

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

STEADMAN SECURITY CORPORATION :

STEADMAN INVESTMENT SERVICES CORPORATION :
(8-14704)

REPUBLIC SECURITIES CORPORATION :
(8-13223)

THE STEADMAN CORPORATION OF AMERICA :
(8-13955)

ABERDEEN MANAGEMENT CORPORATION :
(8-1867)

CHARLES W. STEADMAN :

INITIAL DECISION

December 20, 1974
Washington, D.C.

David J. Markun
Administrative Law Judge

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CHARLES W. STEADMAN :

APPEARANCES: William R. Schief, Administrator, Washington Regional
Office, Vernon J. Vander Weide, and Michael A. Starr,
Washington Regional Office, Attorneys for the Division
of Enforcement

Peter J. Nickles, Covington & Burling, Washington, D.C.
and Charles D. Reaves, Washington, D.C., Attorneys
for Respondents

BEFORE: David J. Markun, Administrative Law Judge

THE PROCEEDING

This public proceeding was instituted by an order of the Commission dated June 23, 1971, thereafter amended in various particulars ("Order"),^{1/} pursuant to Section 9(b) of the Investment Company Act of 1940 ("ICA"), Section 203 of the Investment Advisers Act of 1940 ("IAA" or "Advisers Act"), and Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Securities Act") to determine: whether the Respondents^{2/} wilfully violated or wilfully aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206 (1), (2) of the Advisers Act and numerous provisions of the ICA and rules thereunder in connection with acts and practices and failures to disclose alleged to have occurred at various times within the "relevant period" extending from approximately 1965 to the date of the Order involving primarily transactions

1/ On the Division's motion the Commission by order of February 8, 1972, amended its original order to add as respondents the Steadman Corporation of America ("SCA") and Aberdeen Management Corporation ("AMC") and to include various new or amended allegations. By verbal order of April 23, 1973, at the hearing the order was further amended in various particulars by the Administrative Law Judge on motions of the Division dated April 3 and 4, 1973.

2/ This initial decision has application only to the six respondents named in the caption, two of the respondents originally named by the Commission, i.e. Steadman Ameri-Fund N.V. ("Ameri-Fund") and Steadman International Capital Corporation ("InterCap") having made settlements. Investment Company Act Release No. 7378, Sept. 22, 1972. However, since the violations alleged against one or more Respondents remaining in the proceeding involve the two respondents that have settled out, there will necessarily be some mention of such respondents in this decision.

or relationships between Respondents and various investment companies ("Steadman Funds") for which one of the Respondents is the registered investment adviser; whether certain Respondents failed reasonably to supervise with a view to preventing certain of the alleged violations; and the remedial action, if any, that might be appropriate in the public interest.

The evidentiary hearing was held in Washington, D.C. All parties have been represented by counsel throughout the proceeding.

The parties have filed proposed findings of fact, conclusions of law, and supporting briefs pursuant to the Commission's Rules of Practice (17 CFR 201.16). Because of the novelty and complexity of the issues presented, oral argument was ordered and held on motion of the Respondents.

The findings and conclusions herein are based upon the record and upon observation of the demeanor of the various witnesses. Preponderance of the evidence is the standard of proof applied.

FINDINGS OF FACT AND LAW

The Respondents

Respondent Steadman Security Corporation ("SSC"), a Delaware corporation with its principal place of business at 1730 K Street, N.W., Washington, D.C., has been registered with the Commission as an investment adviser under Section 203 of the Advisers Act since December 8, 1971.

During times material to this proceeding, SSC has been the investment adviser or investment counsel to the following investment

companies (sometimes referred to herein as the "Steadman Funds"), either directly or through the use of wholly owned subsidiaries, for the periods of time indicated:

American: Since at least December 15, 1965, SSC has been the investment adviser to Steadman American Industry Fund, Inc. ("American") or its predecessor, Shares in American Industry Inc., an open-end, diversified, management investment company registered pursuant to Section 8 of the ICA since December 3, 1958.

Science: Since at least December 15, 1965 to September 14, 1970, SSC was the investment adviser to Steadman Science and Growth Fund, Inc. ("Science"), an open-end, diversified management investment company registered pursuant to Section 8 of the ICA from October 13, 1952 to September 14, 1970. On September 14, 1970 the assets of Science were acquired by American.

Consumers: Consumer-Investor Planning Corporation (CIPCO), a wholly owned subsidiary of SSC since January 31, 1970, was from before January 31, 1970 to September 14, 1970, the investment adviser to Consumers Investment Fund, Inc. ("Consumers"), an open-end, diversified, management investment company registered under Section 8 of the ICA from December 17, 1957 to September 14, 1970. On September 14, 1970 the assets of Consumers were acquired by American.

Fiduciary: From at least December 15, 1965 to on or about May, 1972, SSC, or its predecessor, William Allen Steadman & Co., was the investment adviser to Steadman Fiduciary Investment Fund, Inc. ("Fiduciary") or its successor, Steadman Investment Fund, Inc., an open-end, diversified management investment company registered pursuant to Section 8 of the ICA since October 31, 1956. In January, 1973, Fiduciary acquired substantially all of the assets of Aberdeen Fund (described below) and changed its name to Steadman Investment Fund, Inc.

Aberdeen: From August 30, 1968 to May, 1972 SSC was investment counsel to Aberdeen Fund ("Aberdeen") an open-end, diversified, management investment trust registered pursuant to Section 8 of the ICA from November 1, 1940 until its assets were acquired by Fiduciary, as described above.

Associated: Associated Fund Management Corporation ("AFMC"), a wholly-owned subsidiary of SSC since December 16, 1968, has been since before December 16, 1968 the investment adviser to and sponsor of Associated Fund Trust ("Associated"), an open-end, diversified, management investment trust registered pursuant to Section 8 of the ICA since November 1, 1940.3/

Respondent Steadman Investment Services Corporation ("SISC"), a wholly-owned subsidiary of SSC since at least June 11, 1969 with its principal place of business at 1730 K Street, N.W., Washington, D.C. has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since June 11, 1969 and as an investment adviser pursuant to Section 203 of the Advisers Act since April 15, 1969. SISC is a member of the National Association of Securities Dealers, Inc. ("NASD"), a national securities association registered pursuant to Section 15A of the Exchange Act. SISC was the distributor or principal underwriter for Science for the years 1969 and 1970 and for American, Fiduciary, and Associated during the years 1970, 1971, and 1972.

Respondent Republic Securities Corporation ("RSC"), a wholly-owned subsidiary of SSC since June 7, 1967 with its principal place of business at 1730 K Street, N.W., Washington, D.C., has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since June 7, 1967 and is a member of the NASD.

3/ The relationship of SSC to Intercap and to Ameri-Fund is discussed below at a later point in this decision where it is relevant to particular alleged violations arising out of securities transactions between Ameri-Fund and various Steadman Funds.

Respondent The Steadman Corporation of America ("SCA"), a wholly-owned subsidiary of SSC since at least June 27, 1968 with its principal place of business at 919 18th Street, N.W., Washington, D.C., has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since June 27, 1968 and is a member of the NASD.

Respondent Aberdeen Management Corporation ("AMC") was from at least August 30, 1968 to January, 1973, depositor, general manager and principal underwriter for Aberdeen. On August 23, 1968 SSC acquired 50% of the outstanding capital stock, including all of the voting stock, of AMC. Since February 6, 1970 AMC has been a wholly-owned subsidiary of SSC with its principal place of business at 919 18th Street, N.W., Washington, D.C. AMC has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since January 1, 1936 and is a member of the NASD.

Respondent Charles W. Steadman ("Steadman") has been Chairman of the Board of Directors, President, and beneficial owner of all the outstanding voting securities and between eight and thirty-six percent of the non-voting common stock of SSC from at least December 15, 1965 to the time of the Order. No other person has owned as much as ten percent of the outstanding non-voting common stock of SSC during that period.

Respondent Steadman has been chairman of the boards of directors and president of SISC, RSC, SCA and AMC at all times relevant herein and during such times has also been chairman of the boards of directors, president, and chairman of the investment advisory committees of the

various Steadman Funds, i.e. American, Science, Consumers, Fiduciary, Aberdeen, and Associated.

Respondent Steadman is a member, within the meaning of Section 3(a)(3) of the Exchange Act, of the PBW Stock Exchange, Inc., a national securities exchange registered pursuant to Section 6(a) of the Exchange Act.

Steadman, SSC, RSC, SISC, SCA and AMC are affiliated persons of registered investment companies, i.e. the Steadman Funds, and Steadman and SSC are associated with RSC, SISC, SCA and AMC.

Transactions Between Ameri-Fund and Registered Steadman Funds

Section IIE of the Order includes a charge that during the period January 1, 1969 through June 1, 1970, ". . . Ameri-Fund, ^{4 /} Intercap, SSC and Steadman, as principals, wilfully violated and ^{5 /} wilfully aided and abetted violations of Section 17(a)(1) of the ICA in that SSC caused Ameri-Fund, an affiliated person of SSC, and thereby an affiliated person of an affiliated person of the registered investment companies involved herein [the Steadman Funds], to sell certain securities out of its portfolio to Aberdeen, Science, Associated and Consumers." Section IIF of the Order alleges in similar vein that the same respondents, ". . . as principals, wilfully violated and wilfully aided and abetted violations of Section 17(a)(2)^{6 /}

^{4 /} Respecting Ameri-Fund and Intercap, see footnote 2 above.

^{5 /} Insofar as here pertinent Section 17(a)(1) of the ICA makes it unlawful for an affiliate (here alleged to be Ameri-Fund) of an affiliate of a registered investment company (here alleged to be SSC), acting as principal, knowingly to sell any security to such a registered investment company (here alleged to be particular Steadman Funds).

^{6 /} Insofar as here pertinent Section 17(a)(2) of the ICA makes it unlawful for an affiliate (here alleged to be Ameri-Fund) of an affiliate of a registered investment company (here alleged to be SSC), knowingly to buy from any such registered investment company (here alleged to be one particular Steadman Fund, i.e. American) any security not issued by the investment company.

of the ICA in that SSC caused Ameri-Fund, an affiliated person of SSC and thereby an affiliated person of an affiliated person of American, to buy from American certain securities of which American is not the issuer."

The record establishes, and the Respondents do not question, that Ameri-Fund sold certain of its portfolio securities to various Steadman Funds and that it purchased certain portfolio securities from American, as detailed below:

Ameri-Fund sold securities to Science as follows:

- (1) on April 2, 1969, 5,500 shares of Technical Operations, Inc. at \$34.25 per share;
- (2) on April 11, 1969, 2,000 shares of American Smelting and Refining, Inc. at \$37.75 per share;
- (3) on May 22, 1969, 2,000 shares of Belco Petroleum, Inc. at \$35.375 per share;
- (4) on December 3, 1969, 1,300 shares of Olla Industries, Inc. at \$29.875 per share.

Ameri-Fund sold 10,000 shares of Jupiter Corporation to Consumers on March 11, 1970 at \$13.50 per share.

Ameri-Fund bought securities from American as follows:

- (1) on May 8 and 12, 1970, 11,000 shares of Cassette Cartridge Corporation at \$7.50 per share;
- (2) on May 8, 1970, 2,000 shares of Tandy Corporation at \$39.125 per share.

Ameri-Fund sold securities to Associated as follows:

- (1) on June 5, 1969, 18,000 warrants of NVE Company at \$10 per warrant;
- (2) on June 5, 1969, \$400,000 face amount of NVE Company debentures at \$42.625 per \$1,000 debenture;
- (3) on June 20, 1969, 14,500 warrants of NVE Company at \$8.75 per warrant.

Ameri-Fund sold securities to Aberdeen as follows:

- (1) on February 14, 1969, 11,000 shares of Parke-Davis, Inc. at \$30.875 per share;
- (2) on February 14, 1969, 10,000 shares of Tenneco, Inc. at \$30.875 per share.

With respect to the transactions described above no application was filed with the Commission pursuant to Section 17(b) of the ICA seeking to exempt such transactions from Section 17(a) of the ICA. Respondents contend that the transactions were not unlawful and that no application was therefore called for, claiming that SSC and Ameri-Fund were not affiliated persons within the meaning of Section 17(a) of the ICA. The merits of the conflicting contentions of the Division and the Respondents in this respect turn upon the definitions of "affiliated person" of another person and "control" that are provided by Section 2(a)(2), (3), (9) of the ICA.^{7/}

7/

GENERAL DEFINITIONS

Sec. 2. (a) When used in this title, unless the context otherwise requires--

* * *

(Continued on Page 10)

Whether the facts as presented by this record establish the requisite affiliation between Ameri-Fund and SSC under the applicable statutes as construed by the Courts and the Commission requires examination in some detail into the formation, functioning and operation of Ameri-Fund and Intercap and into the relationship of Steadman and SSC thereto.

(Footnote 7 Continued)

(2) "Affiliated company" means a company which is an affiliated person.

(3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

* * *

(9) "Control" means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company.

Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such company. Any person who does not so own more than 25 per centum of the voting securities of any company shall be presumed not to control such company. A natural person shall be presumed not to be a controlled person within the meaning of this title. Any such presumption may be rebutted by evidence, but except as hereinafter provided, shall continue until a determination to the contrary made by the Commission by order either on its own motion or on application by an interested person. If an application filed hereunder is not granted or denied by the Commission within sixty days after filing thereof, the determination sought by the application shall be deemed to have been temporarily granted pending final determination of the Commission thereon. The Commission, upon its own motion or upon application, may by order revoke or modify any order issued under this paragraph whenever it shall find that the determination embraced in such original order is no longer consistent with the facts.

After having studied and explored the opportunities for marketing mutual funds in Europe during the period 1965 through early 1968, and after having attempted without notable success to market in Europe the shares of one or more of the registered Steadman Funds, Steadman conceived the idea of Ameri-Fund^{8/} as an offshore mutual fund to be managed by SSC.

Ameri-Fund was organized under the laws of the Netherlands Antilles on November 26, 1968 as a closed-end, hedge fund for the purpose of investing primarily in securities of United States companies. Ameri-Fund's shares were to be sold only to persons who were not residents or citizens of the United States. The subscribing shareholders of Ameri-Fund were Hill, Samuel & Co., Ltd. ("Hill Samuel"), London, England; Banque Louis-Dreyfus & Cie, S.A., Paris, France; Labouchere & Co., N.V., Amsterdam, Netherlands; Credito Italiano, Milan, Italy; and Stockholms Enskilda Bank, Stockholm, Sweden (collectively referred to as the "Founding Banks"). These banks bought more than \$9 million of the initial \$10 million offering of Ameri-Fund shares in early 1969.^{9/}

^{8/} The fund's name, Steadman Ameri-Fund, N.V., reflects recognition of Steadman's central role in its creation as well as the fact that it was intended to utilize the reputation of SSC as investment adviser to the registered Steadman Funds in marketing Ameri-Fund. In 1967 and 1968 SSC managed a portion of the portfolio of Capital Growth Fund, an off-shore fund, and this experience served in part as a basis for the decision to establish its own off-shore fund.

^{9/} It was contemplated that after the initial sale of up to \$10 million in shares of Ameri-Fund to the Founding Banks ("Phase 1") there would be a "Phase 2", during which an additional \$40 million would be raised for the fund through one or more syndicated offerings, to be made when deemed propitious by Hill Samuel and SSC acting "in concert", and that thereafter, in a "Phase 3", the Fund would be made open-end. Within the period here relevant, Ameri-Fund did not progress beyond Phase 1.

Intericap was organized under the laws of Panama on October 18, 1968 for the purpose of serving as the Managing Director of Ameri-Fund, and it did so from December 30, 1968 to at least June 1, 1970.

During the exploratory period beginning in 1965 prior to formation of Ameri-Fund in late 1968 Steadman traveled to Europe on several occasions to confer with European bankers regarding opportunities for the sale of the Steadman domestic funds in Europe as well as to discuss the development of an off-shore fund for sale in Europe. Among those Steadman consulted during this period were Louis van Damme ("van Damme"), who was later to become an officer and director of Ameri-Fund and Intericap, and Yves-Andre Istel, of Kuhn, Loeb & Co.

When Steadman and SSC undertook to organize Intericap and Ameri-Fund in 1967 Steadman hired Henry F. Shoemaker ("Shoemaker"), a United States citizen residing in Europe, to determine what European banks might be interested in participating in an offshore fund. From April 1967 through 1968 Shoemaker was paid by SSC a total salary of \$8,500 and total travel and entertainment expenses of about \$8,900. These amounts paid to Shoemaker by SSC were eventually charged to Intericap as part of the expense incurred by SSC in organizing Ameri-Fund. Shoemaker later became an officer of Intericap.

During the spring and summer of 1968 Steadman and the principal officers of SSC discussed the organization of an off-shore fund. These officers included David Pettit ("Pettit"), a vice-president, Pierre E. Lorenger ("Lorenger"), treasurer and later a vice-president, and Allin P. Baxter ("Baxter"), vice-president and general counsel. Among the matters discussed were the structure of such a fund, investment policy, what investment techniques such a fund

would be empowered to utilize, the type of management fee, and, if a performance fee were to be utilized, what the appropriate gauges for fixing it might be.

In 1968 Steadman traveled to Europe to find banks which would sponsor, and provide the initial capital for, Ameri-Fund. In July 1968 he went to London, England, to be introduced to officials of Hill Samuel by a representative of Kuhn, Loeb & Company. At this meeting Steadman presented to Hill Samuel a proposal that Hill Samuel and other European banks sponsor an off-shore fund to be managed by SSC.

During the summer of 1968 SSC personnel participated in the preparation of, and reviewed various documents in connection with, the organization of Ameri-Fund and Intericap. Steadman was actively interested in getting Ameri-Fund organized and lent whatever support from SSC was necessary to that end. Steadman either prepared or caused to be prepared a memorandum to be used to publicize Ameri-Fund, which was used as a planning and promotional device. Officers of SSC—Steadman, Lorenger, Baxter and Pettit—and the accounting and public-relations departments of SSC participated in the preparation of a memorandum which described the enterprise and which included a proposed prospectus. This document was prepared in conjunction with Hill Samuel and the law firms of Simpson, Thacher and Bartlett ("Simpson Thacher") and Shearman and Sterling. The printing of such document in the form which it eventually took (Exhibit ^{10/}228) was arranged by and done at SSC's expense. Exhibit 228 was used in the offer and sale of Ameri-Fund shares to the Founding Banks. Baxter and Steadman, in consultation with Hill Samuel

^{10/} The Division's exhibits are numbered, while those of the Respondents are lettered.

and the above-mentioned law firms, also prepared a Plan of Operation to describe the proposed operations and procedures of Ameri-Fund and Intericap.

During the period July 1968 to January 1969 Steadman was one of the principal persons involved in the organization of Ameri-Fund and Intericap; he assisted in the sale of Ameri-Fund's shares and was actively involved in planning the structure, policies, and operations of Ameri-Fund and Intericap. Other officers of SSC in early 1969 were also directly involved in the organization of Intericap. SSC bore substantial costs—over \$140,000 (not including SSC's purchase of 50 percent of Intericap's shares)—in connection with the organization of Ameri-Fund and Intericap. SSC's share of the organizational costs of Intericap (about \$89,000) was substantially greater than that of Hill Samuel (about \$8,000).

The legal work incident to the organization of Intericap and Ameri-Fund was done by Simpson Thacher, by Shearman and Sterling (representing Hill Samuel) and by Baxter, SSC general counsel. Simpson Thacher continued as counsel to Ameri-Fund and Intericap for some time after their organization. Simpson Thacher during this time was also counsel to SSC. Based on studies of the tax and corporate laws of various countries to determine appropriate domiciles, Steadman recommended that Ameri-Fund and Intericap be incorporated in the Netherlands Antilles and Panama respectively, and his recommendation was accepted. Steadman also examined management-contracts between various existing offshore funds and their management companies and the corporate structures of such companies in connection with the formation of Ameri-Fund.

The Steadman name and reputation as investment adviser to registered domestic investment companies was to be a key selling point in marketing Ameri-Fund's shares in the contemplation of the organizers of Ameri-Fund.

That Steadman and SSC took the initiative and were the driving force in developing the concept of, and in organizing, Ameri-Fund is abundantly established by the record. In a memorandum dated September 23, 1968 on SSC letterhead over Steadman's name, the following statements appear: "SSC is now going to start a new mutual fund to be sold outside of the United States and named Steadman Ameri-Fund." "SSC proposes to organize Inter-cap in concert with a group of appropriately situated European banking houses (Founding Banks) which are best positioned to participate in the promotion and distribution of Ameri-Fund's shares, and which will participate jointly with SSC in the founding of Inter-cap and Ameri-Fund." "For the past two years we have been studying the opportunities abroad for marketing mutual fund shares . . . It is our conclusion that there is a great market for such mutual funds outside of the United States, and especially in Western Europe . . . We believe that the entry of SSC into the mutual fund field outside the United States is now timely." "At this point, however, the greater area of the market [for mutual fund shares] remains to be exploited, and this is what we intend to do through Ameri-Fund and Inter-cap." In a document dated December 14, 1968 (Exhibit 2), which was the precursor of Exhibit 228, mentioned above, the following statements appear: "Hill, Samuel & Co. Limited,

London, and Steadman Security Corporation, Washington, D.C., are inviting a select group of European banks to sponsor as Founding Banks a new offshore 'hedge fund', STEADMAN AMERI-FUND, N.V."

"SSC and Hill, Samuel are approaching between five and ten leading European banks with an invitation to participate as Founding Banks." In a meeting of the SSC Board of Directors held on October 2, 1968, Steadman requested and obtained "ratification of the actions taken by the officers in setting up" Intericap and Ameri-Fund. In the SSC Annual Report for 1968 Steadman reported SSC's participation with the European banks in the organization of Steadman Ameri-Fund, N.V. In offering circulars dated August 1 and October 16 and 25, 1968 for an SSC private placement, it was stated that SSC "has completed plans for the establishment of Ameri-Fund, N.V." In a letter dated April 26, 1969 Steadman stated "at the end of January of this year we launched a new off-shore fund known as Steadman Ameri-Fund, N.V."

The directors of Ameri-Fund were selected by Steadman and Hill Samuel; neither Hill Samuel nor Steadman vetoed a choice by the other. The original directors of Ameri-Fund were Steadman (chairman), Louis van Damme ("van Damme"), Dr. Pieter Cornelis Poot ("Poot"), Michael Menzies ("Menzies"), and Sir Philip de Zulueta ("de Zulueta"). Of these five directors, two—Menzies and de Zulueta—were associated with Hill Samuel. Poot, a resident of the Netherlands Antilles, was made a director to satisfy a residence requirement for corporations incorporated in the Netherlands Antilles, and was selected by mutual agreement between Steadman and Hill Samuel.

The directors of Inter-cap were also selected by Steadman and Hill Samuel, and, again, neither rejected a selection offered by the other. The initial directors of Inter-cap were Steadman, van Damme, de Zulueta, Menzies, William G. Dillon ("Dillon") and B.A.C. Whitmee ("Whitmee"). Of these six directors, three— de Zulueta, Menzies and Whitmee— were associated with Hill Samuel. Dillon at that time was a partner in Simpson Thacher (counsel to SSC) and became a director of SSC in 1969. SSC, as a 50 percent shareholder, had the power, in theory, to block the election of any director. However, in terms of practicality, Steadman and Hill Samuel were mutually dependent upon one another for the success of Ameri-Fund, and such mutual dependence is reflected in the balanced composition of the Ameri-Fund and Inter-cap organizations.

Ameri-Fund had no officers. The original officers of Inter-cap, for purposes of getting it organized, were Steadman, president; Shoemaker, vice president; and Baxter, secretary and treasurer.

Menzies, a United States resident, was never intended to be a permanent director of either Ameri-Fund or Inter-cap; he resigned as a director of Ameri-Fund and Inter-cap when Ameri-Fund and Inter-cap became operational on January 23, 1969. When Ameri-Fund became operational, its directors were Steadman (chairman), Poot, van Damme, de Zulueta and D.S. Allison ("Allison"). Allison, an English resident, was associated with Hill Samuel. By amendment to the Inter-cap Articles of Incorporation dated December 30, 1968 the Inter-cap Board of Directors was changed to include Steadman (chairman), van Damme (vice chairman), de Zulueta and Allison. When Inter-cap became operational

its officers were van Damme, president and treasurer; Shoemaker, vice president, assistant secretary and assistant treasurer; J.E.K. Floyd ("Floyd"), vice president; and Mathias Mayor ("Mayor"), secretary. None of these officers was affiliated with Hill Samuel at the time they became officers of Intercap. Mayor, a Swiss attorney, was selected by van Damme. Floyd, an English resident, was suggested by Hill Samuel.

Van Damme, a friend of Steadman, was introduced to Hill Samuel by Steadman. Steadman first met van Damme in 1967, and Steadman consulted with van Damme during 1967 and 1968 regarding the market for mutual funds in Europe. During the period from April through December 1968 van Damme was paid by SSC total salary of \$8,500 and total travel and entertainment expenses of about \$500. These amounts paid to van Damme by SSC were charged to Intercap as part of the expense incurred in organizing Ameri-Fund. From September 1968 to January 1969 van Damme served as consultant to Intercap while being paid by SSC. In this capacity van Damme rendered advice to Steadman and Hill Samuel relative to the organization of Ameri-Fund and Intercap. Among other things, van Damme was instrumental in getting certain of the Founding Banks involved and rendered advice regarding location of Intercap headquarters, Intercap personnel matters, and the capitalization of Ameri-Fund. Steadman suggested to Hill Samuel that van Damme be president of Intercap, and Hill Samuel agreed. Steadman and Hill Samuel mutually agreed that since van Damme was to be president of Intercap, he should also be a director of both Ameri-Fund and Intercap. From January 1969

to May 1970 van Damme resided in Paris and was the principal executive officer of European Financement Bank in Paris. European Financement Bank played no part in the organization of Ameri-Fund or Intercap and did not purchase any shares of Ameri-Fund. Van Damme was not associated with any of the Founding Banks.

The changes in the officers and directors of Ameri-Fund and Intercap which occurred in December 1968 and January 1969 were made primarily to minimize the number of such persons who were United States residents. This was done, and the entire operation was structured, to enable Ameri-Fund and Intercap to avoid being subject to the Internal Revenue Code of the United States. Steadman was made Board Chairman rather than President so he would not appear to be the chief executive officer of Intercap.

In May 1969 Steadman proposed that J.H.I. van Eck ("van Eck"), managing director of Labouchere & Co., be elected a director of Intercap, and Steadman's proposal was adopted by the Intercap board. Steadman had known van Eck since about 1962 when both Steadman and van Eck were directors of the same corporation. In 1965 van Eck arranged to change Science's listing on the Amsterdam Exchange to its new name. In 1965 Steadman also invited van Eck to become a director of Science, but van Eck declined because it was not convenient. In 1968 Steadman visited van Eck in Amsterdam to persuade van Eck that Labouchere should purchase Ameri-Fund shares in the initial private placement, which Labouchere did. Van Eck was not affiliated with Hill Samuel.

Steadman was in reality the chief executive officer of Intercap, because, as developed further below, SSC carried out under an agency

agreement all the then-relevant activities in connection with Intericap's function of managing Ameri-Fund, and Steadman was actively and directly involved in these activities. Steadman presided at the meetings of the boards of directors of Ameri-Fund and Intericap during the period May 1969 through May 1970 and made numerous proposals at such meetings. Steadman signed on behalf of Intericap all the necessary documents in connection with the organization of Ameri-Fund and Intericap, including the Agency Agreement between Hill Samuel and Intericap, Ameri-Fund and SSC and the amendment thereto, a letter of January 3, 1969 regarding the aforementioned Agency Agreement, the Subscription Agreement of December 20, 1968 between Hill Samuel and Intericap and Ameri-Fund and the Amendment thereto, the Hypothecation Agreement between the First National City Bank of New York and Ameri-Fund, the Management Agreement dated December 30, 1968, between Ameri-Fund and Intericap, and the Investment Advisory Agreement dated December 30, 1968, between SSC and Intericap and the amendment of January 20, 1969 thereto. Also, Steadman's facsimile signature appears on the Ameri-Fund specimen share certificates as Chairman of Intericap.

Steadman took the initiative on, and was active in, significant matters pertaining to the operation of Intericap. Thus, Steadman urged Hill Samuel on several occasions to find a way to put additional capital into Ameri-Fund. In this connection Steadman urged that Ameri-Fund go open-end and later that Ameri-Fund issue to existing shareholders rights to purchase additional shares. Steadman also undertook in early 1970 to prepare and did prepare a paper regarding the offer of Intericap warrants

to dealers selling Ameri-Fund shares. Steadman spent a week in London at Hill Samuel preparing for the Intericap board of directors meeting on May 30, 1969, the first such meeting after the organizational meeting of the board. At Steadman's instance S. Paul Palmer ("Palmer") was hired as executive vice-president of Intericap to act as the sales manager. Steadman had known Palmer since 1966 and introduced him to van Damme and de Zulueta. Shoemaker's and van Damme's prior associations with Steadman led to their becoming officers of Intericap. Steadman assisted in arranging, and decided when and how much to utilize, the line of credit extended by the First National City Bank of New York to Ameri-Fund for portfolio purchases. Steadman participated in discussions regarding the use of Intericap's own funds. In September 1969 the Intericap directors directed the "officers of the Corporation" to prepare a study regarding Steadman's proposed Ameri-Fund rights offering. Yet the matter was discussed solely between de Zulueta and Steadman, and Steadman directed that the necessary legal work be commenced. Van Damme, who was president of Intericap, was in Paris during the period January 1969 through May 1970 and made no trips to Washington or New York on Ameri-Fund business. During the period January 1969 to May 1970 Steadman was in reality the only chief executive officer Intericap had. Steadman was considered to be, e.g. in a January 18, 1969 statement of Ameri-Fund's "Plan of Operation", along with the officially named officers, part of the "personnel" of Intericap.

The contractual arrangements and relationships among Ameri-Fund, Intericap, and SSC cast additional, significant light on the question

whether Ameri-Fund and SSC were affiliated persons under Section 2(a) of the I.C.A.

During the period January 1969 through at least May 1970, Intericap was the Managing Director of Ameri-Fund. Ameri-Fund as already noted, had no officers. All executive and management functions of Ameri-Fund were to be performed by Intericap as its Managing Director at least until December 30, 1970, the expiration date of the agreement.

During the period January 1969 through at least May 1970 SSC owned 50 percent of the outstanding shares of Intericap, and it was agreed that SSC would always be able to maintain its 50 percent interest in Intericap. Steadman — sole voting shareholder, chairman of the board and chief executive officer of SSC — was also the de facto chief executive officer and chairman of the board of Intericap.

During the period from January 1969 through May 1970, SSC, through Intericap, was the investment adviser to Ameri-Fund. SSC was generally held out to be the investment adviser of Ameri-Fund, and it had always been intended by those concerned that SSC would be the investment adviser to Ameri-Fund. On the same day Intericap entered into an agreement with Ameri-Fund to manage Ameri-Fund's portfolio it delegated this function to SSC. This agreement was amended January 20, 1969 to specifically grant to SSC sole discretion in placing portfolio orders on behalf of Ameri-Fund. SSC was not required to obtain prior approval from or otherwise consult with Intericap or anyone else in making and carrying out investment decisions for Ameri-Fund. And in practice SSC did not usually consult with Intericap or anyone else but placed

orders for Ameri-Fund at its sole discretion. Even Menzies, associated with Hill Samuel in New York, never became involved in the investment advisory function, though Hill Samuel made general suggestions regarding the desired nature of Ameri-Fund's portfolio from time to time. The transactions were executed by SSC's trading department, and SSC authorized the custodian to make disbursements for the purchase of securities for Ameri-Fund. Solely because of the "exceedingly bad" performance results of Ameri-Fund's portfolio, SSC's discretionary authority was terminated in June 1970. Steadman did not oppose this action, realizing that without the active cooperation of Hill Samuel and other participating European banks Ameri-Fund could not be a viable venture.

After its initial meeting on January 8, 1969, the InterCap Board of Directors met only three times (the minimum allowed by InterCap's by-laws) during the following 16 months: May 30 and September 24, 1969, and February 25, 1970. At successive meetings, as Ameri-Fund's net asset value steadily declined, the directors increasingly concerned themselves with Ameri-Fund's portfolio. It was not until the February 25, 1970 meeting that there was specific criticism of the portfolio of Ameri-Fund. By May 1970, Ameri-Fund's net asset value had declined by about 60 percent.

During January 1969 through May 1970, SSC acted in its sole discretion without specific guidance or authority from the InterCap Board of Directors in deciding when and to what extent to use the line of credit extended by the First National Bank of New York to purchase

securities for Ameri-Fund's portfolio. As found above, Steadman signed the hypothecation agreement with First National City Bank of New York on behalf of Ameri-Fund. The minutes of the Intercap Board of Directors contain no authorization to obtain the line of credit or guidance regarding the use of such a line of credit. SSC unilaterally informed First National City Bank when securities for Ameri-Fund would be purchased on credit. The maximum amount borrowed on this line of credit was \$5 million. Since Ameri-Fund's total assets never exceeded \$10 million, the initial borrowing limit of 30 percent of assets was exceeded. This was done without authorization by the Intercap Board of Directors.

According to the Plan of Operation, SSC was to provide to Intercap certain reports regarding Ameri-Fund, including, on a monthly basis, a statement of net assets and of the portfolio and, on a daily basis, the pricing sheets and the net asset value per share. But at the Intercap Board of Directors meetings on May 30 and September 24, 1969, it was decided that the reports originating with SSC regarding the net asset value per share, the portfolio, and portfolio transactions should be provided directly to each Founding Bank, thereby diminishing Intercap's role as a repository or disseminator of data regarding Ameri-Fund.

Intercap was to perform certain bookkeeping and accounting functions and was to have responsibility for maintaining records, with books of original entry and supporting statements received from the custodian and SSC, sufficient for the purpose of preparing financial statements of Ameri-Fund. However, all the necessary accounting and bookkeeping functions of Ameri-Fund were in fact performed by SSC during

the period January 1969 through May 1970. From January to August 1969 Intericap had an office in Geneva, Switzerland, with a one-man staff which duplicated the bookkeeping and accounting functions performed by SSC. After August, 1969 the Intericap "office" was Palmer's London apartment, and the bookkeeping was ostensibly delegated to the London accounting firm of Singleton, Fabian, Derbyshire & Co. ("Singleton Fabian"). But even after August, 1969 and the assumption by Singleton Fabian of certain bookkeeping responsibilities for Intericap, SSC continued to be primarily responsible for maintaining a complete set of books and records of Ameri-Fund's operations.

SSC personnel set up the accounting system for Ameri-Fund at SSC. The books and records kept by SSC for Ameri-Fund during the period January 1969 through May 1970 included the general journal and general ledger, the purchases and sales journal, the cash receipts and disbursements journal, records of brokerage commissions and allocations, and various subsidiary records such as trading summaries, daily trade sheets, brokers' advices and brokers' and custodians' statements. Three of SSC's clerical employees worked full-time on these Ameri-Fund books and records under the supervision of SSC officers. The net asset value was computed daily by SSC.

Acting on Steadman's instructions, Lorenger, as an SSC officer who was never an officer of Intericap, assumed the responsibility of supervising the accounting, bookkeeping and other administrative functions of Ameri-Fund. Lorenger went to Geneva in February, 1969 to recruit an accountant and to establish the accounting system designed by SSC. Lorenger then reported to Hill Samuel regarding the accounting arrangements

made by SSC. When Intericap's office was moved from Geneva to London, Lorenger became involved in procuring the services of a London accounting firm for both Intericap and Ameri-Fund; Lorenger negotiated the fee for such services and supervised the transfer of the accounting functions from the Geneva office to Singleton Fabian. In March, 1969 Lorenger visited First National City Bank in Brussels to review their functions, being accompanied only by the Geneva lawyer. In 1969 Lorenger undertook to resolve Ameri-Fund's then-existing fail problem.

During the period January 1969 through May 1970, SSC performed for and on behalf of Ameri-Fund all those functions necessary to the management of Ameri-Fund. After the initial private placement of Ameri-Fund shares was completed, Intericap did very little.^{11/} SSC provided the facilities and staff for Ameri-Fund's operations which, according to the Plan of Operation, were to have been provided by Intericap. While the structure of Intericap and SSC and the Plan of Operation were designed to place upon Intericap the principal responsibility for the administration of Ameri-Fund, SSC was actually primarily responsible for and directly and intimately involved in the day-to-day administration of the affairs of Ameri-Fund, including investment advice, trading, borrowing, accounting and bookkeeping, and policy planning. Even according to the Plan of Operation, SSC was a recipient and keeper of all source materials while

^{11/} Since the Ameri-Fund shares were not offered in a public distribution and since it never became an open-end, widely-held fund, the administrative tasks normally incident to marketing a fund's shares and handling redemptions etc. were not here involved.

Intericap was to receive only summary reports, including summary reports from SSC based on primary source material maintained or originated by SSC. Thus, the books maintained by SSC were the books of original entry even though Intericap, based on data furnished by SSC, maintained a set of "official" records. The reason for the existence of Intericap, its European offices and its duplication of SSC's record-keeping and other functions was to minimize the extent to which United States persons appeared to be involved in directing the affairs of Ameri-Fund and thus avoid being subject to United States tax laws. Acting under its contract with Intericap, SSC was in effect the Managing Director of Ameri-Fund.

In May 1970 SSC began negotiating with Hill Samuel to dispose of its interest in Intericap. At this time Steadman also was seeking other potential buyers for Intericap. At least as late as December 31, 1971, SSC remained a 50 percent shareholder of Intericap and Steadman was Chairman of the Board and a Director of Intericap.

On the basis of the foregoing findings, it is concluded that SSC and Ameri-Fund were affiliated persons within the meaning of Section 17(a)(1)(2) of the ICA under the definitions of "affiliated person" and "control" set forth in Section 2(a)(2)(3)(9) of the ICA.

At the outset, it should be noted that the "power to exercise a controlling influence over the management or policies of a company" on its face is satisfied by a lesser degree or element of control than that generally called for in the definitions of control under the Securities Act and the Exchange Act.^{12/} Even under the stricter

^{12/} A.A. Sommer, Jr., Who's "In Control"? S.E.C., 21 Business Lawyer p. 559, 576 (April, 1966); M.A. Hanna Company, 10 S.E.C. 581, 588 (1941); The Chicago Corp., et al., 28 S.E.C. 463, 467 (1948).

legislative standards of the Securities Act the Commission by regulation has broadly defined control as the "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise."^{13/}

Respondents place great stress and reliance upon the fact that, as found above, the Intercap Board of Directors at a scheduled meeting on June 15, 1970, withdrew from SSC its discretionary authority to order purchases and sales of securities for the portfolio of Ameri-Fund. They cite this as establishing conclusively that the ultimate power to control Ameri-Fund and Intercap lay with the Hill Samuel group and not with SSC and Steadman and that, accordingly, the latter two could not have exercised a controlling influence over the management or policies of Ameri-Fund during the relevant period. This argument lacks validity for the reason that under the ICA, which defines control both in terms of power to control and actual control, the existence in one person of the ultimate power to control a company does not preclude the existence of another controlling person, let alone the existence of another person exercising "a controlling influence"^{14/}. The findings above and the record as

^{13/} 17 C.F.R. §230.405(f).

^{14/} Sommer, op. cit. supra, at p. 574; The Chicago Corp., et al., cited above, at p. 467 (1948). Cf. Detroit Edison v. S.E.C., 119 F. 2d 730, 738-9 (C.A. 6th, 1941) holding under §2(a)(8) of the Public Utility Holding Company Act of 1935 that "a controlling influence" may be found even where the person exercising it is not able fully to carry his point.

a whole make it entirely clear that that Ameri-Fund, although ultimately controlled by the Hill Samuel group, delegated by contract control over its management and policies to Inter-cap and in turn, through Inter-cap, delegated broad powers of control (including all powers here relevant), again by contract, to SSC. Thus, SSC had actual control over Ameri-Fund's management or policies, to the extent here relevant, even though "there may be a shareholder or shareholders who could at any moment exercise active control, but choose not to do so because of their satisfaction with management. . ." ^{15/} Here, the Hill Samuel group was not only "satisfied with [SSC's] management" (until the unhappy results Ameri-Fund experienced prompted revocation of SSC's discretion in portfolio management) but the entire concept of Ameri-Fund was set up, and was intended to be promoted, on the basis of having portfolio management reside in SSC. As already found, the Steadman name and the experience of SSC in managing registered domestic investment companies were to be used in promoting Ameri-Fund shares, initially to the Founding Banks (as it was) and ultimately to the European public (a "phase" that the Fund did not come to).

The clear-cut delegation by Ameri-Fund of control over its management and policies to SSC (through Inter-cap as an intermediary) must be considered against the background of Steadman's and SSC's central role in organizing Ameri-Fund and Inter-cap, SSC's 50% ownership

^{15/} Sommer, op. cit. supra, at p. 572. Cf. S.E.C. v. Franklin Atlas Corp., 154 F. Supp. 395, 400-1(S.D.N.Y. 1957), where one who was not an officer, director, or shareholder was found to be in control of the issuer as the manager, his sister having acquiesced in his exercise of her control powers.

of Intericap, and the whole congeries of nexuses, found above, connecting Steadman and SSC to Ameri-Fund and Intericap. These factors, taken together, are sufficient to rebut the presumption of lack of control that would ordinarily arise from lack of ownership by SSC of Ameri-Fund shares.^{16/}

Respondents urge that if the transactions between Ameri-Fund and registered Steadman Funds violated Section 17(a) of the ICA, as has been found above, such violation was at most a "technical violation" of the statute, urging that the Steadman Funds were not damaged by the transactions and that at most the charged respondents ". . . failed to follow the formality of requesting an exemption [from the Commission] pursuant to Section 17(b) prior to consummating the transactions."

This argument is not persuasive for a number of reasons. Firstly, Section 17(a)(1)(2), part of a remedial act designed to correct self-dealing abuses by investment advisers, makes it unlawful for affiliated persons to engage in the proscribed transactions (absent prior application to and approval by the Commission) without proof of injury to registered investment company shareholders.^{17/}

^{16/} See footnote 7 above for statutory language of the presumption.

^{17/} Cf. U.S. v. Deutsch, 451 F. 2d 98, 112 (C.A. 2d, 1971) cert. den. January 10, 1972, a criminal proceeding under section 17(e)(1) of the ICA, which proscribes the acceptance of any additional compensation by an affiliated person of a registered investment company for the purchase of property to or for such company, holding that intent to influence need not be shown.

Secondly, there is no proof in the record that the registered Steadman Funds involved in the prohibited transactions were not in fact damaged by the prohibited transactions, and there is no basis for assuming that an application to engage in such transactions would have been a mere formality that would have been approved as a matter of course. To the contrary, the record suggests that the situation was fraught with such potential for self-dealing as would have made an exemption unlikely. Thus, the bulk of the prohibited transactions (8 of the 10 sales) occurred between February and June, 1969, a time when Steadman was attempting to establish a favorable performance record for Ameri-Fund to enhance its chances of finally penetrating the European market and of ultimately going public with the Fund. This was also a time during which there was a rapidly declining market. The potential for abuse inherent in such a situation is apparent, and there is no way of knowing whether sufficient safeguards against potential abuse could have been structured so as to have warranted the Commission's granting an exemption.

Accordingly, it is concluded that the securities purchase or sale transactions between Ameri-Fund and Aberdeen, Science, Associated, Consumers, and American constituted wilful^{18/} violations of Section 17(a)(1)(2) of the ICA and that SSC and Steadman wilfully aided and abetted such violations.

^{18/} All that is required to support a finding of willfulness under the securities laws is proof that a respondent acted intentionally in the sense that he was aware of what he was doing and either consciously, or in careless disregard of his obligations, knowingly engaged in the activities which are found to be illegal. Hanley v. Securities and Exchange Commission, 415 F. 2d 589, 595-6 (2d Cir. 1969); NEES v. Securities and Exchange Commission 414 F. 2d 211, 221 (9th Cir. 1969); Dlugash v. Securities and Exchange Commission, 373 F. 2d 107, 109-10 (2d Cir. 1967); Tager v. Securities and Exchange Commission, 344 F. 2d 5, 8 (2d Cir. 1965).

Use of Steadman Funds' Custodian Accounts to Benefit Certain Affiliated Respondents; Failure to Disclose Such Action.

In 1967 Steadman initiated and thereafter directed an expansion program by SSC. During the next two years the Steadman organization grew from a single investment adviser managing about \$3 million of assets to a complex which included several registered broker-dealers (including distributors of mutual-fund shares), an off-shore investment adviser and mutual fund and six registered investment companies, with over \$230 million in managed assets. SSC financed its expansion largely by bank loans, adding a heavy burden of fixed debt to an already debt-laden capital structure. SSC had not operated profitably in the past; Steadman and SSC hoped that SSC would be able to service its large debt from the expected increased income resulting from the additional assets under management and the expected appreciation in value of such assets during the coming years. Contrary to expectations, the stock market declined in 1969-70, and SSC's income projections failed to materialize. Thus, by late 1969 SSC found itself seriously over-extended and by early 1970 SSC was faced with serious financing problems. Financing of Steadman's operations through bank loans therefore continued to be vital during the period of the alleged misuse of the custodian accounts of the Steadman Funds treated in this portion of the opinion.

The Division in the Order alleges that during the period from December 1965 to the time of the Order SSC and Steadman, individually and collectively, wilfully violated and wilfully aided and abetted violations of

Sections 15(a)(1), 17(d), 17(e)(1), 20(a) and 34(b) of the ICA and Rule 20a-1 thereunder, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and (2) of the Advisers Act in connection with using the custodian accounts of registered investment companies managed by SSC to obtain loans from banks for themselves and their affiliated companies and causing one such fund to purchase a certificate of deposit from one such bank in an effort to induce an extension on loans to Steadman and an affiliated company.

The Order further alleges that during the period from August 1967 to December 1969, RSC, SSC and Steadman, individually and collectively, wilfully violated and wilfully aided and abetted violations of the statutory provisions mentioned in the next-proceeding paragraph in connection with soliciting and obtaining brokerage commission business from certain banks by reason of such banks' being custodians for funds managed by SSC.

. Interrelationship of Loans and Brokerage Commissions to Award of Fund Custodianships.

The record establishes that deposits and balances are vital to a bank since they generate income. As one bank officer testified "the key to banking is deposits and collected balances." One source of such balances is mutual fund custodian accounts which customarily include sizeable demand balances. These balances are available to the custodian bank to be included in the pool of lendable funds or may be used to meet reserve requirements, thereby freeing other balances or deposits for loans. Banks, therefore, necessarily actively seek balances, in order to increase the amount of loans which can be made. Thus, a loan applicant who can bring to a bank sizeable balances

is more attractive to the bank and is more likely to get a loan than an applicant who has no such balances, other things being equal or substantially so. It is a common practice for a borrower's accounts in which balances are maintained to go to the bank making the loan. It is also not uncommon for a bank to accept relatively unprofitable business in order to establish a relationship involving other business which will be profitable. The practice of extending one less-than-optimally-profitable banking service to a given customer in order to obtain other banking business from him or his affiliates is one aspect of "cross-selling" and is universal among "progressive" banks. In seeking balances banks often require a borrower to maintain "compensating" or "free" balances of 10 to 20 percent of the amount of the loan. Often the balances kept in the banks as compensating balances come from the proceeds of the loan, thereby increasing the effective rate of interest on the loan. Another purpose of the compensating balances is to provide a form of security for the loan. Finally, the balances which a borrower is responsible for placing on deposit in the lending bank can, if sizeable, result in a lower rate of interest on the loan than would be charged absent such balances.

Related to, or perhaps an offshoot of, the concept of cross selling is the practice of banks to look to the "total banking relationship" with a particular borrower or other customer. Thus, if an applicant for a loan is a customer with the power to bring to the bank business of related or affiliated entities, that would be a factor that the bank would consider, always assuming, of course, that the applicant meets the bank's basic criteria as a credit risk.^{19/}

^{19/} Apart from evidence in the record, the above practices of banks respecting bank balances, cross selling, and looking to the total banking relationship are matters that could have been officially noticed as matters "peculiarly within the knowledge of the Commission as an expert body" within the meaning of 17 C.F.R. § 201.14(d) of its Rules of Practice.

Steadman, a businessman of wide experience in corporate finance, was familiar with banking practices regarding balances. Steadman clearly understood the importance of balances to banks and that an applicant for a bank loan can improve his chances for such a loan by promising that sizeable balances will be deposited with the lending bank.^{20/} Steadman also understood that the mutual funds with which he and SSC were affiliated could provide balances and that, by virtue of his relationship with such funds, he and SSC were in a position to promise and to deliver such balances to the lending bank. Steadman also understood that such balances could be used as leverage to obtain other benefits, such as brokerage commission business, from the bank in which such balances were deposited.

The Riggs National Bank ("Riggs") was custodian for Science and American from at least December 15, 1965 to December 31, 1968 and for Fiduciary from April 1967 to December 31, 1968. The custodian account of Fiduciary was transferred from the Bank of New York to Riggs effective July 25, 1966.

Riggs made the following loans to Steadman, secured by marketable securities:

- (a) \$75,000 on December 15, 1965 due on demand;
- (b) \$30,000 on March 4, 1966 due on demand for a total outstanding of \$105,000;
- (c) \$25,000 on August 4, 1966 due on demand for a total outstanding of \$130,000;

^{20/} While fund balances could not be used as security for the loan, they were of interest to a bank in that they could be a factor in generating income.

(d) \$639,000 on February 1, 1967 due on demand for a total outstanding of \$769,000;

(e) less \$20,669.58 repaid on October 5, 1967 for a total outstanding of \$748,330.42;

(f) \$200,000 on October 27, 1967 due January 24, 1968 for a total outstanding of \$948,330.42;

(g) \$200,000 due January 24, 1968 was extended on February 23, 1968 to May 31, 1968;

(h) \$60,000 on April 22, 1968 due on demand for a total outstanding of \$1,008,330.42;

(i) \$100,000 on May 3, 1968 due on demand for a total outstanding of \$1,108,330.42.

Of this \$1,108,330.42, Steadman repaid \$60,000 on July 1, 1968 and the balance on August 26, 1968.

Riggs made the following loans to SSC:

(a) \$75,000 on April 21, 1966 due July 15, 1966;

(b) \$125,000 on April 25, 1966 due July 15, 1966 for a total outstanding of \$200,000;

(c) less \$100,000 repaid on July 25, 1966 with the balance of \$100,000 extended until January 3, 1967;

(d) \$100,000 on November 15, 1966 due February 1, 1967 for a total outstanding of \$200,000 due February 1, 1967;

(e) \$24,500 on August 12, 1968 due September 11, 1968 and extended for successive periods on September 19, October 17 and December 5, 1968.

SSC repaid the \$200,000 loan due February 1, 1967, which was unsecured, on March 30, 1967. The \$24,500 loan, which was secured was repaid on December 31, 1968.

On June 12, 1967 Riggs extended to RSC a secured line of credit for up to \$500,000 for the clearing of broker drafts. This line of credit was increased to \$1 million on October 5, 1967 and was utilized by RSC from August 30, 1967 to October 28, 1968. The amounts borrowed by RSC pursuant to this line of credit ranged from a low of \$7,350 to a high of \$552,432.

On July 21, 1967 Riggs loaned \$40,000 to Elmira Deliveries, Inc. ("Elmira"), due October 19, 1967, which was later extended to January 17, 1968 and was repaid on November 9, 1967. The loan was secured by marketable securities. Elmira is Steadman's personal investment company; he is the chief executive officer of Elmira.

On July 26, 1968 Riggs, at SSC's request, approved a loan to Consumers Financial Corporation ("CFC") of up to \$55,000 for 90 days. At the time of this request SSC was acquiring from CFC all of the stock of CIPCO. SSC was to endorse and guarantee this loan to CFC. The loan was to be secured by and repaid from an amount deposited by SSC into an escrow account at Riggs in connection with SSC's acquisition of CIPCO.

In granting these various loan requests by Steadman and companies controlled by Steadman, Riggs reviewed the custodian accounts maintained by the Steadman Funds at Riggs. For example, on April 26, 1966 a detailed memorandum was furnished to Robert V. Fleming ("Fleming"), chairman of the Trust committee of the Bank's Board, pursuant to his request in connection with a loan matter setting out the earnings

attributable to the custodian accounts of the Steadman Funds. Again, on July 25, 1966 such information was furnished to L.A. Jennings ("Jennings"), chairman of the Riggs board, at his request. On the same date, Jennings, as a member of the loan committee, approved SSC's request that only \$100,000 of the \$200,000 due July 15, 1966 be repaid and that the balance be extended until January 1, 1967. Balances maintained in the Riggs custodian accounts of the Steadman Funds, as well as balances in SSC's accounts, were considered in determining the interest to be charged on loans to Steadman and companies in the Steadman organization, resulting in a lower interest rate than would be charged if there were no such balances. This was so because the Bank was interested in the overall yield from the loan, and available balances helped increase the yield.

In the spring of 1968 SSC embarked on an expansion program to acquire the management rights to additional mutual funds. These acquisitions were to be financed at least in part by bank loans. In May 1968 SSC entered into contracts to acquire AMC and AFMC, the investment advisers of Aberdeen and Associated respectively, for a total cost of \$2.9 million. On May 13, 1968 the Riggs loan committee considered SSC's application for an unsecured loan of \$3 million. In view of SSC's financial condition — a net worth of about \$1 million and a loss of about \$180,000 for the year ended December 31, 1967 — Riggs concluded that the projected debt load would be too large and that the acquisition of AMC and AFMC would better be financed through the sale of stock. However, in view of the balances maintained at Riggs by the Steadman mutual funds, officers of Riggs went to New York to discuss SSC's loan

application with Manufacturers Hanover Trust Company ("Manufacturers"). Manufacturers' officials, including the chairman of the board, agreed that the acquisitions should be financed through the sale of stock. It was the opinion of the chairman of the board of Manufacturers that SSC would be paying too much for AFMC and AMC, and it was the opinion of Riggs that SSC's projections were too optimistic and that SSC could better expand its assets under management by selling more shares in the funds it already had. The Riggs loan committee declined to grant the requested loan in the form presented, but stated it would be willing to consider a modified loan request by SSC. On June 3, 1968 the Riggs loan committee considered and denied SSC's request for an unsecured loan of \$2 million in the form presented. The loan committee told Steadman it would be willing to consider a secured loan of \$2 million to SSC.

On June 24, 1968 Steadman visited Riggs and met with Jennings and Gorman S. Donegan ("Donegan"), a senior Riggs loan officer. Steadman asked that Riggs reconsider SSC's loan application, stating that while he believed he could obtain the requested loan from a New York bank, "he would like to continue his relationship" with Riggs. Jennings responded that, based on the financial information and projections provided by SSC to Riggs, they could not make the requested loans. Steadman then asked whether Riggs would consider participating in such a loan with another bank, and Jennings responded affirmatively. On August 15, 1968 Steadman again visited Jennings and Donegan to apply for an unsecured loan of \$2 million to SSC. Steadman stated he had obtained through Kuhn Loeb a commitment for a loan of \$2 million from

Chemical Bank New York Trust Company ("Chemical") but that he preferred to do business with Riggs. Steadman also supplied revised projections to Riggs. Jennings stated that SSC's application would again be considered. Riggs again considered and again denied the requested loan in view of SSC's financial condition and revised projections. On August 22, 1968 Lorenger requested that Riggs lend SSC \$850,000 to enable SSC to meet the closing date on the acquisition of AMC. Lorenger stated this would be an interim loan to be repaid from the proceeds of the \$2 million loan SSC expected to receive from Chemical. Jennings requested that the Chemical loan commitment be confirmed to Riggs. Steadman replied later the same day that SSC did not have such a commitment. Riggs again considered the \$850,000 loan request and denied it.

During the period May to July 1968, Steadman obtained the assistance of two New York investment banking firms, Kuhn Loeb and Eastman Dillon, Union Securities & Co. ("Eastman Dillon"), to arrange necessary bank financing to consummate the acquisitions of AMC and AFMC. Steadman did not object to an exploratory proposal by Kuhn Loeb that in return for an institutional investor's assistance in negotiating and guarantying a \$3 million loan SSC would, among other things, cause the cash balances of the Steadman mutual funds to be deposited at the institutional investor's commercial bank as part of such institutional investor's compensating balances. Subsequently, in a "Confidential Memorandum" soliciting a \$2 million, five year term loan prepared by Kuhn Loeb ("Kuhn Loeb Memorandum") in consultation with and based upon information provided by SSC and reviewed and approved by SSC, SSC offered to transfer the custodian accounts of the

Steadman Funds from Riggs to whatever bank would make SSC the requested loan. The proposal to transfer the custodian accounts to the lending bank arose out of discussions with Steadman, among others, and was agreed to by Steadman. Included in this memorandum was a table setting out the projected average cash balances of the Steadman Funds from 1968 through 1973, a period corresponding to the term of the loan. The Kuhn Loeb Memorandum was sent to G.A.C. Commercial Corporation, Chemical, and Manufacturers Hanover, all of which declined to make the requested loan to SSC.

At the time he testified, Richard Fishbein ("Fishbein"), the Kuhn Loeb official who prepared the Kuhn Loeb Memorandum, owned \$10,000 principal amount of SSC convertible preferred stock. On two key issues — the purpose of offering the custodian account in the Kuhn Loeb Memorandum soliciting a loan proposal and his understanding of the reason banks seek mutual fund custodian accounts — his testimony was at times contradictory, and clearly inconsistent with exhibits prepared at the time of the events in question. For example, Fishbein acknowledged that the custodian accounts and the loan request were "lumped" together because he, Steadman, Lorenger and Istel thought this would be attractive to a bank. Yet Fishbein later testified that he did not know of any connection between the custodian accounts and the loan request. Moreover Fishbein's statement that he did not know why banks sought mutual fund custodian accounts is belied by the fact he originated the idea of using the Steadman mutual funds' balances as compensating balances for a guarantor and by his status and experience (3 years) as a member of a leading investment banking firm. Based on these considerations and the witness's demeanor, his testimony in the above respects is not credited.

In July 1968 Steadman discussed SSC's need for a bank loan with John Ellis ("Ellis") of Eastman Dillon. At SSC's instance Ellis caused to be prepared a "Confidential Memorandum" dated August 27, 1968 ("Eastman Dillon Memorandum") for the purpose of soliciting a \$2 million term loan. The information set out in the Eastman Dillon Memorandum was provided by and discussed with Steadman and SSC, and the memorandum was reviewed and approved by SSC prior to its distribution. In the Eastman Dillon Memorandum SSC obliquely makes it clear that the bank which makes the requested loan could expect to become the custodian for the existing Steadman mutual funds and those to be acquired. Eastman Dillon, on behalf of SSC, solicited the Chase Manhattan Bank ("Chase"), the Belgian-American Banking Company ("Belgian American", whose name was later changed to European-American Bank), and the Marine-Midland Bank. Eastman Dillon was instrumental in obtaining a \$3.5 million loan from Chase and was paid \$25,000 by SSC for its role in obtaining the loan.

In August 1968 The Fidelity Bank of Philadelphia ("Fidelity") was requested to consider a loan to SSC on the basis of the memorandum prepared by Kuhn Loeb. In negotiations with Fidelity for a \$3 million term loan, Steadman and SSC proposed to satisfy Fidelity's requirement of compensating balances by transferring to Fidelity the custodian accounts of the Steadman mutual funds, and this was agreed to by Fidelity. Fidelity then approved a \$3 million term loan to SSC upon the condition that Fidelity became custodian for the Steadman mutual funds, and Steadman and SSC agreed to this condition. However, these negotiations came to naught because another condition imposed by Fidelity, that Steadman pledge to Fidelity his Class B (voting) SSC stock, was unacceptable to Steadman.

In August 1968 Ellis contacted Belgian-American on behalf of SSC with a request to consider "this \$2 million loan" and offering the cash balances of the Steadman mutual funds as an inducement to make the loan. This loan request to Belgian-American, including the transfer of the fund custodian accounts, was discussed with Steadman. The cash balances of the Steadman Funds were to be part of the consideration for making the loan. Belgian-American declined to consider a larger loan than \$2 million over a period longer than five years. When Belgian-American determined its Trust Department was unable to handle the custodian business of the Steadman Funds, the bank became less interested in pursuing even the \$2 million loan request. To the extent that Bradford Warner ("Warner") testified that these balances were erroneously listed as compensating balances on the "Offering Sheet", his testimony is not credited. Warner was not a loan officer and did not prepare the "Offering Sheet". The reasoning which lead him to conclude these balances could not be looked to by the bank as compensating balances is not persuasive as it does not take into consideration the fact that these balances can be included in determining the overall yield to the bank of a loan to SSC.

In a letter dated August 30, 1968 to Charles A. Agemian ("Agemian"), at that time a Chase senior officer, Ellis, on behalf of SSC, requested an opportunity to discuss "a business matter that could be of an advantage to your bank involving approximately \$9 million worth of deposits." This proposition was referred by Agemian to Robert O. Blomquist ("Blomquist"), a Chase officer with operational responsibility for the area including

Washington, D.C., as an "interesting loan proposition". Blomquist in turn referred the matter to Thomas A. Hayne, ("Hayne"), a second vice president and a commercial lending officer responsible for maintaining and developing commercial banking relationships with corporations located in Washington, D.C. Hayne also received at this time a private-placement offering circular dated August 1, 1968, indicating that SSC was seeking a loan of \$2 million and that SSC managed investment companies.

After reading the offering circular Hayne became curious about the \$9 million in balances referred to in Ellis' letter to Aghemian, because Chase "would always probably want to be in a position of getting \$9 million" in deposits. Hayne thought it was somewhat "strange that we were talking about deposits of \$9 million" in connection with a loan request of \$2 million.

As part of his responsibilities Hayne was a salesman for the various banking services, including trust-department services, offered by Chase. In negotiating a loan it was part of his job to seek the balances of the borrower and of companies affiliated with the borrower and, in the case of SSC, the custodian accounts of the Steadman mutual funds. SSC's loan request presented an opportunity for Hayne, whom Blomquist described as "an extremely able" and "very bright officer", to see what he could do to get a big chunk of business for Chase — to prove himself as a good salesman. Hayne, described by himself and Lorenger as "very aggressive" in negotiating with SSC, "wanted all [the balances] he could get". Hayne stated that "demand deposits are something banks are always seeking [because] deposits are used to generate additional loans for the banking system." Hayne, as a matter

of common banking practice, would customarily also try to get the business of persons or entities other than the borrower which the borrower could influence to be brought to Chase. He was therefore extremely interested in getting the custodian accounts of the Steadman Funds. Hayne testified he "would have to assume" that "net" balances in these custodian accounts would be available for investment [directly or through release of other funds for investment], and that the rate on such invested balances would be the "pool rate", which usually ranges between one-half to one percent below the prime rate.

Chase operated at that time on a "profit-center approach". The United States was divided into districts, and each district was a profit center. The income of a profit-center was derived from interest earned on loans made to corporations located in the district and from the "pool rate" imputed to balances generated from the district. Hayne and his superiors received daily reports showing the balances maintained in accounts for which Hayne was responsible.

Hayne had understood from Ellis that Chase was the only bank SSC had approached but later learned that several other banks were also considering SSC's loan request. On September 6, Hayne told Ellis that Chase was interested in the proposition, and Ellis agreed to arrange a meeting for Hayne with SSC in Washington. Hayne testified he did not remember whether he had asked Ellis about the reference to the \$9 million in deposits in Ellis' letter. On the basis of the record it seems likely that he had, since the matter of the deposits loomed so large in his thinking. In any event, Hayne and another Chase official met with SSC officers in Washington on September 11, 1968 to discuss SSC's loan request,

and during these discussions Hayne did inquire about balances and was apprised that the \$9 million in balances being offered were those balances customarily maintained in the custodian accounts of existing and to-be-acquired Steadman Funds. Hayne was told that Chase could become custodian and thus get these balances if the Chase fees for custodian services were competitive with those of Riggs, one of the then custodian banks. During this one-day visit Lorenger stated that SSC wished to increase the amount of the loan request to \$3 million, and Hayne indicated Chase would consider the new proposal.

Upon his return to New York, Hayne obtained the approval of his superiors to make a \$3 million loan to SSC. In the course of his presentation to his superiors, Hayne outlined the total potential banking relationship with SSC, including the potential of becoming custodian for the mutual funds. Hayne testified that he received the Eastman Dillon Memorandum sometime after his trip to Washington, D.C., but by that time he had already learned the source of the \$9 million plus in balances referred to therein. Hayne then learned from Ellis's assistant that other banks had already made commitments to SSC. Hayne asked whether the "deal was all wrapped up" and was told it was. Hayne expressed his dismay and immediately called Lorenger to tell him that Chase was willing to commit \$3 million on an unsecured term basis. In this same conversation Hayne and Lorenger discussed the custodianships of the Steadman Funds, and Lorenger indicated that it appeared that Chase had the necessary facilities to become custodian. Hayne and Lorenger agreed that Lorenger would come to New York the following week.

Hayne then confirmed this oral understanding by a letter to Lorenger dated September 17, 1968, in which he stated: "As I believe, we both agreed the following conditions would have to be quid pro quo to our advancing the funds . . . 3. the collateral business from the funds . . ."

Lorenger was not required to sign and return a copy of this letter or otherwise respond to it. In this letter Hayne also assured Lorenger that the Chase custodian fees would be satisfactory for presentation to the funds' boards of directors. Steadman's initials appear on the letter, and Lorenger discussed the letter with Steadman. By "collateral business from the funds" Hayne meant, and Lorenger understood the phrase to mean, the custodian accounts of the Steadman Funds then under discussion. Hayne had the authority to condition the loan upon the transfer to Chase of the custodian accounts of the Steadman Funds.

As Hayne and Lorenger both testified, Lorenger, after receiving Hayne's "quid-pro-quo" letter of September 17th, telephoned Hayne to state, in effect, that SSC would not formally be able to go on record as agreeing to delivering the Steadman Fund custodial accounts since a change in custodial accounts would have to be approved by the boards of directors of the Funds. However, it is entirely clear from the findings herein and from the entire record that this phone call did not alter the fundamental understanding between the parties that it was the purpose and intent of SSC and Steadman to deliver the custodial accounts of the Steadman Funds under discussion to Chase in exchange for the loan; the objective of the call was merely to ensure that the ultimate loan commitment would not contain that "gentlemen's understanding" as an express consideration.

After having discussed Hayne's letter of September 17th with Steadman, Lorenger treated the letter point by point in a memorandum dated September 20, 1968 addressed to and initialed by Steadman, indicating in the first paragraph that he would discuss the custodian accounts with Chase's trust department the following Monday or Tuesday.

On September 24, 25 and 27, Lorenger met with various Chase officials, including Hayne, in New York to discuss the loan, SSC's request for an additional \$500,000 and the appointment of Chase as custodian for the Steadman Funds. In response to Chase's request for information regarding the fees paid to Riggs, Lorenger furnished to the Chase trust officials a schedule of the custodian fees purportedly charged by Riggs, but which were lower than those actually charged by Riggs. Lorenger deliberately understated the fees charged by Riggs because Lorenger believed that a recommendation by SSC to the Funds to appoint Chase custodian would be easier to manage if Chase's fees were lower than Riggs's. By letter dated September 27, 1968 Chase furnished to SSC a schedule of fees it would charge as custodian for the three Steadman Funds, which fees were in general more favorable than those then being charged by Riggs.

On October 3, 1968 the boards of directors of Science, American and Fiduciary approved the recommendation of SSC that Chase become custodian of the respective Funds in lieu of Riggs effective December 31, 1968. The Chase trust department was notified immediately of the action of the Funds' directors. On October 3, 1968 Hayne also had a meeting with SSC officials, and Lorenger advised him of the action of the Funds' directors regarding the custodian accounts.

In a memorandum prepared not later than October 10, 1968 for the purpose of recording significant factors regarding the developing SSC-Chase relationship, Hayne affirmatively and positively stated that "some of the benefits" arising from the loan to SSC "will be: (2) Trust Department will become custodian for the mutual funds". (emphasis added.) Hayne went on to recite that mutual funds traditionally maintain 4 to 6 percent of their assets in cash "which will be on demand with us, the custodian", and that Lorenger had shown him "two months daily statements of the existing custodian [Riggs], and cash for the three Steadman funds averaged \$5-6[million]". Hayne also noted that each of the two funds to be acquired in the future by SSC keeps balances of about \$3 million. Hayne stated "[w]e will become custodian of the three Steadman funds before December 31, 1968" and concluded that "(n)aturally, as the portfolios increase over the years, the cash balances will increase". (emphasis added.) The other "benefit" to Chase noted by Hayne in this memorandum was that Lorenger "promised to keep about \$1 [million] in demand deposits with us as long as possible" and that "[i]f the cash flow projections prove correct, the cash of Steadman will average at least [\$700,000 to \$900,000] over the next seven years". On October 14, 1968 Hayne sent a letter to SSC, stating that Chase had agreed to lend SSC \$3.5 million upon SSC's meeting the two remaining conditions.^{21/} As requested by Hayne, Lorenger signed and returned a copy of this letter.

^{21/} These conditions involved SSC's realizing a stated minimum in cash proceeds in an equity sale and authorizations from regulatory bodies clearing the way for SSC's purchase of the stock of CIPCO.

Hayne was concerned that SSC agree to maintain compensating balances of 20 percent of the amount of the loan.

In August and September 1968, SSC had minimal balances — about \$77,000 as of December 31, 1967. Chase loaned SSC the additional \$500,000 beyond the \$3 million initially applied for to enable SSC to maintain compensating balances. Hayne also wanted, and anticipated, balances in addition to these compensating balances, i.e. the Steadman Fund balances, as found above.

As formalized in a loan agreement dated October 17, 1968, Chase loaned to SSC \$3.5 million, unsecured, to be repaid by December 31, 1975. The interest rate was fixed at 1/2 of one percent above the prime rate for the first four years and 3/4 of one percent above the prime rate for the last three years of the loan with a maximum 8 percent and a minimum 6 percent. In October 1968 Chase was not making loans for terms longer than seven years. The interest rate tends to increase with the length of the term of the loan. Also, the longer the term of the loan, the more likely Chase would be to require security for the loan. In the loan negotiations Hayne explored the possibility of security but learned that SSC had no tangible property to pledge as security. The interest rate on an unsecured loan at Chase tended normally to be higher than on a secured loan. The loan to SSC was the first one Chase had ever made to a company engaged in the business of managing investment companies. According to Pettit, the interest rate was favorable. Steadman also viewed the terms of the Chase loan as favorable to SSC.

In October 1968 SSC had a negative earnings history, having incurred operating losses each year since 1965, when it was organized. As of September 30, 1968 SSC had total assets of \$3.7 million with total shareholders' equity or net worth of about \$1 million and an accumulated retained earnings deficit of about \$242,000. In 1967 SSC lost about \$180,000 on revenues of about \$840,000, which were cash losses since SSC had minimal depreciation expense. Because of its operating losses SSC was not in a position to seek public equity financing.

Hayne testified that, in evaluating a loan request, there must be a "clear indication that any loan . . . could be repaid in the term of the loan". The repayment of the loan to SSC was to come solely from the projected increase in SSC's net income as a result of the planned acquisitions — a "cash flow loan". Hayne identified the major risk of a loan to SSC as a decline in the assets of the funds managed by SSC resulting either from a decline in the value of the funds' portfolios or redemptions exceeding sales or from both. Hayne saw as mitigating this risk the above-average performance of the Steadman Funds and the fact that mutual fund sales had exceeded redemptions every year since 1940.

Of the approximately \$100 million in assets managed by SSC in 1968, all but \$3 million resulted from the acquisition of management contracts in October 1965 and November 1967. Hayne conceded he could not recall any other instance in which Chase had made an unsecured loan three times the net worth to a company with a history of operating losses.

Ellis, who was present at the initial meeting with Chase, testified that the custodian accounts in his opinion were a factor in Chase's evaluation of SSC's loan request. Ellis also stated that "in

talking with the Chase people . . . they had everybody in the room that would have to do with it, the custodian people, the whole thing . . . they brought everybody in". Ellis also candidly stated that in his experience of some 20 years in the investment banking business "this is how lending is done in the United States . . . These are the facts of life. If it is a crime, it is a crime. These are the facts of life." Ellis also testified that banks go to great lengths to separate the trust and commercial banking departments "so they can protect themselves". He characterized the Chase loan to SSC as "imaginative" and one that would not have been made by a conservative banker.

Based on his experience in the financial industry since 1961 and his position as an officer and shareholder of SSC in 1968, Pettit was surprised that Chase would make such a loan to SSC for such a purpose and believed that the custodian accounts of the Steadman Funds were a consideration for making the loan.

The facts found herein clearly support conclusions that: (1) in the course of soliciting a \$2 to \$3 million bank loan for SSC, Steadman and SSC and their agents offered to a number of banks, including Chase, the custodian accounts of the Steadman Funds to induce such banks to make the requested loan; (2) because of the large balances in such accounts and in view of SSC's financial condition in 1968, these custodian accounts were the single most attractive thing SSC could offer to a bank considering a loan to SSC; (3) Hayne actively sought the custodian accounts of the Steadman Funds to get the balances normally maintained in those accounts; (4) Chase required as a condition to the loan to SSC the transfer of such custodian accounts to Chase; (5) SSC informally agreed to this condition;

and (6) the principal consideration for Chase's making the \$3.5 million, unsecured, seven year term loan^{22/} to SSC was the transfer to it of the custodian account of the Funds.

Respondents rely heavily on the testimony of Hayne, Blomquist, and Lorenger in urging a contrary conclusion, i.e. that transfer of various Steadman Fund custodial accounts to Chase was not a principal consideration for the \$3.5 million loan by Chase to SSC.

Hayne's testimony was often evasive, inconsistent, and non-responsive. His conclusional statements on the witness stand that the custodian accounts of the Steadman mutual funds and their balances were not a condition for or in any way a factor considered in making the loan to SSC are belied by Hayne's own memoranda and correspondence and the facts found herein, and are therefore not credited.^{23/}

Even Hayne's conduct subsequent to the Chase loan refutes his testimony as to the role the fund balances played in getting the loan. Between October 1968 and June 1970, during the latter part of which period SSC became unable to meet its obligations under the loan, Hayne on a half-dozen occasions in written form noted the balances maintained in the custodian accounts of the Steadman Funds for which Chase was custodian. Hayne conceded that he did consider these balances important and that in some of these instances he reviewed these balances in the context of his concern about the financial condition of SSC and the overall profitability of the SSC relationship. In January 1970 the

^{22/} The proceeds of the Chase loan were used to repay a \$300,000 loan to SSC from Steadman as well as to purchase the management rights of Associated and to capitalize InterCap.

^{23/} Hayne's testimony that he sought the fund custodial accounts as just another piece of business for the trust department is not persuasive because the fees generated from handling such accounts (an estimated \$13,000) were minor as compared with the amount to be generated from investing fund balances at a pool rate of 5 or 6% (estimated at \$300,000).

bank examiners criticized the SSC loan. In commenting on these criticisms, Hayne observed that while it appeared SSC would not be able to make the required quarterly principal payments of \$125,000 each in 1970, "paradoxically" the total relationship with SSC was profitable. Hayne noted that SSC's net balances ("District III") for six months were \$840,000 and the trust department was "running about \$4 [million] in demand deposits in custody funds". Hayne also noted that when the trust department "is able to take on additional business, we will become custodian for two other funds [Associated and Aberdeen] with additional cash balances of about \$4 [to] \$5 [million]".

Blomquist, in a bit of reverse reasoning, testified on the quid-pro-quo issue that ". . . at that time it was outside the power of the Steadman Security Corporation to commit to that kind of thing, so we could not have asked it." Actually, as already found above, SSC's inability to formally commit the Steadman Funds merely operated to convert what Hayne had initially tried to make an express, formal condition into an informal, but nevertheless mutually understood, condition. Blomquist also testified at some length to the effect that Chase would not grant a loan to a loan applicant unless it were satisfied of the basic credit worthiness of the applicant without consideration of what balances from affiliates the applicant may be able to bring to the banking relationship. This may be true (though there is some indication in the record that Chase was generous or overly optimistic in assessing SSC's credit worthiness) but is essentially beside the point. The allegations of the Order are not that SSC was not credit worthy but that it used the Steadman Fund custodial accounts to help get the loan for itself, as to which the record leaves no doubt.

Blomquist and Hayne both testified that a potential borrower is more attractive to a bank if he can bring or cause someone else to bring sizeable balances to the bank. Blomquist stated that under certain circumstances the prospect of balances would be a factor in the decision to grant a loan and that the total relationship with a borrower which itself had larger than normal demand balances or controlled or was affiliated with a company which had such balances would be more profitable than a relationship with a borrower that did not have such balances. Blomquist also testified that such balances result in a lower rate of interest than if the borrower did not have such balances.

Lorenger testified that so far as SSC was concerned Chase's loan to it was not conditioned upon SSC's transfer or "delivery" to Chase of Steadman Fund custodial accounts. This denial is simply not credible in light of the findings herein, including, notably, the fact that from the outset, when Steadman and SSC first sought the help of investment bankers in arranging a bank loan and/or other financing one of the principal "selling points" they utilized was the balances that would be available from the Steadman Funds. Lorenger's testimony was at points evasive or reluctant, but the prime reason for not crediting it on this basic point is that it does not square with the facts as disclosed by the record. For this last reason the testimony of Baxter, likewise, to the effect that to the best of his knowledge the Fund custodial accounts were not a condition to the making of the Chase loan, is not credited.

Steadman stated to the Funds' directors as his reasons for recommending the change in custodian from Riggs to Chase (1) problems

encountered in dealing with the Riggs "over the past several years", which would be alleviated by dealing with a bank whose operations are more "sophisticated" than Riggs or any other Washington-area bank; (2) Chase's location as a New York bank and its proximity to the New York securities markets; and (3) Chase's lower fees which had been negotiated "(a)fter reviewing the operations and fee schedules of major New York banks".^{24/} According to Steadman the annual savings to be realized with Chase as custodian were \$4,026 for Science, \$413 for Fiduciary and \$567 for American. Steadman failed to disclose to the Funds' directors that SSC was seeking a large, unsecured, term loan from Chase and that Chase was requiring (albeit "informally") that the custodian accounts be transferred to it as a condition for making the loan or that Steadman and SSC were using the lure of the custodian accounts to obtain the Chase loan. At the meeting one director stated that Riggs had provided excellent service and that in his view the complaints were minor, but he chose not to vote against the proposed change.

There were in fact no uncommon or unusual problems with the Steadman Funds' custodian accounts. Riggs was not aware of any complaints from the Steadman Funds regarding its custodian services. In 1968 Riggs was also custodian for other mutual funds. During the problems encountered in 1968 regarding delivery of securities, Riggs performed as well or better than most custodians. Riggs has experienced no difficulties in acting as custodian with respect to its Washington location vis-a-vis the New York securities markets. In 1968 Riggs

^{24/} No inquiry was directed to Riggs to determine whether Riggs would be willing to meet Chase's fees. Also, Steadman had never requested of Riggs on behalf of the Steadman Funds that in fixing their custodian fees they receive credit for the balances in their accounts, as Chase was willing to do.

could make overnight delivery of securities and through its correspondent banks in New York and other cities Riggs was able to promptly accept delivery and make payment or receive payment and make delivery with the necessary transfers of cash being wired immediately to or from Riggs and its correspondent bank.

Steadman was in fact dissatisfied with Riggs because Riggs was not allocating enough brokerage-commission business to RSC (discussed at a later point herein) and because he was having difficulty getting a loan from Riggs. Steadman had not at this time expressed to Pettit, a principal operating officer of both the Funds and SSC, any dissatisfaction with the custodian services of Riggs. According to a Riggs officer, the custodian accounts were withdrawn from Riggs, as expected, because Riggs refused to make the large loan to SSC it had requested. Riggs at this time had also declined to increase Steadman's personal loan.

As a result of the withdrawal of the custodian accounts, Riggs terminated its line of credit to Steadman and RSC. RSC was advised on February 4, 1969 that Riggs had cancelled its line of credit to RSC, "[s]ince the Steadman Security Corporation Funds are now operating out of New York. . ."

Some time prior to January 24, 1969, Fidelity^{25/} extended to RSC a line of credit to enable RSC to clear transactions on the PBW stock exchange. This line of credit was terminated by Fidelity on or about February 25, 1969 because of the difficulties encountered in handling the account, the inadequate staff of RSC and its resulting inability to correct these difficulties, and the absence of ascertainable long

^{25/} The Fidelity Bank of Philadelphia, referred to earlier at p. 42 above.

term benefits to Fidelity. On April 9, 1969 Lorenger "urgently requested" that Fidelity resume its line of credit to RSC, but Fidelity declined. At Lorenger's request, a Fidelity officer contacted Girard Trust Company and another Philadelphia bank to determine whether they would be willing to make a loan to RSC. Both declined. In the meantime, RSC obtained a line of credit from the First National Bank of Washington, as discussed at a later point in this decision.

In May 1969 Chase declined to become custodian of Associated because of a policy decision by Chase not to take on any more mutual fund custodian accounts in view of the problems existing at that time in connection with the processing of securities transactions and the delivery of securities.

Upon becoming dissatisfied with Riggs in the summer of 1968, one of the banks Steadman turned to was the First National Bank of Washington ("FNBW"). Pettit introduced Steadman to George Olmstead, ("Olmstead"), chairman of the board of the International Bank of Washington ("IBW"), who referred Steadman to FNBW, a subsidiary of IBW. During the first meeting Steadman and Olmstead explored the areas in which a potential relationship between SSC and FNBW might develop, including the custodian accounts of the Steadman Funds and dividend disbursing accounts. Later, in the initial discussions between officers of FNBW and SSC regarding loans, the custodian accounts were again discussed.

On August 26, 1968 FNBW made to Steadman a demand secured loan of \$1.3 million at 6 1/2 percent interest, part of which was "participated out" to Arlington Trust Company (later renamed Bank of Virginia).

On the same day FNBW also made to SSC a demand secured loan of \$480,000 at 6 1/2 percent interest. Most of the \$1.3 million loan to Steadman was used to repay Steadman's personal loan from Riggs.

At the time FNBW made these loans to Steadman and SSC, FNBW anticipated it would become custodian for one or more of the Steadman Funds. The prospect of these custodian accounts was one of the reasons FNBW decided to make these loans. Steadman held out these custodian accounts to FNBW as a "carrot" to induce FNBW to make these loans. FNBW actively sought the Associated custodian account and was prepared to expand its facilities to accommodate this business, because the Steadman organization represented a potential major relationship for FNBW.

On March 19, 1969 FNBW made a \$348,300 loan to RSC which was repaid by April 11, 1969. On July 16, 1969 FNBW agreed to extend to RSC a \$600,000 line of credit to clear purchases of securities by RSC. Among the factors considered in determining to extend this line of credit to RSC was the prospect of FNBW's becoming custodian for two of the Steadman Funds.

On February 30, 1969 FNBW made a secured loan of \$300,000 due June 30, 1970 to Elmira.^{26/} This loan was repaid in payments of \$75,000 on June 1, 1970 and \$225,000 on December 30, 1970.

By March 13, 1970 Steadman agreed to arrange that FNBW become custodian for Associated. In the negotiations leading up to this agreement, Steadman agreed that \$400,000 of Associated's assumed average custodian balance of \$2.5 million would be used as an "equivalent. . .

26/ See p. 37 above for Elmira's relationship to Steadman.

compensating balance" for the loan to Steadman and the proposed loan to Ameri-Fund. Steadman and FNBW further agreed that Associated would receive a credit to be applied against the basic annual custodian fee based on the amount of its average custodian balances remaining after deducting the amounts for the equivalent compensating balances and for reserves.^{27/} Associated customarily maintained balances of about \$2.3 million in its custodian account. Under the FNBW proposal, Associated's credit for its balances would have exceeded the estimated custodian fees. This proposed agreement, however was never carried out, because of subsequent developments affecting the banking relationship.

During the summer of 1970 the collateral securing the loans to Steadman and Elmira, consisting of marketable securities, declined in value below levels necessary to provide adequate security for such loans. In May 1970, when the value of the collateral securing the loan to Elmira declined below the outstanding balance of the loan, Harold T. Hedges ("Hedges"), an FNBW officer, requested that Steadman provide additional collateral in the amount of \$50,000. Even with this additional \$50,000 in collateral, the collateral to loan ratio would be "considerably below [FNBW's] normal requirements", but this amount would be considered sufficient "in consideration of our total banking relationship". By this it was meant that the \$50,000 in additional collateral would be sufficient "in consideration" of the potential business, including custodian accounts, FNBW expected to develop with the Steadman organization; it was mentioned to remind Steadman that additional business was expected. In June 1970,

^{27/} The set-off was not to be available against other charges, e.g. transaction fees, monthly bookkeeping charges, etc.

after selling about \$75,000 of the collateral, leaving a balance of \$225,000 on the Elmira loan, the value of the collateral was approximately \$196,000, and the loan was cited by the bank examiner. Hedges requested additional collateral in the amount of \$179,000 to provide a loan to collateral ratio of 60 percent. As of September 17, 1970, the collateral securing the Elmira loan was still deficient.

From July through September 1970 FNBW repeatedly attempted, without success, to obtain additional collateral from Steadman for his personal loan. Steadman agreed in July to provide an additional \$600,000 in collateral, which would result in a loan to collateral ratio of 68 percent, above the 60 percent which banks normally require a borrower to maintain. However, Steadman never did provide the necessary additional collateral. Since participation in the Steadman loan by the Bank of Virginia was contingent on the receipt of additional collateral, Hedges wrote to the Bank of Virginia in August 1970 to assure them that FNBW was "in the process of increasing the collateral", even though there was no firm assurance such additional collateral would be received. During this period the discussions regarding FNBW's becoming custodian continued.

On or about August 11, 1970, FNBW granted Steadman a 90-day extension on his personal loan, expiring November 9, 1970. On August 13, 1970 Science Fund purchased from FNBW a \$1.5 million certificate of deposit, expiring November 10, 1970.

Pettit, the portfolio manager for Science, purchased the \$1.5 million certificate of deposit from FNBW at Steadman's specific instruction, with Steadman naming both the amount and the bank. This was the only certificate of deposit ever bought by a fund during

Pettit's ten years with SSC. Pettit opposed the purchase of this certificate of deposit because he believed it restricted the Fund's liquidity and because the certificate of deposit was a 7 percent whereas the Fund at that time could get a higher interest rate (8 1/2 to 9 percent for 90 days) on commercial paper without limiting liquidity. Pettit also questioned the propriety of purchasing a certificate of deposit from a bank which had relationships with affiliated persons of the Fund. Steadman replied that he wanted it done.

On October 22, 1970 FNBW formally demanded that Steadman repay the outstanding balance of about \$1.3 million on his personal loan or suffer a liquidation by FNBW of his collateral. On November 18, 1970 Steadman paid off his personal loan from FNBW, using the proceeds of a \$1.6 million loan made to him by the National Bank of Washington on November 10, 1970. While Steadman's loan was called primarily because of deficient collateral, Robert A. Bisselle ("Bisselle"), then senior vice president of FNBW, stated in an investigative statement to Commission investigators (and reaffirmed in substance at the hearing), that "the failure of FNBW to obtain the kind of deposit relationship it had expected to establish with the Steadman organization, including becoming custodian for one or more of the Steadman funds" was another reason "to the extent that the loan relationship with Mr. Steadman by itself did not justify the bank [sic] extending itself on this loan." "FNBW estimated [that] from a profitability standpoint it was only breaking even on the loan", and that had the other relationships been established as expected FNBW "might have been able to justify extending itself with respect to this loan to Mr. Steadman".

The above findings clearly support conclusions that (1) Steadman held out to FNBW the prospect of becoming custodian for Associated to induce FNBW to make loans to himself, SSC, RSC and Elmira; and (2) Steadman and SSC caused Science to purchase a \$1.5 million certificate of deposit from FNBW to induce FNBW to grant an extension on the personal loan to Steadman, which FNBW did, and to forbear from calling the loan to Elmira.

Regarding their transactions with FNBW, Respondents rely primarily upon the testimony of William John Schuiling ("Schuiling"), chairman of the board of FNBW, Bisselle, and Hedges, all officers of FNBW at the relevant times.

While Schuiling testified that in his judgment the Bank's anticipation of getting custodial fund accounts was not a requirement for any loan, he also indicated in a statement given to Commission investigators on October 5, 1971 that while he helped set up the loan in an initial contact with Steadman, various subordinates of his followed up on the negotiations and supervised the day to day operation of the loan. In that statement Schuiling also said that if Hedges in a memorandum of March 13, 1970 provided that FNBW required use of a portion of Associated's balances as a form of compensating balance for the loans to Steadman and Ameri-Fund, that was a matter of Hedge's own devising and contrary to FNBW policy or customary practice.

Bisselle's testimony at the hearing that the possibility of custodial fund accounts played no role at all in determining whether to extend loans to Steadman and SSC, after having first testified it was "not a determining factor", is contradicted by his prior statements to Commission investigators, mentioned at p. 62 above.

The testimony of Hedges, a vice president and manager of the commercial loan department during the relevant period, to the extent it is inconsistent with the above findings, is not credited. Hedges denied the plain meaning of documents he prepared and tried to twist the ordinary meaning of words. As one example, Hedges testified that the maximum loan to collateral ratio which FNBW would allow was 80 to 90 percent and that FNBW would have sold Steadman's collateral if he exceeded that ratio. Elmira's loan to collateral ratio was considerably over 100 percent, and FNBW continued to carry the loan. Yet Hedges denied Steadman was receiving preferential treatment.

Based upon the entire record, and upon an assessment of the demeanor of the pertinent witnesses, there is nothing in the testimony of Schuiling, Bisselle, or Hedges that negates the foregoing findings concerning the FNBW transactions.

By the fall of 1970 SSC was unable to meet its obligations on the Chase loan, and Steadman and SSC were under strong pressure from Chase to take measures to reduce the unpaid balance or pay off the loan, including, if necessary, a sale or merger of SSC with another company. Steadman was also faced with the need to obtain a loan to pay off his FNBW loan, due November 10, 1970. On October 8, 1970 Steadman, as president and board chairman of SSC, wrote to True Davis, president and board chairman of the National Bank of Washington ("NBW"), offering the custodian accounts of the Steadman Funds and other corporate accounts to NBW and asking NBW to take over the Chase and FNBW loans to himself, SSC, RSC and Elmira. In reporting

to SSC's Board of Directors in September 1970 the progress of negotiations with Chase to recast the Chase loan to SSC, Steadman stated that a possible alternative was the assumption of this loan by another bank "with part of the consideration being the transfer of several or all of the Fund's [sic] custodial accounts and the corresponding cash balances which would thereby be generated."

On November 10, 1970 NBW determined to make a loan of about \$1.6 million to Steadman expressly in consideration of becoming custodian for four of the Steadman Funds by June 30, 1971, to which Steadman agreed. The ratio of the loan to collateral was 77 percent with a single stock comprising the major portion of the collateral. The usual ratio is 60 to 66 percent. The loan was made with an awareness that it would likely be criticized by the bank examiners. The prospect of receiving the custodian accounts was a factor in deciding to allow a loan to collateral ratio higher than was deemed appropriate.

On January 13, 1971 by letter agreement Steadman and SSC agreed to arrange the transfer of the custodian accounts of Associated, American and, after their merger, Fiduciary and Aberdeen, to NBW by July 1, 1971. The custodian fees, as agreed to between SSC and NBW, to be charged the four Steadman Funds were as follows: (1) a responsibility fee computed as a percentage of assets not to exceed \$20,000 for any Fund with assets up to \$50 million and not to exceed \$25,000 for any Fund with assets between \$50 million and \$75 million; and (2) an activity fee of \$7.50 per transaction reduced by a credit of 3 percent of the average cash balances of the Fund after reducing such balances by 15 percent to satisfy the reserve requirement. These charges were less favorable

than proposals SSC had earlier received. Thus, in December 1969 SSC had received from Suburban Trust Company ("STC") of Wheaton, Maryland, a proposal to serve as Associated's custodian pursuant to which Associated would receive a credit for its average cash balances which greatly exceeded the estimated total custodian fees. Also, in February 1970 SSC received a proposal from FNBW, as found above at p. 60, pursuant to which the credit for Associated's average cash balances exceeded the estimated basic annual custodian fee.

On February 16, 1971 SSC formally notified Associated's custodian, St. Louis Union Trust Company, that NBW was to become custodian for Associated. AFMC's directors were not informed of a proposal to change custodians until February 24, 1971, when they authorized the transfer of Associated's custodian account to NBW. The reasons given for the transfer of Associated's custodian account to NBW were the possibility of lower fees and the "convenience of working with a custodian domiciled in Washington, D.C." SSC represented that "additional efficiencies could be realized by locating the custodianship of all of the Steadman-managed Funds with a single bank here in Washington" The AFMC board of directors was told neither of the STC and FNBW proposals involving more favorable charges nor of the fact that Associated's custodian account was being transferred to NBW in consideration of NBW's making a loan to Steadman. Effective April 15, 1971, NBW became custodian for Associated.

In March 1971 NBW advanced to RSC a \$1.2 million line of credit which was increased in September 1971 to \$1.7 million. Appearing on the RSC loan summary regarding the increase to \$1.7 million is a reference to

the custodian accounts of three of the Steadman Funds, noting that one custodian account had been transferred to NBW and that the other two Funds were to be merged.

On or about May 25, 1971 NBW advised Steadman it would not consider taking over the Chase loan until SSC demonstrated sufficient cash flow to service such a loan. NBW has not become custodian for any of the other Steadman Funds.

Respondents rely principally on the testimony at the hearing of William C. Yowell, Jr. ("Yowell"), then executive vice president of NBW, in support of their contention that the loans made by NBW to Steadman and to RSC were unrelated to the Bank's having gotten the Associated custodial account and to the negotiations for obtaining additional Steadman-Fund custodial accounts.

Yowell testified to the effect that while NBW strongly sought the fund custodian accounts, their actually getting them was not a condition to granting the loan or to desisting from calling the loan. This testimony is not credited because it is belied by the entire course of the negotiations, as found above, as well as by Yowell's statement in October 1971 to Commission investigators in which he clearly used the term "condition" twice in describing the relationship between the loans and the fund custodianships. Yowell's attempt in his testimony to explain his understanding of the term "consideration" as meaning something different from what the term normally conveys to an experienced businessman is simply not persuasive. Moreover, as indicated in his October 1971 statement to investigators, Yowell had learned from Bisselle (of FNBW)

by October 28, 1970, that FNBW had earlier made a loan to Steadman with the understanding that FNBW would get a Steadman Fund custodial account then with a bank in St. Louis, Missouri, and that FNBW ultimately called the loan after failing to get the fund custodianship. Knowing of this prior experience of FNBW's, it appears from the entire record that FNBW was determined not to get into a similar situation with Steadman and therefore made its "conditions" fairly clear. Since it was unwilling to take over the Chase loan, however, it was unable to get more than one Steadman Fund custodianship.

In October 1969 SSC requested Suburban Trust Company ("STC"), mentioned above at p. 66, to consider becoming custodian for Associated and making a loan to RSC. At this time STC was custodian for other types of accounts but not for any mutual funds. The transfer of Associated's custodian account to STC was contingent upon STC's extending the requested line of credit to RSC. Lorenger indicated to STC that Girard Trust Company of Philadelphia and FNBW were expected to submit proposals regarding the custodian account of Associated.

STC notified SSC in December 1969 that it would be willing to become custodian for Associated and proposed a fee arrangement which allowed Associated a credit of 6 percent on the cash balances in the custodian account (after deducting for the 15 percent reserve requirement) to be applied to the full amount of the custodian fees. Under this proposal Associated would, based on the information provided by SSC, receive a total credit of \$102,000 to be applied against an estimated annual custodian charge of \$30,000. STC was "willing to absorb

the custodial fee in order to obtain the cash balances." STC also decided in December 1969 not to advance the requested line of credit to RSC. STC was not surprised that it never received a response to its custodianship proposal since it believed that if it did not make the requested loan to RSC it would not get Associated's custodian account.

During the period April to October 1969, SSC discussed with Girard Trust Company ("Girard") of Philadelphia, Pennsylvania, the possibility of becoming custodian for Associated and requested that Girard make a loan to RSC. Girard declined to make the loan and did not become custodian for Associated.

In August 1967 Steadman sought and obtained from Riggs brokerage commission business for RSC. Riggs decided to place with RSC \$50,000 of brokerage on an annual basis. The decision to allocate brokerage to RSC was made in consideration of the balances maintained in the several Steadman organization accounts at Riggs, including the balances in the custodian accounts of the Steadman Funds. The continued allocation of brokerage to RSC would depend upon the analysis made by Riggs' Analysis Department of the profitability of these accounts. In August 1967 RSC had been in existence approximately two months and had limited capital. Consequently, Riggs determined to limit the brokerage business directed to RSC to purchase orders, since sell orders would cause RSC to utilize its line of credit from Riggs. The amount of brokerage business allocated by Riggs to RSC for the last five months of 1967 was \$21,000 and for 1968 was \$25,000. Those at Riggs responsible for allocating brokerage did not believe RSC was

capable of handling \$50,000 worth of brokerage on an annual basis consistently with the "best-execution" requirement.

Upon arranging for the transfer of the custodian accounts of Science, American and Fiduciary from Riggs to Chase, SSC sought to obtain brokerage commission business from Chase in consideration of the custodian account and the total banking relationship with Steadman and affiliates. Lorenger wrote Chase that "it is imperative that the business we will obviously lose from Riggs be replaced by Chase." In response to SSC's and Steadman's repeated requests for allocation of more brokerage business to RSC, a Chase official observed that "Steadman should not look at the loss in commission business suffered by moving from the Riggs to Chase in a vacuum. Rather, the marginal revenue accruing to the Steadman interest as a product of our loan, should be compared to the marginal cost of having lost some commission business." Because of "commitments" by Chase to other broker-dealers for reciprocal business, Chase directed to RSC only some \$4,000 in brokerage commissions during the period 1968-1970.

During negotiations with FNBW and STC regarding Associated's custodian account, SSC and Steadman sought brokerage commission business from those banks. During negotiations with STC Lorenger suggested that STC allocate brokerage commission business to RSC in consideration of the unused credit which would arise from the balances in Associated's custodian account.

. Failure to Disclose Interrelationship.

During the period from on or about December 15, 1965 to the date of the Order, Steadman and SSC offered and sold shares of American, Associated Fiduciary and Science by use of the means and instrumentalities of interstate

commerce. In the offer and sale of such shares, Steadman and SSC used prospectuses which failed to disclose certain material^{28/} facts, i.e. (1) that Riggs, Chase and NBW made loans to Steadman, SSC, RSC and Elmira while such banks were custodians for American, Science, Fiduciary and Associated; (2) that Steadman, SSC and RSC sought and obtained brokerage commission business from Riggs and Chase by reason of such banks's being custodians for American, Science and Fiduciary; (3) that the custodian accounts of American, Science and Fiduciary were transferred to Chase and that of Associated to NBW in return for and in consideration of which said banks made loans to Steadman, SSC, RSC and Elmira; (4) that Science purchased a certificate of deposit from FNBW at a time when Steadman, RSC and Elmira had loans from FNBW and to induce FNBW to grant an extension on its loan to Steadman; and (5) that SSC and Steadman had interests adverse to those of American, Associated, Science and Fiduciary and their shareholders in the selection of and in dealing on behalf of said funds with Riggs, Chase and NBW as custodians for said Funds and in the purchase of a certificate of deposit from FNBW on behalf of Science.

During the period from on or about December 15, 1965 to the present, SSC and Steadman caused American, Associated, Fiduciary and Science to file with the Commission and to transmit to the shareholders of these respective funds proxy-soliciting materials and to file with the Commission registration statements and amendments thereto, prospectuses,

^{28/} For cases defining "material" facts within the meaning of the Securities laws see: Affiliated Ute Citizens v. U.S. 406 U.S. 128, 154 (1972); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 385 (1970); Chasins v. Smith Barney & Co., 438 F. 2d 1167, 1171 (C.A. 2, 1971); Gilbert v. Nixon, 429 F. 2d 348, 356 (C.A. 10, 1970); Securities and Exchange Commission v. Great American Industries, Inc., 407 F. 2d 453, 459-60 (C.A. 2, 1968) (en banc), certiorari denied, 395 U.S. 920 (1969); Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F. 2d 833, 849 (C.A. 2d, en banc, 1968).

reports and other documents required to be filed or transmitted under the I.C.A. which omitted disclosure of the material information set forth in the next-proceeding paragraph.

The management agreements between SSC and the various Steadman Funds in effect during the period 1965 to the date of the Order do not disclose or describe the loans and brokerage commission business described in the findings above.

In summary, the foregoing findings demonstrate unmistakably that beginning in late 1965 and until the time of the Order Steadman and SSC used the assignment to particular banks of the custodial accounts of various Steadman Funds for which SSC was investment adviser as a bargaining resource whereby Steadman and SSC received in exchange from the custodian banks loans and loan extensions for themselves or affiliates and brokerage allocations on behalf of RSC. Further, they failed to make the necessary disclosures of such acts and practices. There remains for determination the question of what statutes and regulations may have been violated by such conduct and failures to disclose,

. Violations of Various Antifraud Provisions.

It is concluded that, as charged in the Order, the above-found conduct was in wilful violation of the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule

28a/
10b-5 thereunder, and Section 206(1),(2) of the Advisers Act in that
the self-dealing conduct constituted a fraudulent course of conduct
and in that the failure to disclose such conduct, and the conflicts
of interest 28c/ generated thereby, likewise were fraudulent.

The Investment Company Act and the Investment Advisers Act
by their structure and content establish the relationship of an

28a/ 15 USC 77q(a); 15 USC 78j(b); 17 CFR 240. 10b-5. Rule 10b-5 provides
as follows:

Rule 10b-5. Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly,
by 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 circum-
stances 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.

28b/ 15 USC 80b-6. Section 206 provides in pertinent part as follows:

PROHIBITED TRANSACTIONS BY REGISTERED INVESTMENT ADVISERS

SEC. 206. It shall be unlawful for any investment adviser, by
use of the mails or any means or instrumentality of interstate
commerce, directly or indirectly —

- (1) to employ any device, scheme, or artifice to defraud
any client or prospective client;
- (2) to engage in any transaction, practice, or course of
business which operates as a fraud or deceit upon any client
or prospective client;

• • •

28c/ The most obvious conflict of interests would be that arising from
the tendency to maintain substantial cash balances in the custodial
accounts of the funds, even when that might not be in the funds'
best interests.

investment adviser or other affiliated person of an investment company to the investment company as that of a fiduciary, and the Courts and the Commission have so held in many cases.^{29/}

For example, Section 17 of the ICA imposes on such persons the standards traditionally applied to trustees. Likewise, Sections 205 and 206 of the Advisers Act contain prohibitions against self-dealing on the part of investment advisers at the expense of their clients that are characteristic of a trust relationship. Accordingly, it is instructive to look here to the great body of law respecting the standards and obligations of a trustee.

It is clear that fiduciaries must avoid even the appearance of a conflict of interest. As Chief Judge (later Justice of the Supreme Court) Cardozo said in Meinhard v. Salmon,^{30/} 164 N.E. 545, 546, 249 N.Y. 458, 464:

"Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity

^{29/} SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 at 194 (1963); Brown v. Bullock, 194 F. Supp. 207, 229 (S.D.N.Y. 1961), aff'd. 294 F. 2d 415 (C.A. 2d 1961); Consumer-Investor Planning Corp., et al 43 S.E.C. 1096, 1100 (1969); Kidder, Peabody & Co., Inc., 43 S.E.C. 911, 915 (1968); Dow Theory Forecasters, Inc., 43 S.E.C. 821, 831 (1968); Roman S. Gorski, 43 S.E.C. 618, 620 (1967); Edward J. Moschetti, 41 S.E.C. 942, 943 (1964); 2 Loss, Securities Regulation, 2d Ed, 1412.

^{30/} Cited approvingly, Seminole Nation v. U.S., 316 U.S. 286, 297 n. 12, (1942); First National Bank of Colorado Springs v. McGuire, 184 F. 2d 620, 625 (C.A. 7th 1950). In Perlman v. Feldmann, 219 F. 2d 173, 176 (2d Cir. 1955) the Meinhard standard was applied to the fiduciary relationship existing between a controlling shareholder and the minority shareholders in a corporation.

when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."

The policy of equity is to remove every possible temptation from a trustee.^{31/} A fiduciary may not obtain any advantage by the slightest misrepresentation, concealment or adverse pressure.^{32/} In all his dealings with the trust estate, the fiduciary, must act with candor and frankness and must not only be strictly truthful in all his representations but must not remain silent concerning any matter of which he has knowledge that would throw light on the trust estate.^{33/} A fiduciary is required not only to avoid actionable fraud but also circumstances which are improper or suggest the appearance of fraud or lack of loyalty.^{34/} A trustee is at all times disabled from obtaining any personal benefit, advantage or gain from his administration of the trust, his dealing with the trust property, or his relation to the trust estate.^{35/} Nothing in the law of fiduciary trusts is better settled than that the trustee shall not be allowed to advantage himself in dealings with the trust estate. Any benefit or profit obtained by the trustee inures to the trust estate, even though no injury was intended and none

^{31/} Liberty Title & Trust Co. v. Plews, 77 A. 2d 219, 224 (N.J. 1950).

^{32/} In re Vokal's Estate, 263 P. 2d 64, 67-8 (Cal. D.C. of App. 1953).

^{33/} Winn v. Shugart, 112 F. 2d 617, 621 (C.A. 10th 1940).

^{34/} Muth v. Mayton, 119 N.E. 2d 162, 167 (Ohio, Ct. Comm. Pleas 1954).

^{35/} Anderson v. Bean, 172 N.E. 647, 654 (Mass. 1930); Chicago, M. & St. P.R. Co. v. Des Moines Union R. Co., 254 U.S. 196, 222 (1920).

^{36/}

was in fact done to the trust estate. A trustee is prohibited from placing himself in any position where his self-interest will, or may, conflict with his duties as trustee,^{37/} or in a position where he will be exposed to the temptation of acting contrary to the best interests of the beneficiaries.^{38/}

Perhaps the leading case on the fiduciary responsibilities of investment advisers is SEC v. Capital Gains Research Bureau, supra. The Supreme Court quoted approvingly (at 375 U.S. 187) from the Commission's report of its study of investment counsel and advisory services^{39/} ("SEC Report") which culminated in the Investment Advisers Act of 1940, which Report, inter alia, embraced the concept that investment advisers could not

"completely perform their basic function—furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments—unless all conflicts of interest between the investment counsel and the client were removed". [SEC Report, p. 28]

^{36/} Magruder v. Drury, 235 U.S. 106, 119-20 (1914).

^{37/} Zahn v. Transamerica Corp., 162 F. 2d 36, 43 (C.A. 3d 1947); Bruun v. Hanson, 103 F. 2d 685, 698 (C.A. 9th 1939), Cert. den. 308 U.S. 571 (1939).

^{38/} In re Franklin Bldg. Co., 83 F. Supp. 263, 267 (E.D. Wis. 1948), aff'd 178 F. 2d 805 (C.A. 7th 1949) cert. den. Simonsen v. Emmerling, 339 U.S. 978, (1950).

^{39/} Investment Trusts and Investment Companies; Report of the Securities and Exchange Commission on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services, H.R. Doc. No. 477, 76th Cong., 2d Sess., 1.

The Supreme Court, at 375 U.S. 188, in recounting the applicable standards, noted that the SEC Report had incorporated the Code of Ethics and Standards of Practice of "one of the leading investment counsel associations":

"[An investment adviser] should continuously occupy an impartial and disinterested position, as free as humanly possible from the subtle influence of prejudice, conscious or unconscious; he should scrupulously avoid any affiliation, or any act, which subjects his position to challenge in this respect," (Emphasis added by the Court)

The court quoted from earlier opinions on the reasons underlying the prohibition of conflicts of interest by a fiduciary, at 375 U.S. 196, note 50:

"The reason of the rule inhibiting a party who occupies confidential and fiduciary relations toward another from assuming antagonistic positions to his principal in matters involving the subject matter of the trust is sometimes said to rest in a sound public policy, but it also is justified in a recognition of the authoritative declaration that no man can serve two masters; and considering that human nature must be dealt with, the rule does not stop with actual violations of such trust relations, but includes within its purpose the removal of any temptation to violate them . . ."

"In Hazelton v. Sheckells, 202 U.S. 71, 79, 26 S. Ct. 567, 568, 50 L. Ed. 939, we said: 'The objection . . . rests in their tendency, not in what was done in the particular case. . . . The court will not inquire what was done. If that should be improper it probably would be hidden and would not appear.'" United States v. Mississippi Valley Generating Co., 364 U.S. 520, 550, 81 S. Ct. 294, 309, 5 L. Ed. 2d 268 n. 14.

The Court held that "It is the practice itself, however, with its potential for abuse, which 'operates as a fraud or deceit' within the meaning of the [Advisers] Act when relevant information is suppressed. . ." and that the Advisers Act was "directed not only at dishonor, but also at conduct that tempts dishonor." (375 U.S. at p. 200).

The findings herein disclose an egregious breach of fiduciary trust by Steadman, SSC, and RSC^{39a/} in connection with their misuse of the custodian accounts of the Steadman Funds.

There is no indication in the record that these Respondents ever made any concerted effort to obtain for the Steadman Funds the best possible custodial services at the lowest cost to the Funds; instead, the record shows that these Respondents consistently used the custodial accounts as bargaining power for obtaining bank loans for Steadman, SSC, and their affiliates, and that they consistently attempted, with only moderate success, to use such custodial accounts to get brokerage business for RSC. When the Respondents got Chase to come in with custodial rates competitive with those of Riggs it was in order to "sell" the proposed shift in custodianships to the Steadman Funds and not as part of a comprehensive and independent search to obtain the best custodial agreements for the Funds.

The true reasons for "recommending" shifts in custodianship were never disclosed to the Steadman Funds. Instead, phony reasons were advanced, such as an ostensible (but unreal) lack of good service from Riggs, a desire to locate the custodianships in New York rather than Washington, D.C., followed, later, by a desire to relocate them in Washington, D.C.!

^{39a/} While RSC was more a "beneficiary" than a prime perpetrator of the breach of trust it must be deemed to have participated knowingly and wilfully in view of the fact that Steadman is its president and board chairman and because it is a wholly-owned subsidiary of SSC, of which Steadman is also president and board chairman.

In simple fact, the Steadman Fund custodial accounts were kept with or handed out to whatever bank or banks Steadman, RSC, and their affiliates had or were establishing banking relationships with, as if there had existed some sort of symbiotic relationship between SSC et al and the Steadman Funds in respect of establishing banking relationships with the same bank or banks. Sadly, the record discloses that the relationship was not symbiotic but parasitic, with the Respondents fraudulently gaining unlawful, trust-breaching advantages from placement of the custodial accounts. Moreover, as already found, the placement or retention of the custodial accounts with banks upon which Respondents were relying for bank loans created a continuing conflict-of-interests situation that was fraudulent.

. . . . • Violations of Section 15(a)(1) of I.C.A.

It is further concluded that the use by SSC of the Steadman Funds' custodial accounts in order to obtain, retain, or extend bank loans for itself and its affiliates, and its use of such custodial accounts to obtain brokerage commission for an affiliate, RSC, constituted the receipt by SSC of "compensation" within the meaning of Section 15(a)(1)^{40/} of the I.C.A. Such compensation should have been, but was not, disclosed

40/ 15 USC §80a-15. Section 15(a)(1) provides as follows:

INVESTMENT ADVISORY AND UNDERWRITING CONTRACTS

Sec. 15. (a) It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company and —

(1) precisely describes all compensation to be paid thereunder;

in the investment advisory contracts under which SSC served as investment adviser to American, Science, Fiduciary and Associated. Thus SSC wilfully violated, and Steadman and RSC wilfully aided and abetted violations of, Section 15(a)(1) of the I.C.A.

. . . . Violations of Sections 20(a) and 34(b) of I.C.A.

Failure to disclose as material facts the above-found use of the Steadman Funds' custodial accounts in connection with obtaining bank loans and brokerage commissions also violated Sections 20(a) of the I.C.A. and Rule 20a-1 thereunder and Section 34(b) of the I.C.A.^{41/}

41/ 15 USC §80a-~~20~~, §80a-~~33~~. The provisions read as follows:

PROXIES; VOTING TRUSTS; CIRCULAR OWNERSHIP

Sec. 20. (a) It shall be unlawful for any person, by use of the mails or any means or instrumentality of interstate commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security of which a registered investment company is the issuer 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,

RULES UNDER SECTION 20

Rule 20a-1. Solicitation of Proxies, Consents and Authorizations.

(a) No person shall solicit or permit the use of his name to solicit any proxy, consent or authorization in respect of any security of which a registered investment company is the issuer, except upon compliance with Rules 20a-2 and 20a-3 and all rules and regulations adopted pursuant to section 14(a) of the Securities Exchange Act of 1934 that would be applicable to such solicitation if it were made in respect of a security registered on a national securities exchange. Unless the solicitation is made in respect of a security registered on a national securities exchange, none of the soliciting material need be filed with such exchange.

DESTRUCTION AND FALSIFICATION OF REPORTS AND RECORDS

Sec. 34. * * *

(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this title or the keeping of which is required pursuant to Section 31 (a). It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an accountant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document.

Thus, during the relevant period SSC and Steadman wilfully violated and wilfully aided and abetted violations of the mentioned provisions of statute and rule by filing or causing to be filed with the Commission and by transmitting by mail to shareholders of Science, American, Fiduciary and Associated of proxy materials, and by filing or causing to be filed with the Commission registration statements and amendments thereto, prospectuses, reports and other documents concerning such Steadman Funds required to be filed or transmitted under the I.C.A., which omitted to state the material facts concerning the use of custodial accounts of Science, American, Fiduciary, and Associated ^{to obtain} bank loans and brokerage commissions.

. Alleged Violation of Section 17(d) of I.C.A.

The Division also urges, as the Order charges, that use of the custodial accounts of the Steadman Funds to obtain bank loans and brokerage commissions constituted wilful violations of Section 17(d) of the I.C.A. and Rule 17d-1 ^{42/} thereunder, contending that Steadman and

42/ 15 U.S.C. §80a-17(d), 17 CFR §270.17d-1. Section 17(d) and Rule 17d-1 provide as follows:

TRANSACTIONS OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS
 Sec. 17.

* * *

(d) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company (other than a company of the character described in section 12(d) (3) (A) and (B) or any affiliated person of such a person or principal underwriter, acting as principal to effect any transaction in which such registered company, or a company controlled by such registered company, is a joint or a joint and several participant with such person, principal underwriter, or affiliated person, in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant. Nothing contained in this subsection shall be deemed to preclude any affiliated person from acting as manager of any underwriting syndicate or other group in which such registered or controlled company is a participant and receiving compensation therefor.

SSC in carrying out their objectives caused and induced the various Steadman Funds to participate with them in joint arrangements of a kind proscribed by Section 17(d) and Rule 17d-1 thereunder.

(Footnote 42 Continued)

Rule 17d-1. Applications Regarding Joint Enterprises or Arrangements and Certain Profit-Sharing Plans.

(a) No affiliated person of or principal underwriter for any registered investment company (other than a company of the character described in Section 12(d) (3) (A) and (B) of the Act) and no affiliated person of such a person or principal underwriter, acting as principal, shall participate in, or effect any transaction in connection with, any joint enterprise or other joint arrangement or profit-sharing plan in which any such registered company, or a company controlled by such registered company, is a participant, and which is entered into, adopted or modified subsequent to the effective date of this rule, unless an application regarding such joint enterprise, arrangement or profit-sharing plan has been filed with the Commission and has been granted by an order entered prior to the submission of such plan or modification to security holders for approval, or prior to such adoption or modification if not so submitted, except that the provisions of this rule shall not preclude any affiliated person from acting as manager of any underwriting syndicate or other group in which such registered or controlled company is a participant and receiving compensation therefor.

(b) In passing upon such applications, the Commission will consider whether the participation of such registered or controlled company in such joint enterprise, joint arrangement or profit-sharing plan on the basis proposed is consistent with the provisions, policies and purposes of the Act and the extent to which such participation is on a basis different from or less advantageous than that of other participants.

(c) "Joint enterprise or other joint arrangement or profit-sharing plan" as used in this rule shall mean any written or oral plan, contract, authorization or arrangement, or any practice or understanding concerning an enterprise or undertaking whereby a registered investment company or a controlled company thereof and any affiliated person of or a principal underwriter for such registered investment company, or any affiliated person of such a person or principal underwriter, have a joint or a joint and several participation, or share in the profits of such enterprise or undertaking, including, but not limited to, any stock option or stock purchase plan, but shall not include an investment advisory contract subject to Section 15 of the Act.

* * *

In essence, the Division claims that Respondents got the Steadman Funds to participate with them in getting loans for various Respondents and brokerage commissions for RSC even though the Steadman Funds were carefully kept ignorant of the fact of their participation.^{43/}

It is concluded that the abuse here found does not come within the reach of Section 17(d) as implemented by Rule 17d-1. Initially, it must be noted that Section 17(d) is not self executing — it requires promulgation by the Commission of rules thereunder "for the purpose of limiting or preventing participation . . . on a basis different from or less advantageous than that of such other participant." Accordingly, whatever may be the breadth of the Commission's authority to define and to regulate joint or joint and several participations covered by Section 17(d), it is clear that that power has only been exercised to the extent that the Commission has chosen to regulate by promulgation of Rule 17d-1. That Rule, particularly subsection 17d-1(c), which defines "Joint enterprise or other joint arrangement or profit-sharing plan", indicates that the Commission in this Rule is concerned with joint enterprises or joint arrangements that are in the nature of a joint venture, i.e. that involve the element of seeking to realize a profit or gain through the investment of funds and not factual situations such as here involved where, at most, it could be found that the "joint participants"

^{43/} While those officers and directors of the Steadman Funds who were also officers or directors of one or more of the Respondents of course knew what was going on, there is nothing in the record to indicate that the independent directors or the shareholders of the Steadman Funds were aware of how allocation of the Steadman Fund custodial accounts was being employed to advantage Respondents.

made separate transactions or contracts with the same bank for distinct kinds of banking services. Nothing in the cases cited by the Division suggests that the profit motive or element of "investment" is not a necessary ingredient under Rule 17d-1.^{44/} Since Section 17(d) and Rule 17d-1 are deemed inapplicable to the factual situation here found, it is unnecessary to consider the other, numerous arguments made by the parties concerning their scope and applicability.

44/ The Division relies primarily upon SEC v. Midwest Technical Development Corp., 1961-64 CCH Fed. Sec. L. Rep. ¶91,252, (U.S.D.C. Minn., 1963); SEC v. Talley Industries, 399 F. 2d 396 (C.A. 2d 1968, cert. den., 393 U.S. 1015 (1969)); and Imperial Financial Services Inc., 42 SEC 717 (1965). In Midwest, both participants invested in securities of the same issuers. In Talley there was an agreement by the investment company and its affiliate for each to buy stated amounts of stock of an issuer and not sell it without the other's consent. Likewise, in Imperial, both "participants" purchased for investment securities of the same issuers. The Division also cited, at the oral argument, Monheit v. Carter, 376 F. Supp. 334, 341-2 (USDCSDNY, 1974), involving civil litigation between private parties, in which the plaintiff urged that the purchase of certificates of deposit by an investment company from a bank violated Section 17(d) in that the purchase of such certificates was prompted by various affiliated persons of the investment company who, in consideration thereof, obtained loans or loan commitments and advances from the bank. Plaintiff argued that the net effect of all this was that the investment company was indirectly and unlawfully making loans to its affiliates. The court stated that if ". . . plaintiff can prove that the transactions with [the bank] were in fact effected by the affiliated persons of [the investment company] and [the investment company] to the detriment of the latter, then a violation of §17(d) will have been established." Since the Court did not develop the rationale underlying this conclusion, the ruling of the Court having been on a motion to dismiss, its value as precedent is not deemed persuasive. At any rate, in Monheit, there is at least the element of investment for profit, i.e. in the certificates of deposit, whereas in the instant proceeding there is absent any element of investment for profit.

. . . . Alleged Violation of Section 17(e)(1) of I.C.A.

The Division further urges, as the Order charges, that the use of custodial accounts of various Steadman Funds to obtain bank loans and brokerage commissions violated Section 17(e)(1) of the I.C.A., ^{45/} urging inter alia that the contracting for custodial services constituted a "purchase of property" within the meaning of Section 17(e)(1) by the Steadman Funds.

Respondents rely on Neuwirth et al. v. Allen et al., ^{46/} where the Court, in upholding as fair a settlement between an investment company and an affiliated insurance broker, concluded, at p. 94,380, that, ". . . while its language might conceivably justify an application of Section 17(e)(1) to the placing of insurance by an insurance broker, the history of the Act shows that such was not the objective toward which this provision was directed." The Court further stated, ibid.,

"Then Section 17(e) deals with transactions of an affiliated person as 'agent' or 'broker'; again the statutory language indicates that investment bankers or brokerage houses, and dealings in securities, are primarily in mind."

^{45/} 15 U.S.C. 80a-17(e). Section 17(e)(1) reads as follows:

TRANSACTIONS OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS
Sec. 17.

* * *

(e) It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person —

(1) acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker; or

* * *

^{46/} CCH Fed. Sec. L. Rep. ¶91,324 (U.S.D.C. S.D.N.Y., Feb. 3, 1964), pp. 94,375 - 94,382, aff'd 338 F. 2d (1964).

In support of its position the Division relies upon Consumer-Investor Planning Corporation, ("CIPCO") 43 S.E.C. 1096, 1100 (1969) and Imperial Financial Services, Inc., 42 S.E.C. 717 (1964). Both decisions were written in cases that were settled.^{47/} Both proceedings involved situations in which affiliates of the investment company received various forms of benefits or other compensation from broker-dealers to whom the business of executing the fund's portfolio transactions had been awarded. The Commission held in both cases that there had been a violation of Section 17(e)(1). Without discussing the point expressly, the Commission evidently considered in each case that the affiliated person who awarded the fund's business as agent to one or more broker-dealers received his compensation, while acting as agent, "for the purchase or sale of . . . property . . . for such registered company" even though the actual purchases and sales were not carried out by the affiliated person himself but by the broker-dealers to whom he had allocated the business.

The Division contends that awarding a bank a fund's custodial account involves the purchase or sale of property for the fund just as much as does awarding a broker-dealer the business of handling portfolio transactions for the fund. In both cases, the Division

^{47/} See In the Matter of Carl L. Shipley, S.E.C. Release 34-10870, June 21, 1974, S.E.C. Docket, vol. 4, no. 13, July 2, 1974, p. 476, footnote 6 (at pp. 479-80) for a statement of the value as precedent of orders and opinions issued by the Commission on the basis of offers of settlement.

contends, the potential conflict of interests that the investment adviser can find himself in are equally severe. While the latter proposition is valid, it does not establish or support the former. The fact that a conflict of interest exists doesn't mean that Section 17(e)(1) is necessarily available to prevent or control it. The language ". . . for the purchase or sale of property . . ." must be accorded some limiting function. It is concluded that the CIPCO and Imperial decisions are materially different on their facts from the instant proceeding; they both involved the purchase and sale of portfolio securities for the fund whereas the instant proceeding involves not the purchase or sale of property for the funds but contracts for custodial services. Accordingly, it is concluded that the custodial arrangements did not violate Section 17(e)(1) of the I.C.A.

Borrowings by SSC from Science and American in Contravention of Sections 17(a)(3), 15(a)(1), and 34(b) of the I.C.A. and of Various Antifraud Provisions.

Pursuant to the distribution agreement between Science and Steadman Investment Service Corporation ("SISC"), Science's distributor, SISC was required to reimburse to Science the amount by which Science's expenses exceeded one percent of the average net assets of the Fund for a fiscal year. For its fiscal year ending June 30, 1970 Science's expenses exceeded one percent of its average net assets by some \$155,000. On August 24, 1970 SSC assumed SISC's obligation to Science. Effective September 14, 1970 American acquired Science's assets. The assumption by SSC of SISC's obligation was not ratified by either Science or American as Science's successor until October 21, 1970.

In view of its financial condition, SSC was unable to pay the \$155,000 obligation to Science. At least in part in order to ameliorate the effect of this obligation, SSC proposed that Science's one percent expense limitation be increased to 1 1/2 percent retroactively. SSC also proposed in August and October 1970 that shareholder approval be sought for reimbursing SSC for past services for which the Funds had not previously been charged.

Although American's board of directors met on August 24, 1970 it was not informed of the Science overrun until its October 21, 1970 meeting. Thus, neither the directors of Science nor the directors of Science's successor were informed of the Science overrun until almost four months after it became due.^{48/} At their October 21, 1970 meeting American's directors were informed by SSC that "such amount will be paid in installments" to American. The board of directors thereupon ratified the assumption of the obligation by SSC and acquiesced in SSC's proposal that the amount of the overrun be reimbursed by reducing the management fee otherwise payable to SSC by American in the amount of \$4,876 in August 1970 and \$10,000 per month thereafter. In the Science Annual report for its fiscal year ending June 30, 1970 it

^{48/} The boards of directors of the various Steadman Funds included both "affiliated" members such as Steadman, who were of course aware of the activities of SSC, and "independent" or "outside" directors not affiliated with SSC or its non-fund affiliates. (Section 10(a) of the I.C.A., 15 U.S.C. §80a-10(a), requires that at least 40% of an investment company's board consist of outside, non-interested i.e., non-affiliated persons of the investment company). The Steadman Funds boards of directors each contained a majority of outside directors.

was reported that "[b]y action of the Board of Directors [of SSC] August 24, 1970 the parent company [SSC] assumed this obligation, said amount to be repaid by installments of \$10,000 per month through a corresponding reduction in the management fee payable to [SSC]." This Science annual report was mailed on September 30 and October 1, 1970, 20 days before American's board of directors approved the method of reimbursement, clearly evidencing that Steadman and SSC considered approval by the American Board a mere formality.

American's board of directors acquiesced in the method of reimbursement of the Science overrun as advanced by SSC. The proposal was made by Steadman. While the directors received Science's annual report prior to this meeting there was no discussion of the question raised by the auditors regarding the collectibility of the overrun from ^{49/}SSC. Present at this meeting were Steadman, Edward R. Farley, Jr. ("Farley"), Robert W. Fleming ("Fleming"), Joseph P. Kazickas ("Kazickas"), and Harry C. Mills. ^{50/}Kazickas and Farley testified they did not recall having seen Science's annual report (Exhibit 17) before they were shown it on the witness stand, and Farley testified that had he seen it before he would have remembered it. While Farley, Kazickas and Fleming all testified that they were generally aware of SSC's financial condition at this time, the directors did not receive SSC financial statements and

^{49/} The opinion of the auditors, Peat, Marwick, Mitchell & Co. ("Peat Marwick"), was given "subject to the collectibility of the item discussed in Note 2," i.e. the amount due the Fund from SSC for the expenses overrun.

^{50/} Farley, Fleming, and Kazickas were "outside", or independent directors. See footnote 48 above.

were not told that SSC was unable to meet its current obligations. Farley, Fleming, and Kazickas had the impression that either SSC was unable to pay the total amount of the overrun at once or that it would be very difficult for SSC to do so, but there was no discussion of SSC's financial condition or its ability to continue as the Fund's management company. While Kazickas testified he had doubts as to SSC's ability to continue to perform the necessary service for the Funds and while he was aware of SSC's program of cutting costs by eliminating personnel and even warned Steadman not to impair SSC's ability, he did not inquire as to specific cut-backs or what areas of SSC's operations were being affected. The directors of the Steadman Funds did not begin to receive SSC financial statements on a regular basis until December 1971, following the effective date of the amendment to the I.C.A. requiring that such information be furnished to disinterested directors. The SSC financial statements for September and November 1970 that Farley had ^{51/} received were received in connection with the Atlas Corporation proposal and the September statement probably was not received by Farley until after the October 22, 1970 meeting between SSC and Chase officials. Kazickas received SSC financial statements throughout 1970 and 1971 in connection with his efforts to help SSC out of its financial difficulties.

Although the minutes do not reflect such a discussion, the directors at this meeting were informed by SSC and SSC's counsel that

^{51/} During the period September - November 1970 when Steadman was attempting to refinance the Chase loan one alternative explored was the possibility of having Atlas Corporation, of which Farley is President, guarantee a portion of the loan.

this method of payment of the overrun was legal. Neither Steadman nor any other director considered consulting independent counsel. Even when later advised of the view of the Commission's staff that this method of reimbursement constituted an unlawful borrowing in violation of the I.C.A., American's directors did not reconsider their action or consider seeking independent counsel. Nor did the directors consider alternative ways of handling the reimbursement to the Fund of the overrun or whether interest or some other consideration should be paid to the Fund in return for agreeing to spreading out the reimbursement over 15 months. Kazickas testified that in his own mind he considered raising the question of whether a guarantee of SSC's repayment or interest should be sought, but he decided that in view of SSC's financial problems conditions should not be imposed on SSC it could not meet. Kazickas was concerned that requiring interest might impair SSC's ability to manage the Funds, and he considered the latter more important than the interest. However, Farley testified that in his own business affairs he would likely at least consider whether interest or some other consideration should be paid in return for agreeing to the payment in installments of an amount due in full. And Fleming testified he would not likely rely on debtor's counsel as to the legality of such a transaction in the usual debtor-creditor relationship. Fleming viewed the interests of the Fund as bound to those of SSC and, therefore, considered it appropriate to accommodate SSC in this matter.

The amount of the Science overrun was reimbursed to American in accordance with the arrangement approved by American's directors until

April 6, 1971, when the outstanding balance of \$80,000 was paid to American. No interest on this amount was paid until July 22, 1971, when about \$5,500 was paid to American, computed at the rate of 6 percent on the outstanding daily balance for the period June 30, 1970 to March 28, 1971.^{52/} The 6 percent interest rate set on the amount of the Science overrun was not negotiated with the directors. The directors of American were not consulted prior to receiving the April payment, which came out of the proceeds from the private placement of subordinated notes.

Farley and Kazickas both became directors of the various Steadman Funds at the invitation of William G. Dillon ("Dillon"), counsel to^{53/} and a director of SSC. Farley and Dillon are personal friends and had practiced law together. Dillon is a director of and counsel to Atlas Corporation, of which Farley is chairman of the board and president. Kazickas and Dillon are directors of Cosmos Bank, and Dillon is counsel for Kazickas. Another director of Cosmos Bank, Frederick M. Glass, is also a director of SSC and various of the Steadman Funds. Kazickas knew Steadman for several years prior to becoming a director of the Steadman Funds. Since about 1968 Kazickas and Steadman have explored various possible business opportunities that they might pursue together. Kazickas sought to assist SSC in solving its financial problems in 1969 and 1970. Fleming had been a director of American and Science prior to their acquisition by SSC.

^{52/} By way of revealing contrast, in December 1970 SSC's board of directors agreed to pay Steadman 8% interest on a loan of \$125,000 made by him to SSC in February, 1970.

^{53/} As a member of the law firm of Simpson, Thacher and Bartlett.

The board of directors meetings of the several Steadman Funds are held consecutively on the same day, starting typically about 10 or 10:30 a.m. and concluding by 4 p.m. On October 21, 1970 American's directors were scheduled to meet at 12:40 p.m., after which were scheduled Fiduciary at 1:15 p.m., AFMC at 1:50 p.m. and AMC at 2:30 p.m.

Since before early September 1970 SSC was aware that American's expenses for its fiscal year ending January 31, 1971 might exceed one percent of its net asset value for that year. (Amendment No. 3 to Application for An Order Under Section 17(b) of the I.C.A., Public Official File No. 812-2755-1.) Pursuant to its management agreement with American, SSC was required to reimburse such excess to American. Although American's directors met on August 24, October 21 and December 16, 1970, they were not informed of American's overrun until about January 28, 1971. While unaware of the potential overrun, American's directors^{54/} at their August 24, 1970 meeting considered SSC's proposal to increase American's one percent limitation to 1 1/2 percent. Action on this proposal was deferred. On September 10, 1970 SSC advised the Commission that American would probably exceed its expense limitation for its fiscal year ending January 31, 1971 and that American's shareholders "may" be asked to approve an increase in the expense limitation to 1 1/2 percent for the fiscal year "beginning January 31, 1971". (Public Official File No. 812-2755-1.) At American's October 21, 1970 board meeting the directors, while still not being told of the potential overrun, were informed by SSC that the

^{54/} See footnote 48 above.

shareholders "would probably" be requested to approve an increase in American's expense limitation to 1 1/2 percent retroactive to February 1, 1970.

At SSC's December 11, 1970 board meeting the SSC directors were again told that the approval of American's shareholders would be sought to reimburse SSC "for past expenses incurred in excess of" the one percent expense limitation. In response to Pettit's question, Steadman informed those present at this meeting that the Commission had approved the reimbursement of the \$155,000 Science overrun by installments. After this meeting Steadman rebuked Pettit for raising this question with a member of the Chase Bank present.

On January 28, 1971 American's directors were requested by Steadman to approve by resolution in lieu of a board meeting a change in American's fiscal year from January 31 to June 30 effective June 30, 1970. One of the stated reasons for the proposed change was to eliminate American's expense overrun for its fiscal year ending January 31, 1971. The proposal, which required unanimous approval, was not adopted because of Farley's opposition. Farley considered the proposal procedurally defective as an attempt to change the expense limitation without a meeting of the board of directors.

In January 1971 SSC was advised by the Commission's staff in writing that the proposal to reimburse the amount of American's expense overrun (estimated at \$120,000) for its fiscal year ending January 31, 1971 (apart from the \$155,000 obligation to Science then being reimbursed in monthly installments) by reducing the advisory fee payable each month during the following fiscal year by \$10,000 would be, absent an exemption,

an unlawful borrowing in violation of the I.C.A. Again on February 6 the Commission's staff orally so advised SSC. In response SSC advised the Commission's staff on February 16, 1971 that in its view the 1 percent expense limitation was applicable to the period from June 3, 1970 to June 2, 1971 and not to the fiscal year of the Fund ending January 31, 1971. According to SSC's view there would be no reimbursement of excess expenses required until June 2, 1971.

For its fiscal year ending January 31, 1971, American's expenses exceeded 1 percent of its average net assets by \$105,182. SSC was unable to pay this amount to American when it became due because of SSC's poor financial condition.

At their February 24, 1971 meeting, American's board of directors discussed SSC's February 16 letter to the Commission's staff and the issues raised thereby, notably the theory expressed by SSC in its February 16 letter that the term "fiscal year" as used in the management agreement between American and SSC is not necessarily the fiscal year of American, ending January 31, but can mean the period covered by the management agreement. None of the directors challenged this view, even though Farley testified that he understood the term "fiscal year" to be that of American. The directors were informed that if the Commission's staff did not agree with the views expressed in SSC's February 16 letter, a ruling by the Commission would be sought. At this meeting, the directors did not authorize the filing of anything on the Fund's behalf. While the directors generally understood that SSC was unable to pay the expense overrun at that time, there was no discussion of SSC's precise financial condition or its continuing

ability to serve as the Fund's manager. Nor was there any discussion relating to the payment of interest or other consideration or of alternative methods of reimbursing the overrun. Even though American's directors were advised of the opinion of the Commission's staff that expense overruns must be reimbursed immediately, they did not reconsider their earlier action on the Science overrun and did not consider seeking independent legal counsel.

At their February 24, 1971 meeting, American's directors approved for recommendation to the shareholders a proposal to increase the expense limitation to 1 1/2 percent "for any period of 12 months as determined on each anniversary date of the management agreement effective for the period June 3, 1970 to June 2, 1971." The proposed amendment to the management agreement also provided that any excess would be reimbursed to the fund in installments over 12 months by reducing the management fee. The directors took this action without discussing the effect such a change would have on the amount of the overrun, due January 31, 1971 under the view of the Commission's staff and June 2, 1971 under SSC's view. The directors also did not consider whether the proposed method of reimbursement was appropriate in light of the views of the Commission's staff. Nor did the directors consider seeking independent legal counsel in this matter.

The directors also approved at the February 24 meeting changing American's fiscal year to May 31, effective May 31, 1971, "subject to additional discussion with counsel or the Securities and Exchange Commission." This action was taken ostensibly "in order to ease the problems now encountered in timely completion of audits, reports, and the filing of post-effective amendments to Federal and state registration statements."

Again, the directors did not consider what effect this change would have on the amount of American's expense overrun as of January 31, 1971.

On March 15, 1971 SSC paid to American \$18,623, representing the amount by which American's expenses exceeded the expense limitation for the period February 1, 1970 to June 2, 1970, in accordance with SSC's position regarding the period to which the expense limitation was applicable.

On March 16, 1971 SSC was informed by the Commission's staff that its arguments as set out in its February 16, 1971 letter had been considered but that the staff would continue to adhere to its previously stated position. Thereupon, Steadman by letter dated March 19, 1971 sought the approval of American's directors to request on behalf of the Fund a declaratory order resolving the dispute between SSC and the Commission's staff and, if necessary, to seek an exemption to allow SSC to reimburse American on an installment basis. In the March 19 letter the directors were informed of the views of the Commission's staff regarding the American overrun as of January 31, 1971 but not of the staff's views regarding the Science overrun. By resolution in lieu of a board meeting the directors authorized the Fund's management to file such application and request. This action was taken by the directors without any discussion other than that which occurred at the February 24, 1971 board meeting.

On April 16, 1971 American and SSC filed with the Commission a Motion for Declaratory Order and an Application for an Order under Section 17(b) of the I.C.A. On May 12, 1971 the Division of Corporate Regulation moved to dismiss the motion for a declaratory order and application.

On May 19, 1971 SSC and American replied to the motion to dismiss and on May 19 and June 1 amended their application for an exemption from Section 17(a) of the I.C.A. On June 22, 1971, without prior consultation with the directors of American, the motion for a declaratory order and application for an exemption were withdrawn, and the amount of the outstanding balance of American's expense overrun for its fiscal year ending January 31, 1971 (\$86,559) was paid, together with interest of \$2,020. The interest rate was not negotiated with American's directors. American's directors were informed of the withdrawal on July 19, 1971. The directors were further informed that the application and motion were withdrawn because American's management "became convinced that the Commission would not adopt" SSC's position and "to expedite the orderly processing of the post-effective amendment to the Fund's registration statement and its proxy statement." During the period following February 1, 1971, American's expenses continued to exceed its limitation by almost \$20,000 per month. This continuing overrun was not disclosed to American's directors until August 30, 1971.

Notwithstanding SSC's acquiescence in the views of the Commission's staff on the issue of reimbursement in installments, American's directors at the July 19 meeting approved for recommendation to the Fund's shareholders a proposal whereby any excess over the expense limitation would be reimbursed to the Fund by installments over twelve months.

The payment to American in June, 1971, of the full amount of its expense overrun had a serious impact on SSC's cash position.

At the July 19, 1971 meeting American's directors, upon SSC's recommendation, rescinded their action at the February 24, 1971 board

meeting respecting changing the fiscal year of the fund to May 31. The contemplated change was rescinded because SSC had concluded "that such a change was not necessary or desirable." There was no discussion regarding why this action was no longer "necessary or desirable."

The borrowings described above were in violation of the investment restrictions of Science and American. Neither Fund was allowed to "lend money", except through the purchase of debt securities of publicly-held companies. (Science and American prospectuses in effect in 1970 and 1971, Public Official File Nos. 2-10644-1-2 and 2-14602-1-2). Beyond that, the borrowings contravened Section 17(a)(3) of the I.C.A. ^{55/}

Respondents fail to cite any authority for their contention that Section 17(a)(3) is limited to "direct loans" by the investment company to an affiliated person. Nothing in the legislative history cited by Respondents so limits Section 17(a)(3). The argument that to find a borrowing here SSC would have had to have paid the amount of the overrun to the Funds and borrowed it back to be repaid in installments is to exalt form over substance and practicality. This is in essence what happened, except that the intermediate steps were omitted. The

55/ 15 U.S.C. §80a-17(a). Section 17(a)(3) reads as follows:

TRANSACTIONS OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS

Sec. 17. (a) It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 12 (d) (3) (A) and (B), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal —

* * *

(3) To borrow money or other property from such registered company or from any company controlled by such registered company (unless the borrower is controlled by the lender) except as permitted in section 21(b).

agreement of the Funds to forbear from insisting upon the lump sum payment of a cash amount due to the Funds and to accept the payment of such a cash amount in installments had the same effect as a direct cash loan. Thus, it cannot logically be argued that SSC did not "borrow" liquid assets from the Funds, since a cash amount was clearly due to the Funds.

Respondents' reliance upon Brigham v. McCabe, 20 N.Y. 2d 525, 285 N.Y.S. 2d 294 (N.Y. Ct. of App. 1967) is misplaced. In that case the court held that a deposit in a commercial bank account did not constitute a "borrowing" by the bank within the meaning of a statute prohibiting a borrowing from the Teachers' Retirement Board by members of the Board or any corporation of which a Board member was an officer where the deposit was in a bank of which a Board member was president. A deposit is in the nature of a bailment that is wholly different from an extension of credit. According to the Court the distinction between a loan and a deposit is that a loan requires "an intention to place the funds at the borrower's disposal" whereas a deposit is only a holding by another for one's own use and convenience, supra, at 298. Here, it cannot be argued that SSC was merely holding the amount of these overruns for the convenience of the Funds. The amounts of these overruns were not set aside but were used in SSC's ordinary course of business to meet other obligations, as Respondents concede. By their action in agreeing not to insist on immediate payment but to allow the overruns to be paid in installments, the Funds' directors placed these monies at the borrower's disposal.

Likewise, Domestic Finance Corporation v. Czerwinski, 29 N.Y.S. 2d 588 (Syracuse Mun. Ct. 1940), relied upon by Respondents, where the Court refused to hold that a guarantor of a note was a "borrower," is distinguishable from these transactions. A guarantor of a note does not normally receive the proceeds or the benefit of the loan, as did SSC here. Moreover, SSC was not a "guarantor" in the nature of a guarantor on a note. SSC had the primary obligation to pay these overruns; its liability for such overruns was not secondary, as is that of a guarantor on a note. SSC did not incur this obligation as the result of a default by the primary obligor. Thus, SSC was not a "guarantor";

To adopt a narrow, technical construction of the word "borrow" under Section 17(a)(3) in light of the fiduciary relationship of the borrower to the lender and the remedial legislative purposes of the I.C.A. would be most unwarranted.

SSC's wilful violations of Section 17(a)(3) were wilfully aided and abetted by Steadman.

SSC's failure to report as additional compensation its failure to reimburse American under the expense limitations was also violative of Section 15(a)^{56/}(1) of the Investment Company Act which, in pertinent part, precluded SSC from serving as investment adviser to American except pursuant to a written contract that "precisely describes all compensation to be paid thereunder." SSC, by depriving American of part of its assets for a period of time and employing such assets in SSC's business, received compensation not specifically described in the advisory contract. SSC, in effect, received loans on which it had not agreed to pay any interest.

^{56/} See footnote 40 above for text of Section 15(a)(1). SSC's wilful violations were wilfully aided and abetted by Steadman.

During the period from on or about June 30, 1970 to the time of the Order, Steadman, SSC and SISC offered and sold shares of American and Science by use of the means and instrumentalities of interstate commerce. In the offer and sale of such shares, Steadman, SSC and SISC used prospectuses which failed adequately to disclose various 56a/ material facts, i.e.: (1) that SSC unlawfully borrowed certain amounts from Science and American, as found above, in violation of the Funds' investment policies and Section 17(a)(1) of the I.C.A.; (2) that the terms and conditions of those borrowings were not the result of arms-length bargaining; (3) the risk borne by the Funds in extending credit to SSC in view of SSC's poor financial condition; (4) the terms and conditions of these borrowings; and (5) that SSC and Steadman took advantage of their fiduciary relationship with such Funds to obtain benefits they reasonably would not otherwise have been able to get. (Public Official File Nos. 2-10644-1-2, 2-14602-1-2, 811-615-2-2 and 811-855-2-2.)

During the period from on or about June 30, 1970 to the time of the Order, SSC and Steadman caused Science and American to file with and transmit to the Commission registration statements and amendments thereto, prospectuses, reports and other documents required to be filed or transmitted under the I.C.A. which omitted the disclosure of the material information set forth in the next-preceding paragraph above. (Public Official File Nos. 2-10644-1-2, 2-14602-1-2, 811-615-2-3 and 811-855-2-2.)

By causing Science and American to make filings with the Commission which omitted to set forth the material information referred to in the two preceding paragraphs, which omissions caused the filings to be materially

56a/ See footnote 28 above for cases defining "material" facts.

misleading, Steadman and SSC wilfully aided and abetted violations of Section 34(b) of the I.C.A.^{57/}

By borrowing from Science and American as found herein, SSC breached the fiduciary duty^{58/} it owed these Funds as investment adviser. No genuinely arms-length negotiations occurred. The information furnished the Funds' outside directors was woefully inadequate, e.g. as to SSC's precise financial condition; what information was furnished was not given in timely fashion, so as to allow time for prior reflection, and the time allotted at Board meetings to take up such an important matter was patently inadequate. Reliance on SSC's counsel does not excuse the violations. SSC overreached and took advantage of its relationship with these Funds to obtain a benefit it would not otherwise have been able to get. Thus, SSC employed a scheme to defraud and engaged in practices and a course of business which operated as a fraud and deceit upon Science and American and their shareholders in wilful violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and (2) of the Advisers Act.^{59/} Steadman wilfully aided and abetted these violations.

Since American's prospectus then in effect failed to disclose the above-found unlawful borrowings or the surrounding circumstances, such prospectus was materially false and misleading and its use was in wilful violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act,

^{57/} See footnote 41 above for text of Section 34(b).

^{58/} See discussion above, commencing at p. 72, concerning the trustee-like fiduciary relationship of the investment adviser to the investment company.

^{59/} See footnotes 28a and 28b above for USC citations to and partial quotations of the statutes and rule mentioned.

and Rule 10b-5 thereunder, and Section 206 of the Advisers Act. SSC, Steadman, and SISC wilfully aided and abetted such violations.

Alleged Violation of Section 17(e)(1) of the I.C.A. in Connection with RGS's Receipt of Tender Fees.

The Division contends, as the Order alleges, that Steadman, SSC, and RSC, individually and collectively, wilfully violated and wilfully aided and abetted violations of Section 17(e)(1)^{60/} of the I.C.A. in connection with RSC's receipt of tender fees.

The record shows that in 1969 RSC received some \$33,000 in tender solicitation fees in connection with the tender through RSC of certain securities held by three of the Steadman Funds. That figure represented 2% of the value of the securities tendered and was paid by the tender offeror. In December 1970 RSC, on advice of its counsel that the conservative approach would be to treat itself as a broker rather than an underwriter, paid to the respective Funds the amounts by which the fees received by RSC exceeded 1% of the value of the securities tendered.^{61/} Thus RSC retained about \$16,000.^{62/}

Section 17(e)(1) precludes an affiliated person of a registered investment company, acting as agent, from receiving compensation for the purchase or sale of property to or for such company "except in the course

^{60/} See footnote 45 above for text of Section 17(e)(1).

^{61/} Section 17(e)(2) of the I.C.A. establishes a 1% brokerage fee maximum in the circumstances here present.

^{62/} This amount was subject to being shared by the Funds under an applicable agreement giving 40% of net commission profits of RSC on commissions' generated by Steadman Funds to the Funds.

of such person's business as an underwriter or broker". The Division contends that RSC was only nominally the soliciting broker and that it actually did not perform the usual brokerage services, wherefor, citing the Commission's decision in Provident Management Corp.,^{63/} it should have turned over all of the tender fees to the Funds. The record does not support this contention. Unlike Provident, where the Commission found that the broker had performed no compensable services as broker for the fund, the testimony in this proceeding establishes that RSC did the same things that an unaffiliated broker would have had to do had that task been assigned to it. The Division stresses, again citing Provident, the potential conflict of interest, in that a determination to tender shares might be influenced by the hope of generating brokerage commissions. The short answer to this is that Section 17e(1)(2) recognizes that the performance of certain functions by an affiliated broker may be in the interests of the fund despite such inherent conflicts of interest.^{64/}

Accordingly, it is concluded that the record fails to establish the charged violation of §17(e)(1) of the I.C.A. in connection with RSC's acceptance of tender solicitation fees.

Computation and Disclosure of Formula for Reduction of Management Fee.

The Order alleges that during the period from January 1, 1968 until the time of the Order RSC, SSC, and Steadman, individually and collectively, wilfully violated and wilfully aided and abetted violations

^{63/} CCH Fed. Sec. L. Rep. ¶77,937, Dec. 1, 1970, p. 80,083.

^{64/} First Multifund of America, Inc., CCH Federal Sec. L. Rep. 1970-71, ¶78,209 at p. 80,602.

of the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Advisers Act in connection with calculation and disclosure of the applicable formula for reduction of SSC's management fee to the Steadman Funds. Specifically, the Order alleges that Respondents did:

"1. Fail to compute on a monthly basis, in accordance with such funds' prospectuses, the amount equal to 40 per cent of RSC's net income attributable to each such fund by which the management fee of each such fund is to be reduced.

"2. Use inflated expenses in computing the amount described in subparagraph 1 of this paragraph.

"3. Fail to disclose the substantial loss in management fee credits resulting from RSC being treated as though it paid federal income taxes when in fact no such taxes were paid."

Pursuant to the management agreements in effect from 1967 through 1970 between SSC and the various Steadman Funds, the management fee payable each month by such Funds to SSC was to be reduced by an amount equal to 40 percent of RSC's net income attributable to brokerage services rendered by RSC for each such Fund. The prospectuses of the several Funds in effect from 1967 through 1970 did not define "net income" directly but referred to the applicable management agreement or trust indenture for such definition and stated that RSC's net income would be "determined in accordance with generally accepted accounting principles." The applicable management agreements or trust indentures defined "net income" as the "net income of RSC on portfolio transactions for the Fund . . . less provision for Federal income taxes as if RSC were to file a separate Federal income tax return." (emphasis added). The prospectuses

^{65/} See footnotes 28a and 28b above for citations to the mentioned Sections and Rule and for text of Rule 10b-5 and Section 206(1),(2).

also stated that "[r]eductions will be computed and made, when required, each calendar month under the supervision of the principal accounting officers of RSC."

In computing RSC's net income, expenses of RSC were supposed to be "allocated in the same ratio as business attributable to [the Steadman Funds] bears to the gross revenue and income of RSC from all sources."

In April 1969 Steadman was informed by SSC's auditors that monthly computations of the amount, if any, to be credited to the Funds pursuant to this sharing arrangement had not been made during 1968. In 1970 such computations were also not made monthly.

In April 1969 Steadman was advised by SSC's auditors that "it is imperative that the company adopt scientific methods of allocating expenses among the various companies and the method as adopted should be formalized and consistently followed." The auditors so advised because the amounts involved in the allocation of salaries and other expenses among SSC and its subsidiaries, due to the expanded activity of the Steadman organization in 1968, had become "relatively material." Steadman was told that the allocation of such expenses had become a "significant problem to be dealt with in the overall accounting procedures" and that the method of allocating expenses is important for both "meaningful internal reporting" and the reporting required by the Commission and the PBW Stock Exchange. This advice was not followed by Steadman and SSC. Previously, in September 1968, Steadman had been advised that a file of invoices should be maintained to support the monthly \$500 allocation of travel expenses to RSC.

In October 1967 RSC incurred a salary expense of \$3,630, including \$1,000 for Steadman, as allocated by RSC and SSC. In November 1967 RSC accrued a salary expense of \$3,130, including \$1,000 for Steadman, as allocated by RSC and SSC. And in December 1967 RSC accrued a salary expense of \$4,675, including \$2,000 for Steadman, as allocated by RSC and SSC. The allocation of \$2,000 of Steadman's monthly salary to RSC was continued through 1969.

During 1969 RSC's monthly salary expense, as allocated by SSC, was about \$5,000 or about \$60,000 for the year. RSC's auditors reduced this amount by almost \$24,000. In addition, other expenses allocated to RSC were reduced by about \$5,000. Included in this \$5,000 amount is about \$3,000 resulting from the reduction of the travel expense allocation from \$5,500 to about \$2,500. SSC had continued to allocate \$500 per month in travel expenses to RSC without regard to whether there was any travel on behalf of RSC. These adjustments are reflected in work sheets prepared in March 1970 and would necessarily have been reported to Steadman at a reasonable time thereafter. As of August 31, 1970 expenses were still being arbitrarily allocated to RSC.

Although these arbitrary expense allocations of RSC by SSC and RSC were subject to adjustment at the end of the fiscal year in accordance with the auditor's findings, nevertheless in the meanwhile RSC had the use of such moneys at the expense of the Funds. This constituted fraudulent abuse of the fiduciary obligation owed by both SSC and RSC to the Steadman Funds.^{66/} Its overreaching character is particularly evident in light of the

^{66/} For a discussion of the nature and extent of the fiduciary obligation see p. 72 et seq., above.

obligation to compute and make adjustments each month in the management fee." ^{67/}

In computing the amount to be credited to the Funds pursuant to this sharing arrangement, RSC deducted from its net income the amount of its Federal income tax liability. These deductions amounted to \$14,555 in 1967, \$53,444 in 1968 and \$86,500 in 1969. Because RSC was included in the consolidated tax returns for SSC and its subsidiaries, which had net operating losses since 1967, RSC did not actually pay any Federal income taxes during those years. The Division contends that this treatment of RSC's Federal income tax liability and the effect thereof on the computation of the amounts to be credited to the Funds pursuant to the sharing arrangement were not adequately disclosed in the prospectuses of the several Steadman Funds in effect in 1967, 1968 and 1969 or in the several management agreements or trust indentures to which the prospectuses made reference for a definition of "net income."

It is concluded that this last contention of the Division is not supported by the record for the reason primarily that the language contained in the management agreements stating that RSC's net income would be computed "as if RSC were to file a separate tax return" conveys to the reasonable reader of such language that RSC would not be, or very probably would not be, filing a separate return. Otherwise there would be no point in couching the language in the subjunctive

^{67/} Respondents' excuse for not making monthly calculations in 1970 was that RSC was losing money at that time and that no credit was therefore applicable. This, however, does not excuse the failures to make monthly calculations in 1968, which failures constituted a fraudulent breach of fiduciary obligation. That adjustments were made at the end of the fiscal year does not excuse their not having been made monthly, as required.

"as if" terminology. Secondly, the actual results of the application of the tax feature of RSC's net revenues were reviewed annually in the course of independent audits which presumably could have been obtained by anyone interested in the actual workings of the tax reduction feature of RSC's net-income formula.^{68/}

Failure to File Required Reports on Time.

The Order includes charges that RSC, SISC, AMC, and SCA, wilfully aided and abetted by Steadman, wilfully violated Section 17(a)^{69/} of the Exchange Act and Rule 17a-5^{70/} thereunder by failing to file timely reports of financial condition with the Commission for 1970 and 1971 and that SSC and Steadman wilfully aided and abetted violations of Sections 30(a)^{71/} of the I.C.A. and Rules 30a-1 and 30a-2^{72/} thereunder in connection with the failure of various Steadman Funds to file various required reports on time.

Throughout the period 1968 through mid-1972 the various Steadman affiliates, including the registered Steadman Funds advised by SSC, repeatedly failed to file required reports within the prescribed time. In many instances the reports were filed so late as to be of minimal value in serving the purposes intended by the requirement for filing the reports.

^{68/} In so concluding it is not intended to convey that more adequate disclosure of the tax-reduction feature would not have been desirable but merely that it cannot fairly be held to have been fraudulently inadequate.

^{69/} 15 U.S.C. §78q.

^{70/} 17 C.F.R. §240.17a-5.

^{71/} 15 U.S.C. §80a-2q

^{72/} 17 C.F.R. §270.30a-1; 17 C.F.R. §270.30a-2.

Thus, SISC, AMC, and SCA did not file their Form X-17A-5 reports for their respective years ending December 31, 1970 and due February 14, 1971 until May 3, 1971. RSC filed its Form X-17A-5 report for its year ending December 31, 1971 and due February 14, 1971 on May 11, 1971. On February 11, 1971 SISC, AMC, TSCA and RSC requested extensions to March 1, 1971; all four were denied. SCA and SISC were 40 days and 28 days late, respectively, in filing these reports for calendar year 1969.

RSC, SISC, AMC and SCA did not file their Form X-17A-5 reports for their respective years ending December 31, 1971 and due February 14, 1972 until June 19, 1972. On February 11, 1972 RSC, SISC, AMC and SCA requested extensions of 45 days; all four were denied.

Aberdeen, American, Associated, Fiduciary and Science failed to file their Form N-1R annual reports within the time prescribed by the applicable statutes and rules as follows:

- (a) The Form N-1R annual reports for Aberdeen for its fiscal years ending December 31, 1969, December 31, 1970 and December 31, 1971 and due April 30, 1970, April 30, 1971 and April 30, 1972, respectively, were not filed until September 4, 1970 and June 9 and 19, 1972, respectively.
- (b) The Form N-1R annual reports for American for its fiscal years ending January 31, 1970, January 31, 1971 and January 31, 1972 and due May 31, 1970, May 31, 1971, and May 31, 1972, respectively, were not filed until December 9, 1970 (report due May 31, 1970) and June 19, 1972.

- (c) The Form N-1R annual reports for Associated for its fiscal years ending September 30, 1969, September 30, 1970 and September 30, 1971 and due January 28, 1970, January 28, 1971 and January 28, 1972, respectively, were not filed until March 23, 1970 and June 9 and 19, 1972, respectively.
- (d) The Form N-1R annual reports for Fiduciary for its fiscal years ending December 31, 1969, December 31, 1970 and December 31, 1971 and due April 30, 1970, April 30, 1971 and April 30, 1972, respectively, were not filed until September 4, 1970 and June 9 and 19, 1972 respectively.

With respect to each of the above delinquent reports no request for extension of time was received by the Commission.

Pursuant to its management agreements or trust indentures with the funds SSC undertook to "maintain the books of the Fund . . . and supervise the Fund's relations with its custodian, auditors, and federal and state regulatory bodies."

The cause of these late filings is clear from the record. Steadman was more interested in expanding his organization than he was in properly managing what he already had. Moreover, even when the need became painfully apparent, Steadman refused to expand SSC's managerial capability to manage properly the newly acquired Funds and the broker-dealers because the profitability of such acquisitions was predicated upon SSC's ability to manage the new Funds with little or no increase in SSC's personnel and other facilities.

In April 1969 Steadman and SSC were advised by Peat Marwick in strong terms that serious deficiencies existed in SSC's organization and capability to meet the increased responsibilities resulting from the expansion of the Steadman organization in 1967 and 1968. Peat Marwick ^{72a/} specifically advised Steadman in April 1969 that, because of poor organization and lack of adequate working space, personnel, and supervision, daily accounting functions were not being performed, records were not being maintained, errors were going undetected, and report deadlines were being met with difficulty. Peat Marwick specifically noted that RSC's records were not being properly maintained. The auditing firm emphasized that they believed this to be a serious situation which might in the future require notice to regulatory agencies. Peat Marwick concluded that while the assets managed by SSC had increased substantially during 1967 and 1968, there had been "a tendency in the midst of this growth to deemphasize internal control and sound accounting procedures for the sake of expediency."

In February 1969 Fidelity terminated its line of credit to RSC because of RSC's inadequate staff and inability to correct problems encountered in the account. In July 1970 Steadman was advised by auditors of material deficiencies in the books and records of Science. In August 1970 Steadman was advised by auditors of the poor condition of RSC's books and records. In this instance a surprise examination of RSC begun on August 30, 1970 was not completed until January 4, 1971. In December 1970 Steadman was advised by Peat Marwick that because of the condition of the books and records of certain Funds they could not accurately determine in advance the time that would be required to do the audits of the Funds. In April 1971 Steadman and RSC's board of directors

^{72a/} See footnote 49 for full designation of the auditing firm.

received reports from two different auditors, detailing "material weaknesses" and "material inadequacies" in RSC's accounting and management.

Steadman not only ignored this advice, but in early 1970 he began a cost-cutting program that resulted in SSC's personnel costs being reduced by one-third by year-end. This was done under pressure from Chase to enable SSC to meet its obligations under the Chase loan agreement. Thus, at the very time Steadman was being warned that SSC, its subsidiaries and the Funds were not being properly managed, Steadman drastically reduced SSC's managerial resources.

The reporting violations charged are thus fully established by the record.

Alleged Failure on the Part of Steadman and SSC Reasonably to Supervise.

The Division contends, as the Order alleges, that Steadman and SSC failed reasonably to supervise persons subject to their supervision and entities under their control with a view to preventing the violations alleged in the Order.^{73/}

As respects this issue it should be noted that SSC is vicariously subject to the imposition of sanctions predicated upon violations by Steadman or any other officers or employees of SSC or by any "person" (natural person or a company) directly or indirectly controlled by SSC under Section 203(e)

^{73/} Section 15(b)(5)(E) of the Exchange Act, as added by the 1964 amendments to it, provides an independent ground for the imposition of a sanction against a broker or dealer or a person associated with a broker or dealer who ". . . has failed reasonably to supervise, with a view to preventing violations of such statutes, [various securities statutes, including the Exchange Act, the I.C.A. and the Investment Advisers Act], rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision." Section 203(e)(5) of the Advisers Act contains parallel provisions.

of the Advisers Act, since Steadman or such other officer or employee would be a "person associated" with SSC, as well as under the concept of Respondeat Superior.^{74/} Indeed, the violations found above to have been committed by SSC are based in large part upon the conduct of Steadman, a reflection of the fact that a corporate body can act only through its officers and employees and must therefore be responsible for their conduct within the scope of employment.^{75/}

As to the alleged failure of Steadman to supervise, it is noted that as to each of the violations found herein Steadman was found to have actively committed the violation or aided and abetted its commission.

In these circumstances it would be a "confusion of concepts" to find Steadman or RSC in violation of the requirement reasonably to supervise.^{76/}

^{74/} Cf. Armstrong, Jones & Co. v. SEC, 421 F.2d 359, 362 (C.A. 6, 1970), cert. den. June 15, 1970, 398 U.S. 958.

^{75/} To hold SSC liable on the facts herein for a failure to supervise Steadman or employees subject to his command, where it is clear that Steadman as sole owner of all the voting shares of SSC directed policy and management, would be to impose a species of liability without fault, whereas Section 15(b)(5)(E) and 203(e)(5) of the Exchange Act and the Investment Advisers Act, respectively, predicate liability upon a wilful or at least negligent failure to carry out supervisory obligations.

^{76/} Anthony J. Amato et al., Exchange Act Release No. 10265, p. 5, June 29, 1973, 2 SEC Docket 90; Fox Securities Company, Inc. Exchange Act Release No. 10475, November 1, 1973, at pp. 6-7.

Conclusions

In general summary of the foregoing, it is concluded that during the respective relevant periods, some commencing as early as December 15, 1965, and some continuing until the date of the Order, the indicated Respondents committed violations of the following provisions of law or regulation as a result of the following acts, practices, or failures to disclose, all as more particularly found above:

(1) Between February 1969 and May 1970 Ameri-Fund, an affiliated person of an affiliated person (SSC) of the Steadman Funds, had a total of 12 purchase or sale transactions in securities with five of the Steadman Funds. These transactions constituted wilful violations of Section 17(a)(1),(2) of the Investment Company Act of 1940, a section that makes it generally unlawful for affiliated persons of affiliated persons of a registered investment company, acting as principal, knowingly to sell or buy securities to or from such investment company. Steadman and Steadman Security Corporation wilfully aided and abetted such violations.

(2) Between about December 1965 and about February 1972 Steadman, Steadman Security Corporation, and Republic Securities Corporation, individually and collectively, wilfully violated and wilfully aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) of the Investment Advisers Act in that such Respondents, in connection with the offer and sale of the shares of American, Fiduciary, Associated, and Science Funds and the purchase and sale of their portfolio securities by use of the mails and other means and instrumentalities of interstate commerce engaged in practices and a course of business in

which (a) Respondents Steadman and Steadman Security Corporation, on behalf of themselves and various affiliates (including RSC) retained, obtained, or sought to obtain sizeable bank loans and loan extensions in exchange for the retention, designation, or promise to designate a bank or banks as the custodian for one or more of the mentioned Steadman Funds, (b) the mentioned Respondents obtained and sought to obtain for Republic Securities Corporation brokerage-commission business from banks acting as custodian banks for various Steadman Funds, and (c) SSC failed to disclose in prospectuses used to sell shares of American, Science, Associated and Fiduciary the practices described in subparagraphs (a) and (b) of this paragraph (2) and Steadman and RSC aided and abetted such failures to disclose.

(3) Steadman Security Corporation wilfully violated, and Steadman and Republic Securities Corporation wilfully aided and abetted violations of, Section 15(a)(1) of the Investment Company Act, which Section requires that an investment adviser's contract with a registered investment company precisely describe all compensation to be paid thereunder, by failing to disclose as compensation the benefits obtained by Steadman, Steadman Security Corporation, and other affiliates in the form of bank loans or extensions thereof or by RSC in the form of brokerage commission business, as described in paragraph (2) above.

(4) Between about December 1965 and about February 1972 Steadman and Steadman Security Corporation wilfully violated and wilfully aided and abetted violations of Section 20(a) of the Investment Company Act and Rule 20a-1 thereunder and Section 34(b) of the Investment Company Act by filing or causing to be filed with the Commission and by transmitting by mail to shareholders of Science, American, Fiduciary, and Associated of proxy materials, and by filing or causing to be filed with the Commission

registration statements and amendments thereto, prospectuses, reports and other documents concerning such Steadman Funds required to be filed or transmitted under the Investment Company Act, which omitted to state the material facts concerning the use of custodian accounts of such Steadman Funds to obtain bank loans and brokerage commissions, as found in this decision and mentioned in paragraph (2) above.

(5) During the period from June 30, 1970 to April 6, 1971, Steadman Security Corporation and Steadman Investment Services Corporation wilfully violated, and Steadman wilfully aided and abetted violations of, Section 17(a)(3) of the Investment Company Act in that SISC and SSC, affiliated persons of Science and American (American acquired the assets of Science on 9-14-70), unlawfully borrowed money from Science, a registered investment company, by failing to reimburse or pay to Science or American the full amount (some \$155,000) of the obligation that arose when Science's expenses under its distribution agreement with SISC ^{77/} for its fiscal year ending June 30, 1970 exceeded 1 percent of Science's average net asset value for the fiscal year. During the period January 31, 1971 to June 22, 1971, SSC wilfully violated and Steadman wilfully aided and abetted violations of Section 17(a)(3) of the I.C.A. in that SSC, an affiliated person of American, borrowed money from American, a registered investment company, by failing to reimburse or pay to American the full amount of the obligation that arose when American's expenses for its fiscal year ending January 31, 1971, exceeded 1 percent of American's average net asset value for the fiscal year.

77/ SISC's obligation to Science was assumed by SSC on August 24, 1970.

(6) In connection with the unlawful borrowing resulting from the Science Fund expenses overrun referred to in paragraph (5) above, SSC wilfully violated, and SISC and Steadman wilfully aided and abetted violations of, Section 15(a)(1) of the I.C.A. in that SSC served as investment adviser to Science pursuant to a written contract that failed to describe precisely all compensation to be paid thereunder, i.e. the waiver of the immediate payment of the full amount of the obligation due the Fund as a result of the expenses overrun. In connection with the American Fund expenses overrun referred to in paragraph (5) above, SSC wilfully violated, and Steadman wilfully aided and abetted violations of, Section 15(a)(1) of the I.C.A. in that SSC served as investment adviser to American pursuant to a written contract that failed to describe precisely all compensation to be paid thereunder, i.e. the waiver of the immediate payment of the full amount due the Fund as a result of the expenses overrun.

(7) In connection with engaging in the unlawful borrowings referred to in paragraph (5) above, SSC wilfully violated, and SISC and Steadman wilfully aided and abetted violations of, the antifraud provisions of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and (2) of the Investment Advisers Act in that such Respondents, by use of the mails and other means and instrumentalities of interstate commerce in purchasing and selling securities, i.e. shares of Science and American as well as portfolio securities held by such Funds, (a) overreached and took advantage of their fiduciary relationship with Science and American for their own advantage and thus engaged in acts, practices, and a course of business

which operated as a fraud on the Funds and its shareholders and (b) obtained money and property by means of Fund prospectuses which omitted to state material facts necessary in order to make the statements made in the light of the circumstances under which they were made not misleading, i.e. (i) the fact that, and the extent to which, SISC and SSC owed money to Science and to American as the result of the expense overruns of those Funds mentioned in paragraph (5) above, (ii) the failure of SISC and SSC promptly to pay the Funds the amounts due when they became due, (iii) the terms and conditions under which payment was to be made to the Funds, the financial condition of the debtor, SSC, or the fact that the repayment terms were not the product of arms-length bargaining, and (iv) the fact that the deferred payment arrangements constituted a borrowing from the Funds in violation of Section 17(a)(3) of the I.C.A. as well as of the Funds' investment restrictions.

(8) In connection with the unlawful borrowings referred to in paragraph (5) above, SSC and Steadman, individually and collectively, wilfully violated and wilfully aided and abetted violations of Section 34(b) of the Investment Company Act by causing the filing with and transmitted to the Commission of registration statements and amendments thereto, prospectuses, reports and other documents required to be filed or transmitted under the I.C.A. which omitted to state the material facts respecting such borrowings described in paragraph 7(b) above.

(9) Within the period from about January 1, 1968 to June 23, 1971, Republic Securities Corporation, Steadman Security Corporation, and Steadman, individually and collectively, wilfully violated and wilfully aided and abetted violations of the antifraud provisions of Section 17(a) of the

Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(1) and (2) of the Investment Advisers Act in that such Respondents, in connection with the offer and sale of the shares of various Steadman Funds by use of the mails and other means and instrumentalities of interstate commerce engaged in acts, practices and courses of business that operated as a fraud upon the purchasers or prospective purchasers of the Funds' shares by (1) failing to compute at all times on a monthly basis, in accordance with the Funds' prospectuses, the amount equal to 40 percent of RSC's net income attributable to each Fund by which the management fee of each Fund was to be reduced and (2) by using arbitrary and inflated salary and travel expense allocations to RSC, thereby improperly reducing RSC's net income and the Funds' share thereof.

(10) Steadman and Steadman Security Corporation wilfully aided and abetted violations of Section 30(a) of the Investment Company Act and Rules 30a-1 and 30a-2 thereunder in that these Respondents repeatedly caused Aberdeen, American, Associated, and Fiduciary Funds to fail to file with the Commission annual reports in the form prescribed by Rule 30a-2 within the time prescribed by Section 30(a) and Rule 30a-1.

(11) Republic Securities Corporation, Steadman Investment Services Corporation, Aberdeen Management Corporation, and the Steadman Corporation of America, wilfully aided and abetted by Steadman, wilfully violated Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that such corporations failed to file with the Commission reports of financial condition for the years 1970 and 1971 within the time prescribed by Rule 17a-5.

PUBLIC INTEREST

The violations found in this proceeding to have been committed by Respondents are serious, numerous, and many extended over a substantial period of time. Most involved fraud or overreaching or the violation of statutory or regulatory prohibitions or requirements designed to prevent the avoidance of fiduciary obligations and the abuse of fiduciary trust. It is the statutorily-established fiduciary relationship between the victims and the victimizers that makes the violations here found ones of utmost gravity and ones that compel giving maximum consideration to the public interest in preserving confidence and integrity in the registered investment company as a vehicle for investment in securities.

Respondents urge strenuously that their conduct, particularly as respects use of the custodian accounts of the Steadman Funds to obtain bank loans and brokerage commissions, but more generally as well, has not heretofore been held to be violative of any statute or regulation and that therefore the Commission, if it desires to proscribe such conduct, should do so through the rulemaking rather than through the adjudicatory process. Respondents seem to argue, in this connection, that the Commission should not rely upon broadly-couched antifraud provisions of the Securities, Exchange, or Advisers Acts but should fashion a specific prohibitory or regulatory rule under the I.C.A. or the Advisers Act.

This argument ignores the fact that the Courts have long held that the choice between proceeding by detailed rulemaking or by ad hoc adjudication is one that lies primarily in the informed discretion of the administrative agency. SEC v. Chenery Corp., 332 U.S. 194, 202-3 (1947).

In Chenery, the Supreme Court stated in pertinent part, at pages 202 and 203, as follows:

" . . . Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations. In performing its important functions in these respects, therefore, an administrative agency must be equipped to act either by general rule or by individual order. To insist upon one form of action to the exclusion of the other is to exalt form over necessity."

" . . . Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective. There is thus a very definite place for the case-by-case evolution of statutory standards. And the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency. See Columbia Broadcasting System v. United States, 316 U.S. 407, 421."

What the Court said in Chenery is particularly applicable to the definition of securities fraud, which seems to take form in a seemingly ^{78/} infinite number of factual variants, mutations, and permutations. And it is perhaps even more particularly applicable to securities fraud or

78/ As the Commission stated in Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961), the antifraud provisions of Section 17(a) of the Securities Act and Rule 10b-5 of the Exchange Act ". . . are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others." In a footnote to this statement, the Commission observed:

"12. It might be said of fraud that age cannot wither, nor custom stale its infinite variety."

In Investors Management Co., Inc., et al., Exchange Act Release No. 9267, July 29, 1971, the Commission stated, at pp. 14-5: ". . . The ambit of the antifraud provisions is necessarily broad so as to embrace the infinite variety of deceptive conduct."

See S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963). Cf. Chasins v. Smith Barney & Co., Inc., 438 F.2d 1167 (C.A. 2, March 2, 1971); Opper v. Hancock Securities, 200 F. Supp. 668, 676 (S.D.N.Y. 1966), aff'd 367 F.2d 157 (C.A. 2, 1966).

overreaching where, as here, a strong fiduciary relationship is present, a relationship that affords a kaleidoscopic infinitude of opportunities for self-dealing or abuse of trust by the fiduciary.

Respondents endeavor to defend some of their actions, notably the "borrowing" violations, on the ground that the boards of directors of the affected Funds, the majority of whose members were "independent" or "outside" directors, approved the borrowing by approving plans for deferred payment. This defense lacks validity for a number of reasons. Firstly, as already found above, the Board lacked the advice of outside legal counsel and lacked full information and adequate advance notice to consider either the merits of the proposal or the desirability of engaging outside counsel to advise them. Secondly, the proposal for deferred payment without any provision for payment of interest was so patently an overreaching and breach of fiduciary trust that Respondents should never even have submitted the proposals to the Funds. And lastly, with or without Fund-Board approval, an unlawful borrowing is still an unlawful borrowing.

Respondents urge, mistakenly, that under Section 15(b) of the Exchange Act sanctions may be imposed only against registered broker-dealers and their principals. This position overlooks the fact that while Section 15(b)(5) of the Exchange Act governs the imposition of sanctions against registered broker-dealers, Section 15(b)(7) permits the imposition of stated sanctions against "any person," and "person" is defined by Section 3(a)(9) of the Exchange Act to include ". . . an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization."

Respondents also urge, again mistakenly, that sanctions imposed under Section 9(b) of the Investment Company Act or Sections 203(e) or 203(f) of the Advisers Act may not be based upon acts or practices that occurred before December 14, 1970, the effective date of those Sections, on the ground that to do so would contravene Article I, Section 9 of the U.S. Constitution, which prohibits ex post facto laws.

An "ex post facto law" has been held to be a law which makes an act criminal which was not criminal at the time it was committed - i.e., the retroactive application of a statute defining a new crime. Harisiades v. Shaughnessy, 90 F. Supp. 397, 424 (D.C.N.Y. 1950), motion to amend pet. denied 90 F. Supp. 431, reversed on other grounds 187 F.2d 137, aff'd. 342 U.S. 580, 594 (1952) rehearing denied 343 U.S. 936. It has consistently been held that the prohibition against ex post facto laws is limited to punitive or penal legislation. Galvan v. Press, 347 U.S. 522, 531, (1954); Bugajewitz v. Adams, 228 U.S. 585, 591 (1913); Johannessen v. U.S., 225 U.S. 227, 242, (1912). The ex post facto prohibition does not apply to legislation imposing civil disabilities. Harisiades, supra, 342 U.S. at p. 595.

The charges against Respondents are not lodged under a statute making criminal what was not criminal when engaged in by Respondents. Section 9(b) in no way makes acts criminal which were not criminal when committed. Nor is that the result if remedial sanctions are imposed under Section 9(b) in this proceeding. The sanctions authorized by Section 9(b) are remedial, not penal; these sanctions involve only removal from certain occupational activities and do not involve a fine, penalty or forfeiture. The remedial sanctions authorized by Section 9(b) are of the same nature as those authorized by Section 15(b)(7) of the Exchange Act except that the

Section 9(b) sanctions apply to persons associated with registered investment companies. It has consistently been held that the provisions of Section 15(b) are not penal but remedial, affording a means by which the public may be protected in the future from those who have shown themselves in the past to be unqualified to participate in an area as sensitive as the securities business. Pierce v. SEC, 239 F.2d 160, 163 (9th Cir. 1956); Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Blaise D'Antoni & Associates, Inc. v. SEC, 289 F.2d 276, 277 (5th Cir.), rehearing denied per curiam, 290 F.2d 688, cert. denied, 368 U.S. 899 (1961); Associated Sec., Corp. v. SEC, 283 F.2d 773, 775 (C.A. 10th 1960). The instant proceeding is not criminal but administrative. Thus, the ex post facto prohibition has no application to this proceeding.

The ex post facto prohibition does not prevent regulation by Congress of conduct which it has the power to regulate, even though subjection to regulation depends upon behavior occurring before enactment of the statute. Smith v. U.S., 312 F.2d 119, 120-1 (C.A. 10, 1963.) If a statute is a bona fide regulation of conduct which Congress has the power to regulate, it is not bad as an "ex post facto law," even though the right to engage in the conduct is made to depend upon past behavior, even behavior before the passage of the regulatory act. Cases v. U.S., 131 F.2d 916, 921 (1st Cir. 1942), cert. denied, Velasquez v. U.S., 319 U.S. 770; Bauer v. Acheson, 106 F. Supp. 445, 450 (D.C. 1952). Congress may impose penalties or disabilities for prior conduct if such penalties are relevant and incidental to the regulation of present conduct, such as qualifications for a profession. Hiss v. Hampton, 338 F. Supp. 1141, 1148 (U.S.D.C. D.Col. 1972).

Respondents concede that the legislative history of Section 9(b) appears to contemplate applicability of the procedures and sanctions there authorized to violations occurring prior to enactment of the Section.^{79/} However, they contend that Congress could not have intended to permit the Commission to conduct administrative proceedings under Section 9(b) or Sections 203(e) and 203(f) of the Advisers Act in which "novel and expansive interpretations of [the I.C.A. and Advisers Act] sections and rules could be adopted and then applied, together with heavy sanctions, to transactions occurring prior to [their] effective date."

Respondents cite no authority for this contention and the record and this decision belie that there are any "novel or expansive interpretations" involved. The fact of the matter is that the conduct found herein to have violated various provisions of law and regulation had been unlawful under existing law when the conduct occurred; the amendments enacting Sections 9(b) and 203(e), (f) merely added new, additional administrative procedures and sanctions for enforcing and effectuating the provisions and purposes of those Acts.

Additionally, it should be noted in connection with Respondents' ex post facto argument that a great many of the violations found herein of the I.C.A. or the Advisers Act resulted from misconduct which

^{79/} At the conclusion of the discussion on proposed Section 9(b), the Report of the Committee on Interstate and Foreign Commerce, House Report No. 91-1382 (91st Congress, 2d Session) states at pp. 20, 21:

"Your committee does not expect the Commission to exercise its authority to expand administrative proceedings instituted under the other Federal securities laws prior to the effective date of this amendment. However, the Commission would not be precluded from exercising this authority in administrative proceedings instituted after the effective date of the amendment based on violations which occurred before that date."

was also found to be violative of various antifraud provisions of the Securities Act and the Exchange Act, as to which, of course, the ex post facto argument has no application.

Respondents' argument regarding Section 203(e) and (f) of the Advisers Act fails for reasons analogous to those stated above with reference to Section 9(b) of the I.C.A.

Respondents raise a number of jurisdictional issues, none of which has merit. As to the charges in Section II, Paragraphs I, O, and R, which charge various kinds of fraud committed by SSC, the investment adviser, and other Respondents, the Respondents urge that insofar as those paragraphs of Section II of the Order allege fraud under Sections 206(1) and 206(2) of the Investment Advisers Act the charges are defective in that they do not allege, in the language of the statutes, a fraud by the investment adviser against his "client or prospective client", i.e. against the Steadman Funds. Section II I alleges the fraud was against "the funds' shareholders and the purchasers or prospective purchasers of the funds' shares"; Section II O alleges the fraud and deceit was "upon purchasers and prospective purchasers of such [Science and American] securities"; and Section II R alleges that the conduct operated as a fraud and deceit "upon the purchasers or prospective purchasers of such funds' shares." It is concluded that these allegations sufficiently allege fraud against the Funds, the "clients," particularly when read in the context of the entire allegation of each of the paragraphs in question. At the hearing the issues were tried as if they sufficiently charged fraud against the Steadman Funds, and no objection was raised until Respondents filed their proposed findings, conclusions and brief. Purchasers

of Fund shares inevitably became shareholders of the Fund and were, to the extent of their shareholdings, the owners thereof. While more precise pleading would have been desirable, the objection is at best a highly technical one which at any time could have been, and could still be, cured by a motion to conform the pleadings to the proof.

Respondents further contend that insofar as paragraphs I, O, and R of Section II of the Order allege various violations of the antifraud provisions of the Securities Act and the Exchange Act, the record is jurisdictionally defective for failing to establish use of the mails or other instrumentalities of interstate commerce in connection with the alleged violations. The contention is not valid for a number of reasons.

Interstate commerce for purposes of Section 17(a) of the Securities Act is defined in Section 2(7) of the Securities Act as including

"trade or commerce in securities or any transportation or communication relating thereto . . . within the District of Columbia"

In Lawrence R. Leeby, 13 SEC 499, 505 (1943), the Commission held that

". . . transactions consummated in the District of Columbia are within the purview of Section 17(a), even though mechanical means or facilities are not used. The use of the offering sheets in the course of sales in the District would, of itself, constitute a use of means of communication in interstate commerce as 'interstate commerce' is defined in Section 2(7) of the Securities Act. It would be anomalous to construe Section 17 as a regulation of mechanical interstate facilities rather than as a regulation of transactions."

Since the Steadman Funds were located, together with their investment adviser, in the District of Columbia, any conduct regarding the securities

of such Funds was in interstate commerce.

The Steadman Funds during the entire period covered by the alleged violations in this Order bought and sold their securities. (See Item 1.07 of the Form N-1R annual reports filed by each of the Steadman Funds during the period 1968-1972, Public Official File Nos. 811-615-2, 811-855-2, 811-18-2, 811-747-2, 811-176-2.) During this same period of time the several Steadman Funds had on file with the Commission registration statements pursuant to Section 5 of the Securities Act kept current by post-effective amendments. (Public Official File Nos. 2-10644-1, 2-14602-1, 2-13383-1, 2-1335-1, and 2-11017-1.) Steadman testified at the private investigation that prospectuses were used in the offer and sale of the shares of the Steadman Funds (Exhibit 273, p. 10):

Q. ...are you responsible for preparing prospectuses and proxy material with respect to the funds which are managed by Steadman Securities Corporation?

A. I don't think I understand your question. Would you elaborate upon it?

Q. Well, these investment companies use prospectuses in connection with their offer and sale of securities, is that correct?

A. That is correct.

Steadman went on to testify that such prospectuses were prepared and reviewed by SSC.

The custodian of the Steadman Funds during 1968 was the Riggs National Bank in Washington, D.C. From January 1, 1969 on the custodian for three of the Steadman Funds was Chase Manhattan Bank in New York. The custodians for Aberdeen and Associated during 1969 and

1970 were in New Jersey and Missouri, respectively. In 1971 the National Bank of Washington in Washington, D.C. became the custodian for Associated. Aberdeen retained its New Jersey custodian until its assets were acquired by Fiduciary in May 1972. (See Public Official Files, supra.) The proceeds from the sale of Fund shares necessarily went to the bank custodian, which involved the use of the instrumentalities of interstate commerce even if the Steadman Funds had sold their shares only in the District of Columbia. Cf. Kogan v. Schulte, 61 F.Supp. 604, 608-9 (S.D.N.Y., 1945).

The shares of the Steadman Funds were registered in at least 15 states. (Exhibits 207 pp. 3-4, 208 p. 5, 209 pp. 7-81). The shares of the Funds during this period were distributed throughout the country by the Steadman Corporation of America on a retail basis through a network of regional offices, later franchises, and by Steadman Investment Services Corporation through broker-dealers. (Exhibits 273 pp. 26-29, 115 p. 6, 122 pp. 3-4; Items 1.34 - 1.38, Forms N-1R annual reports, supra.) Thus, the record shows that the Steadman Funds have sold shares during the relevant period, that current prospectuses have been filed with the Commission, that prospectuses were used in the offer and sale of shares of the Steadman Funds, that the shares of the Steadman Funds were registered in numerous states and that the shares of the Steadman Funds were sold through a nation-wide network of salesmen and broker-dealers. The record discloses, therefore, abundant evidence that the instrumentalities of interstate commerce were customarily and necessarily used in the offer and sale of shares of the Steadman Funds and that the prospectuses contained in the Commission's public official files were used in the offer and sale of such securities.

Finally, respondents' non-public filings with the Commission, which are necessarily within the knowledge of the Commission, show that the Steadman Funds regularly use the instrumentalities of interstate commerce in the offer and sale of their shares. See Items 2.23 and 2.24 of Form N-1R, Part II, annual reports filed by the Steadman Funds during this period. Official File Nos. 811-615-2A, 811-855-2A, 811-18-2A, 811-747-2A, 811-176-2A.^{80/} The following language regarding the customary use of the instrumentalities of interstate commerce appears in those reports for the relevant period:

"Teletype, telegram, telephone, mail and wire orders are time-stamped by the order room upon receipt."

Official File No. 811-855-2A-2, Part II of Form N-1R for fiscal year 1970, Steadman American Industry Fund, Inc. Item 2.23.

Additionally, certain of these reports include the following disclosures:

"The majority of orders for the purchase of shares of the registrant are received by mail, teletype, and telephone by the underwriter. The orders received by mail are accompanied by the investor's remittance for the purchase . . ."

"The normal procedure followed by the underwriter is to remit sales proceeds to the custodian of the registrant approximately ten days following the day on which the order is received." Official File No. 811-18-2A, Form N-1R for fiscal year ending September 30, 1970, Associated Fund Trust, Item 2.24.

^{80/} The Division's motion that official notice be taken of these files for such limited purposes was granted pursuant to 17 C.F.R. 201.14(d) by order dated May 13, 1974.

Receiving by and through the instrumentalities of interstate commerce the payment for the shares sold clearly constitutes a use of the instrumentalities of interstate commerce in the sale of shares of the Steadman Funds. It has been held that using the mails to deposit and collect checks for the purchase of securities — one step removed from the issuer's receiving payment in the mail — satisfies the jurisdictional requirement of use of the instrumentalities of interstate commerce. U.S. v. Robertson, 181 F. Supp. 158, 164 (D.C.S.D.N.Y. 1960). It is not necessary that the fraudulent representations respecting the offer or sale of securities actually be made through the mails. SEC v. Midland Basic, Inc., 283 F. Supp. 609, 617 (D.C.S.D. 1968). The fact that the mails and other instrumentalities would be used in the purchase of the Fund's shares could be reasonably foreseen by Respondents; they were in fact so used in the ordinary course of business and, therefore, such use can be attributed to them in that they caused it. Pereira v. U.S., 347 U.S. 1, 8-9; 74 S. Ct. 358, 363 (1954). Beckwith v. U.S., 367 F.2d 458, 460-1 (C.A. 10th 1966). It is the use of the mails in furtherance of the fraudulent scheme that is prohibited rather than fraud upon any recipient of material sent through the mails. Frank v. U.S., 220 F.2d 559, 563 (C.A. 10th 1955).

The Division urges that maximum sanctions be imposed against all Respondents, without detailed analysis or comparison of the respective violations committed by each Respondent, evidently relying upon the facts that Steadman, SSC, RSC, SISC, SCA and AMC are affiliated persons of registered investment companies (the Steadman Funds) and Steadman and SSC are associated with RSC, SISC, SCA and AMC. The Division argues, as

the Order alleges, that SSC and Steadman, individually and collectively, as control persons of the other Respondents, dominated and controlled the practices and procedures of the other Respondents and exercised or were in a position to exercise executive and managerial responsibility in conducting the daily affairs of such other Respondents and of the Steadman Funds. While the findings and conclusions reached in this decision substantially support this contention, the Division does not elaborate an argument for "visiting the sins" of SSC and Steadman for the purpose of sanctions upon each Respondent, or for treating the "Steadman Organization" as a single entity rather than as a number of corporate entities, if that is its intention. Accordingly, the sanctions imposed herein upon each Respondent are predicated upon the number, nature, and gravity of violations committed by each particular Respondent.

By way of mitigation, it is noted that Respondents have not heretofore been sanctioned by any regulatory or self-regulatory body. However, this can only counterbalance to a limited extent the magnitude of the multiple and serious violations, taken as a whole, particularly 80a/ in light of the egregious breach of fiduciary obligations that the violations entail. It is concluded, therefore, that strong sanctions are required to protect the public interest.

Less severe sanctions are imposed upon SCA and upon AMC because of their non involvement in some of the more serious violations. Likewise, less severe sanctions are imposed against Steadman under the Exchange Act than the maximum sanctions imposed upon him under the I.C.A. and the Advisers Acts because the violations under the last two Acts are deemed more significant in terms of the need for long-range protection of the public interest.

80a/ Steadman, a lawyer, should have been particularly aware of and sensitive to the duties and responsibilities of a fiduciary.

ORDER

Accordingly, IT IS ORDERED as follows:

(1) Respondent Charles W. Steadman is hereby:

(a) prohibited permanently from serving or acting as an employee, officer, director, member of an investment advisory board, investment adviser of, or principal underwriter for a registered investment company or from being an affiliated person of such investment adviser, depositor or principal underwriter within the meaning of the I.C.A., pursuant to Section 9(b) of the I.C.A.;

(b) barred from being associated with an investment adviser, pursuant to Section 203(f) of the Advisers Act;

(c) suspended from being associated with a broker or dealer, pursuant to Section 15(b)(7) of the Exchange Act, for one year;

(d) suspended from being associated with a member of the NASD, pursuant to Section 15A(1)(2) of the Exchange Act, for one year; and

(e) suspended from the PBW Stock Exchange, Inc., pursuant to Section 19(a)(3) of the Exchange Act, for one year.

(2) Respondent Steadman Security Corporation

(a) is hereby permanently prohibited to serve or act as an investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor or principal underwriter, pursuant to Section 9(b) of the Investment Company Act;

(b) its registration as an investment adviser is hereby revoked, pursuant to Section 203(e) of the Investment Advisers Act; and

(c) it is barred from being associated with a broker or dealer, pursuant to Section 15(b)(7) of the Exchange Act.

(3) The registration as a broker-dealer of Respondent Republic Securities Corporation is hereby revoked, pursuant to Section 15(b)(5) of the Exchange Act, and it is hereby expelled from membership in the NASD, pursuant to Section 15A(1)(2) of the Exchange Act.

(4) Respondent Steadman Investment Securities Corporation

(a) is hereby permanently prohibited to serve or act as an investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, pursuant to Section 9(b) of the Investment Company Act;

(b) its registration as an investment adviser is hereby revoked pursuant to Section 203(e) of the Investment Advisers Act;

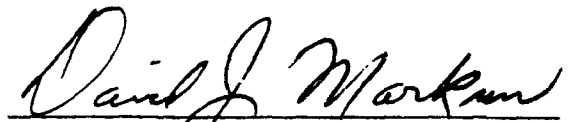
(c) its registration as a broker-dealer is revoked pursuant to Section 15(b)(5) of the Exchange Act; and

(d) it is expelled from membership in the NASD, pursuant to Section 15A(1)(2) of the Exchange Act.

(5) The registrations as broker-dealers of Respondent The Steadman Corporation of America and Respondent Aberdeen Management Corporation are hereby suspended for one year, pursuant to Section 15(b)(5) of the Exchange Act, and they are hereby suspended from membership for one year in the NASD, pursuant to Section 15A(1)(2) of the Exchange Act.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice, 17 CFR 201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless 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 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.^{81/}


David J. Markun
Administrative Law Judge

Washington, D.C.
December 20, 1974

81/ All proposed findings, conclusions, and supporting arguments of the parties and those given leave to be heard have been considered. To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, conform with the findings, conclusions, and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the material issues presented by the record.