

SECURITIES EXCHANGE ACT OF 1934

Release No. 20866 / April 16, 1984

In the Matter of

PACCAR Financial Corp.

File No.: 81-701

ORDER GRANTING APPLICATION PURSUANT TO SECTION 12(h)  
OF THE 1934 ACT

The Securities and Exchange Commission has issued an order granting the application of PACCAR Financial Corp. for an exemption from the requirements of Sections 14(a) and 14(c) of the Securities Exchange Act of 1934.

SECURITIES EXCHANGE ACT OF 1934

Release No. 20867 / April 16, 1984

INVESTMENT COMPANY ACT OF 1940

Release No. 13890 / April 16, 1984

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 28 / April 16, 1984

In the Matter of

SEABOARD ASSOCIATES, INC.

(811-486)

REPORT OF INVESTIGATION PURSUANT TO SECTION  
21(a) OF THE SECURITIES EXCHANGE ACT OF 1934

I. INTRODUCTION

Based on information received in a non-public investigation, the Commission hereby issues this Report of Investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934 ("Exchange Act") with respect to the activities of the directors of Seaboard Associates, Inc. ("Seaboard"), a registered closed-end investment company, and Douglas T. Yates ("Yates"), the chairman of the board and a major stockholder of Seaboard.<sup>1</sup> The Commission publishes this Report (1) to emphasize the responsibilities of investment company directors to value those assets of a fund not having a readily ascertainable market value and (2) to emphasize the responsibilities of a broker affiliated with a registered investment company to disclose material facts concerning commission rates charged on a fund's portfolio transactions.

<sup>1</sup> Section 21(a) of the Exchange Act authorizes the Commission, in its discretion, to publish information gathered during its investigation concerning "any facts, conditions, practices or matters which it may deem necessary or proper" in fulfilling its responsibilities under the Exchange Act.

Seaboard, its directors and Yates have consented to the issuance of this Report and, solely for purposes of this Report, have admitted the facts as stated. They have neither admitted nor denied the conclusions herein.

The investigation on which this Report is based was not an adjudicatory proceeding nor are the findings of the Report a determination of the rights or liabilities of any person.

## II. BACKGROUND

Seaboard Associates is a closely-held, closed-end management company with offices in New York City. Although Seaboard has a portfolio of marketable securities, Seaboard's most significant asset is its investment in Metropolitan Royalty Corporation ("Metropolitan"), a 97.6% owned subsidiary. Metropolitan derives substantially all of its income from oil and gas royalty interests in properties located primarily in Texas, Oklahoma and Louisiana. As of June 30, 1981, Seaboard reported total assets of approximately \$13.5 million, of which 70%, or \$10.3 million, represented the fair value of its investment in Metropolitan.

Seaboard's chairman, Yates, is the president and a director of Metropolitan. Yates' principal business activity, however, has been as a vice-president and account executive at a registered broker-dealer, a New York Stock Exchange member firm, in New York City. Since 1963 Yates, as a broker-dealer account executive, personally handled the brokerage accounts of both Seaboard and Metropolitan, receiving as compensation a percentage of the commissions generated by these accounts. During this period, Yates also provided Seaboard with substantially all of its investment advice. During this period, he has not charged Seaboard or Metropolitan an investment advisory fee, although he has received an annual salary of \$7,500 from Seaboard in his capacity as chairman.

The Yates family owns 69% of Seaboard's shares. The remaining shares are owned by certain Seaboard directors and their families and by approximately 269 public investors.

## III. DISCUSSION

### A. The Valuation of Seaboard's Interest in Metropolitan

#### 1. The 1972 Appraisal

During the period from 1972 through June 1979, the financial statements of Metropolitan and Seaboard were prepared in-house, audited by the companies' accountants (a national accounting firm) and approved by the companies' directors. Seaboard's and Metropolitan's securities portfolios were simply valued at market prices. Metropolitan's

oil and gas royalty interests had no readily ascertainable market price and, until 1972, Seaboard and Metropolitan valued those interests at cost. In 1972, the companies commenced reporting the oil and gas royalty interests at fair value. They retained a recognized engineering firm which appraised the interests as having a fair value of \$1.2 million as of January 1, 1972.

For the years 1972 through 1980, the directors of Seaboard continued to use the 1972 appraisal of Metropolitan's oil and gas royalty interests as the basis for determining the fair value of Seaboard's investment in Metropolitan. In 1978, Seaboard used this valuation of its investment in Metropolitan as the basis for a tender offer to repurchase its outstanding shares. In its solicitation materials, Seaboard failed to advise its shareholders that the tender offer price was based on a 1972 appraisal and that significant changes in the oil industry were likely to have affected the value of Metropolitan.

## 2. The Red Flags

### a. The OPEC Oil Embargo

Early in 1974, Seaboard's auditors suggested that consideration be given to revaluing Metropolitan's royalty interests in light of substantial increases in oil prices due to the OPEC oil embargo in 1973 and 1974. The directors of Seaboard concluded that the extraordinary events in the oil markets were too recent and the world oil situation too unsettled to justify a revaluation at that time. Although the auditors certified Seaboard's financial statements for the year ended December 31, 1973, concluding that the procedures used by Seaboard's directors in determining the fair value of Seaboard's investment in Metropolitan were reasonable, they qualified their opinion with respect to the valuation of Metropolitan. Their opinion was "subject to the possible effect on the financial statements of the valuation of the investment in Metropolitan determined by the Board of Directors". Moreover, the auditors specifically stated in notes to the financial statements that the determination of fair value involved subjective judgment not susceptible to substantiation by auditing procedures.<sup>2</sup>

### b. The Auditors' Recommendation

Later in 1974, the auditors specifically advised Seaboard, by letter, that substantial increases in oil prices presented a problem in determining the fair value of Metropolitan. The auditors explained that the directors' basis

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Prior to 1973, the value of Seaboard's investment in Metropolitan was recorded at cost and the auditors issued unqualified opinions with respect to Seaboard's financial statements.

for the determination of fair value, the 1972 appraisal, was predicated on the present value of expected recoverable revenues adjusted by annual depletion charges. Because the expected revenues for 1974 had increased dramatically (87%) from 1973, the auditors assumed that the estimated recoverable revenues were understated. Although the directors of Seaboard acknowledged at this time that higher oil prices appeared permanent, they did not authorize a reappraisal of Metropolitan's royalty interests. Instead, Seaboard adopted a computation proposed by the auditors as an alternative for valuing Metropolitan's royalty interests. This computation adjusted the 1972 appraised value to reflect the increase in oil prices and was first used in Seaboard's financial statements for the period ending June 30, 1974.<sup>3</sup> Using this adjustment formula, Metropolitan reported its oil royalty interests as of June 30, 1974 at a value of \$1.8 million, up from the appraised value of \$1.2 million in 1972. During the period from 1974 to 1979, however, Seaboard's use of the formula resulted in a decrease in the fair value of Metropolitan's royalty interests to \$1.04 million.

Seaboard's semi-annual financial statements disseminated to shareholders between June 30, 1974 and June 30, 1979 contained values for Metropolitan which were determined using this computation. During this period, the directors of Seaboard accepted the auditors' calculations of fair value based upon the computation, and did not question whether Seaboard's procedures for the determination of fair value or the continued use of the computation were appropriate. They relied on the auditors notwithstanding the fact that the auditors' opinions, during this period, as discussed above, were qualified as to the fair value of Metropolitan as determined by the board of directors.

c. Unitization of the Yates Field<sup>4</sup>

A significant portion of Metropolitan's oil and gas royalty interests are in the Yates Field, the nation's second largest oil field, located in southwest Texas. In 1975, Metropolitan was advised of the proposed unitization of the

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3 Under the computation, the net estimated future revenues as per the 1972 appraisal (less revenues received after 1972) were increased by an annual percentage rate to reflect the increased revenues for each year after 1974. The formula took into account the gradual depletion of reserves by the subtraction of revenues and assumed that the estimated reserves as of 1972 were constant.

4 There is no relation between Yates and the family after whom the Yates Field was named.

Yates Field.<sup>5</sup> Engineering studies in 1975 established that implementation of a pressure maintenance program in the Yates Field on a field-wide basis would increase oil recovery by approximately 200 million barrels.<sup>6</sup>

On or about September 16, 1975, Metropolitan ratified its participation in the proposed plan of unitization of the Yates Field. Before the unitization agreement was signed, Yates specifically authorized the hiring of the petroleum engineer who conducted the 1972 appraisal to render an opinion as to whether Metropolitan should vote for or against unitization. The petroleum engineer recommended that Metropolitan ratify the unitization agreement.

The minutes of Seaboard's board of directors meeting of September 23, 1975 reflect discussion of the unitization plan. The minutes of the Metropolitan board meeting of the same date reflect that Metropolitan had consulted a petroleum engineer with respect to the unitization agreement and that a fee of approximately \$1300 had been paid for such opinion. The petroleum engineer had rendered a written opinion which specifically described the advantages to Metropolitan of unitization. The opinion letter advised Metropolitan that there was a strong probability that unitization would result in the doubling of the field's daily allowable production from 50,000 barrels per day ("b/d") to 100,000 b/d, thereby doubling Metropolitan's share of the net production.

The unitization of the Yates Field became effective July 1, 1976. On the same day, as a result of hearings before the Railroad Commission of Texas,<sup>7</sup> the daily oil allowable from the field doubled, as had been expected. As a result of

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5 Unitization is the joint operation of separately-owned interests in an oil field for the purpose of implementing a field-wide, cost-effective oil recovery program.

6 Under unitized operations, a pressure maintenance program could be established to control the reservoir drive of the field and thus maximize oil production by (1) the injection of inert gas into the field and (2) waterflooding.

7 The Railroad Commission of Texas, a state regulatory agency, establishes and enforces oil and gas production quotas. The agency was created to prevent waste, enforce conservation and protect correlative rights. See TEX. [Nat. Res.] CODE ANN. §§81-113 (Vernon 1978).

federal price controls, most of the additional 50,000 b/d in production was permitted to be sold at higher "upper tier" prices. As a result of unitization, Metropolitan's royalty income from the Yates field tripled.

Effective November 1, 1978, the daily oil allowable in the Yates Field was again increased 25,000 b/d to 125,000 b/d. As with the previous production increase, these extra barrels were allowed to be sold at significantly higher prices. Metropolitan realized an immediate increase in royalty income from its interest in the field.

Despite the substantial impact of unitization and increased revenues on the value of Metropolitan's royalty interests, Seaboard did not seek a reappraisal of Metropolitan following the unitization of the Yates Field. Rather, the Seaboard directors continued to use the 1972 appraisal adjusted by the auditors' formula and did not, until the Commission's investigation, adequately assess the significance of the OPEC oil embargo, the qualification in the opinion of the auditors, the opinion of the petroleum engineer concerning unitization, and the substantial increase in revenues from the Yates Field.

### 3. The Tender Offer

By letter dated October 10, 1978, transmitted to its stockholders, Seaboard offered to repurchase all of its outstanding stock at a price of \$26.00 per share, a premium over Seaboard's reported net asset value of \$22.26 per share as of September 30, 1978.<sup>8</sup> The tender offer materials separately stated, as of September 30, 1978, (1) the net asset value of Seaboard excluding its interest in Metropolitan as \$15.89 per share and (2) the fair value of Seaboard's interest in Metropolitan as \$6.37 per share. These values substantially understated the value of Seaboard's assets and shares due to the undervaluation of Metropolitan's oil and gas interests. The tender offer materials did not state that the fair value of Seaboard's investment in Metropolitan was based on the 1972 appraisal and that there had been very significant changes in the oil and gas industry which had affected the value of Metropolitan's royalty interests.

During the tender offer, one Seaboard stockholder, an independent oil company in Texas, wrote a letter to Seaboard

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There has never been a substantial public market for Seaboard shares. During 1977 and 1978, prior to the tender offer, Seaboard shares had been sold over-the-counter at prices ranging from \$21 to \$21.50 per share.

stating that Metropolitan was being "valued modestly" and proposing to negotiate a possible purchase of Metropolitan's oil and gas royalty interests for more than \$2.5 million. At that time Seaboard was carrying the investment on its financial statements at approximately \$1.5 million. The directors rejected this proposal. Upon receipt of this letter, Seaboard should have reviewed the value of the royalty interests to determine whether they were being undervalued. Seaboard failed to take this action.

In response to the tender offer, 58 shareholders tendered 4,078 shares or 2.63% of the outstanding stock for an aggregate of \$106,028.<sup>9</sup> By thus reducing the number of outstanding shares, the Yates family's proportionate interest in Seaboard increased from 67% to 69%.

#### 4. The 1980 Appraisal

Subsequent appraisals of Metropolitan's oil and gas holdings confirmed the inadequacy of the 1978 tender offer price and the gross undervaluation of Metropolitan's assets in Seaboard's financial statements. In February 1980, ten months after the conclusion of the tender offer and eight years after the last appraisal, Seaboard's board of directors authorized a reappraisal of Metropolitan's assets. The appraisal was recommended by the auditors because of the effect on world oil prices of political instability in Iran in 1978 and 1979. The appraisal, adopted by the board of directors, determined Metropolitan's fair market value to be \$8,565,072 as of January 1, 1980,<sup>10</sup> compared to \$1,036,760, the value stated in Seaboard's semi-annual report to stockholders as of June 30, 1979. As a result of this 1980 appraisal, Seaboard's net asset value rose from \$23.18 to \$58.84 per share.

#### 5. The Retrospective Appraisals

Two subsequent retrospective appraisals of Metropolitan's oil and gas royalty interests, conducted as of the time of the tender offer in 1978, also confirmed the inadequacy of the tender offer price, which was based on the \$1,349,021 fair value for Metropolitan reported in Seaboard's

<sup>9</sup> Approximately 124 shareholders holding 485.4 shares or .3% of Seaboard's outstanding stock could not be located during the tender offer.

<sup>10</sup> Subsequent appraisals conducted in 1981 and 1982, adopted by the board of directors, are consistent with the 1980 appraised value.

financial statements for the six months ended June 30, 1978. One of the retrospective appraisals valued Metropolitan's royalty interests at \$4,957,102 as of June 1, 1978. The other determined these interests to be worth \$3,554,000 as of July 1, 1978. Neither of these appraisals took into account the increase in the daily oil allowable in the Yates Field from 100,000 b/d to 125,000 b/d, effective November 1, 1978, which would have further increased the present value of the field.

B. The Brokerage Commissions

1. Yates as Seaboard's Account Executive

In addition to its investment in Metropolitan, Seaboard owns portfolio securities with a market value of approximately \$2.7 million as of June 30, 1981. Since at least 1975, Seaboard had effected substantially all of its portfolio transactions through the broker-dealer with which Yates is associated. Yates personally handles the Seaboard account at the broker-dealer in his capacity as account executive. He does not receive a fee for investment advisory services. Of the 620 active accounts managed by Yates at the broker-dealer, Seaboard is Yates' fourth largest account. In 1979 and 1980, Seaboard's account generated over \$46,000 in gross commissions of which Yates received a payout of approximately \$20,000 in net commissions. He also earned approximately \$5,000 during the same period from the Metropolitan account.

Based upon the gross commissions generated by Seaboard in 1979 and 1980, Yates could have recommended that Seaboard receive a discount of up to 35% from standard retail commission rates. Seaboard was eligible for such consideration under the guidelines promulgated by Yates' firm. All of Seaboard's transactions, however, were effected at full commission rates. Although it was clearly within Yates' discretion to request a discount from his office manager, he did not make such a request; any discount given would have reduced Yates' own compensation. Yates' stated reason for not seeking any discount for his client, Seaboard, was that he was providing substantial research to his client and was not receiving any separate compensation for investment advice.

Yates did not formally notify the other Seaboard and Metropolitan directors of his authority to recommend that some accounts receive discounts or the fact that he was not recommending that Seaboard and Metropolitan receive discounts. Yates believed that the other directors were aware of discounted commissions based on their general business background.



## 2. Yates' "most favored customer"

Seaboard's proxy statements mailed to stockholders for the annual meetings of 1979 and 1980 contained a statement that brokerage commissions paid to Yates' firm were "at the same rates as are charged by such brokers to their most favored customers." The statement further provided that Seaboard would continue to place its portfolio transactions with such broker-dealer, but that Seaboard did not intend to use the services of said broker "if it would result in the Company not getting the best price and execution."

Seaboard disseminated these proxy materials to shareholders in 1979 and 1980.<sup>11</sup> Yates knew that Seaboard paid standard commissions and that it was not receiving the lowest rate of commission, but he did not carefully review the proxy statements disseminated by Seaboard until the Commission's investigation. Had Yates read the proxy statement carefully, he would have known that the "most favored customer" language was false and inaccurate because he had determined not to give Seaboard a discount.

## IV. CONCLUSIONS

### A. Responsibilities of Investment Company Directors With Respect to Valuation

While there has been no judicial or administrative adjudication of the facts herein, the facts developed in this investigation exemplify the problems that may arise when directors of a registered investment company do not exercise adequate care in monitoring the fair value of assets not having a readily ascertainable market value.<sup>12</sup> While the

<sup>11</sup> The minutes of Seaboard's directors' meetings reflect that Seaboard's Vice President and Yates were authorized to disseminate these proxy materials.

<sup>12</sup> Section 2(a)(41) of the Investment Company Act of 1940, 15 U.S.C. §80a-2(a)(41), defines the term "value" with respect to assets and securities of registered investment companies for which market quotations are not readily available as "fair value as determined in good faith by the board of directors". Rule 2a-4 under the Investment Company Act, 17 C.F.R. §270.2a-4, provides that in computing the "current net asset value" of a redeemable security for the purpose of distribution, redemption and repurchase, those securities and assets  
(footnote continued)

Commission recognizes the difficulties inherent in the valuation of royalty interests, directors have an affirmative responsibility to keep informed of developments which materially affect those assets not having a readily ascertainable market value. It is incumbent upon the board of directors of a registered investment company to monitor carefully the value of such assets and to consider all relevant factors with respect to value. Consistent with this responsibility, the directors of a registered investment company must continuously review the appropriateness of the method used in valuing the asset not having a readily ascertainable market value.<sup>13</sup>

Between 1972 and June 1979, there were significant changes in the oil industry which substantially increased the value of Seaboard's investment in Metropolitan. The directors of Seaboard did not recognize the significance of such changes and failed to adopt adequate procedures to monitor the value of Seaboard's investment in Metropolitan. The directors' procedures -- adjustment of the 1972 appraised value to reflect current oil prices and depletion -- became materially deficient because of the substantial increase in oil production. Consequently, from 1976 to 1980, the directors of Seaboard allowed Seaboard to materially understate the fair value of its investment in Metropolitan in reports filed with the Commission and mailed to shareholders of Seaboard.

The directors of Seaboard and Metropolitan were not justified in continued reliance on the 1972 appraisal as adjusted. The auditors' repeated qualification of their opinion with respect to the fair value of the oil royalty interests, determined by the Board of Directors, should have alerted the Seaboard directors that they could not rely solely on the auditors to provide an accurate valuation of the oil royalty interests. Particularly in light of the well publicized oil price increases, the unitization program and the resulting increases in revenue to Metropolitan, Seaboard's directors should have realized that the interests were substantially undervalued. Upon becoming aware of these red flags, they should have taken additional steps to insure that the stated values in Seaboard's and Metropolitan's financial statements were accurate.

other than portfolio securities for which market quotations are readily available "shall be valued at fair value as determined in good faith by the board of directors of the registered company".

<sup>13</sup> See Accounting Series Rel. No. 118 (December 23, 1970).

The Commission wishes to emphasize that the directors of a registered investment company may not delegate to others the ultimate responsibility of determining the fair value of any asset not having a readily ascertainable market value, such as oil and gas royalty interests. While directors of a registered investment company may obtain the technical assistance of engineers, accountants and other professionals, the directors must carefully review the findings of such persons in determining that the resulting valuations are fair under all relevant circumstances.<sup>14</sup>

In this situation, in which the facts clearly indicated that the valuation of the oil and gas royalty interests was unrealistically low, the directors should have taken the necessary steps to obtain a current valuation. Their obligation was particularly important in light of the tender offer. Here the directors failed in their responsibility to value properly Seaboard's assets, with the result that Seaboard's financial statements contained erroneous asset values in violation of Sections 30(d) and 34(b) of the Investment Company Act. The similarly erroneous tender offer letter raises serious questions under Sections 10(b) and 14(e) of the Exchange Act.

#### C. Duties of An affiliated Broker

The facts described herein illustrate how a broker affiliated with a registered investment company must exercise a high degree of care to insure that disclosure concerning commissions paid on portfolio transactions is complete and accurate. Such a relationship involves an inherent potential for self dealing that requires meticulous and thorough disclosure. An affiliated broker of a registered investment company must make sure that directors and shareholders have complete and accurate information concerning rates of commissions being charged on portfolio transactions effected through an affiliated broker, discounts granted or denied, and the conditions under which discounts might be available. Here Yates' and Seaboard's failure to exercise due care in connection with Seaboard's proxy materials resulted in the distribution of false and misleading proxy materials in violation of the Commission's proxy rules.

The Commission is also concerned that some of the shortcomings in the management of Seaboard may have resulted from the fact that Seaboard's shares are closely-held. The Commission wishes to emphasize that directors in such situations may not be adequately sensitive to their responsibilities to

<sup>14</sup> Id.

minority shareholders.

D. The Response of Seaboard

In response to the issues raised by this Report, Seaboard has undertaken to rescind the 1978 tender offer. Yates has also made full disclosure to Seaboard's directors and shareholders concerning brokerage commissions.

In addition, Seaboard has undertaken to distribute copies of this Report of Investigation to its shareholders.

By the Commission.

Securities Exchange Act of 1934  
Release No. 20868 / April 16, 1984

An order has been issued granting the application of the Philadelphia Stock Exchange, Inc. to strike the common stock (\$.01 par value) of DMG, INC. from listing and registration thereon.

Securities Exchange Act of 1934  
Release No. 20869 / April 16, 1984

An order has been issued granting the application of URS CORPORATION to withdraw its common stock (\$.25 par value) and 8 3/4% convertible subordinated debentures (due 2008) from listing and registration on the American Stock Exchange, Inc.

SECURITIES EXCHANGE ACT OF 1934  
Release No. 20870 / April 16, 1984

An order has been issued granting the application of INDIANAPOLIS POWER AND LIGHT COMPANY to terminate unlisted trading privileges in the 4% cumulative preferred stock (\$100 par value) on the American Stock Exchange, Inc.