

Wright

ADMINISTRATIVE PROCEEDING
FILE NO. 3-3185

UNITED STATES OF AMERICA
-Before the
SECURITIES AND EXCHANGE COMMISSION

FILED
NOV 29 1972

SECURITIES & EXCHANGE COMMISSION

In the Matter of

GERALD H. WRIGHT & CO.
Dallas, Texas

(8-13628)

GERALD H. WRIGHT

(ANALYTICAL INVESTMENT DECISION SYSTEMS, INC.)
d/b/a AIDS

INITIAL DECISION

Washington, D.C.
November 24, 1972

Sidney L. Feiler
Administrative Law Judge

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APPEARANCES: H. Dawson French, Esq., Lyne, Klein & French,
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75202 for Gerald H. Wright and Gerald H.
Wright & Company

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Washington, 98104, for the Division of Enforce-
ment

BEFORE: Sidney L. Feiler, Administrative Law Judge

These proceedings were instituted by order of the Commission pursuant to Sections 15(b), 15A and 19(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), to determine whether certain allegations in the order are true and, if so, what, if any, remedial action is appropriate in the public interest.

The order for the proceedings sets forth allegations of the Division of Trading and Markets (now known as the Division of Enforcement) that during the period from on or about January 1, 1971 to April 30, 1971, Gerald H. Wright & Company, a registered broker-dealer ("registrant") and Gerald H. Wright, registrant's chief officer and owner of over 90% of its voting stock at all times material herein, willfully aided and abetted violations of Section 203(a) of the Investment Advisers Act of 1940, as amended ("Advisers Act"), in that they caused Analytical Investment Decisions Systems, Inc., ("AIDS"),^{1/} a Washington corporation, to make use of the mails and the means and instrumentalities of interstate commerce within said period in connection with AIDS' business as an investment adviser at a time when AIDS was not registered as an

^{1/} AIDS and its principal officers were named in the order for these proceedings, but the Commission has accepted an offer of settlement submitted by them (Investment Advisers Act Release No. 300, November 4, 1971).

Robert T. Putnam, at all times material herein, vice president and resident manager of registrant's Bellevue, Washington office, was also named in the order for these proceedings. The Commission has accepted an offer of settlement submitted by him (Securities Exchange Act Release No. 9827 October 19, 1972).

investment adviser under said section.^{2/}

It is further alleged that registrant and Wright willfully aided and abetted violations of Section 205(1) of the Advisers Act in that they caused AIDS to make use of the mails and the means and instrumentalities of interstate commerce, directly and indirectly, to enter into and perform investment advisory contracts during the aforementioned period which provided for compensation to AIDS on the basis of a share of the capital gains upon, and capital appreciation of, the funds of AIDS' clients, in violation of the express prohibition contained in this sub-section. It is also alleged that registrant and Wright willfully violated and willfully aided and abetted violations of the anti-fraud provisions of the Advisers Act, (Section 206(4) and Rule 206(4-1) thereunder) and the anti-fraud provisions of the Exchange Act (Section 10(b) and Rule 10b-5 thereunder) in connection with the publication, circulation and distribution of information concerning AIDS and its relationship with the registrant.^{3/}

2/ Except for certain exclusions, not material herein, any investment adviser is prohibited from using the mails or any means or instrumentalities of interstate commerce in connection with his business as an investment adviser unless he is registered under Section 203(a) of the Advisers Act.

3/ The composite effect of these provisions, as applicable herein, is to make unlawful the use of the mails or any means or instrumentalities of interstate commerce to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative or to employ any device, scheme, or artifice to defraud, or to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make statements made not misleading or in connection with the purchase of any securities to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Pursuant to notice, a hearing was held in Seattle, Washington. The parties still remaining in this proceeding were represented by counsel. During the hearing a Stipulation of Facts, entered into on behalf of the parties, was received in evidence (Div. Ex. 1). This stipulation sets forth in detail the underlying facts relating to the allegations in the order for the proceedings. This was supplemented by oral evidence from Putnam and the president of AIDS, Robert E. Bronson, concerning business arrangements between the registrant and AIDS and the knowledge that Wright had of these arrangements and the status of AIDS as a registered investment adviser.

After the conclusion of the evidentiary hearing, the Division filed proposed findings of fact, conclusions of law and a brief in support thereof. No proposed findings or brief were submitted on behalf of registrant or Wright. However, a letter was received from counsel for these respondents citing certain matters in mitigation. Prior to the filing of the proposed findings and brief by the Division, a Notice of Withdrawal from Registration as Broker-Dealer was filed on behalf of the registrant. This Notice, pursuant to the provisions of Rule 15b6-1(b) of the rules under the Exchange Act, has not yet become effective.

On the basis of the entire record, including his evaluation of the testimony of the witnesses, the undersigned makes the following:

II. FINDINGS OF FACT AND LAW

A. The Respondents

At all times here relevant, the registrant was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act. It maintained its principal place of business at Dallas, Texas and a branch office in Bellevue, Washington. Registrant is a member of the National Association of Securities Dealers, Inc. ("NASD"), a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act. It also is a member, within the meaning of Section 3 of the Exchange Act, of the Midwest Stock Exchange, a national securities exchange registered pursuant to Section 6 of the Exchange Act.

At all times here relevant, Gerald H. Wright was the president and chairman of the board of registrant, and owner of over 90% of registrant's voting stock. Robert T. Putnam was a vice-president of registrant and the manager of its Bellevue, Washington office.

B. Violations of the Exchange Act and the Advisers Act

The stipulation entered into by the parties includes the following factual data: AIDS, during the period material herein, was not registered as an investment adviser pursuant to the provisions of the Advisers Act. Nevertheless, it proceeded to provide investment advisory services to financial institutions, including broker-dealers and the general public with respect to

securities listed on the New York and American Stock Exchanges and generally held itself out to the public as offering investment advisory services. It did contact the Seattle Regional Office in November 1970 seeking information on registration as an investment adviser and filed deficient applications for this purpose on March 29 and April 16, 1971. A revised application filed on June 1, 1971 did become effective after the period covered by the order for these proceedings.

In December 1970 or January 1971 registrant's Bellevue office, with permission obtained from its main office in Dallas, began offering and selling AIDS' securities portfolio management services to registrant's customers by means of three-party investment advisory contracts executed by AIDS, a representative of registrant, and customers of registrant who subscribed to such services. Under such contracts, AIDS received a fee (based on a percentage of deposited assets) for setting up the service for each customer. In addition, AIDS was to receive a performance fee for each account at the end of each six months' period if there had been a gain in the account which was more than the gain would have been if the account's assets had been invested in the securities shown in the New York Stock Exchange Composite Index. This performance fee was to be 25% of the extra gain, if any; no fee was to be paid if a particular account had underperformed the market or had not shown a net profit for the period involved.

Registrant acted as the billing and collecting agent for fees from its customers. These payments totaled approximately

\$18,000.00 during the first four months of 1971. The 70 retail customers who subscribed to these services gave registrant discretionary authority (by means of limited powers of attorney) to buy and sell securities for their accounts within the guidelines of AIDS' recommendations. Confirmations of these transactions were mailed directly to customers from registrant's head office in Dallas. AIDS remitted 10% of the initial "set-up" fee to registrant of sums received from registrant's customers where AIDS did not consult with a customer prior to his execution of the three-way contract previously referred to. The customers were not informed of this arrangement.

Briefly, the AIDS service included the preparation of bi-weekly reports entitled "AIDS REPORTS" prepared for and mailed to institutional customers (Div. Ex. 1, Ex. A). These reports contained a schedule of 100 selected New York Stock Exchange stocks ranked in groups according to AIDS' prediction as to their long-term performance together with similar schedules for 100 stocks listed on the American Stock Exchange and 100 stocks selected from both exchanges. Charts and schedules were also attached purporting to show the performance of the AIDS program. These reports were used as the basis for instructions which AIDS gave to registrant as to which securities were to be purchased or sold for customers of the registrant who had agreed to the use of the plan. Those customers of the registrant who had stated in their contracts that they were interested in aggressive trading, and approximately 90% of the subscribing

customers obtained through the registrant so indicated, received special attention in that the aforementioned reports were only one of seven factors used in an undisclosed and confidential formula used by AIDS and not disclosed to customers. The bi-weekly reports were used as a basis for recommendations in other accounts.

To induce non-institutional customers to avail themselves of AIDS' services, AIDS, assisted by registrant, prepared and distributed to the public a brochure describing AIDS's services and its success in making profitable market recommendations to its customers (Div. Ex. 1, Ex. B). This brochure contained copies of newspaper articles lauding AIDS' service as one which, among other things, could outperform the New York Stock Exchange Composite Index by five times. In addition, meetings were conducted at registrant's office one evening a week to introduce prospective customers to the AIDS service.

The stipulation, summarized above, while it admitted the matters of fact as to the alleged violations set forth in the Commission's order for proceedings, expressly excluded therefrom Wright's understanding or lack of understanding that AIDS was not registered with the Commission under the Advisers Act at all time material herein.

Robert E. Bronson, president of AIDS at all times here relevant, testified that he had met Wright some time prior to December 8, 1970 and on that date wrote to Wright enclosing a copy of the investment research contract then being used by AIDS. This mailing followed a conversation that Bronson had

had with Wright with reference to the service that AIDS might provide to customers of the registrant. Wright replied to this letter by notifying Bronson, on December 31, that the proposal of AIDS had been approved by the registrant's executive committee on a six months' trial basis. He also complimented Bronson on the AIDS reports which he was then receiving.

Continuing his testimony, Bronson stated that in mid-January, 1971, he, Putnam, and Wright had a three-way conversation in which Putnam pointed out to Wright that AIDS was not registered with the Commission because it was still trying to frame its performance fee arrangement in proper language for submission to the Commission. Bronson also told Wright that he was confident that AIDS was in good standing and that it would not commit any violation by carrying on its activity on a limited trial basis.

On January 25, 1971, Bronson wrote Wright that some changes in the investment research contract had been made and it was still being reworded. Wright wrote Bronson, on February 10, 1971, that his Seattle staff were quite pleased with the progress being made through the association with AIDS, discussed payment arrangements, and suggested that he check with the Commission on his fees, set-up charges, and particularly the performance award commission (Div. Ex. 3). Bronson further testified that he had conversations at or about March 24, 1971 with Putnam and Wright advising them that AIDS had filed an application for registration as an investment adviser. He stated that he notified them of difficulties subsequently leading to a rejection of the application. All during this period, commencing from January 9, 1971, customers of the registrant were

solicited by the registrant to subscribe to the AIDS plan. Financial arrangements, including confirmations and payments to AIDS, were handled directly from the Dallas office of registrant. Bronson additionally testified that he had told Wright subsequently that he understood, from conversations he had had with Commission representatives that AIDS was in good standing, as far as the Commission was concerned, and could engage in a pilot program. His concern at that time was to qualify to do business in the State of Washington. Bronson asserted that he regarded the arrangements of AIDS with customers of the registrant as a pilot program even though between 25 and 30 contracts had been entered into by early March.

The last three-way contract was entered into on April 22. Prior thereto, on March 31, Shirley J. Putnam, cashier at the registrant's Bellevue office, sent to the NASD a copy of material that was used as a hand-out when seminars were held (Div. Ex. 4). In its reply, dated April 22, 1971, the NASD pointed out that the material did not comply with the provision of the NASD advertising interpretation and that the material should not be given to the public. It was further pointed out that unless AIDS qualified for an exemption from registration under the Advisers Act serious questions were raised with respect to certain sections under the Advisers Act and, if such violations had occurred, registrant might be considered a participant in violations of the law by AIDS. Registrant was advised that before promoting the AIDS program

it should obtain a written opinion as to its validity from the Commission (Div. Ex. 8).

On April 30, Wright wrote Putnam directing him to cease doing business with AIDS until such time as it was registered as an investment adviser with the Commission and stating that Putnam had assured him that Bronson was a qualified investment adviser (Div. Ex. 5). On May 5, 1971, Wright, commenting on the NASD letter of April 22, stressed to Putnam that he should have no association in any way with Bronson (Div. Ex. 6).

Putnam corroborated Bronson's testimony. He testified that in early December, 1970, he telephoned Wright and mentioned that he wished to enter into a business relationship with AIDS on behalf of the registrant. He further stated that at that time Wright asked him if AIDS was registered with the Commission and he replied that they were not registered, but planned to do so as soon as possible. He further testified that his recollection of conversations with Wright was consistent with Bronson's testimony in that Wright was informed that AIDS was not yet registered as an investment adviser. Wright did know, according to Putnam, that AIDS was entering into advisory contracts with customers of the registrant and with the registrant itself. Putnam was not sure when Wright was made aware that registrant was receiving a fee from AIDS. His best recollection was that this took place in March or April 1971. Putnam was not certain when copies of the hand-out material furnished to registrant's customers (Div. Ex. 1, Ex. B) were sent to Wright but he recalled that this was done, at least prior to the time it was submitted to the NASD. He also

stated that the registrant paid for the cost of the reproduction of two newspaper articles used in the hand-out and AIDS paid the remainder of the expenses. Putnam concluded his testimony by asserting that during the relevant period he understood that AIDS was not registered as an investment adviser, but that he entered into business relations with AIDS and Bronson on assurances from the latter that a pilot program could be undertaken without violation of applicable statutes and rules. However, he made no effort to obtain verification of these assurances from Commission representatives.

As previously mentioned, Wright did not testify. The undersigned credits the testimony of Bronson and Putnam that Wright was told by both of them that AIDS was not a registered investment adviser during the period here relevant and during which time the registrant was attempting to further the AIDS program by presenting it to clients. Even if allowances were made for the fact that almost all discussions with Wright, Bronson, and Putnam were by telephone and that there was some possibility for a misunderstanding, nevertheless sufficient information as to AIDS and its program was furnished to Wright to alert him to the need of further investigation. As chief officer of the registrant it was his duty to do so.^{4/} Instead, under the best construction of the evidence he accepted assurances from Bronson without any attempt at verification.

^{4/} Luckhurst & Company, Inc., 40 S.E.C. 539, 540, (1961); L.B. Securities Corporation, Sec. Exch. Act Rel. No. 7806 p. 5 (Jan. 28, 1966); Alfred Miller, Sec. Exch. Act Rel. No. 8012, p.7, (Dec. 28, 1966); R.A. Holman & Co., Inc., Sec. Exch. Act Rel. No. 7777, p.10, (Dec. 15, 1965); Albion Securities Company, Inc., Sec. Exch. Act Rel. No. 7561, p.4 (Mar. 24, 1965).

It is undenied and established by the evidence that at all times here relevant AIDS carried on the business of an investment adviser using the facilities of interstate commerce and of the mails, during a period when it was not registered as an investment adviser pursuant to the provisions of Section 203(a) of the Advisers Act. It is concluded that the registrant and Wright aided and abetted these violations by their activities in bringing the AIDS program to the attention of their customers and participating in the contractual arrangements with their customers who agreed to use the plan. These violations by the registrant and Wright were willful.^{5/}

It is provided in Section 205(1) of the Advisers Act that no investment adviser, unless he is exempted from registration under the Advisers Act, may make use of the mails or any means or instrumentalities of interstate commerce to enter into any investment advisory contract, if such contract 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 portions thereof of a client. It was expressly provided in the AIDS plan that its compensation would be based on the capital appreciation of the

^{5/} Tager v. SEC, 344 F. 2d. 5,8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord, Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. SEC, 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946); Van Alstyne, Noel & Co., 22 S.E.C. 176 (1946); Thompson Ross Securities Co., 6 S.E.C. 1111, 1122 (1940); Churchill Securities Corp., 38 S.E.C. 856 (1959). See generally Loss, Securities Regulation, (1961 Ed.), Vol. II, pp. 1309-1312 (1969 Supp.), Vol. V, pp. 3368-3374.

funds of those who entered into arrangements with AIDS. The registrant was fully aware of these arrangements since it joined in contractual arrangements with AIDS and its customers who participated in the program of AIDS. The registrant further assisted AIDS by executing its instructions for customers of registrant and remitting compensation to AIDS. It is concluded that the registrant and Wright willfully aided and abetted violations of Section 205(1) of the Advisers Act by their conduct.

Pursuant to the provisions of Section 206(4) of the Advisers Act, investment advisers are prohibited from using any means or instrumentalities of interstate commerce or of the mails to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative, as defined and prescribed by rules and regulations issued by the Commission. In Rule 206(4)-1 under the Advisers Act the Commission has defined as a fraudulent, deceptive, or manipulative act, for any investment adviser to publish or distribute any advertisement which refers to any testimonial of any kind concerning him or his services. Testimonials were contained in the brochure prepared with the help of registrant and which was used to persuade customers of the registrant to contract with AIDS (Div. Ex. 1, Ex. B)^{6/}. In the aforementioned rule, references to past specific recommendations of an investment adviser which were or would have been profitable to any person are forbidden

^{6/} The term "advertisement" is defined in the aforementioned rule to include the brochure as used here.

(except for certain provisos not material herein). Here again, the brochure specifically made references to passed specific recommendations in violation of this provision.

Other activities prohibited under this rule are representations that any chart or formula being offered can be used in and of itself to determine which securities to buy or sell or when to buy or sell them. Such a representation was made in the brochure and was a cornerstone of the plan being offered.

In addition to the aforementioned violative conduct, which the undersigned concludes the registrant and Wright willfully aided and abetted, it is also concluded that they aided and abetted violations of the general provisions of Section 206(4)-1 of the applicable rules by aiding and abetting publication of incomplete and misleading statements. They also violated the anti-fraud provisions of the Exchange Act (Section 10(b) and Rule 10b-5) thereunder by making misleading statements of material facts and omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading concerning: the interest of registrant in fees paid by its customers for the service of AIDS; the relationship between AIDS and the registrant and the services to the rendered by AIDS; and participation in the preparation and circulation of the aforementioned brochure. It is concluded that registrant and Wright willfully violated and aided and abetted these violations.

III. CONCLUDING FINDINGS; PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b)(5) of the Exchange Act, so far as it is material herein, is required to censure, suspend for a period not exceeding twelve months or to revoke the registration of any broker or dealer if it finds that such action is in the public interest, and such broker or dealer has willfully violated any provision of the Exchange Act, the Advisers Act, or any rule or regulation thereunder. It also may, pursuant to the provisions of Section 15(b)(7) of the Exchange Act, censure, bar, or suspend, for a period not exceeding twelve months, any person from being associated with a broker or dealer if it finds that such sanction is in the public interest and that such person has willfully committed violations of the Exchange Act, the Advisers Act, or any rule or regulation thereunder. It also, pursuant to the provisions of Section 15A of the Exchange Act, may expel or suspend a member from membership in a registered securities association whom it finds is subject to sanction imposed pursuant to Section 15 of the Exchange Act. A similar provision is applicable to members of a national securities exchange, pursuant to Section 19(a) of the Exchange Act.

It has been found that the respondents have willfully aided and abetted violations of the registration provisions of the Advisers Act and also investment advisory contract and the anti-fraud provisions of that Act thereunder. They also wilfully violated and aided and abetted violations of the anti-fraud provisions

under the Exchange Act. The Division has argued that in view of the fact that these violations occurred over approximately a period of four months a sanction of suspension for a like period should be found appropriate here in the public interest.

It is urged on behalf of Wright that he has sustained severe financial loss as a result of the proceedings herein; has ceased doing business as a broker-dealer, paying off all customers and other accounts in full; that he relied on assurances from Bronson and Putnam that the AIDS operation was "all-clear" with the local office of the Commission; and that he has a long record as a reputable and responsible businessman.

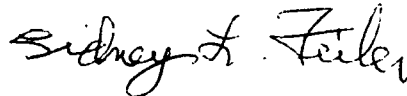
However, the evidence does establish that Wright failed to carry out his responsibilities as chief executive of the registrant and made it possible for serious violations of important provisions of the Advisers Act to be committed. The sections violated were key sections designed to protect the public interest and the interests of investors. The undersigned concludes that a sixty-day suspension of the registrant and of Wright is warranted and required in the public interest. Accordingly,

IT IS ORDERED that the registration of Gerald H. Wright & Co., as a broker-dealer is suspended for a period of sixty days.^{7/} Its memberships in the National Association of Securities Dealers, Inc. and the Midwest Stock Exchange are also suspended for sixty days.

^{7/} Absent further action by the registrant, the notice of withdrawal of its registration will become effective upon expiration of the period of suspension.

IT IS FURTHER ORDERED that Gerald H. Wright is suspended from association with any broker or dealer for sixty days.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him. This initial decision pursuant to Rule 17(f) shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.^{8/}



Sidney L. Feiler
Administrative Law Judge

Washington, D.C.
November 24, 1972

^{8/} All contentions and proposed findings have been carefully considered. This initial decision incorporates those which have been found necessary for incorporation therein.