ADMINISTRATIVE PROCEEDING
FILE NO. 3-4618

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

RICHARD O. BERTOLI :
CATHERINE BERTOLI
ALFRED B. AVERELL, JR. :
RAYDOP CORPORATION
FREELTON INVESTMENTS LIMITED :

:

INITIAL DECISION

Washington, D.C.
June 18, 1979

Max O. Regensteiner
Administrative Law Judge

ADMINISTRATIVE PROCEEDING
FILE NO. 3-4618

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

RICHARD O. BERTOLI
CATHERINE BERTOLI
ALFRED B. AVERELL, JR.
RAYDOP CORPORATION
FREELTON INVESTMENTS LIMITED

INITIAL DECISION

APPEARANCES: Lawrence J. Toscano, Jerome L. Merin, Don L. Horwitz, Larry H. Irom and Charles E. Padgett, of the Commission's New York Regional Office, for the Division of Enforcement.

Richard O. Bertoli, *pro se* and, as president, for Raydop Corporation and Freelton Investments Limited.

Catherine Bertoli, *pro se*.

Leo Gitlin, for Alfred B. Averell, Jr.

BEFORE: Max O. Regensteiner, Administrative Law Judge

These proceedings, instituted in 1975 under Section 9(b) of the Investment Company Act of 1940, Section 203(f) of the Investment Advisers Act of 1940, and Sections 15(b) and 15A of the Securities Exchange Act of 1934, principally involve allegations of misconduct in connection with portfolio transactions of a registered open-end investment company by the name of Fundamatic Investors, Inc. ("the Fund"). The respondents with whom this decision deals are Richard O. Bertoli ("Bertoli") and Alfred B. Averell, Jr., who were officers of the Fund, Bertoli's wife Catherine ("Mrs. Bertoli"), Raydop Corporation and Freelton Investments Limited.[1/] Bertoli is president of Raydop and Freelton, which during the period under consideration were so-called "hedge funds." The Division of Enforcement alleges that some or all of the respondents willfully violated, or willfully aided and abetted violations of, Sections 17(a) and 37 of the Investment Company Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the Fund's portfolio transactions in 1972. It further alleges that Bertoli and Averell willfully aided and abetted violations by the Fund of reporting and record-keeping requirements under the Investment Company Act.

Shortly before hearings on the merits of the allegations were scheduled to begin in the spring of 1976, Bertoli and

---

1/ As to other respondents named in the order for proceedings, the proceedings were concluded on the basis of settlement offers accepted by the Commission. While this decision refers to certain of the former respondents, the findings made are binding only on the above-named respondents.

Averell moved for the suppression of various documents which the Division had indicated it would offer in evidence, on the ground that such documents had assertedly been obtained in violation of their constitutional rights. Hearings on the suppression issue began in June 1976 and continued intermittently to July 1977 when they came to a halt because of certain court proceedings. After those matters had been resolved, Bertoli and Averell withdrew their suppression motions in July and August 1978, respectively.

Hearings on the merits of the allegations were held in November and December 1978.[2/] The Division's case consisted principally of documentary evidence, including specified portions of numerous documents in the Commission's public files, and of the transcripts of testimony given by Bertoli and Averell in 1972 during the Division's investigation of possible securities law violations in connection with the Fund's affairs.[3/] Averell's testimony was offered and received as evidence against him alone. Bertoli's testimony was offered and received not only against him, but also in part against Raydop, Freelton and Mrs. Bertoli, who held substantial equity interests

---

2/ Mrs. Bertoli made an appearance through counsel at the initial prehearing conference in October 1975. Counsel thereafter withdrew, and she made no appearance at any of the subsequent conferences or at the hearings. However, the Division did not seek to have her declared in default pursuant to the Commission's Rules of Practice. Mrs. Bertoli did make a post-hearing submission, pro se.

3/ At the conclusion of the Division's case, I dismissed, for lack of evidence, an allegation that Bertoli and Averell willfully aided and abetted violations by the Fund of Section 15(c) of the Investment Company Act.

in those companies, on the theory that admissions therein were made by Bertoli as an employee or agent of those respondents.[4/] Respondents did not testify in their own behalf. As their only witnesses, they called three staff members of the Division to testify concerning the recordkeeping allegations and the nature of Averell's affiliations.

Following the hearings, the parties other than Raydop and Freelton filed proposed findings and conclusions and memoranda.[5/]

The Fund; Participation of Bertoli and Averell in its Management

The Fund, whose original name was Samson Fund, became registered with the Commission in 1960. In February 1971 it changed its name to Fundamatic Investors. As of the end of 1971, its net assets totalled only about $325,000. In November 1972, a receiver was appointed for the Fund pursuant to a suit instituted by the Commission, and the Fund was ultimately liquidated. The principal focus of these proceedings, as previously indicated, is on the Fund's portfolio transactions in 1972.

Concurrently with the Fund's name change in early 1971, Fundamatic Management, Inc. ("FMI") became its investment adviser[6/],

---

4/ See Federal Rule of Evidence 801(d)(2)(D).

5/ In his submission, however, Bertoli, who as their president represented Raydop and Freelton during the proceedings, advanced certain arguments on behalf of those companies.

6/ FMI registered as an investment adviser in December 1971, when amendments to the Advisers Act removing the exemption from the Act's registration requirements for investment advisers whose only clients were investment companies became effective. In 1973 it withdrew its registration.

and Systematic Distributors, Inc. ("Distributors"), a registered broker-dealer which was a wholly-owned subsidiary of FMI, became its principal underwriter.[7/] Pursuant to a contract between FMI and a sub-adviser, which was a subsidiary of a national brokerage firm, the sub-adviser in substance made the Fund's investment decisions. During 1971, Averell's father was president of the Fund, FMI and Distributors and the single largest shareholder of FMI. Bertoli, who is by profession a certified public accountant, was during most of 1971 assistant secretary and a 16 percent shareholder of FMI.

In November and December 1971, significant changes occurred in the management of the above companies, related at least in part to the termination, effective at the end of 1971, of the contract between FMI and the sub-adviser. The full scope of those changes, as they pertain to the Fund and FMI, is less than clear. It is undisputed, however, that Bertoli became the Fund's secretary-treasurer and Averell, whose background is in the securities business, its vice-president. Bertoli also became secretary and a director of FMI.[8/] In addition, at about the same time he

---

7/ Distributors withdrew its registration in 1974.

8/ This finding does not rest on Bertoli's investigative testimony which, as he correctly points out, is not clear as to the date or dates on which he assumed those positions, but on the order for proceedings and his answer thereto, the outline of his defense as submitted prior to the hearings and the FMI investment adviser registration file. It is not necessary to determine whether, as claimed by the Division but denied by Bertoli, he also became FMI's treasurer.

became secretary-treasurer and a director of Paramount Leasing Corporation, which had a substantial stock interest in FMI. In December 1971, Averell acquired ownership of Distributors from FMI and succeeded his father as president of Distributors.[9/]

The major obscurity pertains to whether during the period under consideration the Fund had a president and, if so, who it was, as well as to the composition of the board of directors. It appears that Averell Sr. intended to resign as president, but that such resignation may not have been effective. On the other hand, there are indications that Henry Dopler, who succeeded Averell, Sr. as president of FMI and who was president of Paramount and of Dopler & Co., Inc. ("Dopco"), a wholly-owned subsidiary of Paramount, was considered by persons involved with the Fund also to have succeeded Averell, Sr. as Fund president. Dopler signed as president the quarterly reports which the Fund filed with the Commission in 1972. The record is quite unclear as to the composition of the board of directors during 1972.

Regardless of the identity of the president and the directors, there is no indication in the record that they played an active or material role in the management of the Fund. Bertoli's

---

9/ The Division, based on information in the FMI broker-dealer registration file, claims that Averell was also vice-president of FMI from November 1971 to sometime prior to February 28, 1972. Averell denies that he was ever an officer of FMI. There is no need to resolve this matter, since, assuming the accuracy of the file, the information in the file is consistent with termination of Averell's status as an officer prior to the time of the alleged violations.

testimony demonstrates that once the sub-adviser was out of the picture, Bertoli alone made the Fund's investment and brokerage allocation decisions. He caused the Fund to liquidate the portfolio accumulated under the sub-adviser's direction, consisting of listed securities, and to engage in short-term trading, mostly in unlisted securities, for the avowed purpose of utilizing the Fund's substantial tax loss carry-forward. In substance, he alone directed the Fund's day-to-day operations. The Division takes the position that Averell was the only other active officer of the Fund; that as an officer he was a fiduciary; and that, particularly in the absence of a functioning board of directors, he had a duty to be aware of the Fund's transactions and to prevent violations. As discussed below, however, Averell had a very limited role in the Fund's management, and I cannot agree with the Division's position that he had supervisory responsibility with respect to all of the Fund's activities.

Bertoli and Averell, particularly the former, were also affiliated with certain other companies that play a role in the alleged violations. Those affiliations are detailed below.

Alleged Violations of Section 17(a) of the Investment Company Act

Section 17(a) of the Investment Company Act, as here pertinent, makes it unlawful for an affiliated person of a registered investment company or an affiliated person of such person, acting as principal, knowingly to sell any security to or purchase any security from such company.[10] The order

10/ Under Section 17(b), the Commission, upon application, may exempt a proposed transaction from the prohibitions of Section 17(a). No exemptions were sought here.

for proceedings alleges that: (1) Raydop and Freelton, affiliated persons of Bertoli, who in turn was affiliated with the Fund, engaged in prohibited transactions with the Fund between January and May 1972; and (2) Dopco, also an affiliated person of Bertoli, engaged in such transactions during the period April-September 1972. Bertoli and Averell are charged with willfully aiding and abetting the violations and Mrs. Bertoli with willfully aiding and abetting the Raydop and Freelton violations.

Section 2(a)(3) of the Investment Company Act defines the term "affiliated person" of another person to include a person directly or indirectly controlling or controlled by such other person and an officer or director of such other person. As a Fund officer during the period encompassed by the above allegations, Bertoli was an affiliated person of the Fund. Raydop and Freelton were affiliated persons of Bertoli at the time of their transactions with the Fund. Bertoli was then president of those companies, and he made their investment decisions.[11/] Furthermore, Mrs. Bertoli was virtually the sole owner of Freelton and owned about 20 percent of Raydop.[12/] Bertoli himself owned

---

11/ While Bertoli's investigative testimony may not be entirely clear regarding the period when he made investment decisions for Freelton, he admitted making the decision in the transaction discussed below in which Freelton sold securities to the Fund.

12/ Although Bertoli is technically correct in urging that in his investigative testimony pertaining to his wife's interests in Freelton and Raydop, he spoke in the present tense, he stated in his defense outline that she had the interests noted in the text beginning in the autumn of 1971.

about 10 percent of Raydop. Under the circumstances, it is clear that those companies were controlled by Bertoli.[13/]

During the period under consideration, Dopco, which was then a registered broker-dealer, was, as noted, a wholly-owned subsidiary of Paramount.[14/] Bertoli was secretary-treasurer and one of three directors of Paramount, one of the other directors being his brother-in-law, and, according to Paramount's annual reports on Form 10-K for the fiscal years ended September 30, 1971 and 1972, was a "parent" of Paramount, i.e., a person controlling Paramount.[15/] As such, he indirectly controlled Dopco, which

---

13/ The Investment Company Act, in Section 2(a)(9), defines "control" as "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."

14/ Dopco was no longer registered when the proceedings were instituted and was not named as a respondent.

15/ See the definition of "parent" in Rule 12b-2 under the Exchange Act (17 CFR 240. 12b-2). Contrary to Bertoli's argument, control may exist even in the absence of a stock interest. See M.J. Merritt & Co., Inc., 42 S.E.C. 1021, 1031 (1966), aff'd sub nom. Vickers v. S.E.C., 383 F.2d 343 (C.A. 2, 1967). While that decision relied on the definition of "control" in Rule 12b-2, the Investment Company Act's definition, as quoted in note 13 supra, is no less broad.

It should be noted, however, that Bertoli himself testified that his wife owned about 5 percent of Paramount's stock and that almost every member of his family owned some stock in the company. According to Paramount's 1972 10-K report, Mrs. Bertoli, Raydop and another company in which Mr. and Mrs. Bertoli had a substantial interest collectively owned about 10.6 percent of Paramount's common stock.

consequently was an affiliated person of Bertoli.[16/]

In sum, Raydop, Freelton and Dopco, as affiliated persons of Bertoli, were prohibited by Section 17(a) from engaging in principal securities transactions with the Fund. The record shows, however, that there were a number of such transactions.

1. Transactions Between Raydop or Freelton and the Fund

On February 18, 1972, Raydop purchased 1,300 shares of Donbar Development Corp. from the Fund, through Dopco. Bertoli made the decisions and placed the orders for both sides. Later the same day Raydop sold the shares to Dopco at a slightly higher price.[17/] On May 3, 1972, Raydop sold 1,000 shares of Barclay Industries to the Fund, through Dopco. Raydop had previously bought the shares from Dopco at a slightly lower price. Apparently on the same day, Freelton also sold 1,000 shares of

---

16/ The record indicates that Dopco was also directly controlled by Bertoli. There is some evidence that he was the firm's vice-president beginning in 1971. Bertoli asserts that he did not assume that position until late in the summer of 1972. I accept Bertoli's version which is consistent with his 1972 testimony that his initial association with Dopco was as a consultant. But that testimony indicates that even though he was not an officer, he had a significant impact on Dopco's management and policies. Thus, he testified that he was "brought in" to Dopco in October 1971 to "completely redo the back office, rehire front office personnel, ... increase their volume of business, and generally administer the firm." (pages 10-11, 16) He further testified that his function at Paramount was to be a "watchdog" over Dopco.

17/ Bertoli testified that Raydop lost money on the transactions because of commission and transfer tax. He further testified that the Fund made a slight profit, and that the Fund did not sell directly to Dopco because he understood it could not legally sell directly to an affiliated broker.

Barclay to the Fund.[18/] Bertoli's investigative testimony refers in general terms to other transactions between Raydop or Freelton on the one hand and the Fund on the other. However, only one other specific transaction was mentioned in the course of the interrogation. And Bertoli believed that that one (involving Air Pollution bonds) had been cancelled.

2. Transactions Between Dopco and the Fund

During the period between April 4 and September 11, 1972, Dopco, in 34 transactions, sold securities to or purchased securities from the Fund. In each of these transactions, another broker-dealer acted as the Fund's agent, and the person handling the transaction for that broker-dealer was advised by the person calling for the Fund and placing the order that Dopco would be on the other side of the transaction.[19/]

On the basis of the above findings, it follows that Raydop and Freelton willfully violated Section 17(a) of the Investment Company Act by their transactions with the Fund, and that Bertoli, who caused their transactions as well as the Dopco transactions to take place, willfully aided and abetted the violations of that

---

18/ Bertoli testified that shortly thereafter, the Fund sold the 2,000 shares of Barclay purchased from Raydop and Freelton at a profit. While Raydop and Freelton also made a profit on these transactions, Bertoli testified that on an over-all basis, those companies lost money in their dealings with the Fund, and that the purpose of these types of transactions was to make short-term profits for the Fund and thereby to utilize its tax loss carry-forward. He further testified that his wife and he, because of their investment in Paramount which stood to gain through its investment in FMI if the Fund did well, were willing to have Raydop and Freelton lose money on transactions with the Fund.

19/ That person further testified that before executing the transaction, he
(CONTINUED ON NEXT PAGE)

Section in connection with all of those transactions.[20/]

The evidence does not, however, warrant a finding that, as alleged, Mrs. Bertoli aided and abetted the Raydop/Freelton violations. The Division's theory of responsibility with respect to her is that she was presumptively a controlling person of both Raydop and Freelton and by permitting her husband to use those companies to engage in the affiliated transactions aided and abetted the violations. As virtually its sole owner, Mrs. Bertoli clearly controlled Freelton. In the case of Raydop, as previously noted, she owned about 20 percent and her husband about 10 percent.[21/] Under Section 2(a)(9) of the Investment

---

19/ (Cont'd)
determined that there was not a better bid or offer, respectively, available.

20/ While as a factual matter he caused the violations, the applicable statutory provisions do not contemplate a finding that he (or other respondents) "caused" violations, as alleged in the order for proceedings. This is a matter of no practical consequence, however.

Bertoli, as well as the other respondents, urge that under Collins Securities Corp. v. S.E.C., 562 F.2d 820 (C.A.D.C., 1977), violations of the Investment Company Act must be established by clear and convincing evidence. However, the Collins decision, requiring the Commission to apply the "clear and convincing" rather than the "preponderance of the evidence" standard of proof in that proceeding, is limited to fraud cases. It is true, of course, that this is a "fraud case," in that violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder are alleged, and that fraud findings are made against Bertoli. And there is language in Collins, particularly in the decision's penultimate sentence, suggesting that where fraud allegations are involved, findings on other allegations must also meet the clear and convincing standard. However, consideration of the opinion as a whole indicates that that was not the Court's intent, particularly as to non-fraud allegations which, as here, are unrelated to the fraud allegations. In any event, the facts pertaining to the Section 17(a) violations are essentially undisputed, so that the application of either standard of proof yields the same results.

21/ According to Paramount's 1971 10-K Report, Mr. and Mrs. Bertoli owned 33.9 percent of Raydop's stock at or about the end of that year. Paramount's report for 1972 stated that such ownership was 62 percent. Neither report indicated the ownership division as between the Bertolis.

Company Act, a beneficial owner of more than 25 percent of a company's voting securities is presumed to control such company. Accepting, arguendo, the Division's position that Mrs. Bertoli had presumptive control of Raydop, it does not follow that, as a controlling shareholder of the two companies who was not shown to have taken any part in their management or even to have been aware of the few transactions here in question, she can be held responsible for those transactions. The Division's argument leaps from the premise that she had the power to supervise the activities of the two companies with a view to preventing their use for illegal transactions, to the conclusion that she abdicated her responsibility to do so and thereby aided and abetted the violations. The leap is simply too big. The Division has cited no authority for holding a person in Mrs. Bertoli's position responsible in comparable circumstances.[22/] And I find no basis for holding her responsible here.[23/]

As to Averell, who is charged with aiding and abetting all of the Section 17(a) violations, the Division, while not

---

22/ The only case cited by the Division on this aspect of the case is S.E.C. v. Coven, 581 F.2d 1020, 1027 (C.A. 2, 1978), cert. denied __ U.S.__ (1979), apparently for its holding that in enforcement proceedings under Section 17(a) of the Securities Act of 1933 only negligent misconduct, not scienter, need be shown. The case does not aid the Division's position.

23/ This conclusion makes it unnecessary to rule on Mrs. Bertoli's contention that Bertoli's investigative testimony, which is the sole evidence of the Raydop/Freelton transactions, should not have been admitted as against her.

claiming that he played an active role in causing the affiliated transactions to take place, contends that as an active Fund officer he knew or should have known they were taking place. His failure to rectify or prevent those transactions, it is contended, amounted to aiding and abetting the violations. Averell contends that the Division greatly overstates his participation in the Fund's management and ignores the role and responsibility of Dopler who was president both of the Fund and FMI, its investment adviser, and signed the Fund's quarterly reports reflecting its securities transactions.

As previously indicated, there is nothing in the record suggesting that Dopler participated in the Fund's day-to-day management. On the other hand, Averell's uncontroverted testimony shows that his role in the Fund's management was also very limited. Throughout the period under consideration, his place of work was Distributors' office in New Jersey rather than the Fund's office in New York City. Distributors engaged in a general securities and underwriting business. It engaged in no effort to sell Fund shares during 1972 because, among other things, current financial statements were not available. Distributors' and Averell's only activities on behalf of the Fund consisted of acting as transfer agent and processing redemption requests by Fund shareholders. For the first quarter of 1972, the Fund's books were at Distributors' office, but were apparently maintained by public

accountants. During the period in question, Averell was also a salesman for Dopco. Under the circumstances, I find no predicate for imposing on Averell a general oversight responsibility as if he had been the Fund's president. However, once he was apprised, as described below, that Bertoli was engaged in effecting "affiliated transactions," he had an obligation, as a principal Fund officer, to take measures designed to prevent continuation of that course of conduct.

The findings above concerning the Raydop/Freelton transactions are based on Bertoli's testimony, which was not offered or received as evidence against Averell. There is no evidence that Averell was aware of those transactions until after they had occurred or of the Dopco transactions at any time. Averell testified, however, that in August 1972 he attended a meeting with his father and the Fund's counsel, in the course of which counsel stated that the Commission investigation then in progress was concerned particularly with "affiliated trading." Counsel referred in this connection to Raydop and Freelton as the affiliated companies that had traded with the Fund. There is no indication that counsel referred to the Fund's transactions with Dopco. However, as a result of the meeting Averell was on notice that Bertoli was causing affiliated companies to engage in improper transactions with the Fund, and he should have taken steps designed to prevent further such transactions. There is no evidence that he did so. In September 1972, four additional transactions were effected between Dopco and the Fund. As to those transactions, I find that Averell willfully aided and abetted the Section 17(a)

violations.[24/]

Alleged Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

The order for proceedings alleges that during the period January-September 1972, Bertoli, Mrs. Bertoli and Averell willfully violated,and willfully aided and abetted violations of, the antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that, among other things, they failed to disclose to the Fund's shareholders that they had personal interests in companies whose securities the Fund purchased and sold. The transactions and interests on which the Division relies are as follows:

1. SYS Industries, Inc. The Fund purchased 6,600 shares of SYS common stock during the first quarter of 1972 and an additional 900 shares during the next quarter. When it went into receivership in November 1972,it still held the 7,500 shares. During the period when the Fund acquired the shares, Bertoli was president and a director of SYS and, at least through May 1972, he and Mrs. Bertoli each owned more than 10 percent of SYS's stock. With respect to Averell, the only "interest" referred to by the Division is that as of September 1972, when he testified, some of his clients owned an unspecified number of shares of SYS stock.

24/ Cf. Gross v. S.E.C., 418 F.2d 103 (C.A. 2, 1969).

2. Door Openings Corp. During the first quarter of 1972, the Fund bought 19,238 shares of Door Openings common stock and sold or otherwise disposed of 5,000 of these shares. In the ensuing quarter, it sold or otherwise disposed of an additional 4,000 shares. At the time the Fund went into receivership, it still held the remaining 10,238 shares.

Door Openings was a majority-owned subsidiary of SYS. Bertoli's brother was its president. Distributors, which as noted was wholly owned by Averell, was co-underwriter of a Door Openings offering of convertible debentures in May 1972. Additionally, with respect to Averell , the Division points out that in his testimony he acknowledged that he knew the Fund had a position in Door Openings; that some of his clients owned shares; that Distributors owned some warrants to purchase Door Openings stock; [25/] and that he knew that Bertoli's brother was the company's president.

3. Rojean Enterprises, Inc. During the first quarter of 1972, the Fund purchased 2,700 shares of Rojean common stock and 2,100 units which apparently consisted of one share of common and warrants to purchase two more. In the following quarter, the Fund bought an additional 5,000 shares of stock and

---

25/ The offering circular for the debenture offering indicates that Distributors received the warrants as part of its underwriting compensation.

3,600 units. All or most of these securities were still held when the Fund went into receivership.

Dopco and Distributors were members of an underwriting group for an offering of 100,000 Rojean units beginning in March 1972. According to Averell's September 1972 testimony, Distributors owned Rojean warrants and he owned some stock in the company. 26/

4. Mauchly Management Services, Inc. During the first quarter of 1972, the Fund purchased 176 units (consisting of common stock plus warrants to buy additional stock) and 2,200 shares of common stock of Mauchly. In the next quarter, it purchased 4,110 warrants and sold or otherwise disposed of 1,720 shares of common stock. The remaining Mauchly securities were still in the Fund's portfolio when it went into receivership.

Dopco and Distributors were co-underwriters of an offering of Mauchly units in December 1971 and January 1972. According to Averell's testimony, Distributors owned Mauchly warrants, and he understood, from conversations with others, that the Fund then or previously held Mauchly securities.

26/ The Division interpreted the testimony regarding Averell's stock ownership as referring to Mauchly Management Services, Inc., discussed *infra*. I read it as referring to Rojean.

The Division contends that Bertoli and Averell had "significant personal interests" in some or all of the above-named companies and in the Fund's transactions in their securities, which were potentially adverse to the interests of the Fund and its shareholders, and that the existence of such interests by persons who as officers of an investment company were fiduciaries represented material information which should have been disclosed to shareholders and prospective shareholders.[27/]

As noted, Bertoli made the Fund's investment decisions in 1972 and is therefore responsible for the transactions discussed above. With respect to at least two of the issuers, his personal interest is clear. Thus, he and his wife each owned more than 10 percent of SYS's stock. In addition, he was the company's president. He had an indirect financial interest in Door Openings, SYS's subsidiary, and his brother was president of that company.[28/] The record is silent as to who

---

27/ The Division, which had originally sought a finding against Mrs. Bertoli as well under the Section 10(b) - Rule 10b-5 allegation, now concedes that the evidence presented does not warrant such finding.

28/ On the record before me, Bertoli's links with Rojean and Mauchly are of a more elusive nature. As noted, Dopco and Distributors were underwriters of offerings of those companies' securities. Bertoli's affiliation with Dopco has been discussed above. And he knew, of course, that Averell, a fellow-officer of the Fund, owned Distributors. However, the record pertaining to Bertoli does not indicate whether the Fund purchased Rojean or Mauchly securities from or through the underwriters, whether the offerings had been completed at the time the Fund made its first purchase, or whether Dopco and/or Distributors had any material financial interest in those companies at the time the Fund bought, sold or held those securities. I therefore make no findings against Bertoli with respect to the Fund's transactions in Rojean and Mauchly securities.

was on the other side of the Fund's transactions in the securities of those companies, and there is no indication whether Bertoli personally benefited from those transactions. But by importing such securities into the Fund's portfolio, he placed himself in a position of potential conflict, since the Fund's interests were different from those of the issuers and of Bertoli himself. He "disabled himself from looking at the [Fund's portfolio] in a wholly disinterested way, with an eye single to the [Fund's] best interests. Investors had a right to know this." 29/ Yet no disclosure of Bertoli's interests or of the potential conflicts was made in the quarterly reports filed by the Fund reflecting transactions in SYS and Door Openings securities, or elsewhere.

Accordingly, I find that Bertoli willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. 30/

29/ The quotation is a paraphrase of the Commission's decision in Steadman Security Corporation, Securities Exchange Act Release No. 13,695 (June 29, 1977), 12 SEC Docket 1041, 1047-48, app. pending. See also Maldonado v. Flynn, CCH Fed. Sec. L. Rep. ¶96,805 (C.A. 2, 1979), where the Court, in a proxy statement disclosure context, stated: "Since self-dealing presents opportunities for abuse of a corporate position of trust, the circumstances surrounding corporate transactions in which directors have a personal interest are directly relevant to a determination of whether they are qualified to exercise stewardship of the company."

30/ In making that finding, I have assumed the applicability of the "clear and convincing" standard of proof as enunciated in the Collins case, supra, note 20.

Further, assuming that the Supreme Court's interpretation of Section 10(b) and Rule 10b-5 in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), is applicable to administrative proceedings — a position which the Commission does not believe to be required by that decision (see, e.g., Charles M. West, Securities Exchange Act Release No. 15,454 (January 2, 1979), 16 SEC Docket 592) — I find that Bertoli had the requisite scienter.

A different conclusion is required as to Averell, however. There is no evidence that he (or Distributors) had anything to do with the Fund's transactions in the four companies' securities and no clear evidence that prior to the August 1972 conference with the Fund's counsel he was aware of the fact that the Fund's portfolio included any of those securities. At that meeting, counsel pointed out as a problem area that the Fund held securities of certain companies in which Bertoli had an interest. Counsel specifically referred to Door Openings and may have mentioned SYS. Averell further stated in his September 1972 testimony that, based on conversations with his father, Fund counsel and others, he understood that the Fund had or had had positions in Mauchly and possibly Rojean. Again, the record is not clear as to whether he or Distributors had a material interest in any of the above companies at the time he learned that the Fund owned their securities. 30a/ While Averell admittedly became aware at an unspecified date in August that the Fund had in its portfolio securities of issuers in which he knew that Bertoli had a material interest, under all the circumstances, including the fact that the fraud allegation covers the period only through September 11, 1972, his failure to make or insist on immediate disclosure of Bertoli's interests does not in itself warrant a finding that he engaged in, or willfully aided and abetted, fraudulent conduct.

30a/ While Distributors owned Rojean and Mauchly warrants, the record does not show the extent of these holdings in August 1972. It is not clear to me that, as the Division suggests, the mere fact that at a previous time Distributors had been an underwriter for offerings of securities of those companies and Door Openings in itself constituted a material interest requiring disclosure.

Alleged Violations of Section 37 of Investment Company Act

The order for proceedings further alleges that by reason of the transactions described in the two preceding sections of this decision, Bertoli and Averell willfully violated and willfully aided and abetted violations of Section 37 of the Investment Company Act.[31/] Section 37 in pertinent part makes it a crime for anyone to steal, or "unlawfully and willfully" to convert to his own or another's use, the assets of a registered investment company. Although the Section is on its face a criminal provision, the Commission has held that administrative proceedings may be based on it.[32/] Here, however, the evidence falls short of establishing a violation of Section 37.

The Division asserts that between the beginning of 1972 and November of that year, when the receiver for the Fund was appointed, Bertoli caused the Fund's assets to be invested in securities in which he and persons associated with him had personal interests and transformed its portfolio from one comprised of listed securities worth over $325,000 to one containing over-the-counter securities with little or no value. Such conduct, it argues, amounted to "misuse or abuse" of the Fund's property which falls within judicial definitions of "conversion."[33/]

31/ Raydop and Freelton were also charged with violating Section 37, but the Division has not proposed that I find such violations by those respondents.

32/ International Research and Management Corp., Investment Advisers Act Release No. 617 (March 6, 1978), 14 SEC Docket 410. As there pointed out by the Commission, Section 37 has also been found to provide a basis for private actions and for Commission injunctive actions.

33/ The Division cites Brown v. Bullock, 294 F.2d 415, 419 (C.A. 2, 1961), which quoted from a Supreme Court decision interpreting the term "conver[sion]" in another statute as including "misuse or abuse of property."

The Division also refers to a decision holding that "the use of corporate funds to finance one's private scheme for gain" constitutes a willful conversion within the meaning of Section 37.[34/]

Even in an administrative context, the charge under consideration is a particularly serious one. And the evidence regarding the Fund's transactions in SYS, Door Openings, Rojean and Mauchly securities (insofar as it was admitted against Bertoli) is limited to the facts that transactions in such securities took place, and that those securities represented a major portion of the Fund's portfolio when it went into receivership. The record is far from clear as to the value of the Fund's portfolio when the receiver took possession in November 1972.[35/] Under the circumstances of this case, including the absence of evidence of personal benefit to Bertoli or his associates from the transactions discussed above, a finding that he willfully violated Section 37 would unduly enlarge the scope of that Section. A fortiori, such a finding is not warranted against Averell in view of my prior findings with respect to him.

34/ Tanzer v. Huffines, 314 F. Supp. 189, 194 (D.C. Del., 1970).

35/ In his December 1974 report to the U.S. District Court, the receiver characterized the portfolio at the time he took possession as one consisting of "speculative unlisted securities . . . . having no reliably ascertainable market or value." He further noted that according to the Fund's records (which, however, he described as being "in considerable disarray and uncertain completeness"), it carried the portfolio at a value of $242,600. At an unspecified time prior to submission of his report, he liquidated the portfolio for total proceeds of about $40,000.

Alleged Violations of Recordkeeping and Reporting Requirements

The order for proceedings includes allegations that Bertoli and Averell willfully aided and abetted violations by the Fund of

1. Section 31(a) of the Investment Company Act and Rule 31a-1 thereunder during the period December 1971-November 1972, in that they caused the Fund to fail to properly maintain certain required books and records; and

2. Sections 30(a) and (d) of the Investment Company Act and Rules 30a-1 and 30d-1 thereunder during the period May-November 1972, in that they caused the Fund to fail to file with the Commission and transmit to shareholders its annual report for the year ended December 31, 1971.

During an inspection of the Fund in late June and early July 1972, staff compliance examiners determined that the Fund's books and records were deficient in various respects. General and auxiliary ledgers were not kept current; the purchase and sales journal did not show the market on which each portfolio transaction was effected; and the dividend memorandum record, the record of each brokerage order, monthly trial balances and the quarterly record showing, among other things, the basis for the allocation of brokerage orders were not maintained as required by Rule 31a-1.

The staff examiners, who testified at the hearings, had no present recollection regarding the condition of the Fund's books and records as they found it. The above findings of deficiencies reflect pertinent parts of the inspection report which were received in evidence. The inspection report speaks in general terms, essentially as paraphrased above, and, as Bertoli and Averell point out, gives no indication of the period or extent of the deficiencies. As testified by one of the examiners, however, it is and was normal practice to determine compliance with the requirements as of the time of the inspection. I am satisfied from that testimony and the inspection report itself that as of the time of the inspection (and therefore within the period covered by the allegation) the Fund's books and records were not in compliance with, and therefore were in violation of, applicable requirements. On the other hand, there is simply no way to appraise the seriousness of the deficiencies.[36/]

Bertoli claims that there is no evidence that during the relevant period "he" had any of the books and records cited in the inspection report. However, the testimony of the

---

36/ Reference was made in the preceding footnote to the receiver's characterization of the Fund's books and records, when he received them, as being "in considerable disarray and uncertain completeness." In accepting parts of the receiver's report in evidence, I indicated that I would not give much weight to statements of this nature, as distinguished from strictly objective statements. In any event, his comments cannot be tied in with the specific deficiencies alleged.

staff examiners and Bertoli himself shows that at the time of the inspection the books and records for the most part were maintained at Dopco's offices (which, it appears, were also the Fund's offices). Bertoli further testified that Dopco paid the Fund bookkeeper's salary,[37/] and that he participated in hiring a series of bookkeepers. As previously noted, Bertoli "generally administer[ed]" Dopco.[38/] Under the circumstances, I find that he willfully aided and abetted the Fund's recordkeeping violations. On the other hand, in light of the uncertainty regarding the extent of the deficiencies, that finding is given little weight in the determination of the appropriate sanction.

The record does not warrant an adverse finding with respect to Averell. It indicates that he had nothing to do with the records in question at the time of the inspection or in the weeks preceding it. And there is no indication that he was on notice of any deficiencies in those records during that period.

With reference to the reporting requirements, it is undisputed that no report for the Fund's 1971 fiscal year was filed with the Commission or transmitted to shareholders. It appears from Bertoli's testimony that an annual report was prepared in part, and that the failure to complete it was attributable to

---

37/ He explained that while the management company (FMI) had the responsibility for paying the Fund's recordkeeping expenses, it had no money with which to do so, and that Dopco's interest derived from the fact that its parent, Paramount, had a twenty percent equity interest in FMI and contemplated a merger with FMI.

38/ Note 16, *supra*.

problems with the Fund's accountants persisting from a period preceding the change in the Fund's management in late 1971. In view of the murky and skimpy state of the record on this matter and with respect to the management of the Fund during 1972, a finding that Bertoli and/or Averell willfully aided and abetted violations of the reporting requirements is not warranted.[39/]

Bertoli's Motion to Dismiss

Claiming that there was undue delay between completion of the Division's investigation and the institution of these proceedings in January 1975 and that such delay prejudiced him by preventing him from adequately defending himself, Bertoli moves for dismissal of the proceedings against him. He also requests a hearing on the motion for the purpose of examining staff members involved "in this matter" during the period from mid-1972 through January 1975.[40/]

While Bertoli variously asserts or suggests that the Division's investigation was concluded in July or at the latest August 1972, and that the case then remained dormant until the end of 1974, the record does not support this view of the matter. Thus, Averell's investigative testimony was taken in

---

39/ The Division has not sought any findings against Bertoli and Averell with respect to alleged violations of Section 10(a) of the Investment Company Act.

40/ Bertoli has offered no explanation for his failure to raise the issue of delay prior to November 1978, when hearings on the merits commenced.

September 1972. The Division states that the investigative testimony of one of the original respondents was not taken until April 1974. Even assuming, however, that there was a lack of diligence by the Division in bringing its allegations before the Commission, Bertoli has failed to show that he was prejudiced.[41/]

Bertoli's claim of prejudice rests on the fact that three asserted key witnesses died, two in 1974 and one in 1977, and on the claimed unavailability of others, including Bertoli himself, because of "failure of memory due to the extended time lapse of over seven years." It thus appears that, aside from the two persons who died in 1974, Bertoli's contentions rest in large part on the delay following institution of the proceedings, to the time of the hearings. Neither side can be "blamed" for that delay. But if Bertoli deemed that his defense would be prejudiced if certain potential witnesses became unavailable, he should have taken steps to preserve their testimony. In any event, no such prejudice appears.

Charles Bernstein, who died in 1977, was an officer of Dopco and a director of FMI (not an officer as Bertoli asserts) during the relevant period. According to Bertoli's "offer of proof," Bernstein could have testified that Dopco's trades with

---

41/ It is clear that the absence of a showing of prejudice is fatal with respect to a motion such as that before me. See Costello v. U.S., 365 U.S. 265, 281-284 (1961); Commonwealth Securities Corp., 43 SEC 833, 840 (1968), remanded on other grounds, 413 F.2d 832 (C.A. 6, 1969); Richard N. Cea, 44 S.E.C. 8, 20-22 (1969); D.H. Blair & Co., 44 S.E.C. 320, 333 (1970). Bertoli himself states that under applicable cases, the sole question is whether he has shown substantial prejudice.

the Fund were reasonable as to price and execution, that Bertoli, Mrs. Bertoli, Raydop, Freelton and Dopco had no "intent to benefit" in transactions involving the Fund and that Freelton, Raydop and Mrs. Bertoli in fact lost money on such transactions. The testimony which a now deceased person would have given is of course conjectural. Here, it is not apparent how Bernstein could have testified regarding the intent of other persons or of companies with which he was not associated. Bertoli himself testified in 1972 that Raydop and Freelton lost money on their transactions with the Fund.[42/] And Bertoli, who caused the Fund's transactions with Dopco to take place, was in the best position to testify concerning them. In this connection, I simply cannot credit Bertoli's bald assertion that he has no present recollection respecting "the events involved in this action."

Bertoli refers to an asserted lack of memory by various other persons. He has attached to his motion affidavits by Averell, Sr. and John B. Huhn, both of whom were Fund and FMI directors in 1971. Averell, who was also president of the Fund and FMI, may have continued as a director and possibly as Fund president into 1972. According to the affidavits, Averell and Huhn are 76 and 81 years old, respectively, live in Florida,

---

42/ There is no allegation or finding regarding transactions between Mrs. Bertoli and the Fund.

are unable to travel and have no present recollection with respect to matters concerning the Fund and FMI. However, these generalized claims of absence of recollection are meaningless. And arrangements could have been made to take the testimony of these gentlemen at their homes, by deposition or otherwise, had Bertoli so requested. Moreover, it does not appear that Huhn was a director either of the Fund or of FMI during the relevantperiod.

Bertoli refers additionally to the lack of memory of certain persons who testified at the hearings, including Stanley Simon, a one-time director of the Fund, and several staff members.[43/] But Simon resigned as a Fund director in December 1971. And the staff members testified only regarding the Fund's books and records which play a minor role in my disposition of these proceedings. Moreover, it cannot be assumed that, had they recalled the state of those books and records and thereby enabled me to make findings beyond those based on their generally worded inspection report, their testimony would have been favorable to Bertoli.

43/ Bertoli also adverts to an asserted lack of memory by John Malkin, at one time a director of the Fund, and by respondent Averell. These are wholly unsupported assertions.

Turning to the two individuals who died in 1974, one of them, Julius Frank, had been an officer and director of FMI but no longer held those positions during the period relevant here. The other, William Dahlman, was an officer and director of the Fund in 1971 and apparently continued as a director in 1972. Bertoli asserts that Dahlman could have testified, among other things, to the following matters: that the directors were aware that Fund portfolio activity was increased with a view to creating short-term profits so as to utilize the Fund's tax loss carry-forward, its "only valuable asset"; that the directors knew of the Fund's investments in the securities of SYS and Door Openings and the fact that Bertoli was SYS's president; that Bertoli had "only the best intentions" in investing Fund assets in those securities; that the Fund made substantial profits in its transactions in Door Openings stock; and that Fund actions "were directed for the most part" by its assistant secretary, an attorney associated with the Fund's law firm, who knew that the Fund purchased SYS stock and that Bertoli was SYS's president. Bertoli further asserts that Dahlman would have testified that "all parties" and the above attorney believed that the "activity in the Fund" was proper until it was challenged by the Commission's staff.

Aside from the fact that there simply is no way to determine whether Dahlman would have testified as Bertoli posits,

Bertoli's "offer of proof" itself indicates that Bertoli himself could have testified concerning the enumerated matters and refutes his claimed lack of memory. Moreover, certain of those matters -- such as the directors' purported knowledge of his investment activities for the Fund -- are irrelevant to the issues in these proceedings. And Bertoli has not indicated why he could not have called the Fund's former assistant secretary to testify regarding the latter's knowledge and activities.

Public Interest

The remaining issue is what, if any, sanctions are appropriate in the public interest with respect to those respondents found to have willfully violated, or willfully aided and abetted violations of, the securities laws. As to Bertoli, the record reflects a pattern of causing illegal affiliated transactions and transactions in securities of companies in which he had significant personal interests without disclosure of those interests to the Fund's shareholders. With limited exceptions, Bertoli's assertion that the Fund sustained no loss on any of these transactions and that he derived no personal benefit from them is without support in the record. [44/] And while he

---

44/ Bertoli's 1972 testimony covered only the Raydop and Freelton transactions.

testified in 1972 that it was his impression that an investment company could legally trade with affiliated entities, as long as a broker receiving a commission was interposed, he was unable to identify the source of that impression. I have given consideration to the fact that the Fund was already in a very precarious state when Bertoli took over its management. But his regime was characterized by self-dealing and nondisclosure of material information. That abuse of his fiduciary position requires, in my judgment, that he be excluded for a substantial period from the investment company, investment advisory and broker-dealer business, and that he be permitted to return thereafter only in a nonsupervisory position under proper supervision.

As to Averell, who has been found to have failed to prevent a few violations of Section 17(a) of the Investment Company Act, censure appears to be an adequate sanction.

Finally, with respect to Raydop and Freelton, the Division seeks a sanction only under Section 9(b) of the Investment Company Act.[45/] While Raydop and Freelton willfully violated Section 17(a) in two and one transaction(s), respectively, no useful purpose would be served by imposing restrictions on their association with an investment company in the capacities covered by Section 9(b). There is no real likelihood that such an

---

45/ Thus, the Division's argument that each of those companies was a "dealer," within the meaning of the Exchange Act, and as such subject to sanctions under Section 15(b)(4) of the Exchange Act, need not be considered.

association could come about. And Bertoli, their controlling person and the culpable individual, will be appropriately restricted by the order herein.

ORDER

On the basis of the above findings and conclusions,[46/] IT IS ORDERED that

(1) Richard O. Bertoli's motion to dismiss and his request for a hearing on the motion are hereby denied;

(2) Bertoli is hereby permanently prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, provided that after two years he may apply to the Commission for permission to so serve or act in a capacity which is nonsupervisory in nature, upon an adequate showing that he will be properly supervised;

(3) Bertoli is hereby barred from association with an investment adviser, broker or dealer, provided that after two years he may apply to the Commission for permission to become so associated in a nonsupervisory position, upon an adequate showing that he will be properly supervised;

46/ All proposed findings and conclusions and contentions submitted by the parties have been considered. To the extent such proposals and contentions are consistent with this initial decision they are accepted.

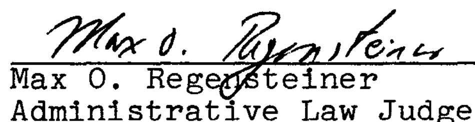
(4) Alfred B. Averell, Jr. is hereby censured;

(5) The proceedings with respect to Raydop Corporation and Freelton Investments Limited are hereby discontinued; and

(6) The proceedings with respect to Catherine Bertoli are hereby dismissed.

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

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



Max O. Regensteiner
Administrative Law Judge

Washington, D.C.
June 18, 1979