

In the Matter of GABELLI & COMPANY, INC. and GAMCO INVESTORS, INC., Respondents

Admin. Proc. File No. 3-8564

SECURITIES AND EXCHANGE COMMISSION

**SECURITIES EXCHANGE ACT OF 1934, Release No. 35057;
INVESTMENT ADVISERS, Release No. 1457**

December 8, 1994

TEXT:

ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 15(b)(4) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e) (4) AND 203 (k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS, AND CEASE-AND-DESIST ORDER

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) (4) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") to determine whether Gabelli & Company, Inc. ("Gabelli & Company") violated Section 15(f) of the Exchange Act and whether GAMCO Investors, Inc. ("GAMCO") (collectively, "the Respondents") violated Section 204A of the Advisers Act.

II.

In anticipation of the institution of these administrative proceedings, the Respondents have submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, the Respondents consent to the issuance of this Order Instituting Proceedings Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 and Sections 203(e) (4) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions, and Cease-and-Desist Order ("Order"), without admitting or denying the findings set forth herein, except as to jurisdiction, which is admitted, and to the entry of the findings and the imposition of the cease-and-desist orders and the remedial sanctions set forth in Section V., below.

III.

Based on the foregoing, the Commission finds the following:

A. The Respondents and Relevant Parties

1. Gabelli & Company

Gabelli & Company is a New York corporation with its main office located in Rye, New York. It is an indirect majority-owned subsidiary of Gabelli Funds, Inc. ("GFI"). Gabelli & Company is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act, and is a member of the National Association of Securities Dealers, Inc. and the New York Futures Exchange. As such, Gabelli & Company acts as a broker or dealer for its clients and makes a market in selected securities.

2. GAMCO

GAMCO is a New York corporation, with its main office located in Rye, New York. GAMCO, a majority-owned subsidiary of GFI, is an investment adviser registered under Section 203(c) of the Advisers Act. GAMCO provides discretionary managed account services for employee benefit plans, private investors, endowments, and foundations.

3. Lynch Corporation

Lynch Corporation ("Lynch") is an Indiana corporation with its headquarters located in Greenwich, Connecticut. Lynch is a diversified holding company with subsidiaries engaged primarily in the manufacturing, telecommunications, and services industries. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the American Stock Exchange.

B. The Respondents' ITSFEA Policies, Procedures, and Practices were Inadequate

This matter arises out of trading in Lynch securities by accounts at the Respondents during February 1992, prior to a board meeting held on February 27, 1992. At that board meeting, Lynch's board of directors approved Lynch's fourth quarter and year-end 1991 financial results, and the release of those financial results on February 28, 1992. This action involves Respondents' failure to adopt policies, procedures, and practices reasonably designed to prevent the misuse of material, nonpublic information in connection with the purchase and sale of Lynch securities by accounts at the Respondents.

Section 15(f) of the Exchange Act and Section 204A of the Advisers Act, which were enacted as part of the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA"), require that broker-dealers and investment advisers establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by such broker, dealer, investment adviser, or any person associated with such broker, dealer, or investment adviser. When Congress enacted ITSFEA, it recognized "that the policies and procedures appropriate to different broker-dealers will depend on the nature of their businesses and the circumstances in which they conduct business and may differ from case to case." n1 Consequently, Section 15(f) of the Exchange Act and Section 204A of the Advisers Act require brokers, dealers, and investment advisers to implement policies and procedures that take into account the special circumstances of their particular businesses and organizations.

n1 134 Cong. Rec. S17218 (daily ed. Oct. 21, 1988) (statement of Sen. Proxmire).

The policies, procedures, and practices in place at the Respondents did not adequately take into account the special circumstances presented by Mario J. Gabelli's role as chairman of the board of directors and chief executive officer ("CEO") of Lynch and his roles as de facto chief investment officer of Gabelli & Company and chief investment officer of GAMCO (the "CIO"). Therefore, those policies, procedures, and practices were not reasonably designed, in view of the Respondents' overall business, to prevent the misuse of material, nonpublic information.

The Respondents' ITSFEA policies and procedures had several components, including, among other things: (1) a prohibition on insider trading, (2) a requirement that individual employees report to counsel when in possession of information that may be material, nonpublic information, (3) a restricted list compiled and monitored by their legal/compliance department that depended in part on self-reporting, and (4) a three-day rule designed to restrict trading in Lynch the day prior to, the day of, and the day after the issuance of press releases and board meetings.

1. Insider Trading Policy

Pursuant to the Respondents' ITSFEA policies and procedures, before an employee could trade for himself or others, including private accounts managed by the Respondents, in the securities of a

company about which the employee may have had potential "inside" information, the employee was required to determine whether the information might have been material and nonpublic.

If, after this determination, the employee either believed that he possessed material and nonpublic information, or had questions as to whether the information was material and nonpublic, the policy required the employee to: (1) report the matter to the Respondents' general counsel or his designee; (2) refrain from purchasing or selling the securities on behalf of himself or others, including investment companies or private accounts managed by the Respondents; and (3) not communicate the information to anyone other than the general counsel or his designee.

As noted above, Section 15(f) and Section 204A require brokers, dealers, and investment advisers to implement and enforce policies and procedures that take into account the special circumstances of their particular businesses and organizations. However, neither of the Respondents adopted procedures reasonably designed to prevent the misuse of material, nonpublic information under the particular circumstances presented by Gabelli's dual roles as the CIO of the Respondents and as chairman and CEO of a public company.

As CEO and chairman of Lynch, Gabelli received potentially material, nonpublic information regarding Lynch, including information relating to Lynch's financial position and results of operation. Under these circumstances, the Commission believes that the policies and procedures of the Respondents that relied in part on self-reporting were inadequate, because they provided for insufficient objective, third-party review to determine whether he possessed material, nonpublic information when he bought or sold Lynch securities.

2. Gabelli & Company's Restricted List

Gabelli & Company also maintained a "restricted list" that purported to restrict trading in securities in several situations, including whenever anyone associated with the Respondents possessed material, nonpublic information. Thus, like the general insider trading policy, the restricted list depended in large part upon self-reporting. n2

n2 In August 1993, Lynch was placed permanently on the Respondents' restricted list. In September 1994, the Respondents returned discretionary control over all clients' Lynch holdings to the clients. The Respondents, accordingly, no longer buy or sell Lynch securities on a discretionary basis for their clients. This Order addresses policies and procedures that existed prior to these steps, and does not address the impact of these changes, if any, on the deficiencies described in this Order.

Under this policy, a person who believed he received material, nonpublic information was responsible for reporting that fact to the general counsel or his designee, who then, if necessary, placed the security on the restricted list. The effectiveness of the restricted list as to Lynch depended upon the CIO himself, or Lynch, informing the general counsel or his designee that he possessed material, nonpublic information. This reliance on self-reporting, as well as the reliance on communications from Lynch, were inadequate under the specific circumstances raised by the CIO's dual roles.

The inadequacy of self-reporting is highlighted by the Respondents' failure to place Lynch on the restricted list prior to the public release on February 28, 1992 of Lynch's year-end financial results. This omission demonstrates that, in practice, the restricted list did not adequately protect against potential misuse of material, nonpublic information.

3. The Three-Day Rule

During the relevant period, the Respondents had an unwritten "three-day rule" concerning when Lynch would be placed on the Gabelli & Company restricted list. n3 This rule purported to prohibit trading in Lynch securities on the day prior to, the day of, and the day after the issuance of press releases or board meetings. Pursuant to an unwritten understanding between Lynch and the Respondents, Lynch was to notify the Respondents when Lynch securities should be placed on the restricted list. The policy

apparently was triggered only by press releases or board meetings. Consequently, the policy was not designed to restrict trading in Lynch securities at any other time that the CIO, as an officer and director of Lynch, might have received potentially material, nonpublic information.

n3 Gabelli & Company appears to have eliminated this rule when it placed Lynch permanently on the restricted list.

The so-called "three-day rule" was ineffective, both in design and application, since there was no correlation to when the CIO received material, nonpublic information concerning financial results, impending Lynch board meetings, press releases, or other corporate matters. Additionally, there were no written procedures governing when and how the three-day rule was to be invoked. Furthermore, Gabelli & Company failed to maintain records concerning when it was notified of an upcoming Lynch board meeting or press release, or who at Lynch made the notification to the Respondents pursuant to the three-day rule.

Moreover, Gabelli & Company did not apply the three-day rule as it was designed. As a practical matter, Gabelli & Company rarely placed Lynch securities on the restricted list on the day prior to press releases, because Lynch rarely gave the Respondents advance notice of such releases. In February 1992, for example, Lynch apparently failed to notify the Respondents prior to both the February 27 board meeting and the February 28 earnings release. As a consequence, Lynch did not appear on the Respondents' restricted list at any time during February 1992, although throughout that period the CIO may have possessed potentially material, nonpublic information concerning Lynch's preliminary and final year-end financial results.

4. Conclusion

The requirement that a broker, dealer, or investment adviser implement and maintain policies and procedures that take into consideration the specific circumstances of its business is critical to effectively preventing the misuse of material, nonpublic information. Here, an associated person of a broker, dealer, and investment adviser, who was responsible for making investment decisions, also served as the CEO and chairman of a public company. In that capacity, he routinely received or had access to material, nonpublic information. Under these circumstances, a broker, dealer, or investment adviser must establish and enforce procedures that expressly address the issues raised by each such individual's multiple employment.

During the relevant period, the Respondents had no written procedures expressly dealing with the CIO's access to material, nonpublic information regarding Lynch. The Gabelli & Company restricted list and the informal "three-day rule" were inadequate to prevent the misuse of material, nonpublic information. For the reasons set forth above, the Respondents' insider trading procedures, as established and applied, were not "reasonably designed" to prevent the potential misuse of material, nonpublic information under the circumstances raised by the CIO's employment as an officer and director of Lynch.

IV.

FINDINGS

On the basis of this Order and the Respondents' Offer, the Commission finds that Respondent Gabelli & Company has willfully n4 violated Section 15(f) of the Exchange Act and Respondent GAMCO has willfully violated Section 204A of the Advisers Act.

n4 As used herein, "willfully" means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating the federal securities laws. See *Tager v. SEC*, 344 F.2d 5 (2d Cir. 1965).

V.

ORDER

In view of the foregoing and the Respondents' Offer,

A. IT IS HEREBY ORDERED, pursuant to Sections 15(b)(4) and 21C of the Exchange Act and Sections 203(e)(4) and 203(k) of the Advisers Act, that Gabelli & Company shall permanently cease and desist from committing any violation, and from committing any future violation, of Section 15(f) of the Exchange Act and GAMCO shall permanently cease and desist from committing any violation, and from committing any future violation, of Section 204A of the Advisers Act.

B. IT IS FURTHER ORDERED that the Respondents each pay civil penalties in the amount of \$ 50,000, pursuant to Section 21B of the Exchange Act and Section 203(i) of the Advisers Act, respectively.

C. IT IS FURTHER ORDERED that, within 30 days of the issuance of this Order, Respondents:

1. Shall retain an Independent Consultant, not unacceptable to the Commission, at the Respondents' expense, to: (a) conduct a comprehensive review of the policies, procedures, and practices maintained and implemented by the Respondents pursuant to Section 15(f) of the Exchange Act and Section 204A of the Advisers Act; (b) report on and make recommendations as to the policies, procedures, and practices, and a system for applying such policies, procedures, and practices, designed to prevent the misuse of material, nonpublic information; and (c) take necessary and appropriate steps to bring the policies, procedures, and practices into compliance with Section 15(f) of the Exchange Act and Section 204A of the Advisers Act. The Independent Consultant may rely on the work of additional consultants or experts as it deems necessary in carrying out its responsibilities;
2. Shall require the Independent Consultant, at the Respondents' expense, to prepare a report ("Report") making recommendations as to the Respondents' policies, procedures, and practices, as described in paragraph V.C.1., above;
3. Shall provide the Commission's staff, within thirty (30) days of the entry of this Order, with a copy of an engagement letter detailing the scope of the Independent Consultant's responsibilities pursuant to paragraphs V.C.1-2., above. The engagement letter shall provide, at minimum, that the review will comply with the requirements contained in paragraph V.C.5., below;
4. Shall adopt, implement, and maintain the procedures and the system for applying those procedures recommended by the Independent Consultant in the Report within the period of time prescribed in paragraph V.C.5., below, provided, however, that as to any recommendation of the Independent Consultant that the Respondents determine is, in whole or in part, unduly burdensome, the Respondents may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Consultant. The Respondents shall set forth in an affidavit to be submitted pursuant to paragraph V.C.5. of this Order such alternative procedure, and a description of how such alternative procedure achieves the same objective or purpose as the Independent Consultant's original recommendation. The Independent Consultant shall evaluate any alternative procedure proposed by the Respondents and the Respondents shall abide by the Independent Consultant's determination with regard thereto and adopt those recommendations that the Independent Consultant shall ultimately determine are appropriate.
5. Shall require the Independent Consultant to complete the review and deliver the Report described in paragraph V.C.2., above, to the Respondents and the Commission's staff within ninety (90) days of the issuance of this Order ("deadline"). The Respondents may apply to the Commission's staff for an extension of this deadline and, upon a showing of good cause by the Respondents, the Commission's staff may grant such extension for whatever time period it deems appropriate, but in no event shall the deadline exceed one hundred and thirty-five (135) days

from the date of the Commission's Order. The Respondents shall, within six (6) months after the issuance of the Independent Consultant's Report, submit to the Commission's staff an affidavit attesting to their implementation of the recommendations contained in the Report and setting forth the details of its implementation of the recommendations contained in the Report.

6. Shall require the Independent Consultant to review the Respondents' policies, procedures, and practices and deliver a supplemental report one year after the delivery of the Report to the Commission's staff, analyzing the Respondents' adoption, implementation, and maintenance of the policies, procedures, and practices contained in the Report and the effectiveness of those policies, procedures, and practices.

By the Commission.