by charging a fixed fee which it would agree to waive or refund, in whole or in part, if the client's account did not achieve a specified level of appreciation.

Among the proposed contingent advisory compensation arrangements that have come to the attention of the staff are those in which (i) fees are waived or refunded, in whole or in part, by an adviser if a specified level of investment performance in a client's account is not achieved,¹⁰ (ii) fees are contingent upon an advisory account having sufficient capital gains or appreciation during a specified period to

⁸ See Securities and Exchange Commission, *Investment Counsel, Investment Management, Investment Supervisor and Investment Advisory Services*, H.R. Doc. No. 477, 76th Cong., 2d Sess. at 30 (1939).

⁹ U.S.C. 80b-8(d).

¹⁰ See, e.g., McCuen & Russell, Inc. (avail. Apr. 27, 1979).

¹ 15 U.S.C. 80b-5(1).

² 15 U.S.C. 80b-1 *et seq.*

³ 15 U.S.C. 80b-3(b).

pay the fees,¹¹ (iii) fees are waived if recommended securities do not appreciate in value within a designated period of time,¹² and (iv) fees are contingent upon an account either not decreasing in value or avoiding a specified amount of capital depreciation.¹³ For the reasons discussed above, the staff believes that the foregoing contingent advisory compensation arrangements, which each pose the inherent conflicts of interest that Section 205(1) was intended to prevent, are properly characterized as involving a fee based upon a share of capital gains or appreciation of the funds of a client and, are thus, proscribed by Section 205(1).

The general interpretive guidance provided in this release should obviate the need, in most instances, for further requests for no action or interpretive advice from the staff relating to contingent advisory compensation arrangements. Accordingly, the staff will not respond to such requests unless they present novel factual or interpretive issues, such as departures from the specific contingent compensation arrangements described above.

Part 276 of Chapter II of Title 17 of the Code of Federal Regulations is amended by adding Investment Advisers Act Release No. IA-721—Statement of the staff as to the application of the Investment Advisers Act to contingent advisory compensation arrangements.

By the Commission.

George A. Fitzsimmons,

Secretary.

May 16, 1980.

[FR Doc. 80-15892 Filed 5-22-80; 8:45 am]

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¹¹ See, e.g., Stanley F. Raczynski (avail. Dec. 5, 1973).

¹² See, e.g., V. L. McKenzie (avail. Sept. 20, 1975).

¹³ See, e.g., Pension Investment Associates of America (avail. Jan. 25, 1977). Although an argument could be made that Section 205(1) literally does not extend to fees based upon "negative" capital gains or appreciation, the staff believes that, for the reasons discussed above regarding contingent fees in general, such fees come within the purview of Section 205(1). As one commentator has observed: "It seems . . . clear that, in a falling market, an adviser may not [under Section 205(1)] compensate himself on the basis of a percentage of the saving of capital loss or depreciation which he has effected by selling out certain securities and buying others whose market price did not fall as much; such a scheme of compensation, which is in effect based on a share of 'negative gains,' involves the same temptations as a profit-sharing scheme which comes within the letter of the statutory provision." 2 Loss. Securities Regulation 1411 (2d Ed. 1961).

DEPARTMENT OF STATE

Office of the Secretary

22 CFR Part 143

[Departmental Regulation 108.789]

Nondiscrimination on the Basis of Age in Programs or Activities Receiving Federal Financial Assistance

Correction

In FR Doc. 80-14872 appearing at page 31713 in the issue for Wednesday, May 14, 1980, second column, the Departmental Regulation number should have appeared as set forth above.

BILLING CODE 1505-01-M

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of Assistant Secretary for Housing—Federal Housing Commissioner

24 CFR Part 219

[Docket No. R-80-810]

Flexible Subsidy Program; Interim Rule

AGENCY: Department of Housing and Urban Development (HUD).

ACTION: Interim rule.

SUMMARY: This interim rule amends Part 219 of Title 24 of the Code of Federal Regulations, to provide for funding of eligible projects having HUD rent supplement contracts and which are in need of additional funding due to rent increases.

EFFECTIVE DATE: June 22, 1980.

COMMENTS DUE: July 22, 1980.

ADDRESS: Comments should be submitted to the Rules Docket Clerk, Office of General Counsel, Room 5218, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, D.C. 20410. A copy of each communication will be available for public inspection during regular business hours at the above address.

FOR FURTHER INFORMATION CONTACT: James J. Tahash, Director, Occupancy Division, Office of Multifamily Housing Management and Occupancy, Department of Housing and Urban Development, Washington, D.C. 20410, (202) 426-8730. This is not a toll free number.

SUPPLEMENTARY INFORMATION: The Department of Housing and Urban Development has exhausted its appropriated rent supplement contract and budget authority funds, which it uses to fund rent supplement contract increases. These contract increases are needed to cover the Department's share

of payments toward the tenants' rents brought about by HUD approved rent increases. The Department received no additional contract or budget authority in its FY 1980 appropriations. Accordingly, the Department is amending 24 CFR Part 219 on an interim basis, effective June 22, 1980.

24 CFR Part 219 is itself an interim rule which was published on May 21, 1979, and this amendment does not change any aspect of the interim rule; it provides, merely, for funding of eligible projects that otherwise would have received rent supplement payments. The Department is evaluating, at present, the comments received during the published Interim rules comment period and will also evaluate the comments received on this amendment prior to formulating and issuing its final regulation.

This amendment is consistent with Sec. 201 of the HUD Amendments of 1978 which states "the purposes of this Section are to provide assistance to restore or maintain the financial soundness, to assist in the improvement of the management, and to maintain the low-to-moderate income character of certain projects assisted or approved for assistance under the National Housing Act or under the Housing and Urban Development Act of 1965." Failure on the part of HUD to fund those projects which are in need of additional Rent Supplement Authority would lead to their financial and physical deterioration. Since there is no Rent Supplement Contract Authority available, those HUD Insured or Held projects which have rent supplement contract under Section 101 of the Housing and Urban Development Act of 1965 in need of additional Rent Supplement Contract Authority are eligible under this program. Any project receiving flexible subsidy payments in lieu of rent supplement payments and which would also qualify for assistance under 24 CFR Part 219, as published on May 21, 1979, may also receive additional flexible subsidy payments.

The Secretary has determined that it is urgent to make this rule effective as soon as possible, in order to avoid the financial and physical deterioration of rent supplement projects. Since providing an opportunity for public comment on this rule prior to its effective date would delay it for a substantial period of time, the Secretary has found that such rulemaking procedure would be contrary to the public interest. Accordingly, this amendment is being published as an interim rule to become effective as provided above, with a 60-day public

comment period following this publication.

The Department has determined that an Environmental Impact Statement is not required with respect to this rule. The finding of inapplicability in accordance with HUD's Environmental procedures is available for inspection at the Office of the Rules Docket Clerk, at the above address. This rule is not listed in the Department's semiannual agenda of significant rules, published pursuant to Executive Order 12044.

Accordingly, 24 CFR Part 219 is amended as follows:

PART 219—FLEXIBLE SUBSIDY PROGRAM

1. Section 219.101 is revised to read as follows:

§ 219.101 Purpose.

The purposes of the Flexible Subsidy Program are:

(a) To provide assistance to restore or maintain the financial soundness, to assist in the improvement of management and to maintain the low- to moderate-income character of certain projects assisted or approved for assistance under the National Housing Act or under the Housing and Urban Development Act of 1965, and

(b) On a temporary and interim basis to provide the funds necessary to pay the Department's share of the rent in a project whose owners are receiving assistance on behalf of eligible tenants under Section 101 of the Housing and Urban Development Act of 1965, Rent Supplements, and whose contracts need to be increased due to a HUD approved rent increase and where no Section 101 contract and budgetary funds are available for HUD to amend said contracts. This provision will expire pursuant to § 219.140 of the regulation.

2. Section 219.110 is amended by redesignating paragraphs (a) and (b) as (b) and (c), respectively, and by adding a new paragraph (a), to read as follows:

§ 219.110 Conditions for approval.

(a) Assistance may be made available under this Part to any project owner who has a Section 101 Rent Supplement contract which is in need of an increase due to a HUD-approved rent increase and where HUD cannot amend the Rent Supplement contract terms due to the lack of Rent Supplement contract and budgetary authority. For project owners in this category, the project either must receive a satisfactory management review and pass a physical inspection or the owner must submit an acceptable plan to remedy the deficiencies cited in such review or inspection before such

assistance is granted. For troubled projects, paragraphs (b) and (c) of this section apply.

3. Section 219.115 is revised to read as follows:

§ 219.115 Local government assurances.

Except for those projects covered under paragraph (b) of § 219.101 which have substantially met this requirement prior to executing a Rent Supplement Contract, the Department, prior to making assistance available to a project, shall consult with the appropriate officials of the unit of local government in which such project is located and seek assurances that:

(a) The community in which the project is located is providing or will provide essential services to the project in keeping with the community's general level of these services;

(b) The real estate taxes on the project are or will be no greater than would be the case if the property were assessed in a manner consistent with normal property assessment procedures for the community; and

(c) Assistance to the project under this part would not be inconsistent with local plans and priorities.

4. Section 219.120 is revised to read as follows:

§ 219.120 Use and amount of assistance.

The assistance shall be provided in any amount which the Secretary determines is consistent with the project's management-improvement and operating plan, subject to the availability of funds appropriated by the Congress in annual appropriation acts. Assistance will not exceed the sum of:

(a) An amount determined by the Secretary to be necessary to correct project deficiencies existing at the beginning of the first year of assistance, which were caused by the deferral of regularly scheduled maintenance and repairs or the failure to make necessary and timely replacements of equipment and other components of the project, and for which payment has not previously been made. Any project deficiencies which require capital improvements are eligible for funding only if: (1) They are necessary to meet local building codes or to maintain the project in a decent, safe and sanitary condition, and (2) such expenditure is necessary and the most efficient method to make the improvement.

(b) An amount determined by the Secretary to be necessary to maintain the low- and moderate-income character of the project by reducing deficiencies, existing at the beginning of the first year of such assistance and for which

payment has not previously been made in the reserve funds established by the project owner for the purpose of replacing capital items; and

(c) An amount not greater than the amount by which the estimated operating expenses for the year of such assistance, exceeds the estimated revenues to be received by the project during such a year, or

(d) In the case of those projects covered in paragraph (b) of § 219.101, which has complied with § 219.110 paragraph (a), the amount of assistance provided for funding of Rent Supplement contracts due to rent increases shall be limited to the difference between 77% of the gross potential rent approved on the units covered by the Rent Supplement contract and the amount being paid under such contract.

5. Section 219.125 is amended by adding a new paragraph (c) to read as follows:

§ 219.125 Estimating project revenue and operating expenses.

(c) For those projects covered paragraph (b) of § 219.101 the amount of assistance provided under this part is limited to the difference between 77% of the gross potential rent approved on the units covered by the Rent Supplement contract and the amount being paid under such contract.

6. A new § 219.140 is added, to read as follows:

§ 219.140 Time limitation on flexible subsidy payments in lieu of rent supplement payments.

No Flexible Subsidy contracts for payments in lieu of Rent Supplement contracts shall be executed after December 31, 1981.

(Sec. 201(g), Housing and Community Development Amendments of 1978 (12 U.S.C. 1715z-1))

Issued at Washington, D.C., May 6, 1980.

Lawrence B. Simons,
Assistant Secretary for Housing, Federal Housing Commissioner.

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24 CFR Parts 203, 204, 213, 220, 235 and 240

[Docket No. R-79-687]

Mutual Mortgage Insurance and Insured Home Improvement Loans

Correction

In FR Doc. 80-15585 appearing on page 33964 in the issue for Wednesday,