ADMINISTRATIVE PROCEEDING
FILE NO. 3-6907

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
GALLAGHER & CO.	:
RUSSELL K. GALLAGHER and LAURA K. GALLAGHER	:
	:

INITIAL DECISION

Washington, D.C.
October 5, 1988

Brenda P. Murray
Administrative Law Judge

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APPEARANCES: Catherine S. Croisant, D. Robert Cervera and Peter W. Gillies on behalf of the Division of Enforcement, Securities and Exchange Commission.

G. Richard Chamberlin on behalf of Gallagher & Co., Russell K. Gallagher and Laura K. Gallagher

BEFORE: Brenda P. Murray, Administrative Law Judge

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I. Introduction

The Securities and Exchange Commission (Commission) instituted this proceeding on November 20, 1987, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 [15 U.S.C. 78o(b)(4)(C), and 78s(h)] (Exchange Act). The Commission's Division of Enforcement (Division) alleges that respondents violated the antifraud provisions of the federal securities laws in connection with the initial public offering on a "part or none" basis of the stock of The Electronics Warehouse, Inc. (Warehouse or the Company). Warehouse, a Delaware corporation headquartered in Connecticut, was formed in 1982 by Edward W. Bremer. Mr. Bremer had been president and owner of Bremer Advertising, Inc., a company engaged in mail order marketing of electronic equipment and electronic components since 1968 (Tr. 90). Warehouse was completely dependent upon the personal efforts and abilities of Mr. Bremer, its chief executive officer. The Warehouse Prospectus stated that the loss of Mr. Bremer's services would have a materially adverse effect on Warehouse's business prospects and/or potential earning capacity (Exhibit 3, p. 4).

A fourth respondent, Donald A. Ehrlich, a person asociated with a registered broker-dealer entered a settlement of these matters with the Commission on November 20, 1987 (39 SEC Docket 1185).

The Divison addresses the following charges against respondents:

	Statute or Rule	Section II of Order (¶)	Allegations
1.	Section 17(a) of the the Securities Act of 1933 and Section 10(b) of the Exchange Act [15 U.S.C. 77q(a), 78j(b)] Rule 10b-5 [17 C.F.R. 240.10b-5]	D	Willful violations by Gallagher & Co. and Russell Gallagher. Aiding and abetting violations by Laura Gallagher. False representations made (1) that consideration paid would be refunded if minimum shares were not sold and fully paid for within 150 days of effective date, and (2) concerning uses of the proceeds, including the offering expenses and net proceeds to Warehouse.
2.	Section 10(b) Rule 10b-9 [17 C.F.R. 240.10b-9]	E	Willful violations by Gallagher & Co. and Russell Gallagher. Aiding and abetting violations by Laura Gallagher Created appearance of a successful all-or-none offering by arranging non-bona fide sales and making false representations that sales were on a "part or none" basis such that consideration paid would be refunded if the minimum was not raised by a specific date.

	Statute or Rule	Section II of Order (¶)	Allegations
3.	Section 15(c)(2) of the Exchange Act [15 U.S.C. 78o(c)] Rule 15c2-4 [17 C.F.R. 240.15c2-4]	F	Willful violation by Gallagher & Co. Aiding and abetting violations by Russell and Laura Gallagher. Accepted part of the sale price and permitted disbursements from the escrow fund even though the contingent event had not occurred.
4.	Section 10(b) Rule 10b-6 [17 C.F.R. 240.10b-6]	G	Willful violations by Gallagher & Co. Aiding and abetting violations by Russell and Laura Gallagher. Purchasing Warehouse shares prior to completing distribution.
5.	Sections 17(a) and 10(b) Rule 10b-5	H	Violations by Gallagher & Co.., Russell Gallagher and Laura Gallagher. Respondents knew or were reckless in not knowing that an indictment by a federal grand jury of Warehouse's principal for mail fraud and aiding and abetting mail fraud was a material fact which should have been, but which they did not disclose to Warehouse's subscribers.
6.		I.	Respondents were permanently enjoined in the United States District Court for the District of Connecticut for the actions described above.

II. Background

Russell K. Gallagher has been active in the securities industry for over twenty-five years. He formed Gallagher & Co., a sole proprietor broker-dealer registered with this Commission, in 1983. From its inception Gallagher has claimed to be exempt from certain reporting requirements because it would not hold funds or securities for customers (Tr. 586-87; Stipulation ¶17). Mr. Gallagher attended several colleges, graduated from the New York School of Finance and holds four registrations from the National Association of Securities Dealers (NASD): registered representative (since 1964), general principal (since 1970), financial principal and options principal and also passed an examination for a license to sell securities in the states (Stipulation ¶4; Tr. 891). Prior to starting Gallagher & Co. in Florida, Russell Gallagher operated a 50 person securities firm with offices in Los Angeles and Denver (Tr. 893-94). In 1979, NASD censured and fined Russell Gallagher $500 (Exhibit 17, p. 3; Tr. 908). In addition to Russell and Laura Gallagher, Gallagher & Co. in 1984-1985 employed four sales people, two in Oregon and two in Florida, and part-time bookkeepers.

In the fall of 1984 Gallagher & Co. entered an oral

underwriting agreement with Warehouse (Tr. 871). A written underwriting agreement dated September 28, 1984 was signed on November 23, 1984 (Tr. 872-74; Exhibit 49). The Warehouse Prospectus states that (Prospectus, pp. 2,21):

> The proceeds from the sale of securities offered hereby, a maximum of $1,223,500 if the maximum number of shares are sold, and $964,000 if the minimum number of shares are sold, will be used by the Company mainly for printing and mailing costs, advertising, research and development and salaries. Limited amounts will be used to purchase equipment and inventory. (See "Risk Factors" and "Use of Proceeds").
>
> * * *
>
> Under the terms of the Underwriter Agreement, the Company has employed the Underwriter as its exclusive agent and the Underwriter has agreed to use its best efforts to offer and sell a maximum of 15,000,000 Shares of Common Stock to the public on a 'best efforts, 12,000,000 shares or none' basis, at $.10 per share within ninety days from the date of this Prospectus or within one hundred fifty days, if extended by mutual agreement between the Company and the Underwriter.

The underwriter's commission was 10 percent of the offering price for each share sold if the initial public offering were successful (i.e. $.01 per share; a maximum of $150,000 or minimum of $120,000). The underwriter would also receive a non-accountable expense allowance of 3.5 percent of the gross amount sold (i.e. a maximum of $52,500 or a minimum of $42,000). No commission was due if the offering was terminated because the minimum number of units were not sold but the underwriter would be entitled to the non-accountable expense allowance

of $0.0035 for each share sold (Tr. 563-64). According to the Prospectus, the net proceeds to the company would be either $1,223,500 or $964,000 depending on whether the maximum or minimum number of shares were sold (Exhibit 3, p. 7).

Prior to the Warehouse underwriting, Russell Gallagher had been actively involved in many undewritings as a registered representative and one successful all-or-none or mini/maxi offering as principal underwriter on a much smaller scale, i.e. $250,000 as opposed to $1.2 million (Tr. 540-41, 924).

Laura K. Gallagher, wife of Russell K. Gallagher, was an active participant in the affairs of Gallagher & Co. and was in charge of company records and customer accounts (Tr. 769). Laura Gallagher was registered by the NASD as a representative and a general principal in 1981 and also passed a state exam (Tr. 766, 799). Prior to her association with Gallagher & Co., Laura Gallagher was a registered representative with the brokerage firm of Engler & Budd. She often answered the phone at the Gallagher & Co.'s office located in the Gallagher home. Subject to consultation with Russell Gallagher, she traded in the company's proprietary account, and she participated actively in discussions, negotiations and business dealings involving Gallagher & Co.'s underwriting of Warehouse's initial public offering (Tr. 80-81, 86-87, 120, 459-60, 626, 643, 659, 781, 794, 823-24).

She maintains that she acted only as a registered representative for the Warehouse offering (Tr. 802-03).

Respondents, Gallagher & Co., Russell K. Gallagher and Laura K. Gallagher, made use of the telephone, mails other means of interstate commerce in connection with the initial public offering of Warehouse (Stipulation ¶69). Russell and Laura Gallagher sent out copies of the Prospectus to potential investors.

Attorney Gary Granai of Granai & Hauslaib was legal counsel for Warehouse and Attorney William Calvo, III, of Calvo & Bofshever, was legal counsel to the underwriter (Stipulation ¶42; Tr. 609). Attorney Calvo prepared the first post-effective amendment to the Prospectus (Tr. 606). Attorney Calvo represents both that he did this work as special counsel to attorney Granai before he agreed to represent the underwriter, and that he did it while representing Gallagher & Co. (Tr. 605-07, 713-14). Mr. Bremer thought Attorney Calvo represented both Warehouse and the underwriter, and that Attorney Calvo's fee to Warehouse was $10,000 (Tr. 56-57, 432-33, 437, 440, 449-50, 511).

This Commission declared Warehouse's amended registration statement effective on November 8, 1984. Russell Gallagher had notice of the Commission's action. The effective date appears on the cover of the Prospectus (Exhibits 3 and 4). The original closing date, 90 days

from the effective date, was February 6, 1985. On January 31, 1985, Warehouse and Gallagher & Co. exercised the option and extended the offering period to 150 days from the effective date (Exhibit 6). The escrow bank, Barnett Bank of South Florida, N.A., mistakenly calculated the extension from the date of the escrow agreement rather than the effective date of the offering and on February 19, 1985 notified Warehouse, Russell K. Gallagher and Attorney William Calvo, III that "the escrow agreement will continue to remain open another 60 days, to be completed by April 22, 1985" (Stipulation ¶29; Exhibit 7, Exhibit 10, p.3). 1/ The recipients of the bank's letter did not correct the bank's mistake, instead they acted as if the correct date for the offering to close was April 22, 1985 rather than April 7, 1985 (Tr. 625-28). Laura Gallagher, however, understood that all tickets reflecting Warehouse stock sales had to be written by April 8, 1985 (Tr. 826). Respondents, Gallagher & Co., Russell Gallagher and Laura Gallagher, did not change, attempt to change or direct anyone else to change the closing date of escrow account set by Barnett Bank (Stipulation ¶30).

1/ There is testimony that later the Bank's position was that closing should occur on April 19, 1985 (Tr. 113, 460-61).

On March 8, 1985, the Grand Jury for the District of Maryland named Edward W. Bremer as the subject of a 17-count criminal felony indictment for mail fraud and aiding and abetting mail fraud. United States v. Cranwell and Bremer, United States District Court for the District of Maryland, Criminal Docket No. Y-85-0150 (Exhibit 14)[2/]. Attorney William Calvo, III learned of the indictment in March 1985 (Tr. 195, 343, 634-35, 742, 750). Russell K. Gallagher and Laura Gallagher learned of the indictment before the close of the public offering on April 22 (Stipulation ¶59; Tr. 195-96, 743, 858). Attorney Calvo discussed with Attorney Granai and Mr. Gallagher whether Mr. Bremer should resign as president of Warehouse and whether they should file a post-effective amendment or sticker the Prospectus. Mr. Bremer did not resign. Attorney Calvo, Attorney Granai and Mr. and Mrs. Gallagher did not file a post-effective amendment informing investors of the indictment and did not sticker the Prospectus to give public notice to investors of the indictment (Stipulation ¶60; Tr. 634-51, 743-48, 862, 885-86). Russell Gallagher and

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2/ The indictment had 20 counts. Counts 16, 17 and 18 name only John R. Cranwell. In July 1985, Edward W. Bremer pled guilty to Count No. 1 and the United States Attorney agreed not to prosecute the remaining counts (Exhibit 44). On October 25, 1985, Mr. Bremer was given a five-year jail sentence which the court suspended subject to four months confinement in a halfway house, five years probation and payment of restitution in the amount of $15,194.00 (Tr. 198-99).

Laura Gallagher continued to sell Warehouse stock after they knew about the Bremer indictment (Tr. 798).

Prior to the closing, Attorney Granai wrote a letter to Gallagher & Co. in which he stated (Exhibit 15, p.2):

> 5. The Registration Statement and the Prospectus (except as to the financial statements contained therein, as to which our firm expresses no opinion) comply as to form in all material respects with the requirements of the Securities Act, the Securities Exchange Act of 1934 and with the rules and regulations of the Commission thereunder and the descriptions in the Registration Statement and Prospectus, or any such amendment or supplement, or contracts and other documents are accurate in all material respects, except as may be required, if required, at all, (as to which our firm expresses no opinion) by the recent proceeding brought against Mr. Bremer, a copy of which is attached.

On April 22, 1985, Attorney Calvo had Attorney Granai draw a line through the underlined language and add at the end of the paragraph the words, "It is our opinion based upon our review of the proceeding and evidence to date that there is little likelihood that the government will prevail in this matter." (Exhibit 15; Tr. 199-201).

Warehouse stock did not sell as the Gallaghers had hoped. At the end of January, February and March 1985, the escrow account balance stood at $130,500; $191,050; and $360,195, respectively. On April 19, 1985, the Friday before the Monday closing, the escrow account balance was $523,287 (Stipulation ¶¶32-35). The escrow bank received deposits of $690,000 on April 22, 1985, the day the bank closed the escrow account. This

amount consisted of three wire transfers: $250,000 from Norman Stern, as attorney for Marvin T. Richmond, and $220,000 each from Attorney Granai and a person by the name of Crane (Exhibit 10, p.3). Mr. Richmond, a self-employed financial consultant or money lender, lent $250,000 to the escrow account of Warehouse based on his terms that the money would have to go in with one hand and out with the other (Tr. 244-45, 248, 251-54, 265-66, 282). Mr. Richmond's wire for $250,000 arrived at the bank around noon on April 22, 1985. The escrow account was closed shortly afterwards and Mr. Richmond received a check for $324,350.00 -- principal plus interest minus the cost of airline tickets to Florida, immediately after the closing (Tr. 254, 262, 265-66).

Mr. Gallagher claims not to have know that all these wire transfers represented loans. He contends he believed that the escrow account reached the $1.2 million minimum because Bremer Advertising bought $690,000 worth of Warehouse stock on April 22. He contends that in early April Mr. Bremer agreed that Bremer Advertising would buy whatever amount was necessary to close the offering on April 22. He claims that the April 5 date which appears on the order ticket for the stock purchase by Bremer Advertising, represents the date that the account was opened not the date of trade (Tr. 177-79, 573-75, 831, 917-18). In earlier sworn testimony, Laura Gallagher, who prepared the order ticket, stated that Russell Gallagher told her on April 5 that Bremer Advertising was buying

6,900,000 shares of Warehouse stock (Tr. 827-31). These stock shares stayed with the Gallaghers. The Gallaghers now say Russell Gallagher, not Gallagher & Co., retained personal possession of this stock until June 11, 1985, when Laura Gallagher delivered 4,400,000 shares to Mr. Bremer (Tr. 180, 832-34, 849, 918-20; Stipulation ¶54). In earlier sworn testimony, Laura Gallagher stated that Gallagher & Co. held the stock for the account of Bremer Advertising (Tr. 832).

The bank disbursed the $1,232,287 in escrow at the direction of Attorney Calvo on April 22, 1985, in the following manner (Exhibit 10; Tr. 659-60):

$324,350.00 - Marvin T. Richmond
$161,358.75 - Gallagher & Co.
$ 15,000.00 - Attorney William A. Calvo III
$731,578.25 - Granai & Hauslaib, P.C. as Trustee

Mr. Gallagher attended the closing and received a copy of the disbursement sheet.

Mr. Bremer understood Attorney Calvo increased his fee from $10,000 to $15,000 for overlooking Mr. Bremer's mail fraud indictment (Tr. 205, 452). Attorney Calvo denies this allegation (Tr. 705). On April 22, 1985, Mr. Bremer authorized Attorney Granai to pay the following amounts from the account the law firm of Granai & Hauslaib held as trustee for Warehouse (Exhibit 21):

$220,000.00- Lauren and Dean Scholl
$426,578.25- Electronics Warehouse
$ 85,000.00- Granai & Hauslaib, P.C.
$731,578.25

On April 22, 1985, Mr. Bremer deposited the $426,578.25 check Electronics Warehouse received into an

account at Barnett Bank and wrote a check on that account to Bremer Advertising Inc. in the amount of $50,000. That check bears the notation "for pre-paid advertising" (Exhibit 23). Mr. Bremer wrote checks to Velma and Margaret Crane for $40,000 from the Bremer Advertising account and for $220,000 from The Electronics Warehouse account on the same date (Exhibits 24 and 25). The next day, April 23, Mr. Bremer wrote a $50,003 check to Bremer Advertising on The Electronics Warehouse account for "prepaid advertising" (Exhibit 26). Those funds were deposited in a Bremer Advertising account in a Connecticut bank. On April 24, 1985, Mr. Bremer wrote a check on this account to Don Ehrlich for $24,700 (Exhibit 27). On April 29, 1985, Mr. Bremer wrote a check to Bremer Advertising on The Electronics Warehouse account in the amount of $12,000 for pre-paid advertising (Exhibit 31). On May 1, Mr. Bremer wrote a check on The Electronics Warehouse account to John J. Stewart for $10,000 for "PR fee" (Exhibit 29).

After the closing, Gallagher & Co. acted as a market-maker in Warehouse stock (Tr. 780-81).

On July 3, 1985 in United States v. Edward W. Bremer, Edward Bremer entered a plea agreement with the United States Attorney for the District of Connecticut whereby he agreed to plead guilty to a one-count felony information charging him with violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder (Tr. 191-92;

Exhibit 42). The plea agreement specifies the applicability of a maximum penalty of five years imprisonment and maximum fines of (1) twice the gross gain to the defendant resulting from the offense; (2) twice the gross loss to others resulting from the offense; (3) $250,000; or (4) the amount specified in the statute setting forth the offense (Exhibit 42). The United States District Court for Connecticut has not imposed sentence on Mr. Bremer pursuant to the plea agreement which specifies that his cooperation or lack thereof will be brought to the attention of the sentencing judge (Tr. 333).

The Securities and Exchange Commission initiated a civil action against Warehouse, Edward W. Bremer, Gary Granai, Gallagher & Co., Russell K. Gallagher, Laura K. Gallagher, William Calvo, Donald E. Erlich, Marvin T. Richmond and Norman Stern. All the defendants except Attorney Calvo consented to permanent injunctions, where, without admitting or denying the allegations in the Commission's complaint, they were restrained and enjoined from violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(c) of the Exchange Act and Rules 10b-5, 10b-6, 10b-9 and 15c2-4. S.E.C. v. The Electronics Warehouse, Inc., et al., Civil Action No. H-86-232-PCD (D. Conn. 1986 and 1987).

On June 7, 1988, the United States District Court for the District of Connecticut granted this Commission's motion for summary judgment against Attorney William A.

Calvo on four counts for violations of the securities laws in connection with the public offering of Warehouse. On June 8, 1988, the court entered a final judgment of permanent injunction against Attorney Calvo (SEC v. The Electronics Warehouse, Inc., et al., Civil Action No. H-86-282 PCD, (D. Conn.)

On December 15, 1987, the NASD Board of Governors decided after hearing to cancel Gallagher & Co.'s membership and revoked the Gallaghers' registrations effective March 14, 1988 (Exhibit 17). Gallagher & Co., Russell Gallagher, and Laura Gallagher appealed the NASD determination to this Commission on January 12, 1988. On February 16, 1988, the Commission granted a stay, pending Commission review, of NASD action.

The United States District Court for the District of Connecticut has appointed a receiver for Warehouse (Stipulation ¶64). The temporary receiver has recovered a portion of the funds, but investors apparently will not be fully reimbursed. S.E.C. v. The Electronics Warehouse, Inc., et al., Civil Action No. H-86-282 PCD, (D. Conn.), Ruling on Motion for Summary Judgment, p.33, n. 18, (June 7, 1988).

None of these respondents have disgorged any of the monies they received from the sale of Warehouse stock (Tr. 838-39, 862-63). At the time of the hearing in these

matters, June 7-10, 1988, Gallagher & Co., had acted as principal underwriter in two or three public offerings since Warehouse, and Russell Gallagher and Laura Gallagher were engaged in the securities business.

III. Argument

The Division charges that respondents' receipt of the Warehouse offering proceeds when the minimum number of shares had not been sold within the specified time constituted a "device, scheme, or artifice to defraud" (Section 17(a)) and an "act, practice, or course of business" (Rule 10b-5) that operated as a fraud upon the purchasers of Warehouse stock. It imputes Russell Gallagher's scienter to Gallagher & Co. (S.E.C. v. Blinder, Robinson & Co., Inc., et al., 542 F. Supp. 468, 476 n. 3 (D. Colo. 1982)). It acknowledges that a showing of scienter is required for violations of Sections 17(a)(1) and 10(b) and Rule 10b-5, while violations of Sections 17(a)(2) and (3) require a showing only that respondents were negligent in omitting or falsely stating a material fact or, in having engaged in a transaction or practice that would operate as a fraud or deceit upon the purchaser. Aaron v. S.E.C., 446 U.S. 680 (1980). It notes that the scienter requirement is satisfied by a showing of reckless disregard for the

truth or falsity of a material statement. See SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985); Sirota v. Solitron, 673 F.2d 566, 575 (2d Cir.), cert. denied, 459 U.S. 838 (1982); Oleck v. Fischer, 623 F.2d 791, 794-95 (2d Cir. 1980) and SEC v. Coven, 581 F.2d 1020, 1025 (2d Cir.), cert. denied, 440 U.S. 950 (1979).

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important. Put another way, there must be substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available, TSC Industries, Inc., et al. v. Northway, Inc., 426 U.S. 438, 449 (1976); Basic Inc. v. Levinson, 56 U.S.L.W. 4232 (March 7, 1988). The Division characterizes Russell Gallagher as a well-educated individual, experienced in the securities industry. It contends that as underwriter Gallagher owed a high duty to the investing public to investigate the issuer's representations, especially where he knew or should have known of misrepresentations and omissions in the Prospectus. The Division claims Russell Gallagher's failure to calculate the correct closing date amounted to recklessness and that he knew or should have known that funds from non-bona fide sales were used to close the offering. See Kiernan v. Homeland, 611 F.2d 785, 788 (9th Cir. 1980). It characterizes as not credible,

Russell Gallagher's claim that he believed Warehouse owed Bremer Advertising over $300,000 so that Bremer Advertising was entitled to receive money from the Warehouse escrow account. Even if Russell Gallagher is as gullible as he claims to be, the Division asserts that he violated the standard of care required of an underwriter. S.E.C. v. Blavin, 760 F.2d 706 (6th Cir. 1985), and Sanders v. John Nuveen & Co., Inc., 524 F.2d 1064, 1069-71 (7th Cir. 1975), vacated on other grounds, 425 U.S. 929 (1976), appeal after remand, 554 F.2d 790 (7th Cir. 1977) and 619 F.2d 1222, (7th Cir. 1980) cert. denied, 450 U.S. 1005 (1981).

The Division charges that the material requirement of Section 17(a)(2) and Rule 10b-5(b) was satisfied when the Gallaghers failed to disclose to investors that at the end of 150 days, less than half the minimum had been raised, and that after the closing on April 22 Warehouse received only $131,000 from the offering. (Tr. 162-70). According to the Division, these variations from representations in the Prospectus required refunds to investors and should have prevented the closing from occurring. Instead, Gallagher & Co. went through with the closing and received $161,000.

The Division cites IIT, an International Investment Trust v. Cornfeld, 619 F.2d 909 (2d Cir. 1980); see also Decker v. Massey-Ferguson, Ltd., 681 F.2d 111, 119 (2d Cir. 1982); Woodward v. Metro Bank, 522 F.2d 84, 97 (5th Cir. 1975); and Cleary v. Perfectune, 700 F.2d 774, 779 (1st Cir.

1983) for establishing the following tripartite standard for aiding and abetting violations of Sections 17(a) and 10(b) and Rule 10b-5:

(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party;

(2) 'knowledge' of this violation on the part of the aider and abettor; and

(3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation.

The Division alleges that as a principal of Gallagher, Laura Gallagher had a duty to investigate and disclose that the offering remained open past the date indicated in the Prospectus, and that Edward W. Bremer through Bremer Advertising was going to buy whatever amount of stock was necessary to close the offering, a fact not disclosed in the Prospectus. It charges that these failures violated her duty as an underwriter to the investing public, and gave substantial assistance to Gallagher & Co. and Russell Gallagher in committing violations of Sections 17(a) and 10(b) and Rule 10b-5 so that she is liable for willfully aiding and abetting those violations.

The Division cites three cases (S.E.C. v. Manor Nursing Center, Inc., 458 F.2d 1082 (2d Cir. 1972); In the Matter of C.E. Carlson, Inc., Fed. Sec. L. Rep. (CCH) ¶93,800 (10th Cir., June 10, 1988) and Blinder, Robinson & Co., Inc., Fed. Sec. L. Rep. (CCH) ¶84,052 (1986),

vacated and remanded on other grounds, 837 F.2d 1099 (D.C. Dir. 1988) to support its charge that Gallagher & Co. and Russell Gallagher acted with scienter or at least with reckless disregard for truth in connection with the Warehouse part or none offering.

The Division points out that the designation "all-or-none" means that the consideration paid will be promptly refunded unless all of the securities being offered are sold at a specified price within a specified time, and the total amount due to the seller is received by him by a specified date (Rule 10b-9). Rule 10b-9 is violated by non-bona fide sales, such as purchases by the issuer through nominee accounts or purchases by persons whom the issuer has agreed to guarantee against loss (SEC Rel. No. 34-11532, 3 Fed. Sec. L. Rep. (CCH) ¶22,730 (July 11, 1975). The Division notes that more than half the minimum shares of the Warehouse offering were paid for from the offering itself, through persons the issuer guaranteed against loss. Russell Gallagher knew that the Prospectus did not show a Warehouse debt to Mr. Bremer in anywhere near the amounts which Attorney Calvo assumed when he opined that the purchases by Bremer Advertising were legal, but Mr. Gallagher did not ask for evidence which would prove these debts existed.

The Division alleges it has satisfied the three part test to show that Laura Gallagher aided and abetted the violations by Gallagher and Co. and Russell Gallagher.

It contends she breached her duty as a principal of the underwriter to make any inquiry to ensure against fraud and her specific duty under Rule 10b-9 to ensure that all Warehouse stock was sold in bona fide transactions.

Section 15(c)(2) and Rule 15c2-4 speak to broker-dealers. The Division imputes Russell Gallagher's actions and mental state to Gallagher & Co., the company he controlled. The Commission has declared that on "all or none offerings" no funds may be disbursed from the agency or escrow account until all the securities are sold in bona fide transactions and are fully paid for (SEC Release No. 34-11532, Fed. Sec. L. Rep. (CCH) ¶22,730 (July 11, 1975). The Division cites In the Matter of C.E. Carlson, Inc., Fed. Sec. L. Rep. (CCH) ¶93,800 (10th Cir., 1988) and In the Matter of Blinder, Robinson & Co., Fed. Sec. L. Rep. (CCH) ¶84,052 (1986), vacated and remanded on other grounds, 837 F.2d 1099 (D.C. Cir. 1988) as examples of analogous factual situations involving loans, rather than bona fide sales, where the courts found Rule 15c2-4 violations.

The Division acknowledges that little authority exists describing what conduct establishes an aiding and abetting violation of Section 15(c)(2) and Rule 15c2-4. It relies on In the Matter of C.E. Carlson, Inc., Fed. Sec. L. Rep. (CCH) ¶93,800 (10th Cir., 1988) for the proposition that the same three part test used for violations of

Sections 17(a) and 10(b) and Rule 10b-5 is applicable. The Division argues that as underwriter of an part or none offering, Gallagher & Co. and its principals owed a duty to the investing public in addition to the duty owed by an underwriter generally. It cites language from Commission Release No. 34-11532 (3 Fed. Sec. L. Rep. (CCH) ¶22,730 (1975)) that:

> Rule 15c2-4. . . imposes an obligation on the broker-dealer to ensure that funds received by him are not dissipated in any fashion -- including by disbursement to the issuer -- unless the contingency has been fully satisfied . . . . Violations of Rule 15c2-4 . . . are serious breaches of the duty owed by issuers, underwriters and broker-dealers to the investing public.

The Division claims that Russell and Laura Gallagher acted recklessly by dissipating the escrow funds because they knew that Mr. Richmond's loan to Edward Bremer made it possible for Mr. Bremer to purchase over one-half the minimum shares and that this loan was repaid out of the escrow account. Laura Gallagher did not deny thanking Mr. Richmond for making the closing possible (Tr. 268, 289) and Russell Gallagher did not deny congratulating Mr. Richmond on making a good day's pay and telling him that without his money the closing would not have occurred (Tr. 266, 288).

Rule 10b-6(c)(3) specifies that an underwriter's participation in a distribution is complete only "when he has distributed his participation, including all other securities of the same class acquired in connection with

the distribution." The Division charges that Gallagher & Co. violated Section 10(b) and Rule 10b-6 because it fell 690,000 shares short of completing its distribution (the amount of non-bona fide sales) so that Gallagher & Co.'s purchases and sales constituted "a continuing after-market distribution of Warehouse stock, prior to Gallagher & Co. having completed its participation in the offering" (I.B. at 64). To support the aiding and abetting violations of Russell and Laura Gallagher, the Division claims the evidence shows that:

1. the offering was never completed according to the terms of the Prospectus and Gallagher & Co. did not complete its participation in the offering,

2. Russell Gallagher was Gallagher & Co.'s sole proprietor,

3. Laura Gallagher was in charge of trading in Gallagher & Co.'s proprietary account,

4. Gallagher & Co. purchased more than 1 million shares of Warehouse for its own account, and

5. Laura Gallagher made these purchases.

According to the Division, greed is the only explanation of why respondents and Attorney Calvo permitted the underwriting to go to an apparent closing. The Division contends that it has satisfied the scienter requirement since Russell Gallagher, Laura Gallagher and Attorney Calvo admit they knew about Edward Bremer's indictment for mail fraud prior to closing the public offering and did not disclose it, and Russell Gallagher's knowledge and actions are

imputed to Gallagher & Co., his wholly owned company (Tr. 798, 858; Stipulation ¶59). In view of the statements in the Prospectus about the importance of Edward Bremer to the success of Warehouse's mail order business, the Division argues that the respondents were reckless in not revealing Edward Bremer's indictment for mail fraud. The Division charges that Laura Gallagher acted recklessly by not attempting to determine the nature of the Bremer indictment (Tr. 798-99). The Division cites Sanders v. John Nuveen & Co., Inc., 524 F.2d 1064 (7th Cir. 1975), vacated, 425 U.S. 929 (1976), appeal after remand, 554 F.2d 790 (7th Cir. 1977) and 619 F.2d 1222 (7th Cir. 1980), cert. denied, 450 U.S. 1005 (1981) as prohibiting the laissez faire attitude of the Gallaghers in this factual situation. The Division finds it incredible that principals with 25 and 5 years, respectively, working in the industry can attempt to defend their failure to inform the public of this material fact by claims of ignorance or reliance on counsel. TSC Industries, Inc., et al. v. Northway, Inc., 426 U.S. 438 (1976).

In summary, the Division charges that Bremer's indictment was a material fact that should have been disclosed to Warehouse investors, that respondents knew or were reckless in not knowing the indictment was a material fact and they knowingly or recklessly omitted to disclose that material fact to investors.

The Division recommends that the Commission bar Russell and Laura Gallagher and revoke the registration of Gallagher & Co., for whom they acted as principals. It notes that the purpose of the Exchange Act is to protect investors from future harm and to deter others. Willard E. Berge, 46 SEC 690, 695 (1976), aff'd sub nom., Feeney v. SEC, 564 F.2d 260 (8th Cir. 1977), and Richard G. Spangler, Inc., 46 S.E.C. 238, 254 n. 67 (1976). The Division is alarmed by the Gallaghers' egregious, cumulative conduct, their refusal to acknowledge their responsibilities as principals, their failure to acknowledge wrongdoing, their attempts to blame others, and the different representations they made while under oath. Factors influencing the Division's recommendation include:

1. Russell Gallagher's view that an underwriter on public offerings is not responsible for (a) calculating the correct offering period, (b) recording a client's accurate net worth on a new account form, (c) accurately stating trade dates on order tickets and confirmations, and (d) reviewing disbursements from the escrow account.

2. Laura Gallagher's attempt to manufacture evidence that Mr. Richmond had purchased stock and her belief that as a principal she was responsible in this situation for only trading and client records.

3. Neither Laura nor Russell Gallagher has disgorged any money received in the offering.

4. Gallagher & Co. has acted as principal in two public offerings since Warehouse.

5. Three separate frauds were perpetrated -- material information was withheld concerning the closing date, the Bremer indictment was not disclosed and use of proceeds was not according to the Prospectus. These violations caused a closing to occur and Warehouse's defunct status with substantial losses to investors. The Commission's position is that a fraudulent closing is a serious breach of the duty owed by an underwriter to the investing public. (Release No. 34-11532, 3 Fed. Sec. L. Rep. (CCH) ¶22,730 (1975).

6. Insistence by the Gallaghers that they did no wrong.

Respondents maintain that they did not commit the statutory violations. They contend that (1) Russell Gallagher did not intentionally, knowingly or recklessly extend the closing past the correct settlement date or arrange improper loans payable out of escrow funds because he reasonably relied on misinformation supplied to him by the escrow bank, Attorney Calvo, and Edward Bremer, and (2) Laura Gallagher did not willfully aid and abet in the violations because she did not know about the mistaken closing date or improper loans and gave no assistance to these wrongs.

Respondents argue that they did not violate Section 10(b) of the Exchange Act and Rule 10b-6 by deceptively purchasing Warehouse shares for the account of Gallagher & Co., and attempting to induce other persons to purchase Warehouse shares prior to completing Gallagher & Co.'s participation

in the Warehouse distribution (Order Instituting Proceedings ¶G). They maintain that Gallagher & Co. began making a market in the stock beginning on April 25, 1985 as it was hired to do, that Gallagher & Co. did not buy any Warehouse stock owned by Edward Bremer or Bremer Advertising and that Russell Gallagher personally held 6,900,000 shares of Warehouse stock owned by Bremer or Bremer Advertising so that this restricted stock would not enter the market.

Finally, respondents claim that they did not violate Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 by failing to disclose Edward Bremer's mail fraud indictment because they relied on legal advice from the attorney for Gallagher & Co., Attorney Calvo.

Respondents portray themselves as honest, gullible, inexperienced individuals betrayed by unscrupulous felons whom the Division has chosen to believe in prosecuting this case against them. In their defense, respondents contend that the Division's main witness, Edward Bremer, stands to lose $500,000 and his freedom, if he does not cooperate with the government's case. Respondents contend that Russell Gallagher did not arrange loans but did not disapprove of Edward Bremer getting loans based on advice from Attorney Calvo (Reply Brief at 11). They maintain that at the time of closing they expected Edward Bremer to be responsible for half the offering, and neither

Gallagher had the slightest idea that funds from non-bona fide sales were used to close the offering (R.B. at 10).

Respondent Laura Gallagher did not attend any significant meetings prior to the closing, she was uninformed about closing dates and loans and she depended on her husband and the company Attorney for direction. As noted by her counsel, "when you don't know you don't know." (R.B. at 16).

Respondents argue that the cases which the Division cites are inapplicable to this situation on the facts because in Carlson and Blinder Robinson the underwriter arranged to buy stock, and in Manor Nursing Center there was an agreement that the broker-dealer commissions and attorney fees would be paid in shares of the issuer.

Respondents maintain that the Commission should not impose any sanction because respondents are not culpable. If, however, the Commission does impose sanctions they should be in the form of minimal censure and workable limitations on activities and operations (R.B. at 22).

IV. Findings

The findings will dispose of the charges in the sequence they appear in the Commission's order.

1. I find that Gallagher & Co. and Russell Gallagher willfully violated Sections 17(a) and 10(b) and Rule 10b-5 and that Laura Gallagher willfully aided and abetted these violations as the Division alleged in Paragraph D of the Order instituting this proceeding.[3/] Violations of Sections 17(a)(1) and 10(b) and Rule 10(b)(5) require that the perpetrator have scienter, i.e., a mental state embracing an

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3/ Section 17(a) of the Securities Act provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly -- (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 10(b) of the Exchange Act provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -- To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(FOOTNOTE 3 CONTINUED ON NEXT PAGE)

intent to deceive, manipulate or defraud. Violations of Sections 17(a)(2) and 17(a)(3) do not require scienter but only a showing that respondents were negligent. Aaron v. S.E.C., 446 U.S. 680 (1980). The actions of Russell Gallagher are imputed to Gallagher & Co., his sole proprietorship for which he was a registered principal (Tr. 834; C.E. Carlson v. S.E.C., Fed. Sec. L. Rep. (CCH) ¶93,800 at 98,800 (10th Cir., 1988) and A.J. White & Co., 556 F.2d 619, 624 (1st Cir. 1977)).

I reach these conclusions because Gallagher & Co., sole underwriter of the Warehouse offering, and its proprietor and principal, Russell Gallagher, had a duty to assure that the offering was conducted as represented in the Prospectus. This did not happen. The facts are

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3/ (FOOTNOTE 3 CONTINUED FROM PREVIOUS PAGE)

Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange
>
> (1) To employ any device, scheme, or artifice to defraud,
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

that Russell Gallagher was part of a device, scheme, or artifice to defraud investors, and that he obtained money by means of untrue statements of material facts and omission of material facts. The evidence shows that Russell Gallagher knew or was reckless in not knowing that:

(1) the closing date for the offering was April 7, 1985, and that the Prospectus stated that investors would receive refunds if at least $1.2 million of Warehouse stock was not sold and paid for by that date. In Mr. Gallagher's opinion offerings that are all-or-none, part or none, or mini/maxi are similar (Tr. 542). The courts have acknowledged that the all-or-none character of a public offering is the investor's principal protection. (SEC v. Blinder, Robinson & Co., Inc., 542 F. Supp. 468, 476 (D. Colo. 1982), aff'd, [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶99,491 (10th Cir. 1983), cert. denied, 469 U.S. 1108 (1985)). Russell Gallagher knew that the minimum shares of Warehouse were not sold and paid for on April 7 but he did not act to refund money to investors. He continued to sell sell Warehouse stock, and he participated in a closing that occurred on April 22, 1985, at which he accepted a check for $161,358.75 made out to Gallagher & Co. (Tr. 559-60).

(2) the Prospectus represented that under a successful minimum sale Warehouse would receive net proceeds of $964,000, yet the April 22 closing resulted in a check to Warehouse of $731,578.25 and it appears Warehouse received net proceeds of only $130,878.25 (Tr. 162-170 506). Mr. Gallagher, the sole proprietor of the underwriter and a registered principal, was not concerned and did not require that the amount Warehouse received from the escrow funds was as represented in the Prospectus. His concern was only with the amount of money Gallagher & Co. received (Tr. 584-85). The omission of the actual net proceeds from the Prospectus is materially misleading because there is a substantial likelihood that a reasonable person would consider it important in deciding whether to buy shares in Warehouse.

(3) the use of the net proceeds from the offering was not as represented in the Prospectus. Before the closing on April 22, Russell Gallagher agreed that some $324,000 of the offering proceeds would go to Marvin Richmond on the theory that Warehouse would be paying Mr. Richmond money it owed Edward Bremer and Bremer Advertising for advertising expenses (Tr. 112-19, 666-72). Mr. Gallagher had no evidence that this alleged indebtedness existed, the Prospectus did not show any amounts owed to Edward Bremer or Bremer Advertising, the Prospectus did not include this item in the use of proceeds section, and

the amount of advertising expense shown in the use of proceeds section of the Prospectus was $28,487. (S.E.C. v. Manor Nursing Centers, Inc., et al., 458 F.2d 1082 (2d Cir., 1972)). The omission of this information from the Prospectus caused it to be materially misleading. TSC v. Northway, 426 U.S. 438, 446 (1976); S.E.C. v. The Electronic Warehouse, Inc., et al., Civil Action No. H-86-282 PCD (D. Conn.), Ruling on Motion for Summary Judgment, p. 18 (June 7, 1988).

Russell Gallagher does not deny that these events described above occurred. I reject as implausible his defense that he is blameless because he was misled by others and his actions did not violate his duty as principal. As proprietor and principal of the broker-dealer underwriter, Mr. Gallagher was responsible for knowing the date the offering period closed. I do not believe his testimony that he never counted 90 and then 150 days from the effective date. However, even if you believe him and not Mr. Bremer who testified that he and Mr. Gallagher discussed that the closing date was April 7 or 8, and that Mr. Gallagher was present at a meeting on February 19, 1985 at which it was calculated to be April 7 or 8, Mr. Gallagher should have done the counting and was reckless in discharging his responsibilities for not doing so. I define reckless as highly unreasonable conduct which is an extreme departure from

the standards of ordinary care. S.E.C. v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985); Hackbart v. Holmes, 675 F.2d 1114, 1117-18 (10th Cir. 1982).

Mr. Gallagher's breach of duty exists despite the letter from the escrow bank saying the escrow account would stay open until April 22 or the failure of the attorney for Gallagher & Co. to tell Mr. Gallagher that the closing should occur on April 7. In the first instance, it is the underwriter not the escrow bank who is responsible for the closing. Also, the bank's letter does not mention the closing date. In the second instance, reliance on counsel is not a complete and absolute defense, but rather a factor or circumstance tending to show a person's good faith or the existence of due care. Hawes and Sherrard, Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases, 62 Va. L. Rev. 1, 7-8 (1976). As noted in the law review article just cited, a client's presumed inability to find and understand the law is a fundamental aspect of the reliance defense. There is no showing here that counting 150 days from the effective date which appeared on the face of the Prospectus required a legal opinion or that Mr. Gallagher asked Attorney Calvo to give one, and there is a serious question as to whether Attorney Calvo acted as independent legal counsel or as a co-conspirator who advanced a legal pretext for what Mr. Gallagher and Mr. Bremer wanted to accomplish. These failures are contrary to the elements of the advice of

counsel defense set out in S.E.C. v. Savoy Industries, Inc., 665 F.2d 1310, 1314 n. 28 (D.C. Cir. 1981). Defendant must establish that he:

1. made a complete disclosure to counsel,
2. requested counsel's advice as to the legality of the contemplated action,
3. received advice that it was legal, and
4. relied on good faith on that advice.

In addition, counsel must be independent. C.E. Carlson v. S.E.C., Fed. Sec. L. Rep. (CCH) ¶98,800 at 98,801 (10th Cir. 1988); Sorrell v. S.E.C., 679 F.2d 1323, 1327 (9th Cir. 1982). For all these reasons and because I conclude that respondents acted with scienter, I reject respondents' defense that they are not responsible for these violations because they relied on legal counsel.

Even if you believe Mr. Gallagher's representations that he relied on Attorney Calvo's opinion that the non-bona fide stock sales used to close the escrow account on April 22 were legal, the results both in terms of net proceeds to Warehouse and use of the proceeds were contrary to what was stated in the Prospectus and Mr. Gallagher knew this or was reckless in not knowing this. His actions were reckless and violated the standard of care required of a registered principal and proprietor of a registered broker-dealer acting as underwriter in this public offering.

Taken together the evidence is persuasive that Mr. Gallagher was an active participant in a fraudulent plot to keep a public offering open beyond the legitimate period, to violate the part or none nature of the offering and to deceive people into thinking that there was sufficient investor interest in the offering and that the proceeds would go toward the purposes detailed in the Prospectus. I agree with the finding of Judge Dorsey that ". . . . sales of Warehouse stock were far below the minimum specified in the Prospectus. Bremer, Russell Gallagher and Granai devised a scheme to give the appearance that the minimum had been sold." (S.E.C. v. The Electronics Warehouse, Inc., et al. Civil Action No. H-86-282 PCD, (D. Conn.), Ruling on Motion for Summary Judgment, p. 11 (June 7, 1988).

The requisite elements for aiding and abetting violations of the antifraud provisions of the securities laws are set out in IIT, an International Investment Trust v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980). The primary violations have been established. I find that Laura Gallagher willfully aided and abetted in these violations because the evidence shows she knew of the violations and gave substantial assistance in carrying them out Laura Gallagher was one of two principals with Gallagher & Co. which in 1984-85 had two sales people in Florida in addition to the Gallaghers. She was the person at Gallagher &

Co. in charge of details of the company's operations, including its recordkeeping, and she did most of the trading. She had extensive conversations with Edward Bremer about the offering, she talked with the escrow bank once or twice a day during the offering period and when people could not find Russell Gallagher they dealt with her. She knew this was an part or none offering and that all proceeds should be returned to investors if the minimum amounts were not reached by the closing date. She reviewed the Prospectus and distributed it to the investing public (Tr. 788-89). At one point she understood that all tickets reflecting sales had to be written by April 8, 1985 (Tr. 826). She did not, however, act to refund money to investors when the correct closing date passed and there were insufficient funds in the escrow account. She sold $240,000 of stock in the Warehouse initial public offering up until April 22, 1985. At one time she testified she knew in early April that Bremer Advertising was buying $690,000 worth of stock but she did not question the source of the funds or whether Warehouse would still receive the $964,000 of net proceeds as represented in the Prospectus. On April 25, 1985, when she saw the disbursement letter showing $324,350 to Marvin T. Richmond and only $731,578.25 to Warehouse she did not ask any questions or take any action (Tr. 835).

I reject Mrs. Gallagher's defense that at the time she did not know that one of the purposes of an all-or-none offering was to protect investors, that even though she was a principal of the underwriter she was only responsible as a registered representative in the Warehouse offering, and she did not understand what was going on and relied on Mr. Gallagher and Attorney Calvo for direction. The evidence shows that Mrs. Gallagher possessed sufficient knowledge to pass three NASD exams, that in earlier sworn testimony she did know the significance to the public of an all-or-none offering, that she held herself out to the public as a qualified registered principal with Gallagher & Co. licensed to do business in various states, and that she was in charge of the firm's trading and customer accounts. With this background, her professed ignorance about basic securities law is unbelievable. The evidence of her dealings with the major actors and her level of participation in the operations of Gallagher & Co. generally and its underwriting of the Warehouse public offering in particular indicate that she knowingly gave substantial assistance in the violations committed by Gallagher & Co. and Russell Gallagher. (Tr. 80-81, 86-87, 111-112, 120, 267-68, 271-73, 289-90, 459-60, 626, 643, 659, 781, 794, 823-24, 835-838).

2. I find further that the evidence is persuasive that Gallagher & Co. and Russell Gallagher willfully violated

Section 10(b) and Rule 10b-9 and Laura Gallagher willfully aided and abetted in these violations as the Division alleged in Paragraph E of the Order instituting this proceeding. 4/ In the prior paragraphs, I have noted that the Warehouse Prospectus represented that the offering was a best efforts, 12,000,000 shares or none basis, at $.10 per share, and that the closing date of April 7, 1985, passed and the escrow account did not have the $1.2 minimum. The Gallaghers knew this fact and yet did not act to refund money to investors. Furthermore, Russell Gallagher knew or was reckless in not knowing that the amount in the Warehouse escrow account reached the $1.2 million minimum amount on April 22, 1985, because of loans which were to be paid out of the escrow funds. I impute Russell Gallagher's knowledge to Gallagher & Co., the registered broker-dealer which he wholly owned and operated. Rule 10b-9 provides that an offering may not be considered sold for purposes of the representation

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4/ Rule 10b-9(a) provides:

> It shall constitute a 'manipulative or deceptive device or contrivance', as used in Section 10(b) of the Act, for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation: (1) To the effect that the security is being offered or sold on an 'all-or-none' basis, unless the security is part of an offering or distribution being made on the condition that all or a specified amount of the consideration paid for such security will be promptly refunded to the purchaser unless (A) all of the securities being offered are sold at a specified price within a specified time, and (B) the total amount due to the seller is received by him by a specified date.

all-or-none unless all securities are sold in bona fide transactions and are fully paid for. (Securities Exchange Act Release No. 11532, (July 11, 1975) Fed. Sec. L. Rep. (CCH) ¶22,730). In C.E. Carlson, Inc. v. S.E.C., Fed. Sec. L. Rep. (CCH) ¶93,800 at 98,799 (10th Cir. 1988) the court held in a similar factual situation that once the part or none representation has been made, it may not be circumvented by transactions primarily designed to create the appearance of a successful offering in order to avoid the refund feature of the offering.

I reject as implausible based on contrary persuasive evidence, respondents' position that the Gallaghers either did not know these facts or were blameless for not knowing. Russell and Laura Gallagher were not neophytes to the securities industry. At the time these events occurred in 1984-85, she had held two NASD licenses (registered representative and general principal) for four years. He had held four NASD registrations including registered representative for 20 years and general principal for 15 years (Tr. 890-92). Both had passed exams for state licenses. Both had extensive participation in underwritings as registered representatives and had worked on previous mini/maxi, part or none, or all-or-none offerings. (Tr. 539-43). She worked on one as a registered representative. He worked on two as a registered representative and one as underwriter (Stipulation ¶6, 7 and 12). I reject respondents' claims that they are blameless

because they did not know that improper loans were being made and they relied on erroneous advice from the escrow bank and Attorney Calvo. The weight of the evidence is that they knew and approved of the loans which resulted in the closing of the escrow account on April 22, 1985, and their only concern was that Gallagher & Co. received the check for $161,358.75 for its activities as underwriter. The persuasive evidence that the Gallaghers knew on April 22 that the escrow account did not contain $1.2 from bona fide stock sales consists of the following facts. On Friday before the Monday closing the escrow account was $676,713 short of the minimum $1.2 million despite respondents' efforts to sell stock over an extended period (Stipulation ¶35), Mr. Gallagher attended small meetings and social gatherings where the loans were discussed (Tr. 113, 124, 420-22, 576-79), testimony by Mr. Bremer that he and Mr. Gallagher discussed the loans (Tr. 90-92, 96-97, 101-10, 122, 478-79), the admissions on brief that Russell Gallagher knew about the Richmond loan and did not disapprove of Mr. Bremer obtaining loans (R.B. at 11), Russell and Laura Gallagher knew that Marvin Richmond received a $324,350 check from the escrow account and they did not bother to establish the basis of this payment, and Russell Gallagher's statement that at the closing his only concern was that his check was sufficient in amount and was properly made out

Tr. 584; see J.A. White & Co. v. S.E.C., 556 F.2d 619, 621-22 (1st Cir. 1977). The most compelling evidence on this subject was Mr. Richmond's description of how over a weekend he learned about the offering and flew to Florida to loan $250,000 to the escrow account for about two hours at an interest cost to Warehouse of $75,000. The Gallaghers did not deny Mr. Richmond's testimony that they knew at the time he was loaning money to the escrow account and indicated this by the statements they made to Mr. Richmond.

Prior litigation has established that undisclosed actions taken by underwriters, issuers or their affiliates to make it appear that an unsuccessful "all-or-none" or "part-or-none" offering has been successfully completed are fraudulent. That case law is applicable here where the evidence is persuasive that the underwriter did not arrange the loans directly, but knew, approved and assisted the actions of others. S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1094-1095 (2d. Cir. 1972); S.E.C. v. Commonwealth Chemical Securities, Inc., 410 F. Supp. 1002, 1016 (S.D.N.Y. 1976), aff'd in pertinent part, 574 F.2d 90 (2d Cir 1978); A.J. White & Co. v. S.E.C., 556 F.2d 619, 624 (1st Cir. 1977). In 1975 this Commission announced (Fed. Sec. L. Rep. ¶22,730 at 16,620):

> Violations of Rules 10b-9 and 15c2-4 are serious breaches of the duty owed by issuers, underwriters and broker-deakers to the investing public . . . . The Commission intends to enforce the requirements of these rules vigorously where the facade of a successful offering is created in derogation of responsibilities owed to public investors who have purchased securities which were offered with the representation that their funds would be returned if the contingency were not fully satisfied.

3&4. I find that Gallagher & Co. willfully violated Sections 15(c) (2) and 10(b) and Rules 15c2-4 and 10b-6 and Russell and Laura Gallagher willfully aided and abetted in these violations as the Division alleged in Paragraphs F and G of the Order instituting this proceeding. 5/

5/ Section 15(c)(2) provides:

> No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security . . . in connection with which such broker or dealer engages in any fraudlent, deceptive or manipulative act or practice . . . The Commission shall, for the purposes of this paragraph, by rules and regulations define... such acts and practices as are fraudulent, deceptive or manipulative. . .

Rule 15c2-4 provides:

> It shall constitute a 'fraudulent, deceptive or manipulative act or practice' as used in Section 15(c)(2) of the Act, for any broker, dealer or municipal securities dealer participating in any distribution of securities, other than a firm-commitment underwriting, to accept any part of the sale price of any security being distributed unless: . . . (b) If the distribution is being made on an 'all-or-none' basis, or on any other basis which contemplates that payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs, (1) the money or other consideration received is promptly deposited in a separate bank account, as agent or trustee for the

(FOOTNOTE CONTINUED ON NEXT PAGE)

The facts are that a valid closing did not occur because this was an part or none offering and the specified level of sales and payments did not occur by the closing date. For this reason Gallagher & Co., the broker-dealer underwriter, violated Section 15(c)(2) and Rule 15c2-4 because it accepted a fee which was part of the sales price of Warehouse shares when the contingent event, i.e. the minimum level of sales and payments

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5/ (FOOTNOTE CONTINUED FROM PREVIOUS PAGE)

persons who have the beneficial interests therein, until the appropriate event or contingency has occurred, and then the funds are promptly transmitted or returned to the persons entitled thereto, or (2) all such funds are promptly transmitted to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred.

Rule 10b-6 provides:

(a) It shall be unlawful for any person, (1) Who is an underwriter or prospective underwriter in a particular distribution of securities . . . directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution . . . or to attempt to induce any person to purchase any such security or right, until after he has completed his participation in such distribution...

had not occurred. C.E. Carlson, Inc. v. S.E.C., Fed. Sec. L. Rep. (CCH) ¶93,800 at 98,800 (10th Cir. 1988); S.E.C. v. Commonwealth Securities, 410 F. Supp. 1002, 1006 (S.D.N.Y. 1976), aff'd in pertinent part, 574 F.2d 90 (2d Cir. 1978). Since the offering was never lawfully closed, Gallagher & Co. did not complete its participation in the distribution. Therefore Gallagher & Co. violated Section 10(b) and Rule 10b-6 when Russell and Laura Gallagher, its two principals, bought and sold Warehouse shares between April 25, 1985 and August 31, 1985.

Even if you consider April 22 as the valid closing date, Gallagher & Co. still violated Rule 10b-6 because the rule prohibits purchases and sales activities by an underwriter until after the distribution is complete. The principals of Gallagher admit to buying and selling stock after April 22, 1985. Because $690,000 worth of loans were not bona fide sales transactions, Gallagher & Co. did not accomplish its participation in the distribution on April 22, 1985, similarly, because the transactions were loans and not bona fide sales, respondents violated Rule 15c2-4 by disbursing the escrow funds before the contingent event occurred.

Russell and Laura Gallagher willfully aided and abetted these violations because they knew or were reckless in not knowing that a valid closing did not occur, yet they accepted a fee for Gallagher & Co. and commissions

for themselves and bought and sold Warehouse stock in the period April 25 through August 31, 1985 (Tr. 781; Stipulation ¶¶55, 56).

5. I find that all three respondents willfully violated Sections 17(a) and 10(b) and Rule 10b-5 as the Division alleged in paragraph H of the Order instituting this proceeding.

Russell Gallagher and Laura Gallagher admit that during the offering period they learned that Edward Bremer, Warehouse's chief executive officer, had been indicted for mail fraud in the United States District Court for the District of Maryland. The Prospectus, which the Gallaghers reviewed and distributed, stated that Warehouse was completely dependent on the personal efforts and abilities of Edward W. Bremer who was devoting and would devote his entire time to Warehouse,and that the loss of Mr. Bremer's services would have a materially adverse effect on Warehouse's business prospects and/or potential earning capacity. Neither respondent, both principals of the undwerwriter, took action to inform investors of the indictment yet the law requires that post-effective developments which materially alter the picture presented in the registration statement must be brought to the attention of public investors. S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1095, 1099 (1972); S.E.C. v. Bangor Punta Corp., 331 F. Supp. 1154, 1160 n. 10 (S.D.N.Y. 1971). This omitted information is material because there

is a substantial likelihood that a reasonable investor would attach significance to information that the chief executive officer of a company organized to engage in mail order marketing of electronic equipment was under a criminal felony indictment for mail fraud. This indictment was pending on April 22, 1985, when Russell Gallagher participated in closing the escrow account and distributing the funds.

The Gallaghers defense is that they are blameless because they relied on Attorney Calvo's advice. As noted earlier, reliance on an attorney's advice is not by itself a complete and absolute defense, but a factor or circumstance tending to show a person's good faith or exercise of due care. Hawes and Sherrard, 62 Va. L. Rev. 1 (1976), supra. I reject this defense for several reasons. The evidence indicates that rather than acting as independent counsel, Attorney Calvo was a party with the Gallaghers in completing the offering regardless of the applicable statutes and regulations. Furthermore Attorney Calvo denies he told Mr. Gallagher the indictment was dropped (Tr. 654-55). Advice that it was legal to proceed without giving notice to the public of the Bremer indictment was so plainly contrary to law that the Gallaghers should have known that such advice was incorrect. Finally, in view of the Gallaghers' training and experience in the securities industry, I give no

credence to their claims that in 1985 they did not know what was meant by a criminal indictment for mail fraud. Even if they did not know, they did not try to find out. Their lack of good faith is supported by evidence that on this very important question they did not request or require that Attorney Calvo give them anything in writing to support his opinion, and Mr. Bremer's testimony that Mr. Gallagher evidenced no real concern to him about the pending indictment, i.e. "Are there any other shoes to drop?" (Tr. 511-12). I find the evidence of record does not show that the Gallaghers relied in good faith on advice from independent legal counsel.

I find that as the Divsion alleged in Paragraph I, all three respondents are the subject of permanent injunctions issued by the United States District Court for the District of Connecticut on March 17, 1987 for the violations specified in thc Commission's Order instituting this proceeding (Stipulation ¶2; Exhibits 1A, 1B and 1C).

V. Sanctions

The case law has established many elements to be considered in determining what sanctions are appropriate: the seriousness of the violations, the time over which they occurred, respondents' prior disciplinary history, respondents' efforts at restitution and rehabilitation

and their dedication to compliance, the probability of future misconduct by respondents and the deterrent effect on others in the security business.

Applying these factors to this case shows that during one initial public offering respondents committed serious and deliberate violations of the securities laws and regulations. Despite Russell Gallagher's position that he does not remember making any money, the evidence is that respondents received a financial benefit as a result of the offering and that the investing public was damaged by over half a million dollars, the amount in the escrow account before the loans. Respondents have made no efforts at restitution and have indicated no concern for the loss suffered by the investing public. Prior to the events at issue, in 1979, the NASD censured and fined respondent Russell Gallagher $500. On December 15, 1987, the NASD cancelled Gallagher & Co.'s membership and revoked the registrations of Russell and Laura Gallagher based on the Gallaghers consent to the permanent injunction entered by the District Court in these matters and for their failure to timely amend NASD forms required in such a situation (Exhibit 17). If respondents were allowed to operate in the securities industry, the evidence shows a high probability of future violations because respondents consider themselves blameless, and show no comprehension of the standards required of fiduciaries (Tr. 551-62, 569-71, 584 and 796-802). In addition, rather than advancing

a plan for preventing reoccurrence of these violations, they tried to cover up their actions and gave different sworn testimony under oath (Tr. 272-73, 496-99, 566-68, 780,816-20, 827-34). There are no mitigating circumstances.

Based on these factors and all the evidence of record, arguments and proposed findings, I find the appropriate remedial action in the public interest under Sections 15(b) and 19(h) of the Exchange Act is to revoke the registration of Gallagher & Co. and to bar Russell and Laura Gallagher from association with any broker or dealer and I SO ORDER. I have considered and rejected those proposed findings, arguments and conclusions that are inconsistent with this decision.

Pursuant to Rule 17(f) of this Commission's Rules of Practice (17 CFR 201.17f), this initial decision shall become the Commission's final decision as to each party who has not filed a petition for review pursuant to Rule 17(b) within fifteen days after service of the initial decision upon him or her, unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Brenda P. Murray
Administrative Law Judge

Washington, D.C.
October 5, 1988