

ADMINISTRATIVE PROCEEDING
FILE NO. 3-4256

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FILED
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SECURITIES & EXCHANGE COMMISSION

In the Matter of
COMTECH VENTURE FUND, INC.
24W-3104

INITIAL DECISION

Sidney Ullman
Administrative Law Judge

Washington, D. C.
November 8, 1973

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INITIAL DECISION

APPEARANCES: Edward Kwalwasser and Thomas J. Baudhuin, of the Washington Regional Office of the Commission, Ballston Centre Tower #3, 4015 Wilson Boulevard, Arlington, Virginia, (William R. Schief Regional Administrator, Paul F. Leonard Assistant Regional Administrator on the Briefs), for the Division.

Robert M. Temko, 610 Sussex Road, Towson, Maryland, for Comtech Venture Fund, Inc.

BEFORE: Sidney Ullman, Administrative Law Judge

THE PROCEEDINGS

These proceedings were instituted by the Commission pursuant to Rule 261 of Regulation A of the Securities Act of 1933 ("Securities Act") to determine whether to vacate or to make permanent an order issued by the Commission on April 18, 1973, ("Order"), temporarily suspending an exemption from Regulation A with respect to a public offering of shares proposed to be made by Comtech Venture Fund, Inc. ("Comtech"). The Order of April 18, 1973 provided that on written request the Commission would set the matter down for hearing "for the purpose of determining whether [the] order of suspension should be vacated or made permanent. . ." Pursuant to an appropriate request by Comtech the matter was scheduled for a hearing which was held on May 29, 1973.

Following the hearing the parties filed proposed findings of fact, conclusions of law and briefs in support of their respective positions. Counsel for the Division of Corporation Finance ("Division") urged that the temporary suspension be made permanent: counsel representing Comtech urged that the Commission permit an amendment to the notification and offering circular which are here in question, and that the temporary suspension of the Regulation A exemption be vacated.^{1/}

^{1/} Regulation A, adopted under Section 3(b) of the Act, provides for exemption from registration when an issuer offers securities with an aggregate public offering price not exceeding \$500,000 provided, among other things, that the issuer files with the Commission a notification (and except where dispensed with under Rule 257 an offering circular) containing certain minimum information.

(CONTINUED)

The Order asserts, in substance, that the Commission has reasonable cause to believe that the terms and conditions of Regulation A have not been complied with because:

1. An affiliate of Comtech, First Federated Commodity Trust Corporation ("First Federated") and John R. Singleton ("Singleton"), an officer, director, and promoter of Comtech, are subject to a decree permanently enjoining them from fraudulent conduct in violation of the Maryland Securities Act;
2. The \$500,000 ceiling limitation of Regulation A has been exceeded by reason of a sale of over \$500,000 of unregistered securities by an affiliated issuer.

The Order also asserts that the notification and offering circular contain untrue statements of material facts and omissions of material facts with respect to the failure to amend the notification and offering circular to disclose the injunction and the sale of unregistered securities by an affiliate in violation of Sections 5 and 17 of the Securities Act; and also that the offering, if made, would be made in violation of Sections 5 and 17 of the Securities Act.

On the basis of the record, including the post-hearing documents filed by the parties, the undersigned makes the following findings of fact and conclusions of law.

1/ Continued.

Rule 261(a), as applicable here, provides for the issuance of an order temporarily suspending an exemption if the Commission has reason to believe that any of the terms or conditions of Regulation A have not been complied with, that the notification contains any untrue statement of a material fact or omits to state a necessary material fact, or that the offering is being made or would be made in violation of Section 17 of the Act, which pertains to fraudulent interstate transactions.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Comtech was incorporated in the State of Maryland on December 20, 1970. On September 5, 1972, the company filed with the Washington Regional Office of the Commission a notification and offering circular pursuant to Regulation A for the sale of 83,200 shares of its common stock at \$5 per share. The filing was subsequently amended to increase the offering to 100,000 shares at \$5 per share, for an aggregate offering of \$500,000.

On January 12, 1973, pursuant to a letter of comment from the staff of the Commission, Comtech disclosed in amendments to its notification and offering circular that First Federated was an affiliate of Comtech by virtue of the relationship of Singleton to First Federated. Subsequent amendments were filed on February 15, 1973 in connection with the Regulation A filing.^{2/}

At the time of the filing of the notification, Singleton was connected with Comtech in the capacity of promoter, vice-president, principal shareholder owning 2,000 of the 8,400 shares then outstanding, affiliate, and proposed investment broker for the operations of Comtech. The offering circular filed with the notification, under the heading "Interest of Management in Certain Transactions," stated:

^{2/} The dates of some of the filings are sometimes confusing because of differences in the time stamps of the Washington Regional Office and of the Commission's main office.

Messrs. Robert M. Temko, John R. Singleton, and Terry Hofmann of Baltimore, Maryland, acted as the organizers of the Company and were instrumental in bringing together the two other individual shareholders who purchased 4,000 shares of the Company's Common Stock for \$10,000 (\$2.50 per share). Messrs. Temko, Singleton, Hofmann, Herche and Kraus may be deemed the "Promoters" of the Company as such term is defined in the Securities Act of 1933."

On March 7, 1973, the Baltimore County Circuit Court of the State of Maryland had filed a consent decree permanently enjoining, among others, Singleton and First Federated from further violations of the Maryland Securities Act. Federated was organized and became affiliated with Comtech within the past two years. Federated had effected sales of unregistered securities in the form of "naked commodity options" throughout the United States in excess of \$500,000 within one year prior to the Commission's order of temporary suspension of April 18, 1973.

Rule 252(d)(2) of the General Rules and Regulations under the Securities Act states that a Regulation A exemption is not available to an issuer "if any of its directors, officers or principal security holders, any of its promoters presently connected with it in any capacity (2) Is subject to any order, judgment or decree of any court of competent jurisdiction temporarily or permanently restraining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security. . . ."

Rule 252(c)(4) states that such exemption is not available "if such issuer. . . or any affiliated issuer [i]s subject to any order, judgment or decree of any court of competent jurisdiction, entered

within 5 years prior to the filing of such notification, temporarily or permanently restraining or enjoining such person from engaging in or continuing such conduct or practice in connection with the purchase or sale of securities."

Rule 254 provides that the aggregate offering price of all securities of the issuer and of any of its affiliates which were incorporated or organized or became its affiliates within the past 2 years, which are being offered under Regulation A and which were sold in violation of section 5(a) of the Securities Act within 1 year prior to the commencement of the proposed offering shall not exceed \$500,000.

The Division contends that inasmuch as Federated and Singleton were enjoined on March 7, 1973 by the Circuit Court of Baltimore County^{3/} from continuing to engage in the sale of naked commodity options in violation of the Maryland Securities Act, the Regulation A exemption is not available because of the proscriptions of Rules 252(d)(2) and 252(c)(4). Inasmuch as the injunction falls within the ambit of Rule 252(d)(2) and its proscription on the availability of the Regulation A exemption, it follows that said exemption is unavailable to Comtech, absent the relief which it requests.

Conversely, inasmuch as Rule 252(c)(4) relates to court decrees "entered within 5 years prior to the filing of such notification," the injunction of March 7, 1973 does not affect the notification filed on September 5, 1972.

^{3/} The decree was issued on consent "solely for the purpose of settlement of these proceedings and without admitting or denying any or all of the allegations in the Bill of Complaint. . ."

As noted above, the Division also contends that the sale by First Federated, when added to the \$500,000 issue under consideration, would exceed the "aggregate offering price" limitation under Rule 254. There appears to be no dispute concerning the basis for the injunction against Federated and Singleton, i.e., that it was predicated on the offer for sale and sale of naked commodity options.^{4/} At the hearing, however, counsel for Comtech argued that such options are not securities, and that the sale of such options did not constitute the sale of unregistered stock. (This position may have been abandoned, for it is not urged in Comtech's post-hearing brief.)^{5/}

At the hearing, counsel cited the case of Milnarik v. M-S Commodities, Inc. et an., 320 F. Supp. 1149 (U.S.D.C., E.D. Ill.) in support of his argument. The case is inapposite, for it involved the question whether or not a discretionary trading account in commodity futures was subject to registration requirements under Section 5 of the Securities Act. The court made a clear and express distinction between this oral contract creating the discretionary account of the plaintiff customer

^{4/} A commodity option gives the purchaser the right to buy and/or sell a futures contract at a set price during a specified time. A naked option is one sold without the seller owning a futures contract or the physical commodity to back it up.

^{5/} The answer filed by Comtech admitted, in part, that Singleton and First Federated are subject to the permanent injunction against engaging in any fraudulent practice in violation of the Maryland Securities Act, but asserted that the court decree was under appeal. However, the Division's post-hearing filing asserts that on May 29, 1973, the Baltimore Court issued a preliminary oral opinion upholding the consent decree. This is not disputed in the Comtech post-hearing documents.

with the defendant broker and commodity futures contracts, which it assumed were securities. The contract under review was found to be a private agency agreement under which the "so-called 'buyer' had transferred funds to the so-called 'seller' and given him authority to enter into futures transactions on the 'buyer's' behalf." It was clearly not required to be registered under the Securities Act.

The Division's position has been asserted by the Commission in recent situations under factual circumstances which vary with each case. The argument that the offer and sale to the public of commodity options constitutes the public offer and sale of a "security" within the meaning of Section 5 was adopted by the court in Traders International, Ltd. on July 25, 1973 (U.S.D.C., D. Nevada), (Proceedings for Arrangement No. 7350). That court reviewed the decisions holding that an investment contract is a security and that diverse business arrangements, regardless of their form or name, have been established as investment contracts. Cf. Securities and Exchange Commission v. W. J. Howey Company, 328 U.S. 293-298 (1945); Tcherepnin v. Knight, 389 U. S. 332, 336 (1967); Securities and Exchange Commission v. C. M. Joiner Leasing Corp; 320 U. S. 344, 351 (1943).^{6/} The court also emphasized the remedial aspects of the Securities Act and the need for its broad

6/ In the recent case of Securities and Exchange Commission v. Goldstein, Samuelson, Inc. et al., capitulation of the defendants to the position of the Commission obviated the need for determination by the court. (Civil Action No. 73-472-MML, U.S.D.C., Central Dist. Calif.).

construction in order that the public may be protected from speculative schemes.

Another aspect of the Division's argument is the axiomatic concept that the burden of establishing the availability of an exemption from registration rests upon the one who claims it. S.E.C. v. Ralston Purina, 346 U. S. 119 (1963). This concept not only strengthens the conclusion that the sale of the commodity options by Federated constituted the sale of securities by an affiliate and would be a predicate for the violation of the \$500,000 ceiling if the Comtech offering took place, but it also strengthens the conclusion that Section 5 was violated by the Federated offer and sale of unregistered securities to the public.

More than this, it imposes on Comtech the burden of establishing the exemption which it seeks in connection with the instant offering. As noted, Comtech requests that an amendment of the notification and offering circular be permitted, urging that it would be appropriate because of a change in circumstances.

The Proposed Amendment

Comtech's Exhibit No. 1 is a document dated May 18, 1973, in which Singleton states that he resigns "as director and officer of Comtech Venture Fund, Inc. and will also no longer act as a promoter of the same." It continues as follows: "I simultaneously execute the transfer of my shares and warrants to Robert M. Temko for the consideration of two thousand dollars, receipt of which is hereby acknowledged." (Robert M. Temko is Comtech's counsel, its president, a director and a promoter, and he originally owned 2000 of its shares). Counsel for Comtech urges,

therefore, that Singleton is no longer an affiliate or promoter of Comtech, that the amendment should be permitted to reflect the change, and that the temporary suspension should be lifted.

The Division cites cases in which the Commission has adopted a strict test of "a clear showing of good faith and other mitigating circumstances" before considering amendments to correct deficiencies in a notification and offering circular under Regulation A. In the Matter of Illowata Oil Company, 38 S.E.C. 720 (1958), 39 S.E.C. 342 (1958); In the Matter of American Television and Radio Co., 40 S.E.C. 641 (1961). In the Illowata decision the Commission emphasized the importance of an accurate filing in the first instance, stating:

"The opportunity to amend cannot in any event be permitted to impair the required standards of careful and honest filings under the Regulation and encourage a practice of irresponsible or deliberate submission of inadequate or false material followed by correction by amendment of the deficiencies found by the staff in its examination. Not only would a free amendment procedure tend to result in less than full and accurate disclosure, but it would impose unwarranted administrative burdens that would tend to impair our investor-protection functions generally. . ."

This position was endorsed in American Television and Radio, where the Commission refused to permit the amendment of the filings because of serious deficiencies, quoting in part the above language from Illowata.

Comtech's counsel (and president) urges that the good faith requirement has been met. His post-hearing filing states that on March 12, 1973, upon learning of the injunction of March 7 against First Federated and Singleton he telephoned Division counsel "to inquire

what should be done" and was told "that they were considering the implications of said consent decree;" that on March 26 he called and was told that "a decision was forthcoming;" and that he took no action "pending some decision by the Securities and Exchange Commission." He also states that an additional call was placed on April 2, 1973, but does not indicate the result.

Comtech's counsel now also asserts that the offering circular, if amended, would afford a potential investor the opportunity to make an informed judgment, and that it "is much more specific in setting out the risks involved than any previous Offering Circular or Prospectus of which [he] is familiar. . ."^{7/}

The Division's Reply Brief correctly points out that no evidence of the asserted good faith appears in the record of these proceedings. The importance of this fact is emphasized by a vigorous denial that any member of the staff had ever discussed with Comtech counsel or any other representative of the company "the consent decree or its effect on Comtech's Regulation A filing" during the period mentioned.^{8/}

7/ Page 7 of Brief. This argument does not seem to be worthy of great weight, for it is noted that at page 5, in support of his good faith argument, he states that he "has never filed an offering of this nature before nor has been associated with such offering."

8/ The Reply Brief concedes that telephone conversations with Comtech's counsel took place prior to and during the period cited, but denies discussion of the injunction decree prior to April 18, 1973, the day on which the Order was issued.

Absent any evidence in the record of good faith and adequate mitigating circumstances supporting the amendment, it is needless to discuss the Division's detailed statement and version of the actual conversations with counsel for Comtech. The evidence and the facts do not support the request for amendment, particularly in light of the policy against a free amendment procedure.^{9/} The burden imposed on Comtech under Ralston Purina has not been met and, conversely, the evidence indicates that the offering would contravene the above-mentioned Rules. It would also be made in violation of Section 5 of the Securities Act as a sale of unregistered shares and in violation of the anti-fraud provisions of Section 17 of that Act. Accordingly, it is concluded that the temporary suspension of the Regulation A exemption should be made permanent, and

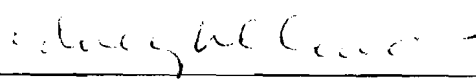
IT IS ORDERED, pursuant to Rule 261(c) under the Securities Act, that the exemption of Comtech Venture Fund, Inc. under Regulation A is hereby permanently suspended.

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 Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to

^{9/} Since the record of these proceedings reflects no amendment reporting the injunction of March 7, 1973 during the six weeks prior to issuance of the Order, the Commission policy would be contravened by permitting amendment following that Order.

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 10/ final with respect to that party.



Sidney Ullman
Administrative Law Judge

Washington, D. C.
November 8, 1973

10/ To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the views herein they are accepted, and to the extent they are inconsistent therewith they are rejected.