U.S. Securities and Exchange Commission

Office of Municipal Securities:

Cases and Materials

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THE ISSUER

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<u>Securities and Exchange Commission v. Robert D. Gersh, Boston Municipal Securities, Inc., and Devonshire Escrow and Transfer Corp.</u>, Civ. Action No. 95-12580 (RCL) (D. Mass.), Litigation Release No. 14742 (November 30, 1995) (complaint).

The Securities and Exchange Commission announced the filing of a complaint in the United States District Court for the District of Massachusetts, seeking a temporary restraining order, preliminary and permanent injunctions, disgorgement, civil monetary penalties and an asset freeze and other equitable relief against Defendants Robert D. Gersh ("Gersh"), of Burlington, Massachusetts, Boston Municipal Securities ("BMS"), and Devonshire Escrow and Transfer Corp. ("Devonshire") and Relief Defendants Ma'Ayan Book Company, Charles River Landing, Ltd., CRL Group, Inc., Culinary Classics of Chestnut Hill, Inc., Culinary Classics of Burlington, Inc., The Kitchen Shelf, Inc. and the Compu-Bill Co., Inc. ("Relief Defendants"). The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and Section 17(a) of the Securities Act of 1933.

On November 30, 1995, the Honorable Reginald C. Lindsay granted the Commission's request for an ex parte Temporary Restraining Order, and an order freezing assets of the Defendants and Relief Defendants, requiring an accounting of these assets and granting other relief. A Hearing on the Commission's application for a Preliminary Injunction has been set for December 12, 1995.

The complaint alleges that from early 1990 to the present, Defendant Gersh and two of his wholly-owned corporate entities, Defendants BMS and Devonshire, offered and sold securities in the form of Certificates of Participation ("COPs") in 34 securities offerings which raised approximately $14 million from investors in at least six states. In connection with the offer and sale of these securities, the complaint alleges that the Defendants have engaged in continuing fraudulent acts which include the misappropriation of over $7 million in investor funds.

The complaint alleges that, to induce public investors to invest in these COPs, the Defendants marketed the offerings as tax-exempt municipal securities, collateralized by equipment leases entered into by state and local governments. The Defendants made multiple false statements and omissions of material fact. These included falsely promising that investments were fully-secured by state and municipal obligations, that Gersh would merely pass-through the collateral payments to investors and that a trustee would protect the interests of investors. In fact, however, Gersh only used a portion of the proceeds to invest in state and local government leases. Gersh commingled the proceeds of the investments and misappropriated the monies to invest in a variety of personal business ventures. The complaint further alleges that Gersh's failure to use investor proceeds as represented deprived investors of information material to an assessment of the tax-exempt status of the COPs.

The complaint further alleges that Gersh falsely represented that a portion of investor monies would be set aside in a debt service reserve account, failed to disclose that he exercised control over the trustee, and falsely represented that the COPs were issued pursuant to the authority of state or local government agencies. On July 1 and September 1, 1995, Gersh defaulted on two COPs issues, the State of Washington Series 1990A ($380,000) and the State of Wisconsin Series 1990A ($380,000), respectively, and those funds have not been repaid to investors.

According to the complaint, additional COPs defaults are imminent. Approximately $2,220,000 of the COPs securities, consisting of the State of Florida Series 1990A ($1,250,000), the State of Wisconsin Series 1990B ($270,000) and the City of Providence, Rhode Island Series 1990B ($700,000), mature on

December 1, 1995. Three other Gersh COPs issues, consisting of the Westchester County, NY 1981 G Lane ($415,000), Livingston County, NY ($400,000) and Onondaga County, NY ($805,000), mature on December 31, 1995, January 31, 1996 and December 15, 1996, respectively. Gersh-controlled bank accounts currently contain only $319,000 and nearly all of the leases securing the outstanding COPs have been prepaid. Gersh has no other apparent source of funds available to repay COPs investors. Accordingly, the complaint alleges that expedited action is necessary to preserve remaining assets and assure an equitable distribution of any remaining funds to all investors.

Securities and Exchange Commission v. Robert D. Gersh, Boston Municipal Securities, Inc., and Devonshire Escrow and Transfer Corp., Litigation Release No. 15310 (March 31, 1997) (settled final order).

The Commission announced that, on March 20, 1997, the Honorable Reginald C. Lindsay of the U.S. District Court for the District of Massachusetts enjoined Robert D. Gersh ("Gersh"), Boston Municipal Securities, Inc. ("BMS") and Devonshire Escrow and Transfer Corp. ("Devonshire") from further violations of certain antifraud provisions of the securities laws. The complaint, filed on November 29, 1995, alleged that the defendants had conducted a fraudulent offering of $14 million in securities in the form of certificates of participation ("COPs").

Gersh, BMS and Devonshire consented to the injunctive orders without admitting or denying the complaint's allegations. Gersh was also ordered to disgorge $7,451,935, plus prejudgment interest thereon, provided, however, that payment of $5,949,185 of such amount, plus the prejudgment interest, was waived based on his demonstrated inability to pay.

The complaint alleged that from early 1990 to the present, Defendant Gersh and two of his wholly-owned corporate entities, Defendants BMS and Devonshire, offered and sold COPs in 34 securities offerings which raised approximately $14 million from investors in at least six states. In connection with the offer and sale of these securities, the complaint alleged that the defendants made numerous misrepresentations and omissions of material facts and misappropriated over $7 million in investor funds.

The complaint alleged violations of the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and Section 17(a) of the Securities Act of 1933 and sought a temporary restraining order, preliminary and permanent injunctions, disgorgement, civil monetary penalties and an asset freeze and other equitable relief. On November 30, 1995, the Court issued a temporary restraining order and asset freeze against the defendants. In addition, on December 11, 1995, the Court granted the Commission's motion for appointment of a receiver to take control of the assets of the corporate and relief defendants, and those assets are being operated by the receiver for the benefit of investors. On January 12, 1996, after a hearing, Judge Lindsay granted the Commission's request for a preliminary injunction against the defendants. (For further information, See Litigation Release Nos. 14742 and 14785).

SEC v. San Antonio Municipal Utility District No. 1, et al., Civ. Action No. H-77-1868 (S.D. Tex.), Litigation Release No. 8195 (November 18, 1977) (settled final order).

The Securities and Exchange Commission announced the filing of a complaint in the U.S. District Court in Houston seeking to enjoin San Antonio Municipal Utility District No. 1 ("District"), San Antonio Ranch Ltd., No. 1 ("Developer") and Surety Savings Association ("Surety") from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder arising from the offer to sell, sale and purchase of municipal securities namely, $2.5 million Unlimited Tax Bonds Series 1976 bearing a coupon interest rate of 9.03% issued by the District.

The District is a raw land district in Bexas County, Texas. The Developer owns 99% of the land within the District, which was formed in connection with a real estate development. Surety, a savings and loan association, purchased the Bonds pursuant to a commitment to bid and later resold $1.575 million of the Bonds.

The Complaint alleges that the disclosure documents used in connection with the offering and sale to the public of the District's Bonds omitted to disclose a multifaceted financing agreement entered into in April, 1976, by the Developer and Surety and omitted to disclose financial information about the Developer.

The financing agreement included commitments by Surety to bid and purchase the Bonds, to make land refinancing ($6.5 million) and development ($2.5 million) loans to the Developer and affiliates, and to purchase $3,000,000 in notes or securities from the Developer or its designees; and commitments by the Developer to purchase $5.5 million of real estate paper from Surety, $20 to $25 million in whole life insurance from a mutually acceptable life insurance company and to participate in a joint venture to purchase $1 million of real estate from Surety. Large portions of the proceeds of the land refinancing and development loans were used to fund the cost of the purchase of the real estate paper.

The District, the Developer and Surety, without admitting or denying the allegations of the Complaint, consented to the entry of orders of permanent injunction enjoining them from further violating the aforementioned provisions of the Federal Securities laws.

SEC v. Whatcom County Water District No. 13, et al., Civ. Action No. C77-103, (W.D. Wash.), Litigation Release No. 7810 (March 7, 1977) (complaint).

Jack H. Bookey, Administrator of the Seattle Regional Office of the Securities and Exchange Commission, announced today that a complaint was filed in the United States District Court for the Western District of Washington at Seattle, Washington on February 10, 1977 seeking an injunction against Whatcom County Water District No. 13, County of Whatcom, Washington (the District), Steven J. Isenhart (S. Isenhart), Thomas E. Isenhart (T. Isenhart), Kristine L. Isenhart (K. Isenhart), all of Sumas, Washington, Harold E. Isenhart (H. Isenhart) of Lynden, Washington and James E. Isenhart, Jr. (J. Isenhart) of Maple Falls, Washington to enjoin them from further violations of the anti-fraud provisions of the federal securities laws in connection with the offer and sale of the District's water and sewer revenue bonds. As to the defendant District, the complaint also seeks an order requiring it to disclose the injunction to existing and future investors and to issue a disclosure statement to existing investors setting forth the substantive and material elements of the bond issue including a correction of the material misrepresentations and omissions alleged in the complaint.

The complaint alleges that the defendants, directly or indirectly, sold $1,200,000 of Whatcom County Water District No. 13, Water and Sewer Revenue bonds, Series A, the principal and interest on which are repayable from assessments against real estate lots, to be sold in a real estate development called Peaceful Valley Subdivision which is being developed and promoted by the individual defendants. The District was formed by a petition signed by S. Isenhart, T. Isenhart and K. Isenhart to local authorities resulting in the appointment of the petitioners as commissioners of the District. The commissioners Isenhart resolved that the District Place on the ballot, during the state general elections in November, 1975, a proposition for a bond issue by the District of $4,500,000. The proposition received an unanimous vote by the residents of the District, namely, S. Isenhart, T. Isenhart, K. Isenhart and the wife of S. Isenhart.

The allegations state that the sales of Series A of the approved bond issue were made through the use of material misrepresentations and omissions in that investors were led to believe: that real estate lots in Peaceful Valley Subdivision were available for sale or had been sold when, in fact, no lots had been sold; that the defendants would be responsible for repayment of the bond principal and interest in event of defaults on the assessments or if the real estate lots are not sold when, in fact, such assurances were not part of the bond issue and the defendants did not disclose any capability of fulfilling such financial

responsibility; that the defendants owned the real property free and clear when, in fact, there were substantial underlying real estate contracts, mortgages, deeds of trust and security interests; that the District was offering the bonds at a discount because of savings through not having an underwriter or by not having the bonds rated when, in fact, the District had been unable to acquire an underwriter because of the high degree of risk in the bonds and that the bonds could not be rated by recognized national rating services; that the District's Commissioners were independent from the developers when, in fact, the commissioners of the District had an interest, directly or indirectly, in the development of Peaceful Valley Subdivision and are related to each other through birth or marriage; and, investors received no financial information for either the District, or the individual defendants.

SEC v. Whatcom County Water District No. 13, et al., Litigation Release No. 7592 (May 10, 1977) (settled final order).

Jack H. Bookey, Administrator of the Seattle Regional Office of the Securities and Exchange Commission, announced today that Decrees of Permanent Injunction were entered on April 27, 1977, by the Honorable Walter T. McGovern, Chief Judge, United States District Court for the Western District of Washington at Seattle, Washington, against Whatcom County Water District #13, County of Whatcom, Washington (District), Steven J. Isenhart, Thomas E. Isenhart, Kristine L. Isenhart, all of Sumas, Washington, Harold E. Isenhart of Lynden, Washington and James E. Isenhart, Jr. of Maple Falls, Washington enjoining them from further violations of the anti-fraud provisions of the federal securities laws in connection with the offer and sale of the District's water and sewer revenue bonds. As to the defendant District, the decree orders it to disclose the injunction to existing and future investors and to issue a disclosure statement to existing investors setting forth the substantive and material elements of the bond issue including a correction of the material misrepresentations and omission alleged in the complaint within 120 days of the date of the decree.

The defendants consented to the Decrees of Permanent Injunction without admitting or denying the allegations of the complaint. For further information, see Litigation Release No. 7810.

SEC v. Washington County Utility District, et al., Civ. Action No. 2-77-15 (E.D. Tenn.), Litigation Release No. 7782 (February 15, 1977) (complaint).

Jule B. Greene, Administrator of the Atlanta Regional Office, announced that on February 1, 1977, a complaint was filed in the U.S. District Court at Greeneville, Tennessee, against Washington County Utility District ("WCUD"), of Washington County, Tennessee, Wade H. Patrick, Paul G. Puckett, Henry C. Miller, and Stella B. Harwood, all of Johnson City, Tennessee, Diversified Securities, Inc., a New York corporation, Thomas R. Alcock, of Hingham, Massachusetts, and Hertz N. Henkoff, of Boston, Massachusetts, alleging violations of the anti-fraud provisions of the federal securities laws in connection with the offer for sale and sale of revenue bonds of WCUD.

The complaint alleges that the defendants have made numerous untrue statements of material facts with respect to the use of the proceeds obtained from the sale of the securities; the purposes for which the bonds were issued; the priority of liens on property owned by WCUD or its divisions; the sufficiency of revenues from WCUD projects to meet operating expenses and to pay interest and principal on the bonds as due; and other matters. Furthermore, the complaint alleges that the defendants have omitted to state numerous material facts, specifically including the fact that WCUD bonds were sold at very substantial discounts to the fiscal agent, Alcock; that proceeds from the sale of the bonds were being utilized for unauthorized purposes such as loans to Patrick, the manager of WCUD, and to companies controlled by him or his relatives, and to pay interest on prior bond issues; and that Patrick was receiving from Alcock portions of the fiscal agent's fees.

In addition to injunctive relief, the complaint seeks an accounting, impressment of a trust upon the assets of the individual defendants, and disgorgement of illegally obtained benefits.

<u>SEC v. Washington County Utility District, et al.</u>, Litigation Release No. 7868 (April 14, 1977) (default entered).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on March 30, 1977, the Honorable Charles G. Neese, Judge of the United States District Court for the Eastern District of Tennessee, Northeastern Division in Greeneville, issued orders of preliminary and permanent injunction from further violations of the anti-fraud provisions of the federal securities laws against Washington County Utility District ("WCUD"), of Washington County, Tennessee, a "municipality or public corporation", Commissioners Paul G. Puckett of Johnson City, Tennessee, and Stella B. Harwood of Jonesboro, Tennessee and Hertz N. Henkoff of Boston, Massachusetts, an attorney who served as bond counsel for several issues of revenue bonds of WCUD.

WCUD was further directed to make an accounting of the receipt and disbursement of all funds received in connection with all revenue bonds it has issued.

Puckett and Harwood were ordered to disgorge certain bonds of WCUD in their possession and to pay over to the Clerk of the Court for the benefit of bondholders the proceeds from the sale of certain other bonds of WCUD.

In addition, Judge Neese signed an order of preliminary injunction with respect to Wade H. Patrick of Johnson City, Tennessee, the manager of WCUD and ordered that a trust be impressed upon all of his assets and that he make an accounting of all income, property or other assets received by him from WCUD or from another source as a result of activities involving WCUD.

Between 1965 and 1975 WCUD had made seven different bond offerings; four for its garbage division ($2,175,000) and three for its cable antenna television division ($1,500,000).

The complaint alleged numerous untrue statements of material facts concerning, among other things, the use of the proceeds obtained from the sale of revenue bonds issued by WCUD; the purposes for which the bonds were issued; the priority of liens of the bondholders on property owned by WCUD or its divisions; and the sufficiency of revenues in each division of WCUD to meet expenses including debt service. The complaint also alleged numerous omissions to state material facts including the following: that WCUD bonds were sold at substantial discounts, ranging from 10 to 42 percent; that WCUD prior to 1975 failed to have audited financial statements prepared; that WCUD was not making payments into a sinking fund to retire the bonds outstanding; that proceeds from the sale of bonds were used for purposes other than represented in prospectuses or authorized in the bond resolutions, such as loans to Patrick and companies controlled by Patrick or his relatives, payment of interest on prior issues of bonds, and loans or advances to other divisions of WCUD.

The individual defendants consented to the relief requested; the decree against WCUD was entered by default. For further information, see Litigation Release No. 7782.

<u>SEC v. Reclamation District No. 2090, et al.</u>, Civ. Action No. 76-1231-SAW (N.D. Cal.), Litigation Release No. 7460 (June 22, 1976) (complaint).

Gerald E. Boltz, Regional Administrator of the Los Angeles Regional Office, and Michael J. Stewart, Acting Associate Regional Administrator of the San Francisco Branch Office, announced the filing of a complaint in the United States District Court for the Northern District of California on June 17, 1976, against Reclamation District No. 2090 [County of Contra Costa, California] ("the District") a quasi-governmental agency of the State of California; Max H. Mortensen ("Mortenson") of Oakland, California; John B. Schoenfeld ("Schoenfeld") and Lowell C. Lundell ("Lundell") of Atherton, California; Robert D. Lewis ("Lewis") and Urban J. Schreiner ("Schreiner") of Palo Alto, California; James H. Dondich

("Dondich"), also known as James Harold, of Santa Ana, California; Louis M. Mayo ("Mayo") of Havertown, Pennsylvania; National Municipal Bond C., Inc ("National") and Roger W. Osness ("Osness") of St. George, Utah; Roy J. Jackson ("Jackson") of Ogden, Utah; MFAI Associates ("MFAI") of Inglewood, California; Lawrence A. Luebbe ("Luebbe") of Los Angeles, California; Benchmark Securities, Inc. ("Benchmark") and Sheldon Fidler ("Fidler") of Beverly Hills, California; Arnold Phillips ("Phillips") of Sherman Oaks, California; All-States Tax exempt Securities, Inc. ("All-States"), Pasquale A. Tamburri ("Tamburri"), also known as Pat Tamburri, and Jules L. Steele ("Steele") of Clearwater, Florida; George E. Grills ("Grills") of Dunedin, Florida; and Norton McGiffin ("McGiffin) of North Largo, Florida, Alleging violations and aiding and abetting of violations of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934, in connection with the offer and sale of approximately $2.2 million in debt securities of the District 161 persons residing in 12 states.

The Complaint alleges that Schoenfeld, Lundell and Lewis are each members of a group which, in 1971, privately purchased approximately 80 per cent of the land encompassed by the District. Subsequently, in 1973, acting in their capacity as Trustees of the District, they jointly authorized the District to purchase that land at a profit to the owning group of approximately $395,000. Thereafter, they voted to authorize the issuance by the District of the bond anticipation notes and promissory notes for the purpose of raising revenues, in part to be used to repay the District's obligation to the selling group. Defendants Schoenfeld, Lundell and Lewis each received a portion of the proceeds from the sale of the said promissory notes.

The Commission's Complaint also alleges that the District, its Trustees Schoenfeld, Lundell and Lewis, its general manager Mortensen, its bond counsel Schreiner, and Dondich, Mayo, National, Osness, Jackson, MFAI, Luebbe, Benchmark, Phillips and Fidler, variously, prepared, authorized, offered, sold and delivered general obligation bond anticipation notes ("bond anticipation notes") issued by the District in violation of the anti-fraud provisions of the general securities laws.

The Complaint charges that the face of the bond anticipation note itself contains misrepresentations of material facts and omits to state material facts concerning among other things: (1) the revenues available to repay the bond anticipation notes; (2) the availability of sources of funds other than revenues to repay the bond anticipation notes; (3) the insufficiency of the District's tax base to generate enough funds to repay the bond anticipation notes; and (4) the absence of any liability of the State of California and the County of Contra Costa to repay the bond anticipation notes.

The Complaint further alleges that the District, Mortensen, Mayo, National, Osness, Jackson, MFAI and Luebbe variously prepared and delivered false and misleading offering circulars and that Benchmark, Phillips and Fidler caused to be prepared and prepared television advertisements purporting to describe the District's bond anticipation notes. The Complaint asserts that these offering circulars and television advertisements contained false and misleading statements and omitted to state material facts concerning, among other things: (1) the use of proceeds derived from the note sales; (2) the underwriting discounts and commissions received by the sellers of the bond anticipation notes; (3) the financial condition of the District; (4) the operating history of the District; (5) the debt structure of the District; (6) the absence of approval by the Treasurer of the State of California for the issuance by the District of general obligation bonds; and (7) the risk factors involved in a purchase of the District's bond anticipation notes.

The Complaint also alleges that Mortensen made misrepresentations and omitted to state material facts regarding the productive capability and financial prospects of the District, and the ability of the District to repay the bond anticipation notes; that Schreiner made misrepresentations and omitted to state material facts regarding his investigation into the legality and validity of the issue and the value purportedly received by the District in exchange for the bond anticipation notes; and that National, Jackson, MFAI, Luebbe, Benchmark and Fidler made misrepresentations and omitted to state material facts concerning the basis for their recommendations to buy the District's bond anticipation notes. Finally, in connection with the bond anticipation note sales, Dondich, Mayo and Osness are alleged to have made misrepresentations and omitted to state material facts to a purchaser regarding the marketability and security of the District's bond anticipation notes.

The Complaint further alleges that the District, its Trustees Schoenfeld, Lundell and Lewis, its general manager Mortensen, its bond counsel Schreinger, and All-States, Tamburri, Grills, McGriffin and Steele authorized, prepared, offered, sold and delivered general obligation negotiable promissory notes ("promissory notes") issued by the District. The Complaint asserts that these promissory notes on their face made the same misrepresentations and omitted the same material facts as the bond anticipation notes.

The Complaint further charges that All-States, Tamburri, Grills, McGriffin and Steele variously prepared and delivered offering circulars purporting to describe the District's promissory notes. The Complaint alleges that the offering circular contained false and misleading statements and omitted to state material facts to investors concerning, among other things: (1) the use of proceeds derived from the note sales; (2) the underwriting discounts and commissions received by the sellers of the promissory notes; (3) the financial condition of the District; (4) the operating history of the District; (5) the debt structure of the District; and (6) the risk factors involved in a purchase of the District's promissory notes.

In addition, the Complaint charges that: Mortensen made misrepresentations and omitted to state material facts concerning: (1) the financial condition and (2) productive capability and financial prospects of the District, and (3) the existence of funds to repay the promissory notes; that Schreiner made misrepresentations and omitted to state material facts concerning: (1) the use of proceeds of the note issue; (2) the failure of the District to generate revenues from operations; and (3) the basis upon which he rendered his legal opinion with respect to the promissory notes; and that All-States, Tamburri, Grills, McGriffin and Steele Variously made misrepresentations and omitted to state material facts concerning: (1) the bases for their recommendations to purchase the District's promissory notes; (2) the risk factors involved in purchasing the District's promissory notes; (3) the nature of the security being offered for sale; and (4) the financial condition of the District.

The Complaint seeks preliminary and permanent injunctive relief against all defendants, including the District, which filed a bankruptcy petition under Chapter IX of the Bankruptcy Act in San Francisco on June 15, 1976.

SEC v. Reclamation District No. 2090, et al., Litigation Release No. 7551 (September 8, 1976) (settled final order).

Gerald E. Boltz, Regional Administrator of the Los Angeles Regional Office, and Michael J. Stewart, Acting Associate Regional Administrator of the San Francisco Branch Office, announced that the Honorable Robert H. Schnacke, United States District Judge for the Northern District of California, entered Final Judgment of Permanent Injunction against Reclamation District No. 2090 [County of Contra Costa, California], a public agency of the state of California, Arnold Phillips and Benchmark Securities, Inc., both of Los Angeles, California, on August 27, 1976, and against Roy J. Jackson of Ogden, Utah, on August 30, 1976. The injunctions proscribe violations of the anti-fraud provisions of the federal securities laws in connection with offers and sales of securities issued by Reclamation District No. 2090 ("the District") and any other security of any other issuer.

The Commission's complaint alleged that the defendants' conduct in violation of the anti-fraud provision of the federal securities laws resulted in the sales of approximately $2.2 million of bond anticipation notes and negotiable promissory notes issued by the District to approximately 161 persons residing in at least twelve states. For more information see Litigation Release No. 7460.

Commission Orders - Settled Administrative Proceedings

<u>In re Newport-Mesa Unified School District</u>, Securities Act Release No. 7589, A. P. File No. 3-9738 (September 29, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that a public administrative cease-and-desist proceeding be and hereby is instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Newport-Mesa Unified School District ("Newport-Mesa USD" or the "District").

II.

In anticipation of the institution of this proceeding, Newport-Mesa USD has submitted an Offer of Settlement, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except that the District admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, Newport-Mesa USD by its Offer of Settlement, consents to the entry of this Order Instituting a Public Administrative Cease-and-Desist Proceeding Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing Cease-and-Desist Order ("Order") and to the entry of the findings and the cease-and-desist order set forth below.

Accordingly, IT IS HEREBY ORDERED that a proceeding pursuant to Section 8A of the Securities Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offer of Settlement submitted by Newport-Mesa USD, the Commission finds that:[1]

A. Summary

In 1994, Newport-Mesa USD, a school district located in the County of Orange, California ("Orange County" or the "County"), offered and sold over $45 million in taxable municipal securities through an Official Statement that was materially misleading. These securities were issued for the purpose of earning interest income by investing the proceeds in the Orange County Investment Pools (the "Pools"), with the expectation of earning a higher yield than the interest rate at which they borrowed. The Official Statement for this offering was materially misleading because it failed to disclose: the intended investment in the Pools for profit, the risks of the Pools' investment strategy, and the Pools' declining investment results.

Newport-Mesa USD knew of the intended investment in the Pools for profit, certain facts concerning the Pools' investment strategy, and the Pools' investment results. Newport-Mesa USD should have known of the risks of the Pools' investment strategy. In light of such knowledge, Newport-Mesa USD, in authorizing the issuance of securities and approving related disclosure documents, should have known that the Official Statement was materially misleading by omitting to disclose such information. The District thus violated Sections 17(a)(2) and (3) of the Securities Act by offering and selling securities through an Official Statement that was materially misleading.

B. The Respondent

Newport-Mesa Unified School District operates public schools in and around the cities of Newport Beach and Costa Mesa, California. During the relevant time period, Newport-Mesa USD served over 17,500 students and had an annual budget exceeding $88 million. Newport-Mesa USD conducted the offering that is the subject of this Order.

C. Facts

1. The Orange County Investment Pools

The Pools operated as an investment fund managed by the Orange County Treasurer-Tax Collector ("County Treasurer" or "Treasurer"), Robert L. Citron ("Citron"), assisted by Matthew L. Raabe ("Raabe"). The Pools consisted of the Commingled Pool, the Bond Pool and certain specific investments, in which the County and various local governments or districts (the "Pool Participants" or the "Participants") deposited public funds. As an Orange County school district, the District was a mandatory Pool Participant because state law required it to deposit its funds with the County Treasurer. As of December 6, 1994 (the date the County and the Pools filed bankruptcy petitions), the Pools held approximately $7.6 billion in Participant deposits, which the Treasurer had leveraged to an investment portfolio with a book value of over $20.6 billion.

The Commingled Pool was the principal investment pool and consisted of $6.126 billion in Participant deposits. The proceeds from the subject offering were deposited into the Commingled Pool.

a) The Pools' Investment Strategy

The Pools' investment policy as stated by the Treasurer's Office to the Pool Participants was, in order of importance: 1) preservation of investment capital; 2) liquidity; and 3) investment yield. Contrary to that policy, the Treasurer caused the Pools to engage in a risky investment strategy. This strategy involved using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days), and investing in securities with a longer maturity (generally two to five years), many of which were derivative securities known as inverse floaters.

The Pools' investment return was to result principally from the interest received on the securities in the Pools. Leverage enabled the Pools to purchase more securities to generate increased interest income. This strategy was profitable as long as the Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

b) The Pools' Portfolio

During 1993 and 1994, the Treasurer, using reverse repurchase agreements, leveraged the Participants' deposits to amounts ranging from 158% to over 292%. The Treasurer then typically invested the Participants' deposits and the funds obtained through reverse repurchase agreements in debt securities issued by the United States Treasury or United States government sponsored enterprises.

Many of the Pools' securities were derivative securities, comprising from 27.6% to 42.2% of the Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. In particular, the Pools were heavily invested in derivative instruments known as inverse floaters which paid interest rates inversely related to the prevailing market interest rate. Inverse floaters are negatively affected by a rise in interest rates.

c) The Rise in Interest Rates During 1994 and its Effect on the Pools

The composition of the Pools' portfolio made it highly sensitive to interest rate changes. As interest rates rose, the market value of the Pools' securities fell, and the interest received on the Pools' inverse floaters

also dropped. Thus, the treasurer's investment strategy was profitable so long as interest rates, including the cost of borrowing through reverse repurchase agreements, remained low and the market value of the Pools' securities remained stable. Indeed, the Treasurer's 1992-93 Financial Statement for the Pools stated that the investment strategy was "predicated on interest rates to continue to remain low for a minimum of the next three years."

During 1993, interest rates remained low and relatively stable. Due to the low interest rates and the Pools' investment strategy, the Pools earned a relatively high yield of approximately 8% during 1993. Beginning in February 1994, interest rates began to rise. This rise in interest rates caused the Pools' yield to decrease, the reverse repurchase costs to increase, the Pools' interest income on inverse floaters to decrease, and the market value of the Pools' debt securities to decline. Month-end reports generated by the Treasurer reflected that the securities marked-to-market experienced a sharp drop in value, ranging from over $26 million in January 1994 (or .45% loss in value), to over $443 million in June 1994 (or 5.24% loss in value).

The rising interest rates and the declining value of the Pools' securities caused the Pools to suffer corresponding losses through collateral calls and reductions in the amounts loaned under reverse repurchase agreements. From January through June 1994, the Pools suffered collateral calls and reductions in loan amounts totaling over $873 million.

2. Orange County's Bankruptcy

On December 6, 1994, Orange County and the Pools each filed a petition for Chapter 9 bankruptcy. The petitions followed the County's public disclosure on December 1, 1994, that the Pools had suffered a "paper" loss of approximately $1.5 billion on an investment portfolio of $20.6 billion. Between mid-December 1994 and January 20, 1995, the County liquidated the Pools' securities portfolio. Ultimately, the Pools realized a loss of about $1.7 billion on Participants' deposits of $7.6 billion, a loss of approximately 22.3%.[2]

3. The Municipal Securities Offering

In 1994, Newport-Mesa USD conducted a taxable note offering.[3] The purpose of this offering was to invest the proceeds in the Pools for profit.

Newport-Mesa USD issued its taxable notes simultaneously with three other Orange County school districts, Irvine Unified School District, North Orange County Community College District, and the Orange County Board of Education (collectively, the "Four Districts").[4]

The Four Districts issued a total of $200 million in taxable notes on June 14, 1994, the proceeds of which were deposited directly into the Commingled Pool.[5] Newport-Mesa USD issued $46.96 million of this total amount.

4. Misleading Disclosure Regarding Investment of the Proceeds

The Official Statement for the subject offering contained misleading disclosure.[6] In the section entitled "Purpose of Issue," this document described the purpose of the offering as providing funds to meet the District's current fiscal year expenditures, including current expenses, capital expenditures, investment and reinvestment and the discharge of other obligations or indebtedness of the issuer. In addition, a separate section of the Official Statement, entitled "Security for the Notes and Available Sources of Repayment," represented that the offering proceeds would be deposited into a repayment account. A third section, "Deposit and Investment of Repayment Fund," stated that the repayment account would be invested as permitted by state law.

This disclosure was materially misleading because it failed to disclose the issuer's intention to invest the note proceeds into the Pools for profit. Instead, the Official Statement merely recited general language of the applicable state borrowing statute, listing a series of permissible uses of the offering proceeds. This language is typically used in tax and revenue anticipation note ("TRAN") offering disclosure documents; its use in the taxable note Official Statement may have created the misleading impression that the subject offering was a TRAN offering.

This characterization is material because the source of repayment, and therefore the risks of repayment, differ for these transactions. Repayment accounts for TRAN offerings are funded by the issuer's anticipated taxes and revenues. In contrast, the repayment account for the subject offering was funded by the note proceeds themselves, which were invested in the Pools. Whereas in TRAN offerings the risks relate to whether the issuer will receive sufficient taxes and anticipated revenues, in the subject offering, the source of repayment is subject to the risks of the underlying investment, which in this case were the risks of investing in the Pools. Despite the importance of this information, the Official Statement failed to disclose both the intended investment in the Pools and the risks of that investment.

Specifically, the Official Statement failed to disclose that the Pools' investment strategy: 1) was predicated upon the assumption that prevailing interest rates would remain at relatively low levels; 2) involved a high degree of leverage through the use of reverse repurchase agreements; 3) involved a substantial investment in derivative securities, including inverse floaters, that are negatively affected by a rise in interest rates; 4) was very sensitive to changes in the prevailing interest rate because of the combined effect of the derivative securities and leverage; and 5) as a result, the investment strategy was speculative and risky.

The Official Statement also failed to disclose the risks of the investment strategy. In particular, the Official Statement failed to disclose that rising interest rates would have a substantial negative impact on the Pools in several respects: 1) the Pools' cost of borrowing on the substantial reverse repurchase position would increase; 2) the interest income on the Pools' substantial investment in inverse floaters would decrease; 3) the Pools' securities would decline in market value; 4) as the value of the securities fell, the Pools would suffer collateral calls and reductions in loan amounts on the reverse repurchase agreements; 5) as a result of the above effects of a rise in interest rates, the Pools' earnings would decrease; and 6) the Pools would suffer losses of principal at certain interest rate levels.

In addition, the Official Statement omitted to disclose certain material information concerning the Pools' investment results. In particular, the Official Statement omitted to disclose that as a result of rising interest rates in 1994: 1) the Pools' cost of borrowing had increased while the income earned from inverse floaters had decreased; 2) the Pools had suffered market losses in the overall value of the portfolio; and 3) the Pools had suffered losses on the reverse repurchase transactions through collateral calls and reductions in loan amounts, which in turn, had a negative impact on liquidity.

5. Conduct of Newport-Mesa USD

In connection with this offering, the District was represented by senior officials who, among other things, were responsible for debt issuance. These officials met with the various financing participants and reviewed and approved the Official Statement to be submitted to the approving body of the District. Before the offer and sale of the securities, the District Board voted to approve the Official Statement and issue the notes.

Before the offering, Newport-Mesa USD knew that the purpose of the offering was to invest the proceeds in the Pools. Also, in September 1993, the District received the Treasurer's 1992-93 Financial Statement. In this report, the Treasurer stated that the Pools' investment strategy involved the use of leverage of approximately two to one and structured or floating rate securities, including inverse floaters, and was predicated on interest rates remaining low over the next three years. The Treasurer further advised that

the County's investment returns were higher than other local investment pools because of the use of reverse repurchase agreements, which added an additional two and one-half percent to the yield.

Around June 1993, a community member notified Newport-Mesa USD officials that he believed the Treasurer was being "overly aggressive in certain areas of the investment portfolio" and in using reverse repurchase agreements. The community member informed the District that, because of the "highly risky" reverse repurchase agreements, "it wouldn't take much for the whole thing to come crashing down."

In 1994, the Four Districts' offering occurred while the County Treasurer was engaged in the re-election campaign that focused significant attention on the Pools' holdings and risky investment strategy. During two meetings in April 1994, which Raabe also attended, the Four Districts' representatives discussed the upcoming taxable offerings and the campaign allegations. The district representatives questioned Raabe about the Pools, including the Pools' liquidity demands. He told them that within the previous two weeks, the Pools had suffered $140 million in "margin" calls (i.e., collateral calls), but had liquidity of $1 billion. Raabe informed the participants that the Pools' earnings would be lower in 1994 and that the "situation had reversed from a year ago" because interest rates were rising. The Districts' financial adviser predicted that interest rates would probably go up and most of the participants agreed with her assessment, although Raabe believed interest rates would decline in July. The participants discussed the fact that increasing interest rates would decrease their arbitrage earnings, but did not discuss the potential negative effect of an interest rate increase on principal.

In April 1994, Newport-Mesa USD became aware that a magazine reporter was planning to do a story on the risks and problems associated with the Pools. Furthermore, in addition to attending the two April 1994 meetings (discussed above), before the 1994 offering, the board and senior administrators of Newport-Mesa USD held additional public and private meetings, some of which were attended by a Rauscher Pierce investment banker. At one of these meetings, Rauscher Pierce's representative noted that the national rating agencies had recently reviewed the Pools without expressing concern about Citron's investments. Even though two board members opposed issuing the 1994 notes based on their evaluation of the risks involved in investing in the Pools and the volatility of interest rates, [7] the issuance was approved without any disclosure in the Official Statement of these debated risks.

Raabe also attended a Newport-Mesa USD board meeting in April 1994 to address concerns about the Pools' safety raised by a community member. Raabe told the District officials that the Pools were safe.

D. Newport-Mesa USD Violated Sections 17(a)(2) and (3) of the Securities Act in the Offer and Sale of the Taxable Notes

Sections 17(a)(2) and (3) of the Securities Act make it unlawful for any person, through the means or instruments of interstate commerce or the mails, in the offer or sale of any security:

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Scienter is not required to prove violations of Sections 17(a)(2) and (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 697 (1980). Violations of these sections may be established by a showing of negligence. SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997); SEC v. Steadman, 967 F.2d 636, 643 n. 5 (D.C. Cir. 1992).

Newport-Mesa USD violated Sections 17(a)(2) and (3) of the Securities Act as the issuer of the securities. See In re CitiSource, Inc. Sec. Litig., 694 F. Supp. 1069, 1072-75 (S.D.N.Y. 1988) (antifraud provisions apply to municipal securities issuers); see also Adoption of Exchange Act Rule 15c2-12, Exchange Act Release No. 26985 n.84, 4 Fed. Sec. L. Rep. (CCH) _ 25,098 (June 28, 1989) ("(I)issuers are primarily

responsible for the content of their disclosure documents and may be held liable under the federal securities laws for misleading disclosure." (citations omitted)).

1. The Disclosure in the Official Statement Was Materially Misleading

The Official Statement for the offering omitted to disclose material information concerning the intended investment of the note proceeds in the Pools for profit, the Pools' investment strategy and the risks of that strategy, material information concerning the risks of the Pools' strategy in a rising interest rate environment, and the Pools' declining investment results. Information is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information made available. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

Information concerning the Pools' investment strategy and the risks of that strategy was material to this securities offering. The Pools' investment strategy and the risks of that strategy were directly related to the safety of the funds pledged to repay the securities.

2. Newport-Mesa USD Should Have Known That the Official Statements Were Materially Misleading
Given Newport-Mesa USD's knowledge regarding the investment purpose of the offerings and facts relating to the Pools' investment strategy, the District should have known that the Official Statement that it authorized was materially misleading as to the matters discussed above.

For purposes of the District's violations, the statements and omissions of its representatives may be imputed to the District. See Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

The District knew of the intended investment purpose and certain facts regarding the Pools' investment strategy. Newport-Mesa USD should have known of the related risks of the Pools' investment strategy. In light of this knowledge, Newport-Mesa USD, in authorizing the issuance of securities and approving related disclosure documents, should have known that the Official Statement was materially misleading by omitting to disclose such information.

E. Conclusion

Accordingly, based on the foregoing, the Commission finds that Newport-Mesa USD violated Sections 17(a)(2) and (3) of the Securities Act.

IV.

Newport-Mesa USD has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's entry of this Order, which makes findings, as set forth above, and orders Newport-Mesa USD to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act. As set forth in the District's Offer of Settlement, Newport-Mesa USD undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transaction that is the subject of this Order.

V.

In view of the foregoing, the Commission deems it appropriate to accept the Offer of Settlement submitted by Newport-Mesa USD and impose the cease-and-desist order specified in the Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED that, pursuant to Section 8A of the Securities Act: 1. Newport-Mesa USD shall cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act.

2. Newport-Mesa USD shall comply with its undertakings described in Section IV. above.

FOOTNOTES

[1]: The findings herein are made pursuant to the Offer of Settlement of the District and are not binding on any other person or entity named as a respondent in this or any other proceeding.

[2]: Orange County was charged, in a settled cease-and-desist proceeding, with disclosure violations concerning eight offerings of municipal securities, the Official Statements for which contained false and misleading information about the Pools. See In re County of Orange, California, Securities Act Release No. 33-7260 (Jan. 24, 1996).

[3]: Although the national rating agencies downgraded these notes prior to maturity, Newport-Mesa USD paid these notes in full and on time.

[4]: These entities are the respondents in a separate proceeding. See In re the City of Anaheim, City of Irvine, Irvine Unified School District, North Orange County Community College District, and Orange County Board of Education, Securities Act Release No. 7590 (September 29, 1998).

[5]: Pursuant to Section 53853 of the California Government Code (West 1983), the notes of each District were issued in the name of and on behalf of the District by the County Board of Supervisors. Each District requested that the County Board of Supervisors authorize the issuance of the taxable notes in its name and on its behalf, which the County Board of Supervisors did without discussion.

[6]: In addition to officials at the District, bond counsel, counsel to the underwriter, and the underwriter participated in the preparation of the Official Statement, which Newport-Mesa USD reviewed and approved before issuing the notes.

[7]: During the meeting at which the issuance was discussed and voted upon, one of these board members expressed concerns about the direction of interest rates, the sale of a security held by the Pools at a loss of $4.8 million and the Pools' derivative holdings, including inverse floaters. He stated, "My primary concern is that what's happening at our County is very risky with regard to taxpayers' money." The other board member referred to the City of Irvine's decision not to issue taxable notes in May 1994 due to its requirement to earn a specified arbitrage profit.

In re City of Moorhead, Mississippi, Securities Act Release No. 7585, Exchange Act Release No. 40478, A.P. File No. 3-9724 (September 24, 1998); Securities Act Release No. 7616, Exchange Act Release No. 40770, A.P. File No. 3-9724 (December 10, 1998).

I.

On September 24, 1998, the Commission instituted public cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against the City of Moorhead, Mississippi ("Moorhead" or “Respondent") to determine whether Moorhead committed or caused violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, the Respondent, without admitting or denying the findings set forth herein, except as contained in Section II. 1., below, and as to the jurisdiction of the

Commission over the Respondent and over the subject matter of these proceedings, which are admitted, consents to the entry of this Order Making Findings And Imposing Cease-And-Desist Order ("Order").

II.

Based on this Order, the Order Instituting Public Cease-and-Desist Proceedings and the Respondent's Offer, the Commission finds[1] the following:

1. The City of Moorhead, Mississippi is a political and legal subdivision of the State of Mississippi and a body corporate and politic.

2. On or about November 8, 1995, Moorhead issued and sold urban renewal revenue notes ("notes") to the public in the face amount of $4.5 million.

3. The notes were issued pursuant to the Mississippi Urban Renewal Law, Miss. Code Ann. Section 43-35-21, and were sold based upon a representation that bond counsel had concluded that interest on the notes would be excludable from gross income for federal income tax purposes. The disclosure documents used in connection with the note offering represented that the note proceeds would be utilized within three years on various public projects. In fact, Moorhead had no intention of spending more than $45,000 on public projects. The $45,000 was received by the Respondent as a "premium" or "fee" for issuing the notes. The remaining proceeds were invested in a guaranteed investment contract ("GIC") yielding a higher rate of return than the notes. The GIC provided the cash flows to pay the debt service required by the notes. This financing structure resulted in a significant and undisclosed risk to the tax exempt status of interest on the notes.

4. Internal Revenue Code ("IRC") Section 103(b) provides that gross income includes interest on any state or local bond which is an "arbitrage bond" as that term is defined by IRC Section 148. IRC Section 148 (a) defines an arbitrage bond as "any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments...."

5. IRC Section 148(c)(1) allows the proceeds of certain issues to be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which the bonds were issued. This provision is known as the "temporary period exception." It provides that the bonds will not be treated as taxable arbitrage bonds if the net sale proceeds and investment proceeds of an issue are reasonably expected to be allocated to expenditures for capital projects within specified time periods. Treas. Reg. Sec. 1.148-2(b)(1) and 2(e)(2)(i)(1993); Treas. Reg. Sec. 1.103-13(a)(2) (1979). When statements regarding reasonable expectations with respect to the amount and use of the proceeds are not made in good faith, the notes are deemed to be taxable arbitrage bonds. Revenue Ruling 85-182, 1985-2 C.B. 39.

6. Although the note offering issued by Moorhead was purportedly structured to comply with the requirements of the temporary period exception, at the time of the offering, Moorhead did not have the resources, intent or expectation to utilize any proceeds from the offering, other than the $45,000 premium or fee, for capital projects. Subsequent to the offering, Moorhead did not utilize any of the offering proceeds, other than the $45,000 premium or fee, for any capital project. The lack of a reasonable expectation to utilize more than a small portion of the proceeds for capital projects would violate the reasonable expectation requirements of IRC Section 148(c)(1) and Treas. Reg. 1.148-2(e)(2). Therefore, a substantial risk existed that the issuer would not be able to rely on the temporary period exception, making the structure of this transaction a prohibited arbitrage device in violation of IRC Sections 103(b) and

148(a)(1). The violation of these sections could cause the IRS to declare interest on the notes subject to the federal income tax.

7. The substantial risk to the tax exempt status of interest on the notes was not disclosed to investors or prospective investors in the offering. The official statement and arbitrage certificate, among other documents, without exception, represented that Moorhead intended to spend the full amount of the offering proceeds within three years on various capital projects. The official statement also represented that the respondent was negotiating with a specified firm for "architectural services." These statements were not true. An official of the City of Moorhead, with the approval of the city council, reviewed and signed the documents.

8. Based on the foregoing, in November 1995, Moorhead violated Section 17(a)(1) of the Securities Act by, directly and indirectly, using the means and instruments of transportation and communication in interstate commerce and the mails to employ devices, schemes, and artifices to defraud purchasers in the offer and sale of securities.

9. Based on the foregoing, in November 1995, Moorhead violated Sections 17(a)(2) and 17(a)(3) of the Securities Act by, directly and indirectly, using the means and instruments of transportation and communication in interstate commerce and the mails to obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and to engage in transactions, practices, and a course of business which operated or would have operated as a fraud and deceit upon purchasers, in the offer and sale of securities.

10. Based on the foregoing, in November 1995, Moorhead violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, directly and indirectly, using the means and instrumentalities of interstate commerce and the mails: (1) to employ devices, schemes and artifices to defraud, (2) to make untrue statements of material facts and to omit 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, and (3) to engage in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, in connection with the purchase and sale of securities.

III.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions set forth in Moorehead's Offer of Settlement.

FOOTNOTES

[1]: The findings herein are made pursuant to the Offer of Settlement of the Respondent and are not binding on any other person or entity in this or any other proceeding.

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ACCORDINGLY, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act that the Respondent cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

In re City of Carthage, MS., et al., Securities Act Release No. 40194, A. P. File No. 3-9650 (July 13, 1998) (administrative cease and desist proceedings against 38 municipalities and settled administrative orders).

I.

The Commission deems it appropriate and in the public interest that public cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") be, and they hereby are, instituted against 38 Mississippi counties, cities and towns ("the Respondents") identified in the caption to this Order.

II.

In anticipation of the institution of these cease-and-desist proceedings, the Respondents have each submitted Offers of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, the Respondents, without admitting or denying the findings set forth herein, except as contained in Section III. B., below, and as to the jurisdiction of the Commission over the Respondents and over the subject matter of these proceedings, which are admitted, consent to the entry of this Order Instituting Public Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order ("Order").

III.

Based on this Order and the Respondents' Offers, the Commission finds the following.[1]1

A. Summary

This matter involves 38 Mississippi political subdivisions, including Counties, Cities and Towns, which issued and sold urban renewal revenue notes ("notes") to the public in 73 separate offerings. The offerings occurred from 1987 through April 1996, and raised a total of approximately $282,800,000; however, while each offering produced arbitrage profit to the respective Respondent involved and others, the Respondents did not intend to use the offering proceeds, other than the arbitrage, on public projects.

In each offering, the notes were sold based upon a representation that bond counsel had concluded that interest on the notes would be excludable from gross income for federal income tax purposes. The disclosure documents used in connection with the note offerings presented that the note proceeds would be utilized within three years on various public projects. In fact, the Respondents had no intention of spending more than a small percentage of the proceeds on public projects. That percentage, generally close to one percent of the proceeds, was received by the Respondent as a "premium" or "fee" for issuing the notes. The remaining proceeds were invested in instruments yielding a higher rate of return than the notes. Those instruments provided the cash flows to pay the debt service required by the notes. This financing structure resulted in a significant and undisclosed risk to the tax exempt status of interest on the notes.

B. Respondents

Each of the Respondents is a political and legal subdivision of the State of Mississippi and a body corporate and politic. Each Respondent conducted one or more note offerings as individually specified in the Appendix to this order.

C. The Urban Renewal Revenue Note

Between 1987 and April, 1996, the Respondents individually issued, offered and sold 73 separate urban renewal revenue note issues in amounts ranging from $2 million to $5 million, totaling approximately $282,800,000. The notes were issued pursuant to the Mississippi Urban Renewal Law, Miss. Code Ann.

43-35-21. The notes were sold based upon unqualified opinions from bond counsel which concluded that interest on the notes would be exempt from federal income tax.

The Respondents were approached and asked to issue the notes by bond counsel or by representatives of the underwriter. The same bond counsel and underwriter were involved in all of the offerings. Following the initial contact, bond counsel or a representative of the underwriter would meet with an individual Respondent's governing body and describe the proposed offering. The proposed offering was generally described to the Respondents' representatives as a mechanism by which the Respondent could receive a modest amount of funds, generally $30,000 to $50,000, as a "premium" or "fee" in exchange for serving as the issuer, without impairing the Respondent's tax base or creating a pay-back obligation. The Respondents considered this premium or fee a substantial benefit.

After issuance, the bulk of the offering proceeds from each offering was used to purchase a certificate of deposit ("CD") or a guaranteed investment contract ("GIC") through the underwriter. The CD or GIC had a three year term and a sufficient rate of interest to pay both periodic interest and the principal on the notes at the end of a three year period. The remaining proceeds were used to pay the premium or fee paid to the issuer, the fees and expenses of bond counsel, the underwriter, the trustee, and other miscellaneous costs of issuance, including the fees and expenses of various third party professionals.

The CDs and GICs provided a higher yield than the notes sold in the offerings. Internal Revenue Code ("IRC") Section 103(b) provides that gross income includes interest on any state or local bond which is an "arbitrage bond" as that term is defined by IRC Section 148. IRC Section 148 (a) defines an arbitrage bond as "any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments..."

IRC Section 148(c)(1) allows the proceeds of certain issues to be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which the bonds were issued. This provision is known as the "temporary period exception." It provides that the bonds will not be treated as taxable arbitrage bonds if the net sale proceeds and investment proceeds of an issue are reasonably expected to be allocated to expenditures for capital projects within specified time periods. Treas. Reg. Sec. 1.148-2(b)(1) and (e)(2)(i)(1993); Treas. Reg. Sec. 1.103-13(a)(2) (1979). When statements regarding reasonable expectations with respect to the amount and use of the proceeds are not made in good faith, the notes are deemed to be taxable arbitrage bonds. Revenue Ruling 85-182, 1985-2 C.B. 39.

Although all the note offerings issued by the Respondents were purportedly structured to comply with the requirements of the temporary period exception, at the time of the offerings, none of the Respondents had the resources, intent or expectation to utilize any proceeds from the offerings, other than the premium or fee, for capital projects. Subsequent to the offerings, none of the Respondents has utilized any of the offering proceeds, other than the premium or fee, for any capital project. The lack of a reasonable expectation to utilize more than a small portion of the proceeds for capital projects would violate the reasonable expectation requirements of IRC Section 148(c)(1) and Treas. Reg. 1.148-2(e)(2).

Therefore, a substantial risk exists that the issuers would not be able to rely on the temporary period exception, making the structure of these transactions a prohibited arbitrage device that violates IRC Sections 103(b) and 148(a)(1). The violation of these sections could cause the IRS to declare interest on the notes subject to the federal income tax.

The substantial risk to the tax exempt status of interest on the notes was not disclosed to investors or prospective investors in any of the offerings. The respective official statements and arbitrage certificates for each offering, among other documents, without exception, represented that the issuers intended to spend the full amount of the offering proceeds within three years on various capital projects, such as roads, parks, a courthouse, and other projects. Each official statement also represented that the

issuer/respondent was negotiating with a specified firm for "architectural services." These statements were not true. Although the investors were under no duty to independently evaluate the degree of risk to the tax exemption, the false representations dealing with the municipalities' intentions to spend the proceeds and their current negotiations for services in that regard, would have made it difficult for investors, even those with access to tax advice, to ascertain the risk to the tax exemption.

Bond counsel provided the respective issuers with all of the necessary documents, including, but not limited to resolutions, official statements, and arbitrage certificates. These documents were signed by the chief executives of the respective issuers. Those chief executives signed the various documents, when they knew or were reckless in not knowing that the documents contained misrepresentations regarding the municipalities' intention to utilize the note proceeds for capital projects. Certain of the respective chief executives and other officials failed to read the documents before signing or authorizing them, relying on bond counsel to ensure that the factual representations being made by the respondent were accurate.

D. Legal Discussion

Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder make it unlawful for any person, in the offer or sale or in connection with the purchase or sale of any security, by use of the means and instrumentalities of interstate commerce, the means and instruments of transportation and communication in interstate commerce or the mails: (a) to employ devices, schemes or artifices to defraud, (b) to make untrue statements of material facts or omit to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; (c) to engage in acts, practices or a course of business which operate as a fraud and deceit; and (d) to obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

The notes issued by the Respondents are securities under Section 2(1) of the Securities Act and Section 3(a)(10) of the Exchange Act.

Information is material if there is a substantial likelihood that a reasonable investor would consider it important to an investment decision. See Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). The official statements used as offering documents in connection with the sale of the notes represented that an unqualified opinion from bond counsel had concluded that interest on the notes would be exempt from gross income for federal income tax purposes, assuming continuing compliance with certain covenants made by the issuer. Although such an opinion was obtained, the offering documents failed to disclose a substantial risk to the tax exempt status of interest payments on the notes. The Respondents made it difficult for investors independently to analyze the tax exemption in that the Respondents misrepresented that they intended to use the proceeds from the note offerings on capital projects within a three year period, and that they were negotiating for architectural services in that regard. These misrepresentations and omissions were material. See In re County of Orange, California; Orange County Flood Control Dist.; and County of Orange, California Bd. of Supervisors, Exchange Act Release No. 36760, 61 S.E.C. Docket 0395 (January 24, 1996).

The Respondents acted with Scienter in making the above misrepresentations and omissions of material fact. For purposes of the Respondents' liability, the Scienter of various officials of the Respondents may be imputed to the Respondents. See SEC v. Manor Nursing Centers, Inc., 458 F. 2d 1082, 1089 n.3 (2d Cir. 1972). Each of the note offerings was approved by the governing board of the respective Respondent. In each case, the official statements and other documents used in connection with the offering, including arbitrage certificates, were executed by the chief executive of the respective Respondent. Those officials were either aware of the misrepresentations contained in the documents, or, in many instances, failed to read the documents closely enough to ascertain whether misrepresentations were being made as to the essential purposes of the offering, for example, the intended use of proceeds. Issuers may not blindly rely on professionals such as bond counsel, to ensure that factual representations being made by the issuers are

accurate. In this case, the practice of executing offering documents containing factual misrepresentations, without first reading the documents to ascertain whether they were accurate as to the essential purposes of the offering, was at least reckless and therefore sufficient to establish Scienter.

Based on the foregoing, during the period from November 1987 through at least April 1996, the Respondents violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

ACCORDINGLY, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act that the Respondents cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

FOOTNOTES

[1]:1 The findings herein are made pursuant to the Offers of Settlement of the Respondents and are not binding on any other person or entity named as a respondent in this or any other proceeding.

APPENDIX

List of Respondents' Urban Renewal Revenue Note Issues

Date	Issuer	Amount
1. 11/24/87	Jefferson County	$3.0 million
2. 12/10/87	Panola County	$4.8 million
3. 3/8/88	Greene County	$3.4 million
4. 6/13/88	Hancock County	$4.8 million
5. 7/14/88	Simpson County	$3.0 million
6. 10/6/88	Coahoma County	$5.0 million
7. 10/20/88	Wayne County	$5.0 million
8. 11/3/88	Pearl River County	$4.9 million
9. 12/22/88	Smith County	$4.9 million
10. 3/13/89	City of Picayune	$4.1 million
11. 4/6/89	Jefferson Davis County	$4.8 million
12. 4/13/89	City of Clarksdale	$3.2 million
13. 6/15/89	Leake County	$4.6 million
14. 4/18/90	Stone County	$4.0 million
15. 7/31/90	Quitman County	$4.4 million

	Date	Entity	Amount
16.	8/2/90	Clarke County	$4.8 million
17.	12/27/90	City of Magee	$2.0 million
18.	2/13/91	Jefferson County	$3.0 million
19.	2/27/91	City of Carthage	$2.0 million
20.	2/27/91	Leake County	$4.6 million
21.	3/7/91	Panola County	$4.75 million
22.	3/28/91	Greene County	$4.2 million
23.	5/16/91	City of Mendenhall	$3.5 million
24.	7/2/91	Coahoma County	$4.8 million
25.	11/18/91	Town of Bay Springs	$4.0 million
26.	12/18/91	Town of Marks	$5.0 million
27.	1/23/92	Town of Raleigh - A	$2.0 million
28.	4/1/92	Town of Raleigh - B	$2.0 million
29.	8/3/92	Town of Crenshaw	$4.5 million
30.	8/27/92	City of Carthage	$2.0 million
31.	8/27/92	Leake County	$4.6 million
32.	9/7/92	Panola County	$4.75 million
33.	9/28/92	Greene County	$4.2 million
34.	10/12/92	Stone County	$4.0 million
35.	11/16/92	City of Mendenhall	$3.5 million
36.	12/15/92	Town of Leakesville	$3.5 million
37.	12/27/92	City of Magee	$2.0 million
38.	12/30/92	Jefferson Davis County	$5.0 million
39.	2/1/93	Quitman County	$4.4 million
40.	2/14/93	Jefferson County	$3.0 million
41.	3/1/93	Coahoma County	$4.8 million
42.	6/18/93	Town of Marks	$5.0 million

43. 9/23/93	Town of Raleigh - A	$2.0 million
44. 10/1/93	Town of Raleigh - B	$2.0 million
45. 12/7/93	City of Magee	$4.0 million
46. 12/8/93	Panola County	$4.0 million
47. 12/8/93	Stone County	$2.0 million
48. 2/1/94	Leake County	$4.0 million
49. 2/15/94	Jefferson County	$3.6 million
50. 3/1/94	City of Carthage	$3.0 million
51. 3/1/94	Quitman County	$4.0 million
52. 4/1/94	Greene County	$4.5 million
53. 6/25/94	City of Mendenhall	$4.0 million
54. 8/10/94	City of Winona	$3.0 million
55. 8/24/94	Montgomery County	$4.0 million
56. 9/1/94	Town of Marks	$4.0 million
57. 11/1/94	City of Purvis	$4.0 million
58. 12/5/94	Town of Raleigh	$4.4 million
59. 12/29/94	Town of Leakesville	$3.6 million
60. 12/29/94	Town of Crenshaw	$3.4 million
61. 3/7/95	Town of Como	$3.6 million
62. 3/7/95	Town of Coldwater	$3.9 million
63. 4/24/95	Town of Lambert	$4.0 million
64. 5/11/95	City of Sardis	$4.3 million
65. 6/27/95	Town of Friars Point	$4.2 million
66. 7/6/95	Town of Coffeeville	$3.9 million
67. 7/20/95	Town of Tchula	$3.9 million
68. 9/21/95	Town of Edwards	$4.0 million
69. 9/28/95	Town of Jonestown	$3.9 million

70. 11/30/95 City of Itta Bena $4.9 million

71. 12/28/95 City of Shaw $4.9 million

72. 2/15/96 Town of Leakesville $4.0 million

73. 4/15/96 Stone County $4.0 million

In re County of Nevada, City of Ione, Wasco Public Financing Authority, Virginia Horler and William McKay, Securities Act Release No. 7503, Exchange Act Release No. 39612, A.P. File No. 3-9542 (February 2, 1998).

On February 2, 1998, the Securities and Exchange Commission ("Commission") issued an Order Instituting Public Administrative Proceedings against three central California municipalities and two professionals for causing or committing securities fraud in connection with the sale of $58 million in municipal bonds. The Order names the County of Nevada ("Nevada County"), the City of Ione ("Ione"), the Wasco Public Financing Authority ("Wasco"), Virginia Horler ("Horler"), of Dain Rauscher Incorporated (formerly known as Rauscher Pierce Refsnes), and William McKay ("McKay"), a real estate appraiser. The Order alleges that the municipalities and individuals created and approved written materials, used in selling the bonds, that fraudulently misstated or omitted important information.

Last July, the Commission sued the underwriter of the offerings, First California Capital Markets Group, and two of its executives, H. Michael Richardson and Derrick Dumont, in the United States District Court for the Northern District of California. See Lit. Rel. No. 15423. That litigation is pending.

Nevada County raised $9.07 million through the sale of "Mello-Roos" bonds, which are used to finance real estate development. The Order alleges that the Official Statement for the Nevada County offering contained misrepresentations and omissions concerning: (1) the value of the property to be developed; (2) the developer's ownership interest in the property; (3) the developer's experience and financial condition; (4) cost estimates to complete the project; and (5) how the project would be financed by the developer and Nevada County. The Order further alleges that Horler, Nevada County's financial advisor, drafted the Official Statement, which was reviewed by Nevada County staff and officials, and approved for distribution by resolution of the County Board of Supervisors.

Ione raised $14 million in two "Mello-Roos" bond offerings. The Order alleges that the Official Statements for the Ione offerings contained misrepresentations and omissions concerning: (1) the ability to complete all of the listed improvements with the offering proceeds; (2) the value of the property to be developed, and (3) the sufficiency of the developer's capital to complete the project.

The Order further alleges that McKay prepared the appraisals for both Nevada County and Ione, as well as summaries of each which he knew were to be included in the Official Statements for the offerings.

The misrepresentations and omissions in the Nevada County and Ione Offering Statements were important to investors because they made the projects and the bonds appear to be less risky than they actually were.

The Wasco offering, which raised $35 million, involved the sale of "Marks-Roos" municipal bonds, which are issued to form pools of money to finance a number of local projects. The Order alleges that the Official
Statement for this offering failed to disclose that nearly all of the projects listed were highly contingent, if not speculative. These misrepresentations were important to investors because they falsely created

the impression that the pools were fully allocated to particular projects. Because the projects were speculative, there was a greater risk to investors that the bonds would not be repaid with interest.

The Order alleges that Nevada County, Ione, Wasco, Horler and McKay violated the antifraud provisions of the federal securities laws, including Section 17(a) of the Securities Act of 1933 and Section 10(b) of the
Securities Exchange Act of 1934 and Rule 10b-5 issued thereunder.

An administrative hearing will be scheduled to litigate the allegations and determine whether the Commission should order any remedial action.

In re County of Nevada, Securities Act Release No. 7535, A.P. File No. 3-9542 (May 5, 1998).

I.

The Securities and Exchange Commission ("Commission") has previously instituted a cease-and-desist proceeding pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against the County of Nevada ("Nevada County"). [1] Nevada County subsequently has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept.

II.

Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except that Nevada County admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, Nevada County consents to the issuance of this Order Making Findings and Imposing a Cease-and-Desist Order ("Order") and to the entry of the findings and the imposition of the relief set forth below.

III.

On the basis of this Order and Nevada County's Offer, the Commission finds [2] the following:

A. RESPONDENT

County of Nevada is a political division and legal subdivision of the State of California invested with corporate powers, and acting through the Nevada County Board of Supervisors. When the term "Nevada County Board of Supervisors" is used herein, it refers to the Board as it was constituted in 1990; none of the current members of the Board of Supervisors was a member of the Board at any time relevant to this proceeding.

B. THE NEVADA COUNTY BOND OFFERING

The Mello-Roos Bond Act

The California Mello-Roos Community Facilities Act of 1982 (the "Mello-Roos Act") [3] authorizes municipalities to organize community facilities districts ("CFDs") to finance the building of infrastructure. Mello-Roos bonds are paid off through special taxes levied on the property being developed. The bonds are not personal debts of the landowners or general obligations of the issuing municipality. Because they are paid off using future real property tax levies, the bonds' financial attractiveness depends upon the underlying value of the land being developed, the contemplated improvements to the land and the developer's ability to carry out the contemplated improvements.

Nevada County's Infrastructure Finance Committee Procedure

On February 20, 1990, the Nevada County Board of Supervisors adopted a public resolution setting out a procedure for considering and approving land-based public financings (the "Procedure"). Under the Procedure, each proposal was to be forwarded to the Board of Supervisors with a report from the Infrastructure Finance Committee (comprising County officials and staff) and its recommendation to proceed. The purpose of the Procedure was to guard against unwise public financings including the bonds for the Wildwood Estates public improvements described below.

The Procedure specified a value-to-lien ratio of "at least" 4-to-1 "after the installation of the public improvements to be financed" in order to undertake a Mello-Roos bond offering. Although the Procedure permitted the County Board to consider a lesser value-to-lien ratio on a case-by-case basis, there must first be a "compelling justification" offered by the Financial Adviser or lead underwriter in order to deviate from the 4-to-1 ratio.

Formation of the Wildwood Estates District

Located within Nevada County is a contiguous, undeveloped, 286-acre parcel which became known as "Wildwood Estates" and which had been owned by a bankrupt entity. In early 1990, G. Michael Montross ("Montross") purchased -- subject to final bankruptcy court approval -- Wildwood Estates for $1.98 million using funds raised through four limited partnerships. During early 1990, Montross placed title to the 286 acres into his wholly-owned corporation, Wildwood Estates, Inc. ("Wildwood Corp."), even though he had promised the investors in the four limited partnerships ("Wildwood Partners") that those entities would receive title to some of the property.

In February 1990, Nevada County initiated the process to issue Mello-Roos bonds to finance the construction of the public improvements for Wildwood Estates. On March 20, 1990, the Nevada County Board of Supervisors ("Board") considered an application by Montross to form the Wildwood Estates Community Facilities District ("Nevada County CFD") in accordance with the Mello-Roos Act. The Nevada County Board of Supervisors voted to form the Nevada County CFD and to retain Derrick Dumont ("Dumont") and First California Capital Markets Group, Inc. ("First California") to underwrite its Mello-Roos bonds.

Horler is Retained as a Financial Adviser

Nevada County had limited experience in municipal bond offerings, and none of those offerings involved Mello-Roos bonds. In view of its lack of experience with Mello-Roos bonds, Nevada County believed that it was appropriate to retain independent professionals to advise it on the bond issue and the proper preparation of the Official Statement. Nevada County relied upon the professionals’ work and recommendations in connection with the Mello-Roos offering.

Consequently, in May 1990, Nevada County retained Virginia Horler ("Horler"), Senior Vice President of Rauscher Pierce Refsnes, Inc. ("Rauscher"), a San Francisco investment banking firm, as Financial Adviser for the bond offering. On July 2, 1990, Nevada County and Rauscher formally executed a financial advisory contract in which Rauscher represented that "it (was) skilled in making the studies and analyses described in the contract and represent(ed) that it is qualified by training and experience to perform the work required by the county."

Horler accepted the responsibility of carrying out Rauscher's performance under the contract. Rauscher agreed to "prepare the preliminary and final official statements describing ... the economic and financial background of the property owner in accordance with the disclosure required by the Securities and Exchange Commission Rule 15c2-12." Rauscher also agreed to "review and analyze all data and information which have a bearing on the program to finance the County's Community Facilities District, including but not limited to ... the value of the appraisal, coverage ratios and debt capacity (and) projected

special taxes." In addition, Rauscher agreed to confer and consult with county staff and elected officials, architects, contractors, property owners, bond counsel and the underwriter "to assist the county in developing a financing plan that meets the county's specific needs for funds and the property owners ability and willingness to pay." Nevada County agreed to pay Rauscher $30,000, but only if and when its bond offering closed.

McKay is Retained to Appraise Wildwood Estates

On March 23, 1990, the underwriter solicited proposals for the appraisal of Wildwood Estates. Of the five appraisers solicited, two did not respond, one replied that it could not submit a bid within the time allowed, one bid $20,000 and William McKay ("McKay") bid $4,000.

On June 6, 1990, McKay prepared a "preliminary" appraisal which was discussed at a June 8, 1990 meeting involving the Infrastructure Finance Committee and Horler. None of McKay's appraised values satisfied Nevada County's 4-to-1 value-to-lien guidelines. However, Horler stated that 3-to-1 was the industry standard and focused on the two highest values in McKay's appraisal -- the only two which satisfied the 3-to-1 ratio.

McKay then prepared a 60-page appraisal which was circulated to Horler and Nevada County. McKay found values ranging from $2.98 million to $38 million. McKay also prepared a 14-page summary to be included in the Official Statement to be provided to investors. McKay, Nevada County and Horler knew the summary would be included in the Official Statement and relied upon by investors to measure the security of the bonds. The summary appraisal only contained the three highest values, ranging from approximately $32 million to $38 million.

Nevada County Issues $9.07 Million in Mello-Roos Bonds

On December 20, 1990, First California underwrote $9.07 million in tax-exempt Mello-Roos bonds for the Nevada County CFD. At the time, the County also intended to issue an additional $2 million in taxable Mello-Roos bonds to finance the remaining public infrastructure which did not qualify for tax-exempt treatment. When its Mello-Roos bond offering closed, Nevada County used over $500,000 of the proceeds to retire a special sewer assessment against the property. That, in turn, allowed the County to recover approximately $160,000 that it had deposited to secure pay-off of the assessment. Additionally, $30,000 of the bond proceeds were used to pay Rauscher for Horler's activities.

Some of the Nevada County Bonds matured between September 1, 1993 and September 1, 2003 and bore an interest rate of between 6.75% and 8.00%, depending upon the maturity date. Most of the Bonds, about $7,370,000, matured on September 1, 2019 and bore a 8.40% interest rate. Those Nevada County Bonds maturing on or after September 1, 2001 could not be redeemed before September 1, 2000. Additionally, if such early redemption for those Bonds occurred before March 1, 2002, a prepayment penalty, along with accrued interest, would have to be paid to the bond holders.

The Official Statement Contains Material Misrepresentations and Omissions Horler drafted the Official Statement for the Nevada County bonds. The Official Statement was also reviewed by Nevada County staff and officials, and it was approved by resolution of the County Board of Supervisors.

Misleading Valuations

The Nevada County Official Statement represented that the build-out value of Wildwood Estates (the estimated value for all the lots after completion of the infrastructure if sold individually to builders or homeowners) was $35,280,000. This figure was materially overstated by at least $4 million because it was based on the inclusion of 45 single family lots to be located on a 22-acre parcel in Wildwood Estates when, in fact, Montross had not sought -- and never received -- approval to develop that parcel into 45 single family lots. McKay also assigned a per lot value almost $10,000 higher for these 45 lots than the

average value for the approved 384 lots. Without the additional $4 million, the Nevada County Bonds would not have met a 3-to-1 value-to-lien ratio (after the County issued the additional $2 million in taxable bonds necessary to complete the project). Additionally, without a clear and viable plan to develop the 22-acre parcel, the Mello-Roos tax liens against that parcel would go unpaid unless Wildwood Corp. was willing and able to pay the taxes.

Furthermore, the Nevada County Official Statement failed to disclose that, in addition to the appraised build-out value of $35,280,000 represented in the Official Statement, the land had also been appraised using other methods of valuation which resulted in substantially lower appraised values which did not meet the 3-to-1 ratio.

Misleading Owner and Developer Information

According to the Official Statement, "(a)ll of the taxable land within the District is currently owned by G. Michael Montross of Montross Barber Investments, Inc." In fact, Nevada County knew since the March 20, 1990 Board meeting that Wildwood Corp. owned the property because Montross signed the election ballot on behalf of that entity and provided a title report disclosing Wildwood Corp.'s ownership.

The Official Statement represented the experience of Montross and Montross Barber Investments, Inc. as follows:

"(Montross Barber Investments) now holds more than $250 million worth of Northern California property for more than 3,000 investors.

". . . Montross has invested in and developed commercial and residential properties for the past 18 years. He has purchased over $200 million worth of residential units and created over 1,200 subdivision lots in the last eight years."

In fact, Montross was not an experienced developer. His real estate experience consisted of managing apartment buildings and forming limited partnerships to syndicate the purchase of apartment buildings and commercial properties. In these syndication's, Montross and his firm retained a minority interest as general partner, usually no more than 6 percent. Montross did not have 18 years of experience developing vacant land into subdivisions, and he had not created 1,200 subdivision lots. Additionally, the reference to "over $200 million worth of residential units" suggested that Montross Barber Investments, Inc. had enormous financial resources when, in fact, the Montross Barber firm had, as of March 1989, a purported tangible net worth of only $300,000 and was experiencing a negative cash flow from its business operations.

Misleading Financing Description

The Official Statement represented that the "portion of the subdivision improvements that will be financed directly by the Developer includes recreational facilities, drainage facilities, roads and certain fees. The remaining subdivision improvements will be financed from proceeds of the Aggregate Bonds." The Official Statement also stated that $6,900,579.41 in improvements would be financed with public Series E-1990 bonds, $1,392,371.71 in improvements would be financed with public Series T-1990 bonds and $5,089,756.76 would be privately financed. In fact, Nevada County was -- at Horler's recommendation -- requiring the property owner and developer to obtain all of the construction financing from private lending institutions because Nevada County would release the Mello-Roos bond proceeds only after each phase of the project was completed. Nevada County therefore used the Mello-Roos bond proceeds to provide "take out" or "permanent" financing for the public improvements, rather than using the proceeds -- as represented in the Official Statement -- for the construction financing as well. This increased the amounts of liens that would be placed against the property, increased the amount of financing that the owner or developer would have to provide and made the obtaining of financing more difficult.

C. LEGAL ANALYSIS

Section 17(a) of the Securities Act generally prohibits misrepresentations or omissions of material facts in the offer or sale of securities. Scienter is not required to establish a violation of Section 17(a)(2) or Section 17(a)(3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 702 (1980).

The misrepresentations contained in the Nevada County Official Statements were material to investors because they directly addressed the security of the bonds. These misrepresentations significantly altered the total mix of information available to the investors.

The misrepresentations contained in the Nevada County Official Statements were "in the offer or sale" of the bonds. All were designed to induce investors to purchase the bonds. There was a causal nexus between the statements made and the investors' decisions to buy the bonds.

Despite its retention of professional advisers and appraisers, Nevada County remained legally responsible for any misrepresentations and/or omissions in the Nevada County Official Statement. The Nevada County Board of Supervisors approved the Nevada County Official Statement.

IV.

Based on the foregoing, the Commission finds that Nevada County committed violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

V.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act, that Nevada County cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

FOOTNOTES

-[1]- / The Commission instituted the cease-and-desist proceeding on February 2, 1998. See Securities Act Rel. No. 7503; Securities Exchange Act Rel. No. 39612.

-[2]- / The findings herein are made pursuant to Nevada County's Offer and are not binding on any other person or entity in this or any other proceeding.

-[3]- / See Article 1, Chapter 2.5, Division 2, Title 5 of the California Government Code (§§ 53311, et seq.).

In re Wasco Public Financing Authority, Securities Act Release No. 7536, A.P. File No. 3-9542 (May 5, 1998).

I.

The Securities and Exchange Commission ("Commission") has previously instituted a cease-and-desist proceeding pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against the Wasco Public Financing Authority ("Wasco PFA"). [1] The Wasco PFA subsequently has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept.

II.

Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except that the Wasco PFA admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, the Wasco PFA consents to the issuance of this Order Making Findings and Imposing a Cease-and-Desist Order ("Order") and to the entry of the findings and the imposition of the relief set forth below.

III.

On the basis of this Order and the Wasco PFA's Offer, the Commission finds [2] the following:

A. RESPONDENT

Wasco Public Financing Authority is a public financing authority formed by a joint powers agreement between the City of Wasco and the Wasco Redevelopment Agency. The City of Wasco is a political division and legal subdivision of the State of California invested with corporate powers. It is located in California's Central Valley, 275 miles south of San Francisco, and has a non-prisoner population of approximately 10,000. The City of Wasco is governed by an elected City Council whose members also serve as the directors of the Wasco PFA Authority and the Wasco Redevelopment Agency.

B. BACKGROUND

The California Marks-Roos Local Bond Pool Act of 1985 ("Marks-Roos Act") [3] permits municipalities to organize "public financing authorities" ("PFAs") that sell bonds to the general public in order to create pools of moneys which are, in turn, used to buy bonds, notes and other obligations of other public entities ("local obligations").

Marks-Roos bonds are payable from the principal and interest of the local obligations purchased with the pool's proceeds.

Funds raised in a Marks-Roos offering must be used within a certain amount of time to purchase local obligations. Under Section 149(f) of the Internal Revenue Code, a pooled financing is tax exempt only if the issuer reasonably expects that 95 percent of the net proceeds of the bond pool will be used within three years of the date of issuance. For this reason, bond pools generally require that all funds not applied within three years of issuance be returned to investors. The Wasco PFA Indenture of Trust ("Indenture") contained a three-year limitation ("the origination period") on the placement of funds and required that all funds not used within the origination period be repaid to investors.

C. FACTS

On September 20, 1989, the Wasco PFA issued $35 million of its 1989 Local Agency Bonds pursuant to the Marks-Roos Act. The Wasco PFA offered and sold its bonds by means of an Official Statement. The Board of Directors for the Wasco PFA approved the Official Statement. The Official Statement (which contained a summary of the Indenture and advised investors to refer to the full Indenture) represented that the Wasco PFA anticipated using the offering's proceeds to purchase certain local obligations described in the Official Statement. These local obligations were typically identified as proposed development projects to be undertaken by area developers. However, the Official Statement failed to disclose the tentative nature of certain projects identified in the Official Statement.

The Official Statement represented that the Wasco PFA intended to finance the purchase by the Delano Regional Medical Center ("the Delano RMC") of an existing facility in Wasco with $1.2 million in bond funds. The Official Statement failed to disclose that while the Delano RMC and the city were engaged in negotiations, no agreement had yet been reached to purchase the facility. Negotiations broke off after the bonds were issued. The Delano RMC did not purchase the facility.

The Official Statement represented that $1.125 million of funds were intended to be used to finance the "Johnson Housing Project Infrastructure" and that construction of the infrastructure for a mobile home park was expected to commence in late 1989. At the time the Official Statement was disseminated, however, no maps, permits or financing for the mobile home park existed. The park was not constructed.

The Official Statement listed the $2.075 million "Wasco Civic/Recreation Center" as a project the Wasco PFA intended to finance. While the city had considered the idea of building a civic center for many years, it had completed virtually none of the planning required to proceed with such a development. For example, no site had been selected for the project. The civic center was not constructed.

The Official Statement also disclosed that $4.0 million of funds were intended to finance the construction of 100 units of low-income housing, called the "Housing Authority Multi-family Housing Project. "While the Official Statement represented that the Housing Authority "is in the process of taking the necessary steps to start construction," no approvals, sites, plans or matching funds had yet been obtained. The project was not constructed.

The Wasco PFA created the appearance that the bond proceeds would be fully subscribed within the origination period. In fact, by the end of the origination period, the Wasco PFA had applied only about fifteen percent of the funds to the local obligations described in the Official Statement. Instead of funding other local projects over that three-year period, the Wasco PFA purchased more than $9 million in bonds from the underwriter for various projects not related to the Wasco community.

D. LEGAL ANALYSIS

Section 17(a) of the Securities Act generally prohibits misrepresentations or omissions of material facts in the offer or sale of securities. Scienter is not required to establish a violation of Section 17(a)(2) or Section 17(a)(3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 702 (1980).

While offering and selling its bonds to the public, the Wasco PFA represented that it intended and reasonably expected to finance twelve specific local obligations with the proceeds of its offering. These statements were false and misleading in light of the tentative nature of certain projects.

These misrepresentations were material to investors because they directly addressed the use of the offering's proceeds. The misrepresentations significantly altered the total mix of information available to the investors.

The misrepresentations were "in the offer or sale" of the Wasco PFA bonds. All were designed to induce investors to purchase the bonds. There was a causal nexus between the statements made and the investors' decisions to buy the bonds.

Despite its retention of professional advisers, the Wasco PFA remained legally responsible for any misrepresentations and/or omissions in the Official Statement. The Wasco PFA Board of Directors, who also sat on the City of Wasco City Council, approved the Official Statement.

IV.

Based on the foregoing, the Commission finds that the Wasco PFA committed violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

V.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act, that the Wasco PFA cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

FOOTNOTES

-[1]- / The Commission instituted the cease-and-desist proceeding on February 2, 1998. See Securities Act Rel. No. 7503; Securities Exchange Act Rel. No. 39612.

-[2]- / The findings herein are made pursuant to Ione's Offer and are not binding on any other person or entity in this or any other proceeding.

-[3]- / See Article 4, Chapter 5, Division 7, Title 1 of the California Government Code (§§ 6500, et seq .).

In re City of Ione, Securities Act Release No. 7537, A.P. File No. 3-9542 (May 5, 1998).

I.

The Securities and Exchange Commission ("Commission") has previously instituted a cease-and-desist proceeding pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against the City of Ione ("City of Ione"). [1] Ione subsequently has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept.

II.

Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except that Ione admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, Ione consents to the issuance of this Order Making Findings and Imposing a Cease-and-Desist Order ("Order") and to the entry of the findings and the imposition of the relief set forth below.

III.

On the basis of this Order and Ione's Offer, the Commission finds [2] the following:

A. RESPONDENT

City of Ione is a political subdivision and legal subdivision of the State of California invested with corporate powers.

B. THE TWO CITY OF IONE BOND OFFERINGS

The Mello-Roos Bond Act

The California Mello-Roos Community Facilities Act of 1982 (the "Mello-Roos Act") [3] authorizes municipalities to organize community facilities districts ("CFDs") to finance the building of infrastructure. Mello-Roos bonds are paid off through special taxes levied on the property being developed. The bonds are not personal debts of the landowners or general obligations of the issuing municipality. Because they are paid off using future real property tax levies, the bonds' financial attractiveness depends upon the underlying value of the land being developed, the contemplated improvements to the land and the developer's ability to carry out the contemplated improvements.

Ione wanted to finance the infrastructure for a 460-acre real estate development project called Castle Oaks Country Club Estates ("Castle Oaks"), consisting of a residential subdivision, a golf course, and other recreational and commercial uses. The underwriter, First California Capital Markets Group, Inc. ("First California"), recommended that Ione issue two series of Mello-Roos bonds to finance the infrastructure. The first series, Ione CFD-1, was initially designed to be used to finance the development of the Castle Oaks golf course, which was to be owned by Ione, but leased to a private, for-profit operator. Because that lease arrangement would have prevented that series of Mello-Roos bonds from being tax free, the Ione CFD-1 offering was delayed for several months, and its purpose was changed to provide financing for certain infrastructure. The second series, Ione CFD-2, was to be used to develop certain other infrastructure at Castle Oaks. Because of the delay in issuing the Ione CFD-1 bonds, the Ione CFD-2 bonds were actually issued first.

The Ione CFD-2 Offering in February 1991

On February 14, 1991, First California underwrote $7.5 million in Ione CFD-2 bonds under the Mello-Roos Act. The Ione CFD-2 Official Statement described public and private improvements that would be made at the Castle Oaks project through bond financing and private financing. That description was false and misleading because there was a significant shortfall in financing for the proposed project that was not disclosed in the CFD-2 Official Statement.

After the Ione CFD-2 bonds were issued, Ione noticed that the tentative map had not been drawn in conformity with the minimum lot size requirement set forth in the Development Agreement between Ione and the developer. When the lot size was recalculated, the development had only 584 single family lots rather than 667 as originally calculated and represented in the Ione CFD-2 Official Statement.

The Ione CFD-1 Offering in June 1991

On June 6, 1991, in a separate underwriting, First California underwrote $6.55 million of Ione CFD-1 bonds under the Mello-Roos Act. The Ione CFD-1 Official Statement represented that the build-out value of the Castle Oaks Project was $44,906,000, an amount that appeared to satisfy the 3-to-1 value-to-lien ratio for the $14.05 million in total bonds (CFD-2 and CFD-1) then issued. The value was based on an appraisal prepared by William McKay.

This representation was false and misleading. The $44,906,000 appraisal was almost $3 million higher than an appraisal prepared the previous year, despite the fact that in the one year intervening period the number of single family lots in the project had been reduced from 667 to 584 and real estate values in California had declined. In addition, the $44,906,000 appraisal was based on the assumption that part of the land would be developed into 90 high-density single family lots. That assumption, however, was not part of the developer's immediate plans, did not meet the required minimum square foot requirements, had not been approved, and lacked any then-developed market.

The Ione CFD-1 Official Statement failed to disclose that the Castle Oaks Project lacked sufficient capital to finance the planned development. The estimated cost of the infrastructure and golf course was between $25 and $30 million. Ione agreed to raise approximately $14 million by issuing bonds, and the developer was to bear the balance of the construction costs from its own private funding sources. The developer had obtained a $10 million construction loan from a foreign bank. Of that amount, $6.5 million was soon diverted by the developer to another company, leaving a substantial shortfall in private financing for the project. Ione was not informed about the diversion of funds until March of 1992.

On October 6, 1994, due to the developer’s failure to pay special taxes, Ione announced that there were no funds to make the October 1, 1994, interest and principal payments on the Ione CFD-1 and CFD-2 bonds and that the bonds were in default. Not a single lot had been sold. The construction lender foreclosed on the property. After the construction lender was unable to sell the property at two successive foreclosure

sales and failed to bring the special tax bonds current, Ione foreclosed on the property. On December 1, 1995, Ione sold the property to an investment group for $3.3 million at a sheriff's auction.

C. LEGAL ANALYSIS

Section 17(a) of the Securities Act generally prohibits misrepresentations or omissions of material facts in the offer or sale of securities. Scienter is not required to establish a violation of Section 17(a)(2) or Section 17(a)(3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 702 (1980).

While offering and selling its bonds to the public, Ione represented that the Castle Oaks Project was a financially viable project and therefore that the bonds were a secure investment. This representation was false and misleading in light of available cost estimates, errors in the tentative map and appraisals, and the developer's lack of sufficient funds for the project.

The misrepresentations contained in the Ione Official Statements were material to investors because they directly addressed the security of the bonds. These misrepresentations significantly altered the total mix of information available to the investors.

The misrepresentations contained in the Ione Official Statements were "in the offer or sale" of the bonds. All were designed to induce investors to purchase the bonds. There was a causal nexus between the statements made and the investors' decisions to buy the bonds.

Even though it retained and relied upon professional financial and legal advisers and appraisers, Ione was responsible under Sections 17(a)(2) and 17(a)(3) for any misrepresentations and/or omissions in the CFD-1 and CFD-2 Official Statements. The Ione City Council approved both Official Statements.

IV.

Based on the foregoing, the Commission finds that Ione committed violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

V.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act, that Ione cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

FOOTNOTES

-[1]- / The Commission instituted the cease-and-desist proceeding on February 2, 1998. See Securities Act Rel. No. 7503; Securities Exchange Act Rel. No. 39612.

-[2]- / The findings herein are made pursuant to Ione's Offer and are not binding on any other person or entity in this or any other proceeding.

-[3]- / See Article 1, Chapter 2.5, Division 2, Title 5 of the California Government Code (§§ 53311, et seq.).

In re City of Syracuse, New York, Warren D. Simpson, and Edward D. Polgreen, Securities Act Release No. 7460, Exchange Act Release No. 39149, AAE Release No. 970, A.P. File No. 3-9452 (September 30, 1997).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be instituted against the City of Syracuse, New York ("Syracuse" or "the City"), Warren D. Simpson ("Simpson"), and Edward D. Polgreen ("Polgreen"), pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act").

In anticipation of the institution of these cease-and-desist proceedings, the City, Simpson, and Polgreen have submitted Offers of Settlement ("Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings set forth herein, except that the City, Simpson, and Polgreen, each admits the jurisdiction of the Commission over them and over the subject matter of these proceedings, the City, Simpson, and Polgreen by their Offers of Settlement, consent to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Issuing Cease-and-Desist Orders ("Order").

II.

Accordingly, IT IS HEREBY ORDERED that proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act be, and hereby are, instituted.

III.

On the basis of this Order, and the Offers, the Commission makes the following findings:

Summary

A. These proceedings involve violations of the antifraud provisions of the federal securities laws by the City in the offer and sale of municipal securities issued in December 1995 and February 1996. In connection with these offerings, the City materially misrepresented its financial condition and results of operations and described certain summary financial information as audited without disclosing that some of this information was derived from financial statements upon which auditors had issued reports containing qualified opinions. These actions were taken knowingly or recklessly, within the meaning of those terms under the federal securities laws. Simpson and Polgreen each were a cause of the City's violations, due to acts and omissions which they knew or should have known would contribute to the violations.

B. On December 19, 1995, the City issued $19.299 million of one-year bond anticipation notes ("12/95 Offering"). On February 22, 1996, the City issued an additional $3.768 million of one-year bond anticipation notes ("2/96 Offering"). In, and in connection with, the offer and sale of securities in the 12/95 Offering and the 2/96 Offering, the City issued official statements which were materially false and misleading in at least two respects:

* First, the official statements contained materially inaccurate summary financial information for the fiscal year ended June 30, 1995 ("FY 1995"). The official statements falsely showed a surplus for FY 1995 of $.4 million in the Combined Statement of Revenue, Expenditures and Changes in Fund Balance for the City's General and Debt Service Funds when, in fact, there was a deficit of $9.4 million, a difference of $9.8 million. As a result of that misstatement and others, including the City's failure to recognize certain tax revenue in conformity with generally accepted accounting principles ("GAAP"), the City overstated the FY 1995 ending fund balance for the General and Debt Service Funds by $24.2 million.

* Second, the official statements contained summary financial information that was labeled "audited," implying that the auditors had rendered unqualified opinions on the information as presented, when, in

fact, certain of the auditors' reports on the financial statements from which such information was derived contained qualified opinions.

Respondents

C. Syracuse is a municipal corporation and the fifth largest city in the state of New York. The City encompasses approximately 25 square miles and, as of July 1994, had a population of 159,895.

D. Simpson was, at all relevant times until November 1995, the most senior accountant in the City's Finance Department. Among other things, the Finance Department was responsible for the City's securities offerings and the preparation of official statements in connection with those offerings. Simpson oversaw the preparation of the summary financial information contained in the official statements for the 12/95 Offering and the 2/96 Offering.<(1)>

E. Polgreen was, at all relevant times, the City's First Deputy Commissioner of Finance.

Other Related Person

F. The Syracuse City Auditor ("City Auditor") is an elected official who is responsible under the City charter for auditing the affairs of the City's officers, departments, and boards. For many years through and including the fiscal period ended June 30, 1994 ("FP 1994")<(2)>, the City Auditor had audited the City's general purpose financial statements.

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<(1)> In November 1995, Simpson was reassigned to the Budget Department; however, he retained responsibilities with respect to the preparation of the official statements after he was reassigned.

<(2)> Due to a change in the City's fiscal year, the fiscal period ended June 30, 1994 was a six-month period.

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The FY 1995 Summary Financial Information in the Official Statements Was Prepared Before the City's Books Were Closed

G. The City historically issued debt securities in or about February, June, and December of each year and included in official statements for its offerings the City's most recent general purpose financial statements,<(3)> as well as summary financial information. At the time of the 12/95 Offering, however, the City's FY 1995 general purpose financial statements were not complete. The Finance Department determined that the most recent general purpose financial statements, for FP 1994, were too stale to include in the official statement. Accordingly, the Finance Department decided to present only summary financial information and hastily produced FY 1995 summary financial information for inclusion in the official statement for the 12/95 Offering, even though the books for FY 1995 had not yet been closed.

H. The summary financial information in the official statement for the 12/95 Offering included a balance sheet and statement of revenue, expenditures and changes in fund balance, as of and for the fiscal year ended June 30, 1995, with comparative data for several preceding fiscal periods for each of the following: (1) the City's combined General and Debt Service Funds, (2) the City's combined Water and Sewer Funds, and (3) the City School District's General Fund.<(4)> In the official statement for the 12/95 Offering, this summary financial information was included as an appendix and identified as "Financial Statements."<(5)>

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<(3)> Under governmental accounting and financial reporting standards, general purpose financial statements may be issued for inclusion in official statements for securities offerings and for distribution to

users requiring less detailed information about the governmental entity's finances than is contained in a comprehensive annual financial report. To comply with GAAP, general purpose financial statements should include, among other things: (1) a combined balance sheet for all fund types, account groups, and discretely presented component units; (2) a combined statement of revenues, expenditures and changes in fund balance for all governmental fund types and discretely presented component units; and (3) notes to the financial statements. See Codification of Governmental Accounting and Financial Reporting Standards, 2200.134, 138 (Governmental Accounting Standards Board 1995).

<(4)> The City School District is a component unit of the City.

<(5)> Historically, the City included summary financial information in official statements in addition to the City's general purpose financial statements.

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I. The FY 1995 summary financial information included in the official statement for the 12/95 Offering was unreliable because the City's books were not closed for FY 1995. The delay in closing the books was due to various factors including: (1) the Finance Department had lost several employees who were experienced in closing the books and preparing the financial statements; (2) several important responsibilities of those who had left the Finance Department had not been reassigned; (3) the audit of the City's FP 1994 general purpose financial statements by the City Auditor was ongoing until October 1995, which required significant attention from the staff of the Finance Department and diverted them from other duties; and (4) the City's accounting systems were antiquated and had significant inefficiencies.

J. The summary financial information included in the official statements for the 12/95 and 2/96 Offerings, including the information for FY 1995, was virtually identical.<(6)> Although the process of closing the City's books for FY 1995 continued between the time of the 12/95 and 2/96 Offerings, in preparing the official statement for the later offering, the City did not consider whether any changes to the FY 1995 summary financial information were necessary.

The FY 1995 Summary Financial Information in the Official Statements Was Materially Inaccurate

K. When the City's Finance Department was unable to complete the FY 1995 financial statements by February 1996, additional personnel with accounting backgrounds were assigned from other departments to assist in completing the statements. The FY 1995 general purpose financial statements were completed in April 1996, approximately six weeks after the 2/96 Offering.

L. The outside auditor who ultimately audited the City's FY 1995 general purpose financial statements found that the City failed to record certain accounting entries, including accruals for accounts payable, workers' compensation, and retirement benefits.<(7)> As a result of the City's failure to record these accounting entries in a timely manner and to record certain other entries accurately, the official statements for the 12/95 and 2/96 Offerings falsely stated that the Combined Statement of Revenue, Expenditures and Changes in Fund Balance for the City's combined General and Debt Service Funds showed a surplus for FY 1995 of $.4 million when, in fact, there was a deficit of $9.4 million, a difference of $9.8 million.

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<(6)> The sole exception was that, in the official statement for the 2/96 Offering, the FY 1995 summary financial information for the City School District was labeled "audited." See discussion below.

<(7)> For many years, the City's general purpose financial statements had been audited by the City Auditor. As the result of disagreements between the City Auditor and the Finance Department, the City decided to hire an outside auditor to audit the FY 1995 general purpose financial statements. The outside auditor found that the City's books were in such disarray that the general purpose financial statements produced in April 1996 were "unauditable." Subsequently, a new version of the FY 1995 general purpose financial statements was prepared from the City's source documents.

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M. The outside auditor also discovered that the City's accounting practices with respect to the recognition of property tax revenue were not in conformity with GAAP.<(8)> To bring its practice with respect to recognition of property tax revenue into conformity with GAAP, the City made a prior period adjustment of $12.5 million to the General Fund balance to reclassify Fund Balance - Reserved for Taxes to Deferred Revenue.<(9)>

N. The City's failure to make certain accounting entries in a timely manner and to record tax revenue in conformity with GAAP resulted in certain misstatements in the FY 1995 general purpose financial statements. Adjustments to correct those misstatements, as well as certain other adjustments, resulted in changes to the FY 1995 summary financial information for the City's combined General and Debt Service Funds and combined Water and Sewer Funds. The following table shows the changes to the FY 1995 summary financial information presented in the official statements for the 12/95 and 2/96 Offerings:

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<(8)> The City had for many years recognized the entire tax levy as revenue at the beginning of the fiscal year and made an entry at the end of the fiscal year to reclassify as Fund Balance - Reserved for Taxes, the taxes that were not collected during the year, but which were expected to be collected in the future. GAAP generally requires property taxes which are expected to be collected after 60 days of the fiscal year-end to be booked as deferred revenue and recognized as revenue when such amounts are collected. See Codification of Governmental Accounting and Financial Reporting Standards, _ P70.103, 104 (Governmental Accounting Standards Board 1995).

<(9)> Additional unrelated prior period adjustments totaled $1.9 million.

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	FY 95 Fund Balance as Presented in Official Statements	FY 95 Fund Balance -- Actual	Understatement/ <Overstatement>/ %	
General & Debt Service Funds	$31 million	$6.8 million	<$24.2 million>	<355%>
Water and Sewer Funds	$2.6 million	$3.2 million	$ 0.6 million	19%
School District General Fund	$27.2 million	$27.2 million	$ 0	0%

The Representation in the Official Statements that Certain Summary Financial Information Was Audited Was Also Materially Misleading

O. The summary financial information for fiscal periods prior to FY 1995 included in the official statements for the 12/95 and 2/96 Offerings was labeled "audited." In addition, the FY 1995 summary financial information for the City School District's General Fund included in the official statement for the 2/96 Offering was labeled "audited." Labeling the information "audited" implied that auditors had rendered unqualified opinions on the information presented.<(10)>

P. In fact, certain of the auditors' reports on the financial statements from which such information was derived contained qualified opinions. The auditor's report for the City's FP 1994 general purpose financial statements contained a qualified opinion, as did the auditors' reports on the general purpose financial statements of the City School District for all the periods presented. The official statements for the 12/95 and 2/96 Offerings did not include the auditors' reports on the general purpose financial statements of the City or of the City School District, from which the summary financial information labeled "audited" was derived, and did not disclose that some of these auditors' reports contained qualified opinions. Labeling certain of the summary financial information "audited" without including related auditors' reports containing qualified opinions or disclosing that the related reports contain qualified opinions was misleading.

City Officials, Including Simpson and Polgreen, Knew or Recklessly Disregarded That the FY 1995 Summary Financial Information Was Materially Inaccurate and That Labeling Certain of the Summary Financial Information "Audited" Was Materially Misleading

Q. City officials, including Simpson and Polgreen, were aware of the problems within the Finance Department, knew that the City's books for FY 1995 had not been closed, and knew that the FY 1995

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<(10)> Labeling the summary information "audited" also implied that the auditors had opined on the summary financial information. Instead, the summary financial information was derived from audited general purpose financial statements of the City and the City School District information included in the official statement for the 12/95 and 2/96 Offerings was subject to revision. In addition, at the time that he caused the FY 1995 summary financial information to be included in the official statements for the 12/95 and 2/96 Offerings, Simpson knew that the City's practice concerning the recognition of property tax revenue was not in conformity with GAAP.

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summary financial information included in the official statement for the 12/95 and 2/96 Offerings was subject to revision. In addition, at the time that he caused the FY 1995 summary financial information to be included in the official statements for the 12/95 and 2/96 Offerings, Simpson knew that the City's practice concerning the recognition of property tax revenue was not in conformity with GAAP.

R. City officials, including Simpson and Polgreen, knew that the auditor's report on the FP 1994 general purpose financial statements of the City and the auditors' reports on the City School District's general purpose financial statements for all periods presented contained qualified opinions. Moreover, prior to the closing of the 2/96 Offering, City officials, including Simpson and Polgreen, knew that the City Auditor objected to the financial presentation in the official statement for the 12/95 Offering because summary financial information presented for fiscal periods prior to FY 1995 was labeled "audited."

S. Simpson oversaw the preparation of the summary financial information included in the official statements for the 12/95 and 2/96 Offerings.

T. Polgreen was Simpson's direct supervisor and was aware that Simpson was providing the summary financial information to be included in the official statements for the Offerings. Polgreen signed a certification stating that the preliminary official statement for the 2/96 Offering did not contain any false statements of material fact, or omit to state material facts.<(11)> Although Polgreen knew that the books for FY 1995 had not been closed and that some or all of the auditors' reports on the financial statements from which certain of the summary financial data was derived contained qualified opinions, Polgreen permitted the inclusion of the FY 1995 summary financial information and the use of the misleading label "audited". Moreover, Polgreen signed the certification for the official statement for the 2/96 Offering without making any inquiries to determine whether he could make the representation contained in the certification.

IV.

Legal Analysis -- Violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

A. Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit any person, in the offer or sale, or in connection with the purchase or sale, of securities, from making any untrue statement of a material fact, or omitting to state a material fact, using any device, scheme or artifice to defraud, or engaging in any transaction, practice, or course of business which operates as a fraud. A misstatement or omission is material if there is a substantial likelihood that it would have been viewed by a reasonable investor as "having significantly altered the `total mix' of information made available." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). See also Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

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<(11)> Certifications for the City's official statements were generally signed by the Commissioner of Finance. The Commissioner signed the certification for the 12/95 Offering. Subsequent to the 12/95 Offering, but prior to the closing of the 2/96 Offering, the Commissioner was injured and went out on disability leave.

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B. Scienter is a required element to prove violations of Section 17(a)(1), Section 10(b) and Rule 10b-5. See Aaron v. SEC, 446 U.S. 680, 701-02 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).<(12)> Scienter is established by a showing of either intentional or reckless conduct. See Ernst, 425 U.S. at 194 n.12; SEC v. Blavin, Inc., 760 F.2d 706, 711 (6th Cir. 1985). Recklessness is "`highly unreasonable conduct which is an extreme departure from the standards of ordinary care.'" Id. (citation omitted). See also Estate of Detwiler v. Offenbecher, 728 F. Supp. 103, 137 (S.D.N.Y. 1989) (dissemination of material "knowing [it was] false or that the method of preparation was egregious as to render [its] dissemination reckless" satisfies the Scienter requirement); Goldman v. McMahan, Brafman, Morgan & Co., 706 F. Supp. 256, 259 (S.D.N.Y. 1989) ("[a]n egregious refusal to see the obvious, or to investigate the doubtful" may give rise to an inference of recklessness).

C. The information misstated in, and omitted from, the official statements for the 12/95 and 2/96 Offerings was material. There is a substantial likelihood that a reasonable investor would view the misstatements of the FY 1995 summary financial information as significantly altering the total mix of information made available. In addition, a reasonable investor would likely conclude from the labeling of certain summary financial information as "audited" that auditors had issued reports containing unqualified opinions on the summary financial information. There is a substantial likelihood that disclosure that the auditors' reports on the City's FP 1994 financial statements and on the City School District's financial statements for FY 1995 and the prior fiscal years, from which that summary financial information was derived, contained qualified opinions, would have been viewed by a reasonable investor as significantly altering the total mix of information available. Accordingly, the inaccuracy of the FY 1995 summary financial information and the failure to disclose that certain of the summary financial information was derived from financial statements upon which auditors had issued reports containing qualified opinions constituted material misstatements and omissions.

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<(12)> Scienter is not required for a violation of Sections 17(a)(2) and (3) of the Securities Act. See Aaron, 446 U.S. at 697.

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D. City officials, including Simpson and Polgreen, acted knowingly or recklessly in including the FY 1995 summary financial information in the official statements for the 12/95 and 2/96 Offerings and labeling certain of the summary financial information in the official statements as "audited", because:

* They were aware of the problems within the Finance Department and knew that the City had not completed its closing process for FY 1995 by the time that summary financial information for FY 1995 was included in the official statements.

* Simpson was aware that the City's accounting for property taxes did not conform with GAAP.

* They knew that the auditor's report on the FP 1994 general purpose financial statements of the City and the auditors' reports on the general purpose financial statements of the City School District for the periods presented contained qualified opinions and knew, or were reckless in not knowing, that labeling the summary financial information in the official statements "audited" would be misleading to investors.

E. While engaged in the conduct described above, the City, directly and indirectly, used the means or instrumentalities of interstate commerce or the mails.

V.

A. Based on the foregoing, the City violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Based on the foregoing, Simpson and Polgreen each were a cause of the City's violations due to their various acts and omissions which they knew or should have known would contribute to the City's violations.

VI.

In view of the foregoing, the Commission deems it appropriate to accept the Offers of Settlement submitted by the City, Simpson, and Polgreen and impose the cease-and-desist orders specified in the Offers of Settlement. In determining to accept the Offers, the Commission considered remedial acts promptly undertaken by the City and cooperation afforded to the Commission's staff.

Accordingly, IT IS HEREBY ORDERED that:

A. The City cease and desist from committing or causing any violation, and any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

B. Simpson cease and desist from committing or causing any violation, and any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and

C. Polgreen cease and desist from committing or causing any violation, and any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

<u>In re Maricopa County</u>, Securities Act Release No. 7345, Exchange Act Release No. 37748, A.P. File No. 3-9118 (September 30, 1996).

On September 30, 1996, the Commission instituted cease-and-desist proceedings against Maricopa County, Arizona ("the County"). The County, formed in 1871, is the population center of Arizona and the sixth largest county in the nation. The Order Instituting Cease-and-Desist Proceedings ("Order") alleges that the County violated the antifraud provisions of the federal securities laws in connection with the July 1993 offer and sale of two series of general obligation bonds.

The County's Official Statements, which were the primary disclosure documents for the offerings, contained financial statements for the County for the year ended June 30, 1992. The Order alleges,

however, that the County's financial condition at the time of the offerings had materially worsened since June 30, 1992. Specifically, during fiscal year 1992-93, the County developed a deficit in its General Fund and had nearly doubled the deficit in its Medical Center Enterprise Fund. The Official Statements failed to disclose these changes. The Official Statements further failed to disclose that the current liabilities of the Medical Center Enterprise Fund on June 30, 1993, exceeded its current assets by approximately 40% more than on June 30, 1992, and that the County's cash flow position had materially declined since the close of the prior fiscal year.

In addition, the Official Statements for one of the offerings represented that bond proceeds would be used to finance specific County projects. The Order alleges that the County in fact planned to, and did, use the bond proceeds to finance its deficit through the end of the 1993-1994 fiscal year. Despite the County's plan to use the proceeds to finance its deficit, it failed to revise or supplement its Official Statement to reflect this plan. Each of the omitted items referenced above would have been important for an investor to consider in deciding whether or not to purchase the County's bonds because they tended to bear upon the County's financial condition at the time the bonds were issued.

In re Maricopa County, Securities Act Release No. 7354, Exchange Act Release No. 37779, A.P. File No. 3-9118 (October 3, 1996).

I.

The Securities and Exchange Commission ("Commission") has previously instituted a cease-and-desist proceeding pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Maricopa County, Arizona ("the County") or "Respondent"). n1 The County has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept.

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n1 The Order Instituting Cease-and-Desist Proceeding in this matter was issued on September 30, 1996. See Exchange Act Release No. 37748.

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II.

Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over it and over the subject matter of this proceeding, which is admitted, Maricopa County by its Offer consents to the entry of this Order Making Findings and Imposing Sanction Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order") containing the findings set forth in Section III below and imposing the sanction set forth in Section IV below.

III.

On the basis of this Order and the Offer submitted by Maricopa County, the Commission finds n2 that:

A. Maricopa County, formed in 1871, encompasses approximately 9,226 square miles and is the population center of Arizona. Between July 26, 1993 and August 10, 1993, Maricopa County offered and sold $25.575 million worth of ten year general obligation project bonds ("Project Bonds") and $22.25 worth of four year general obligation refunding bonds ("Refunding Bonds") (collectively referred to as the "1993 G.O. Bond Offerings"). In, and in connection with, the offer, purchase and sale of the 1993 G.O. Bond Offerings the County violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by using the means and instruments of transportation and communication in interstate commerce and the means and instrumentalities of interstate commerce, and the mails to, directly

and indirectly, obtain money and property by means of untrue statements of material fact and omissions 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.

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n2 The findings herein are made pursuant to Respondent's Offer of Settlement and shall not be binding on any other person or entity named as a respondent in this or any other proceedings.

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B. The County, assisted by others, including a financial adviser, prepared and distributed, or caused others to distribute, Official Statements and Closing Documents which were the primary disclosure documents used in connection with the 1993 G.O. Bond Offerings. The Official Statements were distributed to investors by use of the mails and means and instruments of transportation and communication in interstate commerce and the means and instrumentalities of interstate commerce. The Closing Documents, which included, among other things, a copy of the Official Statement for each offering and a certification of completeness, were distributed to others involved in the offer, sale and distribution of the Bonds.

C. The Official Statements for each offering contained financial statements for the year ended June 30, 1992. However, the County's financial condition at the time of the 1993 G.O. Bond Offerings had materially worsened since June 30, 1992, in that the County's operating cash flow had materially declined. Specifically, during fiscal year 1992-93, the County developed a deficit in its General Fund and had nearly doubled the deficit in its Medical Center Enterprise Fund, from $16.9 million to $31.8 million. The Official Statements, which included financial statements for 1992, failed to disclose these changes. In addition, the Official Statements failed to disclose that the current liabilities of the Medical Center Enterprise Fund on June 30, 1993, exceeded its current assets by approximately 40% more than on June 30, 1992. Furthermore, the Official Statements for the 1993 G.O. Bond Offerings failed to disclose that the County's cash flow position had materially declined since the close of the prior fiscal year. In fact, the County's preexisting G.O. Bond rating was downgraded by Moody's Investor Service due to the cash flow situation.

D. In addition, the Project Bonds' Official Statements represented that bond proceeds would be used to finance specific County projects. The Project Bonds' Closing Documents were even more specific, representing that construction on the projects would start in July 1993 and January 1994. Contrary to these representations, the County planned to and did use $25 million of the $25.575 million Project Bond proceeds to finance its cash flow deficit through July 1994.

E. The Refunding Bonds' Closing Documents represented that, subsequent to June 30, 1992, there had been no material change in the County's financial condition. In fact, the County had developed a deficit in its General Fund and had nearly doubled the size of the deficit in its Medical Center Enterprise Fund, both occurring after June 30, 1992.

F. These facts were material since: 1) the County's changed financial condition, as reflected by the development of a General Fund deficit and the doubling of the Medical Center Enterprise Fund deficit would have been important for an investor to consider in deciding whether or not to purchase the County's G.O. Bonds; and 2) use of Project Bond proceeds to alleviate the County's cash flow deficit was an undisclosed use of investor funds, which an investor would have considered important in deciding whether or not to purchase the Bonds.

IV.

In view of the foregoing, it is in the public interest to impose the sanction specified in the Offer.

Accordingly, IT IS ORDERED THAT:

Respondent Maricopa County shall cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

For the Commission, by its Secretary, pursuant to delegated authority.

In re County of Orange, California; Orange County Flood Control District and County of Orange, California Board of Supervisors, Securities Act Release No. 7260, Exchange Act Release No. 36760, A.P. File No. 3-8937 (January 24, 1996).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that a public administrative cease-and-desist proceeding be and hereby is instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against the County of Orange, California ("Orange County" or the "County"), the Orange County Flood Control District (the "Flood Control District") and the County of Orange, California Board of Supervisors (the "Board").

II.

In anticipation of the institution of this proceeding, Orange County, the Flood Control District and the Board have submitted an Offer of Settlement, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Orange County, the Flood Control District and the Board each admits the jurisdiction of the Commission over them and over the subject matter of this proceeding, Orange County, the Flood Control District and the Board, by their Offer of Settlement, consent to the entry of this Order Instituting A Public Administrative Cease-And-Desist Proceeding Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing Cease-and-Desist Order ("Order") and to the entry of the findings and the cease and desist order set forth below.

Accordingly, IT IS HEREBY ORDERED that a proceeding pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offer of Settlement submitted by Orange County, the Flood Control District and the Board, the Commission finds that:-[1]-

A. SUMMARY

This Order concerns false and misleading statements in the offer and sale of over $2.1 billion in municipal securities issued in 1993 and 1994 by Orange County, the Flood Control District and a school district located in Orange County (the "School District").-[2]- In connection with these

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-[1]-The findings herein are made pursuant to the Offer of Settlement of Orange County, the Flood Control District and the Board and are not binding on any other person or entity named as a respondent in this or any other proceeding.

-[2]-As more fully discussed below, the offerings may be categorized into four types: the reinvestment offerings; the tax and revenue anticipation note ("TRAN") offerings; the Teeter note offerings; and the Pension Bond offering. The reinvestment offerings were: the $400,000,000 COUNTY OF ORANGE, CALIFORNIA 1993-94 TAXABLE NOTES issued by Orange County on July 1, 1993; the $600,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAXABLE NOTES issued by Orange County on July 8, 1994; the [SCHOOL DISTRICT] $50,000,000 TAXABLE NOTES issued by the School District on August 26, 1993; the [SCHOOL DISTRICT] $50,000,000 TAXABLE NOTES issued by the School District on August 1, 1994; and the $100,000,000 TAXABLE NOTES issued by the Flood Control District on August 2, 1994. The TRAN (continued...)

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offerings, the County, the Flood Control District and the Board variously made material misstatements in the disclosure documents for the offerings (the "Official Statements") or authorized the use of Official Statements that were either false or misleading by omitting to state material facts regarding: 1) the Orange County Investment Pools (the "County Pools"), including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield, and investment in the County Pools of the funds pledged to repay the securities, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the municipal securities (the "Purchase Agreements"); 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) the tax-exempt status of the offering; 4) an undisclosed cap on the interest rate payable to investors on certain variable rate municipal securities sold in the offerings; and 5) the unauthorized use of an audit report. In addition, in connection with the offer and sale of certain of the municipal securities, misrepresentations were made to certain national securities rating agencies (the "Rating Agencies") concerning the County Pools. These material misstatements were made in violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

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-[2]-(...continued)
offerings were: the $299,660,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 POOLED TAX AND REVENUE ANTICIPATION NOTES, issued by Orange County on July 1, 1994; the $169,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES A issued by Orange County on July 5, 1994; and the $31,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES B issued by Orange County on August 11, 1994. The Teeter offerings were: the $111,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAXABLE NOTES issued by Orange County on July 20, 1994; and the $64,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAX-EXEMPT NOTES issued by Orange County on August 18, 1994. The Pension Bonds were issued by Orange County on September 28, 1994 in two series: the $209,840,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994A; and the $110,200,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994B.

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B. THE RESPONDENTS

County of Orange, California ("Orange County" or the "County") is a legal subdivision and political subdivision of the State of California and a body corporate and politic having the powers specified in Title 3 of the California Government Code and such others necessarily implied from the express powers.-[3]- On December 6, 1994, the County filed for protection under Chapter 9 of the United States Bankruptcy Code after incurring investment losses in the County Pools. Orange County conducted eight of the eleven offerings of municipal securities that are the subject of this Order.

Orange County Flood Control District (the "Flood Control District") is a body corporate and politic having the powers enumerated in its enabling legislation.-[4]-The Orange County Board of Supervisors is designated and empowered to act as ex officio board of supervisors of the Flood Control District.-[5]-The Flood Control District's principal functions are to provide for the control and preservation of flood and storm waters within Orange County. The Flood Control District conducted one of the municipal securities offerings that are the subject of this Order.

Orange County Board of Supervisors (the "Board") is the body through which the County exercises its powers.-[6]- The Board consists of five full-time members, each serving a term of four years.-[7]-The Board has legislative, financial and police powers. The Board exercises its financial powers through its supervision of and control over the financial affairs of the County. The financial powers of the Board include: examination and audit, or causing the audit, of the financial accounts and records of all officers having responsibility for County moneys;

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-[3]-See Cal. Const. Art. XI, _ 1 (West Supp. 1995); Cal. Gov't Code _ 23003 (West 1988).

-[4]-See Cal. Water Code App. _ 36-1 et seq. (West 1968 & West Supp. 1995).

-[5]-Cal. Water Code App. _ 36-3 (West Supp. 1995).

-[6]-See Cal. Gov't Code _ 23005; see also Board of Supervisors of Modoc County v. Archer, 18 Cal. App. 3d 717, 721, 96 Cal. Rptr. 379, 382 (1971).

-[7]-Simultaneous with the entry of this Order, the Commission, pursuant to Section 21(a) of the Exchange Act, issued a Report of Investigation in the Matter of County of Orange, California as It Relates to the Conduct of the Members of the Board of Supervisors, in connection with the matters discussed herein.

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supervision of the official conduct of all County officers, including the Treasurer; investment of County surplus funds; approval of proposed County budgets and adoption of final County budgets; and contracting for County indebtedness, including issuing municipal securities.-[8]-

C. RELATED INSTRUMENTALITIES AND PERSONS

The Orange County Investment Pools (the "County Pools") were instrumentalities of the County and were not established as legal entities distinct from the County. The County Pools operated as an investment fund managed by Orange County through which the Treasurer invested the County funds and public funds deposited in the County's control by various local governments or districts (the "Pool Participants" or the “Participants"). As of December 1994, the County Pools held approximately $7.6 billion in Participant deposits, including County funds. The County Pools consisted of the Commingled Pool (the principal investment pool with $6.126 billion in Participant deposits), the Bond Pool (the pool primarily for proceeds from tax-exempt offerings with $1.261 billion in Participant deposits) and Specific Investments (investments separately managed for certain Participants, including Orange County, with $210 million in Participant deposits).

As of December 1994, there were approximately 183 Pool Participants. Orange County invested essentially all of its liquid assets in the County Pools, almost $2.3 billion. In addition, approximately 80 other Participants were required by California law to deposit their funds with the Treasurer (the "Mandatory Participants"). As of December 1994, these Mandatory Participants had deposited about $1.6 billion into the County Pools. The remaining approximately 102 Participants voluntarily deposited their funds with the Treasurer for investment in the County Pools (the "Voluntary Participants"). As of

December 1994, these Voluntary Participants had deposited approximately $3.7 billion into the County Pools. In total, the County, the Mandatory Participants and the Voluntary Participants had invested or deposited $7.6 billion into the County Pools.

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-[8]- See Cal. Gov't Code _ 25250 (West 1988) (examination and audit of County financial records); Cal. Gov't Code _ 25303 (West 1988) (supervision of County officials, particularly functions relating to public funds); Cal. Gov't Code _ 53601 (West Supp. 1995) (investment of surplus funds); Cal. Gov't Code _ 29064 & 29088 (West Supp. 1995) (approval of proposed budget and adoption of final budget); Cal. Gov't Code _ 25256 (West 1988) (limitation on amount of debt Board may approve); Cal. Gov't Code _ 53853 (West Supp. 1995) (authorization of short-term note offerings).

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The Orange County Treasurer-Tax Collector (the "Treasurer") is an elected official who manages the treasury and tax collection functions of Orange County under the authority of the Board. The Treasurer is aided in his treasury responsibilities by an assistant treasurer (the "Assistant Treasurer"), a non-elected County official. The Treasurer and Assistant Treasurer also serve as the Treasurer and Assistant Treasurer of the Flood Control District.-[9]- The Treasurer and the Assistant Treasurer managed the County Pools' funds and securities, directed the County Pools' investments and communicated with Pool Participants and prospective investors in the County Pools.-[10]-

D. FACTS

1. Orange County's Financial Condition

Orange County's financial condition was closely tied to the financial condition of the County Pools. The County was heavily dependent on the County Pools as a source of income to balance its current operating budget.-[11]- The County's use of interest income as a revenue source to balance its discretionary budget had been increasing since at least fiscal year 1991-92,

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-[9]-See Cal. Water Code App. _ 36-3 (West Supp. 1995).

-[10]-Simultaneous with the entry of this Order, the Commission filed a complaint, Securities and Exchange Commission v. Robert L. Citron and Matthew R. Raabe, Civil Action No. (C.D. Cal.), in connection with the matters discussed herein.

-[11]-For fiscal year 1994-95, Orange County's total budget was approximately $3.7 billion. Of that amount, the County was required to spend about 88%, or $3.266 billion, for specific purposes. The remaining 12%, or $462.5 million, comprised Orange County's discretionary budget, over which the Board had authority to determine how funds would be allocated. Orange County's discretionary budget for fiscal year 1994-95 was $462.5 million. The largest portion of that amount, $162 million, or 35%, was budgeted to come from investment income on Orange County's investment in the County Pools.

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and increased dramatically for fiscal year 1994-95.-[12]- This increased use of interest income was due to a decline in revenue from other sources, particularly property taxes.-[13]- The Board approved the County's budget and was aware of the County's increasing use of interest income from the County Pools to balance the discretionary budget.

The County had two sources of funds to invest in the County Pools and earn investment interest. First, from January 1993 to December 1994, Orange County had invested essentially all of its liquid assets in

the County Pools, almost $2.3 billion, including funds pledged to repay municipal securities. Second, in 1993 and 1994, Orange County issued $1 billion in municipal securities, through two offerings, for the sole purpose of reinvesting the proceeds in the County Pools, $400 million of which was repaid in 1994.

Due to the County Pools' risky investment strategy, the County Pools ultimately lost approximately $1.7 billion of the Participants' deposits of $7.6 billion, a loss of about 22.3%, when the County Pools' securities portfolio was liquidated. Orange County itself lost approximately $600 million of its $2.3 billion investment in the County Pools. The County also suffered a loss of $157 million in estimated and budgeted interest earnings from the County Pools, contributing to a projected budget deficit for fiscal year 1994-95 of approximately $172 million. As a result of these losses, on December 6, 1994, Orange County filed a bankruptcy petition under Chapter 9 of the United States Bankruptcy Code. As a result of Orange County's economic dependence on the County Pools and their subsequent collapse, the County has not repaid or repurchased approximately $910 million in municipal securities at the time they were to mature by their original terms or were tendered for repurchase.-[14]-

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-[12]-For fiscal year 1991-92, interest earnings were $36.8 million, or 7.4% of the discretionary budget; for fiscal year 1992-93, $64.5 million, or 12.4% of the discretionary budget; and for fiscal year 1993-94, they were budgeted at $58.3 million, or 15.1% of the discretionary budget.

-[13]-Property tax revenues comprised 52.8% of the total discretionary budget for fiscal year 1991-92, 49.1% for fiscal year 1992-93, 33.4% for fiscal year 1993-94, and were projected to be only 25.4% for fiscal year 1994-95.

-[14]-These municipal securities have been rated in default by one of the Rating Agencies. In Orange (continued...)

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2. The Orange County Investment Pools

The eleven municipal securities offerings that raised over $2.1 billion and that are the subject of this Order were significantly dependent on the investment performance of the County Pools in one or more of the following ways such that fair and accurate disclosure about the operation of the County Pools was material to investors in the municipal securities: 1) the proceeds from certain offerings, totaling $1.2 billion, were reinvested in the County Pools to obtain interest earnings; 2) the funds pledged to repay certain of the securities were invested in the County Pools; 3) the County Pools agreed to repurchase or repay certain of the securities; and/or 4) the County's economic reliance on the County Pools materially affected its ability to repay its securities. The false and misleading statements in the offer and sale of the municipal securities also related principally to the County Pools. Accordingly, in order to set forth these false and misleading statements, it is necessary to first discuss the County Pools and the reasons for their collapse.

a. The County Pools' Investment Strategy

The County Pools' investment policy as stated by the Treasurer's office to Pool Participants was, in order of importance: 1) preservation of investment capital; 2) liquidity; and 3) investment yield. The Treasurer, however, caused the County Pools to engage in a very risky investment strategy. The strategy involved using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days), and investing in securities with a longer maturity (generally two to five years), many of which were volatile derivative securities.-[15]-

---------FOOTNOTES----------

-[14]-(...continued)
County's bankruptcy proceeding, the County, the noteholders and the creditors' committee agreed to extend, or rollover, the maturity of approximately $800 million of these municipal securities to June 30, 1996.

-[15]-The term leverage is used where the value of the position is greater than the equity in the position. In other words, a person would be deemed to hold a leveraged position if he or she can maintain a larger position than the equity in the position. The term repurchase agreement refers to an agreement by the seller (i.e., the dealer) to repurchase securities (usually government securities), and an agreement by the (continued...)

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The County Pools' investment return was to result principally from the interest received on the securities in the County Pools. Leverage enabled the County Pools to purchase more securities for the purpose of generating increased interest income. This strategy was profitable as long as the County Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

b. The County Pools' Holdings

During 1993 and 1994, the Treasurer on behalf of Orange County, using reverse repurchase agreements, leveraged the Participants' deposits to amounts ranging from 158% to over 292%. The Treasurer then invested the Participants' deposits and the funds obtained through reverse repurchase agreements in debt securities issued by the United States Treasury or government sponsored enterprises; however, many of these securities were risky derivative securities, comprising from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio.

The County Pools were heavily invested in derivative instruments known as inverse floaters that pay interest rates inversely related to the prevailing market interest rate. Inverse floaters are negatively affected by a rise in interest rates. From January 1993 through November 1994, from 24.89% to 39.84% of the County Pools' total portfolio consisted of inverse floaters. In contrast, the County Pools invested only sparingly in securities that paid interest rates directly related to the prevailing interest rate (variable rate securities) or securities that paid interest rates that rose at certain stated intervals to certain stated rates (step-up securities). From January 1993 through November 1994, only 1.84% to 5.59% of the County Pools' portfolio consisted of such securities. Accordingly, the County Pools invested in inverse floaters to speculate on the direction of short and long-term interest rates.

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-[15]-(...continued)
purchaser (i.e., the investor) to resell the same securities, for a certain price at a certain time in the future. In a reverse repurchase agreement, the dealer agrees to buy the securities and the investor agrees to repurchase them at a later date. Reverse repurchase agreements were a method by which the County obtained funds from broker-dealers and effectively pledged the County Pools' securities as collateral. Derivative instruments encompass a wide array of financial contracts, including swaps, futures, options and forwards, that derive their value from the performance of other assets, such as equities, debt, foreign currency and commodities.

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c. The County Pools' Sensitivity To Interest Rate Changes

The composition of the County Pools' portfolio made it highly sensitive to interest rate changes. As interest rates rose, the market value of the County Pools' securities (debt instruments) fell, and the interest received on the County Pools' inverse floaters also dropped. In October 1992 and January 1993, the

Treasurer was advised that the County Pools' modified duration was seven years.-[16]- In other words, for each 1% increase (or decrease) in the prevailing interest rate, the County Pools' equity (i.e., the value of the County Pools' securities less the amount obtained through reverse repurchase agreements) would decrease (or increase) by approximately 7%. The Treasurer was also advised that the modified duration indicated substantially more price volatility than would be expected from a portfolio with the County Pools' short average maturity. The Treasurer was further advised that the County Pools' lengthy modified duration was the result of the County Pools' investment in inverse floaters and the use of reverse repurchase agreements to leverage the portfolio.

In February 1994, the Treasurer was advised that: over $5 billion of the County Pools' derivative securities (which comprised roughly 75% of the County Pools' total derivative holdings and about 25% of the entire portfolio) had an average duration of approximately five years; and for each basis point (.01%) rise in comparable duration Treasury securities, the mark-to-market value of these securities would fall by $2.7 million.

d. The Effect Of The Rise In Interest Rates In 1994 On The County Pools

The County Pools' investment strategy was profitable so long as interest rates, including rates on reverse

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-[16]-A measure of the County Pools' sensitivity to interest rate changes, and therefore risk, is the portfolio's "modified duration." Modified duration measures the sensitivity of the portfolio's market value to changes in prevailing interest rates (duration does not refer to maturity of the portfolio). The longer the modified duration of a portfolio, the more sensitive its market value is to interest rate change.

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repurchase agreements, remained low and the market value of the County Pools' securities remained stable. The Treasurer's Annual 1992-93 Financial Statement for the County Pools stated that the investment strategy was "predicated on interest rates to continue to remain low for a minimum of the next three years."

During 1993, interest rates remained low and relatively stable. Due to the low interest rates and the County Pools' investment strategy, the County Pools earned a relatively high yield of about 8% during 1993. Beginning in February 1994, interest rates began to rise. This rise in interest rates caused the County Pools' yield to decrease, the reverse repurchase costs to increase, the County Pools' interest income on inverse floaters to decrease and the market value of the County Pools' debt securities to decline.-[17]- The rising interest rates and the declining market value of the County Pools' securities also caused the County to be subject to collateral calls and reductions in amounts obtained under reverse repurchase agreements of over $1.36 billion. In sum, because of the leverage employed in managing the County Pools and the losses which would be incurred by selling the securities subject to reverse repurchase agreements, the County Pools were facing a growing liquidity crisis.

e. Manipulation Of The County Pools' Yield

The Treasurer and the Assistant Treasurer manipulated the County Pools' yield by: 1) diverting interest income from Commingled Pool Participants to an account for the benefit of Orange County; and 2) causing the Commingled Pool to acquire and transfer securities at off-market prices to the detriment of Commingled Pool Participants.

Between April 1993 and June 1994, the Treasurer and the Assistant Treasurer misappropriated a total of $92.9 million from the Commingled Pool Participants, diverting these funds to an Orange County account designated the "Economic Uncertainty Fund." Between April 1993 and June 1994, they reported monthly,

and distributed quarterly, to the Commingled Pool Participants the Commingled Pool's yield less the amount misappropriated. Then

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-[17]-By at least February 1992, the Treasurer generated month-end reports that marked-to-market a substantial portion of the County Pools' portfolio (from 26% to over 43%). These reports reflected that the securities marked-to-market declined in value, ranging from over $26 million in January 1994 (or .45% loss in value), to over $443 million in June 1994 (or 5.24% loss in value), to over $565 million (or 6.27% loss in value) in September 1994.

from July 1994 through November 1994, as the Commingled Pool's yield decreased, they overstated the Commingled Pool's yield to the Commingled Pool Participants by a total of $17.6 million.

From approximately April 1993 through November 1994, the Treasurer and the Assistant Treasurer caused the Commingled Pool to transfer securities at prices below market to, and to Investment Participants (including Orange County). These transactions resulted in a market value loss to the Commingled Pool that otherwise would have been borne by the Specific Investment Participants.

3. The Municipal Securities Offerings

The Board, the Treasurer and the Assistant Treasurer were the County officials primarily responsible for the issuance of the County's municipal securities. The Treasurer and the Assistant Treasurer were responsible for proposing to the Board and preparing the documents for the County's and the Flood Control District's short-term (less than thirteen months) debt offerings that are the subject of this Order. For such short-term debt offerings, they proposed the issuance of the securities, participated in the drafting and review of, and signed, the Official Statements and related documents and participated in the selection of the underwriters, bond counsel and financial advisers. They also participated in determining the County's cash flow deficit and the size of its cash flow borrowings. For the long-term debt offering that is the subject of this Order, the Treasurer and the Assistant Treasurer participated in the drafting and review of the portion of the Official Statement relating to the County Pools and in the preparation of various related documents.

The Assistant Treasurer, acting in his capacity as a County employee, was also principally responsible for the two offerings by the School District. He proposed that the School District issue the municipal securities and assisted in the drafting and review of the Official Statements and the selection of the underwriters, bond counsel and financial advisers. The Assistant Treasurer also met with the Rating Agencies to discuss the offerings that are the subject of this Order.

The Board had final authority to authorize and approve each of the municipal securities offerings by Orange County and the Flood Control District. The Board approved each of the County and the Flood Control District offerings discussed below, which raised over $2 billion. The Board's resolutions authorizing the issuance of the County's municipal securities specifically recited the approval of drafts of the Official Statements and authorized their completion and correction by a County official.

a. The Reinvestment Offerings

In 1993 and 1994, Orange County, the Flood Control District and the School District conducted a total of five municipal securities offerings raising $1.2 billion for the purpose of earning interest income by investing the offering proceeds in the County Pools at an expected higher rate of return (the "Reinvestment Offerings"). In these transactions, the municipal securities issuers expected to generate profits by investing at a rate of return that was higher than the rate of interest paid to the noteholders. Unlike most municipal securities offerings, these Reinvestment Offerings did not provide investors with

interest income exempt from federal income taxation because the reinvestment practices used in these offerings did not conform to federal income tax law for tax-exempt securities.

(1) The 1993 Reinvestment Offerings

Orange County's first Reinvestment Offering was for $400 million in taxable notes (the "$400 Million Reinvestment Notes"). The notes had an interest rate of 3.95% per annum, matured, and were repaid, on July 1, 1994. On August 26, 1993, the School District issued $50 million in taxable notes (the "1993 $50 Million Reinvestment Notes"). The notes had an interest rate of 3.72% per annum, matured, and were repaid, on August 26, 1994.

The Official Statements for these 1993 Reinvestment Offerings represented that: the issuer would deposit the offering proceeds into an account pledged to repay the notes; the issuer intended to invest the funds in the repayment account; if the issuer suffered an investment loss, the pledged funds could be insufficient to repay the notes; and the issuer would satisfy any deficiency in the pledged funds from any other moneys lawfully available for repayment.

As discussed below, the Official Statements for the $400 Million Reinvestment Notes and the 1993 $50 Million Reinvestment Notes contained material misstatements and omissions regarding: 1) the County Pools, including the County Pools' investment strategy and investment in the County Pools of the funds pledged to repay the securities, which matters affected the issuer's ability to repay the municipal securities; and 2) the unauthorized use of an audit report (with respect to the $400 Million Reinvestment Notes only).

(2) The 1994 Reinvestment Offerings

In 1994, there were three Reinvestment Offerings. First, Orange County issued on July 8, 1994, $600 million in taxable notes (the "$600 Million Reinvestment Notes"). These notes had a variable interest rate equal to the one-month London Interbank Offered Rate ("LIBOR"); however, under the terms of the notes, the interest rate was not to exceed 12% per annum. The notes were originally due on July 10, 1995; the maturity of these notes has been extended to June 30, 1996. The School District issued $50 million in taxable notes (the "1994 $50 Million Reinvestment Notes") on August 1, 1994. The 1994 $50 Million Reinvestment Notes had a variable interest rate equal to the one-month LIBOR plus .03%; however, under the terms of the notes, the interest rate was not to exceed 12% per annum. The 1994 $50 Million Reinvestment Notes matured, and were repaid, on August 24, 1995. The Flood Control District, on August 2, 1994, issued $100 million in taxable notes (the "$100 Million Reinvestment Notes"). The notes had a variable interest rate equal to the one-month LIBOR plus .03%; however, under the terms of the notes, the interest rate was not to exceed 12% per annum. The notes matured, and were repaid, on August 1, 1995.

The proceeds from these Reinvestment Offerings were deposited into an account pledged to repay the notes. Each of the Official Statements for these Reinvestment Offerings disclosed that the issuer intended to invest the pledged funds in the County Pools and that, if an investment loss occurred, the issuer would satisfy the deficiency from any other moneys lawfully available for repayment. The lawfully available funds for the $600 Million Reinvestment Notes consisted essentially of funds in the discretionary budget.

The Official Statements for the $600 Million Reinvestment Notes and the $100 Million Reinvestment Notes contained material misstatements and omissions regarding: 1) the County Pools, including the County Pools' investment strategy and investment results, and manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities; 2) Orange County's financial condition, including its economic reliance on investment results of the County Pools as a source of funds to repay its obligations on the securities (with respect to the $600 Million Reinvestment Notes only); 3) an undisclosed cap on the interest rate payable to noteholders; and 4) the unauthorized use of an audit report. The Official Statement for the 1994 $50 Million Reinvestment Notes contained material misstatements and omissions regarding the County Pools, including the County Pools' investment strategy and

investment results, and manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities.

b. The Tax And Revenue Anticipation Note Offerings

In 1994, Orange County conducted three separate tax and revenue anticipation note ("TRAN") offerings raising a total of almost $500 million. TRANs are designed to help local governments cover periodic cash flow deficits that arise because they receive revenues infrequently during the year while their working capital expenses are ongoing. Such notes are later repaid with the expected tax and other revenue received. As the deficits occur only periodically, TRANs proceeds are typically not spent immediately and are invested to earn investment income until needed to fund cash flow deficits. Because of the exclusion from federal income taxation of interest received, tax-exempt TRANs carry a lower interest rate than taxable securities of the same maturity and credit quality, thereby increasing the potential return on reinvestment.

(1) The 1994 $299.66 Million Pooled TRANs

On July 1, 1994, Orange County issued $299.66 million pooled tax and revenue anticipation notes (the "$299.66 Million Pooled TRANs"). These TRANs were tax-exempt and had an interest rate of 4.5% per annum. The notes matured, and were repaid, on July 28, 1995. As represented in the Official Statement, Orange County used the offering proceeds to purchase $299.66 million in notes issued by 27 Orange County school districts. The school districts then used these funds for their cash flow deficits. The Official Statement represented that, to repay the notes, the County would deposit certain funds pledged by the school districts in a repayment account, which the County pledged to repay the notes. The Official Statement also represented that the pledged money would be invested and reinvested but did not disclose where or how the pledged money would be invested.

The County Pools provided for repayment of the $299.66 Million Pooled TRANs through a Purchase Agreement, entitled Standby Purchase Agreement. Pursuant to this agreement, the Treasurer, as fund manager of the County Pools, agreed to purchase the school district notes to the extent they were not repaid by the school districts, thus assuring sufficient funds to repay the TRANs. The Assistant Treasurer signed the Purchase Agreement on behalf of the County Pools.

The Official Statement for the $299.66 Million Pooled TRANs contained material misstatements and omissions regarding the County Pools, including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield, and investment in the County Pools of the funds pledged to repay the securities, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under the Purchase Agreement.

(2) The 1994 $169 Million And $31 Million TRANs

Orange County issued two series of TRANs for its own cash flow purposes. The first, issued on July 5, 1994, was the $169 Million 1994-95 Tax and Revenue Anticipation Notes, Series A (the "$169 Million TRANs"). These notes were represented to be tax-exempt and had an interest rate of 4.5% per annum. The second series of TRANs, the $31 Million 1994-95 Tax and Revenue Anticipation Notes, Series B (the "$31 Million TRANs"), was issued on August 11, 1994. These notes were also represented to be tax-exempt and had a variable interest rate equal to 70% of the one-month LIBOR; however, the interest rate on the notes was not to exceed 12% per annum. The $169 Million TRANs matured on July 19, 1995, and the $31 Million TRANs matured on August 10, 1995; the maturity of these notes has been extended to June 30,1996.-[18]-

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-[18]-The County has also failed to set aside specified pledged amounts to repay these TRANs at maturity, as required under the terms of these TRANs.

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In the Official Statements for these offerings, the County represented that the money to be used to repay the notes would be deposited in the County Pools. The Official Statements further advised prospective investors that, if Orange County suffered an investment loss and the repayment funds were insufficient to repay the notes, the County would satisfy the deficiency from any other moneys lawfully available for repayment. The lawfully available funds for these offerings consisted essentially of funds in the discretionary budget.

The Official Statement for the $169 Million TRANs and the $31 Million TRANs contained material misstatements and omissions regarding: 1) the County Pools, including the County Pools' investment strategy and investment results, and manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities; 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) the tax-exempt status of the offering; and 4) the unauthorized use of an audit report.

c. The Teeter Note Offerings

In 1994, Orange County conducted two Teeter Note offerings. The purpose of the Teeter offerings was to fund the Teeter Plan which is an alternate method of property tax distribution. Pursuant to this plan, the County pays local entities (such as school districts) their share of property taxes from the offering proceeds upon levy rather than actual collection and then retains all property taxes, and the penalties and interest thereon, upon collection.

In the first Teeter offering, the County issued $111 million of taxable notes (the "$111 Million Teeter Notes") on July 20, 1994. These notes had a variable interest rate that was reset monthly at the one-month LIBOR; however, under the terms of the notes, the interest rate was not to exceed 12% per annum. In the second Teeter offering, the County issued $64 million of tax-exempt notes (the "$64 Million Teeter Notes") on August 18, 1994. The $64 Million Teeter Notes had a variable interest rate that was reset monthly at 70% of the one-month LIBOR; however, the interest rate was not to exceed 12% per annum. The $111 Million and the $64 Million Teeter Notes (the "Teeter Notes") matured, and were repaid, on June 30, 1995.

The Official Statements for the Teeter notes represented that the County planned to invest certain delinquent tax receipts pledged to repay the Teeter Notes in the County Pools. The County Pools also agreed to repurchase the Teeter Notes through Purchase Agreements, entitled Standby Note Purchase Agreements, which agreements obligated the Treasurer, as fund manager of the County Pools, to purchase the Teeter notes to the extent that there were insufficient funds to repay them. The Official Statements further advised potential investors that if the repayment funds were insufficient, any deficiency would be satisfied from moneys received under the Purchase Agreements and other moneys lawfully available for repayment. The lawfully available funds for these offerings consisted essentially of funds in the discretionary budget.

The Official Statement for the $111 Million Teeter Notes and the $64 Million Teeter Notes contained material misstatements and omissions regarding: 1) the County Pools, including the County Pools' investment strategy and investment results, and manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under Purchase Agreements; 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) an undisclosed cap on interest rate payable to noteholders (with respect to the $111 Million Teeter Notes only); and 4) the unauthorized use of an audit report.

d. The Pension Bond Offering

In September 1994, Orange County issued taxable Pension Obligation Bonds (the "Pension Bonds") for the purpose of financing the County's unfunded, but accrued, pension liability. The Pension Bonds were issued in two series. The fixed-rate Series A bonds in the amount of $209.84 million were dated as of September 1, 1994, and issued on September 28, 1994, and matured or mature in varying amounts in the years 1995 through 2004. The variable-rate Series B bonds in the amount of $110.2 million were dated and issued on September 28, 1994, and mature in 2008 (the "Series B Pension Bonds").

Under the terms of the Series B Pension Bonds, the investors had the right to tender their bonds to a remarketing agent for repurchase. If the remarketing agent could not remarket the tendered Series B Pension Bonds within seven days, the County Pools, pursuant to a Purchase Agreement, entitled Standby Withdrawal Agreement, agreed to purchase the tendered securities in an amount up to the County's unrestricted funds in the County Pools, which included funds in the County's discretionary budget. According to the Official Statement, that amount was approximately $491.4 million as of June 30, 1994. After Orange County announced the County Pools' losses in early December 1994, the holders of the Series B Pension Bonds tendered the bonds to the County Pools for repurchase. Orange County and the County Pools declared bankruptcy and refused to purchase any of the Series B Pension Bonds.

The Official Statement for the Pension Bonds contained material misstatements and omissions regarding: 1) the County Pools, including the County Pools' investment strategy and investment results, and manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under the Purchase Agreement; and 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities.

4. Misrepresentations And Omissions In The Offer And Sale Of Municipal Securities

The offerings discussed above variously contained material misstatements and omissions regarding: 1) the County Pools, including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield, and investment of funds pledged to repay certain securities into the County Pools, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under the Purchase Agreements; 2) the financial condition of Orange County, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) the tax-exempt status of the offering; 4) an undisclosed cap on the interest rate payable to investors on certain variable rate municipal securities sold in the offerings; and 5) the unauthorized use of an audit report.

a. The Risks Relating To The County Pools

Each of the Official Statements for the eleven offerings misrepresented or was misleading in failing to disclose material information concerning the County Pools. The significance of the County Pools to these transactions was obvious. Where the funds pledged to repay the notes were invested in the County Pools, the issuer looked to that investment to satisfy its repayment obligations. Any risks that those pledged funds would decrease affected the issuer's ability to repay the notes. Similarly, in the offerings where the County Pools, pursuant to Purchase Agreements, provided for repurchase or repayment of the securities, disclosure regarding the County Pools was important so that investors could evaluate the County Pools' financial strength and ability to perform under the agreement. In addition, in certain County offerings in which other County funds were a source of repayment, disclosure regarding the County Pools was important to investors because availability of such other funds depended upon the County Pools' performance. The Official Statements variously contained false or misleading disclosure regarding the County Pools in four areas: 1) the investment strategy; 2) the investment results; 3) the manipulation of

the County Pools' yield; and 4) investment of funds pledged to repay certain securities into the County Pools.

(1) The County Pools' Investment Strategy And The Risks Of That Strategy

The Official Statements for all eleven municipal securities offerings misrepresented and/or failed to disclose material information concerning the County Pools' investment strategy and the risks of that strategy, as more fully stated below. The County Pools' investment strategy, particularly the amount of leverage, and the risks of that strategy were material to these securities offerings. The County Pools' investment strategy and the risks of that strategy were directly related to the safety of an investment in the municipal securities, the safety of the funds pledged to repay the municipal securities and the County Pools' ability to fulfill its obligations to repurchase or repay municipal securities. The County Pools' investment strategy and the risks of that strategy also directly affected Orange County's ability to repay its securities from other available funds because of the County's economic dependence on the County Pools. Investors were not informed of these matters and were deprived of the ability to make an informed investment decision based upon all material facts.

(a) The $400 Million Reinvestment Notes, The 1993 $50 Million Reinvestment Notes And The $299.66 Million Pooled TRANs

The Official Statements for two offerings--the $400 Million Reinvestment Notes and the 1993 $50 Million Reinvestment Notes--completely omitted any discussion of the County Pools. The Official Statement for another offering--the $299.66 Million Pooled TRANs--only referenced the County Pools in setting forth the terms of the Purchase Agreement. This discussion failed to provide any disclosure on the County Pools' investment strategy and the risks of that strategy.

Specifically, the Official Statements for these three offerings failed adequately to disclose that the investment strategy: 1) was risky; 2) was predicated upon the assumption that prevailing interest rates would remain at relatively low levels; 3) involved a high degree of leverage through the use of reverse repurchase agreements; 4) involved a substantial investment in derivative securities, including inverse floaters; and 5) was very sensitive to changes in the prevailing interest rate because of the leverage.

The Official Statements for these three offerings also failed to adequately disclose the disproportionate risks that the investment strategy posed to repayment of the municipal securities.

(b) The 1994 Reinvestment Notes, The $169 Million TRANs, The $31 Million TRANs And The Teeter Notes

The Official Statements for seven of the offerings--the 1994 Reinvestment Notes, the $169 Million and $31 Million TRANs and the Teeter Notes--contained some disclosure regarding the County Pools, which disclosure was virtually identical to each other, with only the deviations noted below.

With respect to the County Pools' holdings, the Official Statements disclosed that the County Pools invested in "various fixed and floating rate securities." n19 It was not disclosed that the County Pools were heavily invested in derivative securities, which comprised from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. In particular, inverse floaters comprised from 24.89% to 39.84% of the County Pools' holdings. The Official Statements further did not disclose the risks these holdings posed to repayment of the municipal securities.

With respect to the County Pools' investment strategy, the Official Statements disclosed that the County Pools' investment policy allowed for the purchase of a variety of securities, "with limitations as to exposure, maturity, and credit rating for each security type. The mix of securities held will vary depending upon liquidity requirements, interest rate expectations and other factors." n20 This statement failed to disclose that the County Pools' investment strategy was risky, and was premised on the

assumption that interest rates would remain relatively low. The Official Statement further did not disclose the risks this investment strategy posed to repayment of the municipal securities.

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n19 The Official Statements for the $64 Million Teeter Notes and the 1994 $50 Million Reinvestment Notes further disclosed that "as of June 30, 1994, approximately 20% of the [Pools] was invested in derivative products of which substantially all were floating rate and inverse floating rate government securities." As stated above, the Pools' derivative holdings were significantly greater than 20% and most of them were inverse floaters.

n20 The Official Statements for the $64 Million Teeter Notes and the 1994 $50 Million Reinvestment Notes stated that the County Pools' investment policy permitted a "variety of domestic securities and derivative products" with the same limitations as set forth above that would vary in the same way, i.e., "depending upon liquidity requirements, interest rate expectations and other factors."

Additionally, with respect to the use of the County Pools' securities as collateral for the reverse repurchase agreements, the Official Statements for these offerings represented that: "from time to time," the Treasurer pledged "a significant portion" of the County Pools' securities "with respect to reverse repurchase agreements." n21 No mention was made of the extremely high degree of leverage involved in the portfolio, at times as much as 292%, or the risk this posed to repayment of the municipal securities.

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n21 With respect to leverage, the Official Statement for the $169 Million TRANs instead stated: "from time to time, the [County Pools have] and may also enter into various reverse repurchase agreements which are essentially leverage investments."

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With respect to the County Pools' sensitivity to interest rate changes, the Official Statements represented that: "[t]he price and income volatility of the [Pools' floating rate securities was] greater than standard fixed income securities and may serve to increase the volatility of the [Pools'] return and market value in various interest rate environments."-[22]- This statement is misleading in that it does not disclose that the County Pools' investment strategy was predicated on interest rates remaining low, nor the extent to which the County Pools were sensitive to interest rate changes; specifically, that rising interest rates would have an extremely negative impact on the County Pools, and in turn, upon the ability to repay the municipal securities from the sources dependent on the County Pools.

The Official Statements also represented that the "market value and liquidity of the [County Pools] will depend upon, among other factors, the maturity of the various investments," and that the average maturity of the County Pools' securities, depending on the offering, was from 843 to 884 days. The Official Statements did acknowledge that the "average maturities do not

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-[22]-The Official Statement for the $100 Million Reinvestment Notes differed only in that it included a reference to reverse repurchase agreements, stating: "[t]he price and income volatility of floating rate securities and reverse repurchase agreements is greater than standard fixed income securities and may increase the volatility of the Pools' return and market value in various interest rate environments. . . ."

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account for the impact of leverage and other factors related to various derivative securities in the portfolio."-[23]- However, this statement also is misleading in that it failed to disclose, as the Treasurer had been advised, that: the modified duration indicated substantially more price volatility than would be expected from a portfolio with the County Pools' short average maturity; and the duration, or sensitivity of the portfolio to interest rate changes, was such that a large portion of the County Pools' securities holdings

had an average duration of approximately five years. Moreover, it did not disclose the associated risks this posed to the repayment of the municipal securities.

Moreover, the Official Statements for these offerings failed to disclose the risks of rising interest rates on the County Pools' investment strategy. Namely, the Official Statements failed to disclose that if interest rates rose, as they did in 1994, it would have a substantial negative impact on the County Pools and, because of its dependence on the County Pools, the County itself. First, the reverse repurchase costs would increase and the income that the County Pools earned from the inverse floaters in the portfolio would decrease, creating lower earnings for the County Pools. Second, the County Pools' securities would decline in market value. Third, as the value of the County Pools' securities fell, the County would suffer collateral calls from broker-dealers and reductions in loan amounts on the reverse repurchase agreements. All three events would reduce the income that Orange County would receive from the County Pools, with the possible loss of principal of invested funds as well.

(c) The Pension Bonds

The Official Statement for the Pension Bond transaction contained even less disclosure regarding the County Pools' investment strategy and the risks of that strategy. The Official Statement represented that: "[t]he [County Pools'] investment policy focuses on retaining the safety of investment principal

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-[23]-The Official Statements for the $64 Million Teeter Notes and the 1994 $50 Million Reinvestment Notes also stated that "[i]f these derivative products were taken into account, the effect would be to lengthen the average maturity of the [County Pools]." As set forth above, the County Pools' derivative holdings were significantly greater than 20% and most of them were inverse floaters. This simple statement that the derivative products would lengthen maturity was inadequate to describe their actual or likely effect on the portfolio's interest rate sensitivity.

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while earning satisfactory yields." It went on to state that: "it is the [County Pools'] practice to select quality investments from reputable, stable and trustworthy dealers, and not to take any risks which . . . would be unreasonable." Additionally, the Official Statement disclosed that:

> The [County Pools'] funds are invested primarily in United States Government Securities, including, but not limited to, United States Treasury Notes, Treasury Bills, Treasury Bonds, and obligations of United States Government Agencies [and that w]hen circumstances warrant, the [County Pools'] investments may also include bankers acceptances, negotiable certificates of deposit of national or state-chartered banks and state or federal thrifts, commercial paper, repurchase agreements, reverse repurchase agreements, medium term corporate notes and collateralized time deposits.

The Official Statement further represented that "[t]o maintain the liquidity of its investments, the [County Pools] invest in securities that are actively traded in the securities markets."

These statements were false or misleading. The County Pools' investment strategy was not "focus[ed] on retaining the safety of investment principal" but was highly risky and premised upon the assumption that prevailing interest rates would remain at relatively low levels. The Official Statement omitted to disclose that the County Pools were highly leveraged through reverse repurchase agreements and that the County Pools were heavily invested in derivative securities, including inverse floaters. The Official Statement further omitted to disclose that the use of this strategy made the County Pools' extremely sensitive to changes in the interest rate.

(2) The County Pools' Investment Results

Moreover, as a result of the County Pools' investment strategy, the County Pools suffered investment losses in 1994, which investment results were also not disclosed to investors in the 1994 municipal securities offerings. As a result, investors were not provided information material to the assessment of the ability to repay the municipal securities from sources affected by the County Pools.

The Official Statements for the nine offerings conducted in 1994 failed to disclose material information concerning the County Pools' investment results. During 1994, the County Pools' investment income declined because reverse repurchase costs had increased while the income that the County Pools earned from inverse floaters had decreased. Additionally, the County Pools had suffered substantial market losses in the overall value of the portfolio. Declining market value of securities in the County Pools subject to reverse repurchase agreements resulted in collateral calls and reduction in loan amounts against such securities on rollover of the agreements, as well as reduction of the liquidity of the County Pools.-[24]- None of these facts were disclosed in any of the Official Statements.

The Official Statements for these 1994 offerings included Orange County's financial statements for the fiscal year ended June 30, 1993, which were based on information that was at least twelve months old at the time of the offerings. The financial statements contained a footnote concerning the County Pools that presented information that the market value of the investments was above the purchase price, indicating that the County Pools had a market profit. By the end of June 1994, just prior to the 1994 offerings, the Treasurer's records indicated that the portion of the County Pools' securities that were marked-to-market had suffered market losses of over $443 million, or a 5.24% loss in value. In light of these market losses, the inclusion of the 1993 financial statements alone in the 1994 offerings without any update regarding investment results was materially misleading because the Official Statements failed to disclose information regarding the recent market losses, which related to the ability to repay the municipal securities.

Information concerning the decline in the County Pools' investment results was material to these securities offerings. The County Pools' declining investment results were directly related to the safety of an investment in the securities, the safety of the funds pledged to repay the securities and the ability of the County Pools to fulfill its obligations to repurchase or repay the securities. The County Pools' investment results also directly affected Orange County's ability to repay its securities from other available funds because of the County's economic dependence on the Pools.

(3) Manipulation Of The County Pools' Yield

The Official Statements for eight offerings--the 1994 Reinvestment Notes, the $169 Million and the $31 Million TRANs, the Teeter Notes and the Pension Bonds--misrepresented that the County Pools' yield would be distributed pro rata to the Participants. The Treasurer and the Assistant Treasurer had in fact diverted interest income from certain Commingled Pool Participants to an account for the benefit of Orange County. As a result, the Commingled Pools' yield was misrepresented in the Official Statements for these offerings. In late 1994, the Treasurer and the Assistant Treasurer used a portion of the misappropriated funds to supplement the Commingled Pool's yield. The "supplemented" yield was then falsely reported in the Official Statement for the Pension Bonds.

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-[24]-From January through June 1994, the County was subject to approximately $873 million in collateral calls or reductions in loan amounts under reverse repurchase agreements.

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The Treasurer and the Assistant Treasurer also shifted $131 million in market losses from some Specific Investment Participants, including the County, to the Commingled Pool, causing the Commingled Pool

Participants to suffer losses that should have been borne by others. This information was not disclosed and also rendered false the representations regarding the pro rata distribution.

The Commingled Pool's accurate reporting of investment results and assumption of market losses were directly related to the safety of an investment in the securities, the safety of the funds pledged to repay the securities and the ability of the County Pools to fulfill their obligations to repurchase or repay the securities. Accordingly, the information concerning the Commingled Pool's true yield, the calculation and payment of the Commingled Pool's yield, the misappropriation of interest income from the Participants and the Commingled Pool's acquisition and transfer of securities at off-market prices was material.

(4) Investment In The County Pools

The Official Statements for three offerings--the $400 Million Reinvestment Notes, the 1993 $50 Million Reinvestment Notes and the $299.66 Million Pooled TRANs--stated that the funds pledged to repay the notes would be invested as permitted by the resolutions authorizing the issuance and sale of the notes and by California law. None of the Official Statements for these three offerings disclosed that the issuer intended to invest such funds in the County Pools. The Official Statement for the $299.66 Million Pooled TRANs only mentions that, under the Purchase Agreement, the County Pools would purchase the school district notes to the extent that any of the school districts failed to repay.

Information concerning the issuers' use and investment of such funds was directly related to their ability to later repay the securities, an issue of critical importance to investors. Moreover, as discussed herein, disclosure regarding investment in the County Pools was material in light of the County Pools' risky investment strategy and poor investment results in 1994.

b. The Financial Condition Of Orange County

The Official Statements for six offerings--the $600 Million Reinvestment Notes, the $169 Million and $31 Million TRANs, the Teeter Notes and the Pension Bonds--failed to disclose Orange County's true financial condition, in particular, that the County was using interest income from the County Pools as the largest single source of revenue for its discretionary budget. Further, Orange County's use of this interest income as a revenue source was increasing while other traditional revenue sources, such as property taxes, were decreasing. The funds invested to generate investment income came from two sources, the County's own funds and proceeds from the Reinvestment Offerings. Orange County had invested essentially all of its liquid assets in the County Pools, including funds to repay its municipal securities. In addition, the investment of virtually all of the County's liquid assets in the County Pools exposed Orange County to the volatility of the County Pools, including the potential loss of not only interest income, but of principal as well. The failure to disclose this information rendered disclosure regarding the County's financial condition and its ability to repay its securities materially misleading.

The Official Statements disclosed the decline in certain traditional revenue and that, as a result of the decline, the County's fiscal year 1992-93 and 1993-94 budgets were becoming increasingly dependent on state funding for revenue to support County services. The Official Statements for the six 1994 offerings failed to disclose, however, that for the County's proposed 1994-95 discretionary budget, the County was using interest income as the largest single revenue source. The inclusion of the information concerning prior budgets was materially misleading in light of the proposed 1994-95 discretionary budget's use of interest income as the largest single revenue source.

Such information regarding Orange County's financial condition was important as it related to Orange County's ability to repay its obligations, including municipal securities debt. Moreover, with the exception of the Pension Bonds, these County offerings were short-term general obligations, which, under California law, the County could repay only with funds received or accrued during fiscal year 1994-95. Therefore, given the County's use of interest income from the County Pools, if the County Pools' investments performed poorly, as eventually occurred, the County would have a budget deficit and could

not repay the securities and meet its other expenses. The County's financial condition was also material to the Purchase Agreement for the Series B Pension Bonds, under which the County Pools, to the extent of the County's unrestricted funds in the County Pools, agreed to repurchase any tendered securities. If the County Pools' investments performed poorly, as eventually occurred, the County would not have sufficient unrestricted funds to purchase the Series B Pension Bonds when tendered under the terms of the Purchase Agreement.

c. The Tax-Exempt Status Of The Offerings

The purpose of the tax-exempt $169 Million TRAN and the $31 Million TRAN offerings was purportedly to fund Orange County's projected cash flow deficit for fiscal year 1994-95. As such, these TRAN offerings were offered and sold as tax-exempt borrowings. Compliance with the Internal Revenue Code and Treasury Regulations is a prerequisite to exemption from federal income taxation of the interest received on the municipal securities by the investors. The Official Statements failed to disclose, however, that the County's activities in calculating the size of the offerings placed the tax-exempt status in jeopardy.-[25]-

The Internal Revenue Service has regulations that limit the size of a municipality's tax-exempt short-term working capital borrowings to, in effect, the amount that the municipality will actually use to fund cash flow deficits.-[26]- Therefore, the determination of available amounts is critical to the sizing of a TRANs borrowing and ultimately to the tax-exempt status of the borrowing.

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-[25]-Orange County's bond counsel issued an opinion that these TRANs were tax-exempt. However, the County was aware of material facts concerning the relationship between the size of the offering and the County's cash flow deficit. As discussed below, the Official Statements were materially misleading in failing to disclose these facts and the significant associated risks that the tax-exempt status could be denied. Investors were, therefore, unable to make an informed investment decision regarding the tax-exempt status of the offerings.

-[26]-More specifically, Treasury Regulations include a proceeds-spent-last expenditure rule which implicitly provides the sizing rule for TRAN offerings. See Treasury Regulation § 1.148-6(d)(3)(i). Sizing analysis of a tax-exempt borrowing is critical because oversizing a borrowing will preclude the conclusion that proceeds will be spent within the allowable temporary period, a necessary element of a tax-exempt borrowing. Under the rules regarding allocation of proceeds of an issue for determining when the proceeds are spent, proceeds of a TRAN borrowing are allocated to working capital expenditures as of any date only to the extent that those working capital expenditures exceed "available amounts." See id. Available amounts include amounts that may be used without legislative or judicial action and without a legislative, judicial or contractual requirement that amounts be reimbursed. See Treasury Regulation § 1.148-6(d)(3)(iii).

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Internal Revenue Code § 103(a) provides the statutory authority for tax-exempt bonds. This section provides, in summary, that gross income does not include interest on any state or local bond (i.e., the bonds are tax-exempt), with certain exceptions, including the exception that the exclusion from gross income does not apply to any "arbitrage bond."-[27]- Municipal securities are arbitrage bonds under Internal Revenue Code § 148 if an abusive arbitrage device is used in connection with the securities issue. Therefore, municipal securities are not tax-exempt if the issuer engages in an "abusive arbitrage device."-[28]- If the IRS determines that a portion of a purported tax-exempt offering is an abusive arbitrage device, then the IRS can declare the entire offering taxable. Moreover, should the IRS later declare the notes to be taxable, its remedy is to seek the unpaid taxes from the noteholders.-[29]-

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-[27]-See Internal Revenue Code § 103(b)(2).

-[28]-Treasury Regulation § 1.148-10(a)(1) defines an abusive arbitrage device as any "action [that] has the effect of: (i) enabling the issuer to exploit the difference between tax-exempt and taxable interest rates to obtain a material financial advantage; and (ii) overburdening the tax-exempt bond market," which occurs if the action "results in issuing more bonds." Treasury Regulation § 1.148-10(a) further states that the regulation concerning abusive arbitrage devices "is to be applied and interpreted broadly to carry out the purposes of section 148."

-[29]-Should the IRS determine that the tax-exempt securities are "arbitrage bonds" under Internal Revenue Code § 148(a), the IRS would seek rebate of the excess interest earned from the issuer. See Internal Revenue Code § 148(f). The IRS, however, does not have a right to tax or assess the issuer but can request that the amount be rebated. If the issuer fails to rebate the arbitrage, the remedy is to seek the amount from the noteholders as the interest earned on the notes is not excludable from the noteholders' income. See Harbor Bancorp v. Commissioner of Internal Revenue, 1995 U.S. Tax Ct. LEXIS at 54-55 (Oct. 16, 1995).

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Information concerning the tax-exempt status of these TRANs offerings was very important to investors. Failure to disclose information regarding the tax analysis that provided the basis for the tax-exemption opinion deprived investors of information material to an assessment of the tax-exempt status of the TRANs.-[30]- Tax-exempt securities typically pay a lower interest rate than other debt securities, which interest rate differential investors accept because of the tax-exempt status. Thus, if the securities are not tax-exempt, the interest rate is not competitive and the securities are not as attractive to investors. Further, the investors may be liable for the unpaid taxes on the interest received.

(1) The $169 Million TRANs

On June 21, 1994, the County restricted $27.5 million so that these funds could not be used to pay future working capital expenditures. The County restricted the funds to increase the amount of its projected cash flow deficit. The County intended to use the $27.5 million for working capital expenditures in fiscal year 1994-95 and budgeted for that purpose in the final budget adopted by the Board on September 27, 1994 (and effective July 1, 1994).

The effect of this artificial increase in the cash flow deficit was to enable the County to increase the size of its TRAN offering from $142 million to $169 million. A County Auditor-Controller employee testified that County officials questioned the propriety of the restrictions to increase the cash flow deficit and the size of the TRAN offering but dropped their objections after bond counsel opined that the $169 Million TRANs would be tax-exempt.

None of the facts relating to the County's artificial increase of the size of its cash flow deficit were disclosed in the Official Statement for this offering. The Official Statement also failed to disclose the risks that the IRS might declare the entire $169 Million TRANs taxable and that the investors may be liable for the unpaid taxes.

(2) The $31 Million TRANs

On August 2, 1994, Orange County restricted another $64 million. The purpose of this restriction was to make the $64 million unavailable to the County to pay future working capital expenditures and to thereby further increase the amount of its fiscal year 1994-95 cash flow deficit by $64 million. Accordingly, the County was able to issue the $31 million TRAN on August 11, 1994, to finance this cash flow deficit. As with the other TRANs borrowing, the Official Statement failed to disclose the facts surrounding the sizing of the offering and the risks this created to the tax-exempt status.

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-[30]-See SEC v. Stifel, Nicholas and Co., Lit. Rel. No. 14587 (Aug. 3, 1995); In the Matter of Derryl W. Peden, Securities Act Rel. No. 7069, Exchange Act Rel. No. 35045, Admin. Proc. File No. 3-8400 (Dec. 2, 1994); SEC v. Matthews & Wright Group, Inc., Lit. Rel. No. 12072 (April 27, 1989).

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d. The Interest Rate Cap

The Official Statements for three offerings--the $600 Million Reinvestment Notes, the $111 Million Teeter Notes and the $100 Million Reinvestment Notes--each stated that they paid a variable interest rate equal to the one-month LIBOR. Undisclosed, however, was the fact that the notes for each of these offerings contained a 12% per annum cap on the maximum variable interest rate that the County would pay. While the existence of this cap was indicated on the face of the actual notes, no disclosure was made to noteholders in the Official Statements. The existence of an interest rate cap is material to investors.-[31]-

e. Unauthorized Use Of Audit Report

The Official Statements for seven offerings--the $400 Million, the $600 Million and the $100 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs and the two Teeter Notes--falsely represented that the County's auditor had consented to the inclusion of its audit report of the County's financial statements in the Official Statements. This report and Orange County's audited financial statements were included as exhibits to the Official Statements for these offerings.

Under Generally Accepted Auditing Standards ("GAAS"), if the auditor had consented to the inclusion of its audit reports in the Official Statements, the auditor would have been required to "extend [its] procedures with respect to subsequent events from the date of [its] audit report[s] up to the effective date [of the sale of the securities]."-[32]- Pursuant to the GAAS

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-[31]-LIBOR never reached 12% per annum during the original term of the notes; therefore, the interest cap never limited the interest rate paid to investors. However, certain investors have investment policies against buying securities containing an interest rate cap.

-[32]-AICPA 1989 Audit and Accounting Guide, Audits of State and Local Governmental Units, Ch. 19, (continued...)

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subsequent events procedures, if the auditor had consented, the auditor should have, among other things, read the County's most recent interim financial statements, read minutes of Board meetings, made inquiries of County officials concerning the County's operations and finances, made inquiries of the County's legal counsel and made such other inquiries as it considered necessary and appropriate.-[33]-

The engagement contract between Orange County and the auditors provided that the auditors would perform a subsequent events review upon the request of the County Auditor-Controller as necessary to allow the use of the auditors' report in the Official Statements and that the auditors would perform two such reviews at no charge.

In fact, Orange County did not obtain the consent of the auditors to include their report in the Official Statements, and the auditors did not conduct any post-audit review. That the auditor had not consented to the inclusion of its audit report accompanying the County's financial statement in these Official

Statements was important. Reasonable investors rely on audited financial statements in making investment decisions. Further, the representation that the auditor has consented to the inclusion of its audit report implies that the auditor has conducted some additional review prior to consenting to this use.

The investors' ability to rely on an audit opinion is affected by the fact that the auditor has not consented to the inclusion of its audit report in the Official Statement and has not conducted any post-audit review.

5. Misrepresentations To Rating Agencies

In presentations to the Rating Agencies relating to eight offerings--the $600 Million, the $100 Million and the 1994 $50 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs, the two Teeter Notes and the Pension Bonds--the Assistant Treasurer misrepresented the County Pools' holdings. These misrepresentations ultimately ran to the purchasers of these securities. The Assistant Treasurer represented that only 20% of the County Pools' portfolio consisted of derivative securities. In fact, derivative securities comprised from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. In particular, inverse floaters comprised from 24.89% to 39.84% of the County Pools' holdings.-[34]-

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-[32]-(...continued)
19.6; see also AICPA Codification of Statements on Auditing Standards ("AU") § 711.

-[33]-See AU § 560.12.

-[34]-Obviously, the materiality of the percentage of securities in a portfolio that are derivatives will depend upon the type and use of the derivatives in that portfolio.

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The Assistant Treasurer also misrepresented to the Rating Agencies that money in the Economic Uncertainty Fund was available to pay the principal and interest on five offerings--the $600 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs and the two Teeter Notes--and omitted to disclose that such funds had been misappropriated from the Commingled Pool Participants.

E. LEGAL DISCUSSION: ORANGE COUNTY, THE FLOOD CONTROL DISTRICT AND THE BOARD VIOLATED THE ANTIFRAUD PROVISIONS OF SECTION 17(a) OF THE SECURITIES ACT AND SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 THEREUNDER IN THE OFFER AND SALE OF THE MUNICIPAL SECURITIES

Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder make it unlawful for any person, in the offer or sale (Section 17(a)) or in connection with the purchase or sale of any security (Section 10(b) and Rule 10b-5), to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact, to omit to state a material fact, or to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person through the means or instruments of interstate commerce or the mails.

The notes and bonds issued by Orange County, the Flood Control District and the School District are clearly securities under Section 2(1) of the Securities Act and Section 3(a)(10) of the Exchange Act. In addition, the County Pools' obligations under the agreements to repurchase the Teeter Notes and the Series B Pension Bonds were puts and, therefore, separate securities under Section 2(1) of the Securities Act and Section 3(a)(10) of the Exchange Act.

Information is material if there is a substantial likelihood that a reasonable investor would consider it important to an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC

Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Furthermore, when the information pertains to a possible future event, materiality `will depend upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" Basic Inc., 485 U.S. at 238 (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969)).

Scienter is required to establish violations of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. See Aaron v. SEC, 446 U.S. 680, 701-02 (1980). Scienter is "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). In the Ninth Circuit, recklessness satisfies the Scienter requirement. Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990) (en banc), cert. denied, 499 U.S. 976 (1991). Recklessness is "an extreme departure from the standards of ordinary care, and which presents a danger of misleading [investors] that is either known to the defendant or is so obvious that the actor must have been aware of it." Id., 914 F.2d at 1569.

1. The Misrepresentations And Omissions Of Material Facts

As described more fully above, in the offer and sale of the Reinvestment Note offerings, the TRAN offerings, the Teeter Note offerings and the Pension Bond offering, Orange County misrepresented and/or omitted to disclose material information regarding: 1) the Orange County Investment Pools (the "County Pools"), including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield, and investment in the County Pools of the funds pledged to repay the securities, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under Purchase Agreements; 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) the tax-exempt status of the offering; 4) an undisclosed cap on the interest rate payable to investors on certain variable rate municipal securities sold in the offerings; and 5) the unauthorized use of an audit report. In addition, misrepresentations were made to the Rating Agencies concerning the County Pools.-[35]-

In the offer and sale of the $100 Million Reinvestment Notes, the Flood Control District misrepresented and/or omitted to disclose material information regarding: 1) the Orange County Investment Pools (the "County Pools"), including the County

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-[35]-The Assistant Treasurer's misrepresentations to the Rating Agencies are separate violations of the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. See SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975).

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Pools' investment strategy and investment results, manipulation of the County Pools' yield, and investment in the County Pools of the funds pledged to repay the securities, which matters affected the issuer's ability to repay the municipal securities; 2) an undisclosed cap on the interest rate payable to investors on certain variable rate municipal securities sold in the offerings; and 3) the unauthorized use of an audit report.

The Board, in the offer and sale of the $169 Million TRANs, the $31 Million TRANs, the $600 Million Reinvestment Notes, the $111 Million Teeter Notes, the $64 Million Teeter Notes and the Pension Bonds, approved Official Statements that misrepresented and/or omitted to disclose material information regarding the financial condition of Orange County, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities.

2. Orange County, The Flood Control District And The Board Acted With Scienter

Orange County, the Flood Control District and the Board acted with Scienter in making the above misrepresentations and omissions of material fact in the securities offerings. For purposes of the County's and the Flood Control District's liability under the federal securities laws, the Scienter of Orange County and Flood Control District officials may be imputed to Orange County and the Flood Control District. See SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

The Treasurer and the Assistant Treasurer acted with a high degree of Scienter. They were involved in the day-to-day management of the County Pools and directed the County Pools' investments. Of all the participants involved, they had the most detailed knowledge of the County Pools' investment strategy and declining investment results during 1994. Further, they directed the misappropriation of interest income from the Commingled Pool Participants, the manipulation of the Commingled Pool's yield and the Commingled Pool's off-market securities transactions with Specific Investment Participants.

The Treasurer and the Assistant Treasurer also participated in Orange County's budget process by providing estimates of projected interest revenue. Additionally, they were involved in determining Orange County's cash flow deficit, increasing the size of that deficit by restricting Orange County funds, thereby artificially increasing the size of the $169 Million TRANs and the $31 Million TRANs. They actively participated in the offer and sale of the municipal securities, including participating in the preparation of the Official Statements and selecting the professional participants.

The Board acted with Scienter in authorizing the disclosure disseminated in connection with the issuance of six offerings--the $600 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs, the two Teeter Notes and the Pension Bonds. The Board knew that the County intended to use interest income from the County Pools to fund a growing percentage of the County's discretionary budget. Nevertheless, the Board authorized the issuance of approximately $1.3 billion in debt in 1994, much of which was solely for reinvestment to generate interest income, without taking appropriate steps under the circumstances to assure that information about the County's finances was fairly and accurately disclosed to investors.

F. CONCLUSION

Accordingly, based on the foregoing, the Commission finds that Orange County, the Flood Control District and the Board violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

Orange County has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's entry of this Order, which makes findings, as set forth above, and orders Orange County to cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As set forth in Orange County's Offer of Settlement, Orange County undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transactions that are the subject of this Order.

V.

The Flood Control District has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's entry of this Order, which makes findings, as set forth above, and orders the Flood Control District to cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. A set forth in the Flood Control District's Offer of Settlement, the Flood Control

District undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transactions that are the subject of this Order.

VI.

The Board has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's entry of this Order, which makes findings, as set forth above, and orders the Board to cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As set forth in the Board's Offer of Settlement, the Board undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transactions that are the subject of this Order.

VII.

In determining to accept this Offer, the Commission considered remedial acts adopted and implemented by Orange County, the Flood Control District and the Board, such as the adoption and implementation of policies and procedures regarding the authorization, approval and issuance of proposed municipal securities offerings and regarding internal audit and accounting procedures and cooperation afforded the Commission staff.

VIII.

In view of the foregoing, the Commission deems it appropriate to accept the Offer of Settlement submitted by Orange County, the Flood Control District and the Board and impose the cease-and-desist orders specified in the Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED that, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act:

1. Orange County shall cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

2. Orange County shall comply with its undertakings described in Section IV above;

3. The Flood Control District shall cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

4. The Flood Control District shall comply with its undertakings described in Section V above;

5. The Board shall cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and

6. The Board shall comply with its undertakings described in Section VI above.

PUBLIC OFFICIALS

Report under Section 21(a) of the Exchange Act

<u>Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of the Board of Supervisors</u>, Exchange Act Release No. 36761 (January 24, 1996).

I. INTRODUCTION

The staff of the Division of Enforcement has conducted an investigation into various events in 1993 and 1994 involving material misrepresentations and omissions in connection with the offer and sale of certain municipal securities, including those issued by the County of Orange, California (the "County" or "Orange County"). Six of these municipal offerings by the County collectively raised approximately $1.3 billion and are the subject of this report. These offerings were related to the Orange County investment pools (the "County Pools"),-[1]- in one or more of the following ways: 1) the proceeds from one of the offerings were reinvested in the County Pools to obtain interest earnings; 2) the funds pledged to repay certain of the securities were invested in the County Pools; 3) the County Pools agreed to repurchase or repay certain of the securities; and/or 4) the County's economic reliance on the County Pools materially affected its ability to repay the securities. The Official Statements for these municipal securities offerings contained material misstatements and omissions concerning the risks relating to, among other things, the County Pools and the
financial condition of Orange County, including its ability to repay the securities.

Based upon information obtained during the investigation, the Commission deems it appropriate that it issue this Report of Investigation ("Report") pursuant to Section 21(a) of the Securities Exchange Act of 1934 "Exchange Act") with respect to the conduct of the individual members of the Board of Supervisors of Orange County, California (the "Supervisors" or "Board members") in authorizing the issuance of these municipal securities.-[2]-

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-[1]- As discussed below, the County Pools were instrumentalities of the County and were not established as legal entities distinct from the County. The County Pools operated as an investment fund managed by Orange County in which the County and various local governments or districts invested or deposited public funds.

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Simultaneous to the issuance of this Report, the Commission has filed and settled a related civil injunctive action against the former County Treasurer-Tax Collector, Robert L. Citron (the "Treasurer"), and the former Assistant Treasurer, Matthew R. Raabe (the "Assistant Treasurer"), pursuant to which they will be enjoined from future violations of the antifraud provisions of the federal securities laws.-[3]- The Commission has also instituted and settled a related cease and desist proceeding pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Exchange Act against Orange County,
the Orange County Flood Control District and the Board of Supervisors of Orange County pursuant to which they will be ordered to cease and desist from violations of the antifraud provisions.-[4]- The Commission's investigation is ongoing.

The Commission is issuing this Report to emphasize the responsibilities under the federal securities laws of local government officials who authorize the issuance of municipal securities and related disclosure documents and the critical role such officials play with respect to the representations contained in the Official Statements for those securities.-[5]-

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-[2]- Section 21(a) of the Exchange Act authorizes the Commission, in its discretion, to publish information "concerning any . . . violations" and to investigate "any facts, conditions, practices or matters which it may seem necessary or proper" in fulfilling its responsibilities under the Exchange Act. This

does not constitute an adjudication of any fact or issue addressed herein. The Supervisors have consented to the issuance of this Report without admitting or denying any of the statements or conclusions set forth herein.

-[3]- See Securities and Exchange Commission v. Robert L. Citron and Matthew R. Raabe, Civil Action No. (C.D. Cal.).

-[4]- In the Matter of County of Orange, California; Orange County Flood Control District; and County of Orange, California Board of Supervisors, Exchange Act Release No. ____________ (January ___, 1996).

-[5]- The Commission has previously reviewed disclosure practices of issuers and others in connection with offerings of municipal securities. See Staff of the Securities and Exchange Commission, Staff Report on Transactions in Securities of the City of New York, Transmitted to subcommittee on Economic Stabilization of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 95th Cong., 1st Sess. (Comm. Print 1977); Final Report in the Matter of Transactions in the Securities of the City of New York, Exchange Act Release No. 15,547, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) 81,936 (Feb. 5, 1979); Staff Report on the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 84,327 (1988); Proposal of Exchange Act Rule 15c2-12, Exchange Act Release No. 26,100, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) 84,326 (Sept. 22, 1988); Adoption of Exchange Act Rule 15c2-12, Exchange Act Release No. 26,985, 4 Fed. Sec. L. Rep. (CCH) 25,098 (June 28, 1989) (the "1989 Release"); Division of Market Regulation, Securities and Exchange Commission, Staff Report on the Municipal Securities Market (Sept. 1993); Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Securities Act Release No. 7049 and Exchange Act Release No. 33,741, 7 Fed. Sec. L. Rep. (CCH) 72,442 (March 9, 1994) (the "March 1994 Release"); Proposal of Amendments to Exchange Act Rule 15c2-12, Exchange Act Release No. 33,742, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85,324 (March 9, 1994); Adoption of Amendments to Exchange Act Rule 15c2-12, Exchange Act Release No. 34,961, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) 85,456 (Nov. 10, 1994).

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Public entities that issue securities are primarily liable for the content of their disclosure documents and are subject to proscriptions under the federal securities laws against false and misleading information in their disclosure documents.-[6]- In addition to the governmental entity issuing municipal securities, public officials of the issuer who have ultimate authority to approve the issuance of securities and related disclosure documents have responsibilities under the federal securities laws as well. In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

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-[6]- See March 1994 Release; 1989 Release, supra note 5, at 18,199-10 and n.84; see also In re Citisource, Inc. Securities Litigation, 694 F. Supp. 1069, 1072-75 (S.D.N.Y. 1988); Draney v. Wilson, Morton, Assaf & McElligot, 597 F. Supp. 528, 531 (D. Ariz. 1983).

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In this case, the Supervisors approved Official Statements that, among other things, failed to disclose certain material information about Orange County's financial condition that brought into question the County's ability to repay its securities absent significant interest income from the County Pools. The

Supervisors were aware of material information concerning Orange County's financial condition; this information called into question the County's ability to repay its securities. Nevertheless, the Supervisors failed to take appropriate steps to assure disclosure of these facts. In light of these circumstances, the Board members did not fulfill their obligations under the antifraud provisions of the federal securities laws in authorizing the issuance of the municipal securities and related disclosure documents.

II. BACKGROUND

A. The Orange County Board Of Supervisors

The Orange County Board of Supervisors (the "Board") is the body through which the County exercises its powers.-[7]- Orange County is a body corporate and politic and has the powers specified in the California (the "State") Constitution, State statutes, and such implied powers as are necessary for the execution of the powers expressly granted.-[8]- The Board consists of five full-time members, each serving a term of four years. The Board has legislative, financial and police powers.

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-[7]- See Board of Supervisors of Modoc County v. Archer, 18 Cal. App. 3d 717, 721, 96 Cal. Rptr. 379, 382 (1971); Cal. Gov't Code 23005 (West 1988).

-[8]- Cal. Const. Art XI, 1 (West Supp. 1995); Cal. Gov't Code 23003 (West 1988).
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The Board exercises its financial powers through its general supervision of and control over the financial affairs of the County. The powers of the Board include, among others: 1) examination and audit of the financial accounts and records of all officers having responsibility for County moneys;-[9]- 2) supervision of the official conduct of all County officers, including the Treasurer, "particularly insofar as the functions and duties . . . relate to the assessing, collecting, safekeeping, management or disbursement of public funds";-[10]- 3) investment and reinvestment of County funds;-[11]- 4) fiscal powers, including approving the County's proposed budget and adopting the County's final budget;-[12]- and 5) contracting for County indebtedness,-[13]- including the issuance of municipal securities.

Although the Board may delegate certain of these duties to County officers and employees, it is ultimately responsible for the execution of these duties. In 1985, the Board formally delegated its authority to invest County funds to its Treasurer.

B. The Supervisors

1. Thomas F. Riley, age 83, was appointed Supervisor in 1974, elected to the Board two years later, and served continuously through 1994, after which he retired. Riley was the Chairman of the Board in 1994.

2. William G. Steiner, age 58, was appointed Supervisor in 1993, elected in 1994, and is currently a member of the Board. His term expires on December 31, 1998.

3. Roger R. Stanton, age 58, was first elected Supervisor in 1980, and is currently a member of the Board and its Chairman. His term expires on December 31, 1996.

4. Gaddi H. Vasquez, age 40, was appointed to the Board in 1987, elected in 1988, and served continuously until his resignation on September 27, 1995. Prior to his resignation, Vasquez was the Chairman of the Board in 1995.

5. Harriett M. Wieder, age 75, was first elected Supervisor in 1978, was Chairman of the Board in 1993 and a member through 1994.

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-[9]- Cal. Gov't Code 25250 (West 1988).

-[10]- Cal. Gov't Code 25303 (West 1988).

-[11]- Cal. Gov't Code 53601 (West Supp. 1995).

-[12]- Cal. Gov't Code 29000-29093 (West 1988 & Supp. 1995).

-[13]- Cal. Gov't Code 25256 (West 1988).

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C. The County Pools And Orange County's Financial Dependence On The Pools

The County Pools were instrumentalities of the County and were not established as legal entities distinct from the County. The County Pools operated as an investment fund managed by Orange County through which the Treasurer invested public funds deposited by various local governments or districts (the "Pool Participants" or the "Participants"). As of December 6, 1994, the County Pools held approximately $7.6 billion in Participant deposits, including County funds.

Under California law, the Board may delegate its authority to invest or to reinvest County funds to the County Treasurer, who thereafter assumes full responsibility for such transactions and who must make monthly reports of the transactions to the Board.-[14]- Pursuant to this law, the Board delegated its authority to invest and reinvest County funds to the County Treasurer. Notwithstanding this delegation of authority, the Treasurer was required to seek approval from the Board for various kinds of investments.-[15]-The investment strategy devised by the County Treasurer was risky and was predicated on the assumption that interest rates would remain low. The strategy involved a high degree of leverage through the use of short-term reverse repurchase agreements and a substantial investment in derivative securities of a longer term (including inverse floaters that are negatively affected by a rise in interest rates). For example, on December 6, 1994, when the County Pools held deposits of approximately $7.6 billion, the book value of the leveraged investment portfolios was $20.6 billion.

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-[14]- See Cal. Gov't Code 53601, 53607 and 53608 (West 1983 & Supp. 1995). See also Cal. Gov't Code 25303 (West 1988) ("board of supervisors shall supervise the official conduct of all county officers, . . . particularly insofar as the functions and duties . . . relate to the assessing, collecting, safekeeping, management, or disbursement of public funds").

-[15]- For example, at the Treasurer's request in 1985, the Board authorized the Treasurer to engage in reverse repurchase agreements. Additionally, in 1993, the Treasurer sought and received Board authorization to invest in securities with maturities exceeding five years.

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Orange County's financial condition was closely tied to the financial condition of the County Pools. The County was heavily dependent on the County Pools as a source of income to balance its discretionary budget. The County's discretionary budget was the portion of the County's total budget over which the Board had authority to determine how funds would be allocated.-[16]- The discretionary budget was also a source of funds for repayment of the municipal securities that are the subject of this report.

The County's use of interest income as a revenue source to balance its discretionary budget had been increasing since at least fiscal year 1991-92, and increased dramatically for fiscal year 1994-95.-[17]-

This increased use of interest income was due to a decline in revenue from other sources, particularly property taxes.-[18]- By budgeting increased projected interest revenue, Orange County was able to balance its budget and avoid implementing other fiscal measures.

The County had two sources of funds to invest in the County Pools and earn investment interest: its own liquid assets and the proceeds of its municipal securities offerings. From January 1993 to December 6, 1994, Orange County had invested essentially all of its liquid assets in the County Pools, almost $2.3 billion. In 1993 and 1994, Orange County issued $1 billion in municipal securities for the purpose of reinvesting the proceeds in the County Pools.

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-[16]- For fiscal year 1994-95, Orange County's total budget was approximately $3.7 billion. Of that amount, the County was required to spend about 88%, or $3.266 billion, for specific purposes. The remaining 12%, or $462.5 million, comprised Orange County's discretionary budget. The largest portion of the $462.5 million discretionary budget, $162 million, or 35%, was budgeted to come from investment income on Orange County's investment in the County Pools.

-[17]- For fiscal year 1991-92, interest earnings were $36.8 million, or 7.4% of the discretionary budget; for fiscal year 1992-93, $64.5 million, or 12.4% of the discretionary budget; and for fiscal year 1993-94, they were budgeted at $58.3 million, or 15.1% of the discretionary budget.

-[18]- Property tax revenues comprised 52.8% of the total discretionary budget for fiscal year 1991-92, 49.1% for fiscal year 1992-93, 33.4% for fiscal year 1993-94, and were projected to be only 25.4% for fiscal year 1994-95.

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In early December 1994, the County announced that the County Pools' $20.6 billion investment portfolio had suffered a loss in market value of approximately $1.5 billion. Following liquidation of the portfolio, the County realized a loss of approximately $600 million of its investment in the County Pools.

The County also suffered a loss of $157 million in estimated and budgeted interest earnings from the County Pools, contributing to a projected deficit for fiscal year 1994-95 of approximately $172 million. On December 6, 1994, the County filed a petition for bankruptcy under Chapter 9 of the United States Bankruptcy Code. As a result of Orange County's economic dependence on the County Pools and their subsequent collapse, the County has not repaid or repurchased approximately $910 million in municipal securities at the time they were to mature by their original terms or were tendered for repurchase.-[19]-

III. THE SUPERVISORS AUTHORIZED THE ISSUANCE OF MUNICIPAL SECURITIES IN 1994

A. The Municipal Securities Offerings

In 1994, the County conducted the six municipal securities offerings that are the subject of this report. These offerings were directly related to the County Pools in one or more of the following ways: 1) the proceeds from certain offerings were reinvested in the County Pools to obtain interest earnings; 2) the funds pledged to repay certain of the securities were invested in the County Pools; 3) the County Pools agreed to repurchase or repay certain of the securities; and/or 4) the County's economic reliance on the County Pools materially affected its ability to repay the securities.

The Official Statements for these offerings variously contained material misstatements and omissions of fact regarding:

1) the County Pools, including the County Pools' investment strategy and investment results, and the manipulation of the County Pools' yield, which matters affected the issuer's ability to repay the municipal securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the municipal securities; 2) Orange County's financial condition, including its economic reliance on the investment results of the County Pools as a source of funds to repay its obligations on the securities; 3) the tax-exempt status of the offering; 4) an undisclosed cap on the interest rate payable to investors on certain variable rate municipal securities sold in the offerings; and 5) the unauthorized use of an audit report.

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-[19]- These municipal securities have been rated in default by one rating agency. In Orange County's bankruptcy proceeding, the County, the noteholders and the creditors' committee agreed to extend, or rollover, the maturity of approximately $800 million of these municipal securities to June 30, 1996.

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1. The Reinvestment Offering

The County conducted one reinvestment offering in 1994, the $600,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAXABLE NOTES, issued on July 8, 1994. The purpose of this offering was to raise funds to reinvest in the County Pools for profit. In such transactions, an issuer such as Orange County expects to generate profits by investing at a rate of return that is higher than the rate of interest to be paid to the purchasers in the offering.

The County deposited the proceeds from this Reinvestment Offering into an account pledged to repay the notes. The Official Statement for this Reinvestment Offering disclosed that the County intended to invest the pledged funds in the County Pools and that, if an investment loss occurred, the County would satisfy the deficiency from any other moneys lawfully available for repayment. The lawfully available funds consisted essentially of funds in the discretionary budget.

2. The Tax And Revenue Anticipation Note Offerings

In 1994, the County conducted two separate offerings of tax and revenue anticipation notes ("TRANs"), raising a total of $200 million for the purpose of funding cash flow deficits. These offerings were the $169,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES A, issued on July 5, 1994, and the $31,000,000 COUNTY OF ORANGE, CALIFORNIA
1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES B, issued on August 11, 1994. TRANs are designed to help local governments cover periodic cash flow deficits that arise because they receive revenues infrequently during the year while their working capital expenses remain constant. Such notes are later repaid with the expected tax and other revenue received.

In the Official Statements for these offerings, the County represented that the money pledged to repay the notes would be deposited in the County Pools. The Official Statements further advised prospective investors that, if Orange County suffered an investment loss and the repayment funds were insufficient to repay the notes, the County would satisfy the deficiency from any other moneys lawfully available for repayment. The lawfully available funds consisted essentially of funds in the discretionary budget.

3. The Teeter Offerings

The County conducted two Teeter offerings in 1994: the $111,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAXABLE NOTES, issued on July 20, 1994; and the $64,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAX-EXEMPT

NOTES, issued on August 18, 1994. Separately, the County Pools guaranteed repayment of the Teeter notes pursuant to Standby Note Purchase Agreements. The purpose of the Teeter offerings was to fund the Teeter Plan, which is an alternate method of property tax distribution. Pursuant to this plan, Orange County pays local taxing entities (such as school districts) their share of property taxes based upon levy rather than actual collection. Orange County then retains all property taxes, and the penalties and interest thereon, upon collection.

The Official Statements for the Teeter notes represented that the County planned to invest certain delinquent tax receipts pledged to repay the Teeter Notes in the County Pools. The County Pools also agreed to repurchase the Teeter Notes, through Standby Note Purchase Agreements, which agreements obligated the Treasurer, as fund manager of the County Pools, to purchase the Teeter notes to the extent that there were insufficient funds to repay them. The Official Statements further advised prospective investors that if the repayment funds were insufficient, any deficiency would be satisfied from moneys received under the Standby Note Purchase Agreements and other moneys lawfully available for repayment. The lawfully available funds consisted essentially of funds in the discretionary budget.

4. The Pension Bond Offering

Finally, in September 1994, the County issued taxable Pension Obligation Bonds for the purpose of funding the County's unfunded, but accrued, pension liability. The Pension Bonds were issued on September 28, 1994, in two series: the $209,840,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994A; and the $110,200,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994B. One feature of the Series 1994B bonds was that investors had the right to tender their bonds to a remarketing agent for repurchase. A remarketing agent would attempt to resell the bonds during a seven-day period. If the bonds could not be remarketed, the County Pools, pursuant to a Standby Withdrawal Agreement, stood ready to purchase the tendered securities in an amount up to the County's unrestricted funds in the County Pools, which included funds in the County's discretionary budget.

B. Procedures Regarding Approval Of Municipal Securities Offerings

Final authority to approve each issuance of Orange County municipal securities rested with the Supervisors, pursuant to State law. Short-term financings in which the securities matured in thirteen months or less were submitted to the Supervisors for approval on the Treasurer's recommendation. With respect to debt securities in which the maturities exceeded thirteen months, the County Administrative Officer initiated the recommendation for Board action instead of the Treasurer.

Municipal securities offerings were submitted to the Board for its approval through a document entitled Agenda Item Transmittal, prepared by the Treasurer for short-term note offerings and the County Administrative Officer for long-term bond offerings. The Agenda Item Transmittal typically contained a very brief description of a particular transaction and was sent to the Supervisors three to five business days prior to a Board meeting. For short-term financings, other documents such as a Contract of Purchase, a proposed Board resolution and a draft of a Preliminary Official Statement were also prepared in advance of the Board meeting. These documents were known as "back-up" to the Agenda Item Transmittal.-[20]-

For the six offerings discussed in this Report, the Board adopted authorizing and sale resolutions. For each offering, the resolution adopted by the Supervisors: 1) authorized the issuance of the notes or bonds in a specified dollar amount; 2) approved the Preliminary Official Statement in the draft form presented; 3) delegated authority to the Treasurer or the Assistant Treasurer (or, in the case of the Pension Obligation
Bonds, to the County Administrative Officer) to: execute a "deemed final" certificate pursuant to Exchange Act Rule 15c2-12; cause the blanks in the Preliminary Official Statement to be filled in and finalize the Preliminary Official Statement; and execute the Official Statement and to deliver the same to

the underwriter; and 4) approved the Official Statement for the offering with such revisions as the Treasurer or Assistant Treasurer (or, in the case of the Pension Bonds, the County Administrative Officer) determined were necessary to make the Official Statement true and correct in all material respects.

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-[20]- The back-up documentation was not always submitted with the Agenda Item Transmittal. In some instances, the back-up documentation was only filed the day before the Board meeting, or was not distributed to the Supervisors' offices but only to the Clerk of the Board. For example, for two offerings in 1994, the draft Preliminary Official Statements were not filed with the Clerk of the Board until the day before the meeting. For a third offering in 1994, the draft Preliminary Official Statement was filed with the Clerk of the Board on the Friday before the meeting scheduled for Tuesday.

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In addition, the County retained financial advisers, bond counsel and underwriters to assist in these municipal securities offerings. The County also retained a national accounting firm to audit the County's financial statements. The Supervisors approved the retention of these professionals. While the Supervisors believed that they could rely on these professionals, the Supervisors never questioned the professionals regarding the disclosure in the Official Statements, despite their knowledge of facts calling into question the County's ability to repay the securities.

In preparation for Board meetings, the Supervisors and/or their executive assistants attended weekly briefings regarding the items on the upcoming agenda, which might consist of 100 or more items. These briefings generally lasted between one and two hours and were conducted by the County Administrative Officer and/or his staff. Prior to the briefing, the County Administrative Officer reviewed each agenda item, including those concerning the securities offerings, and typically concurred with the recommendations made by the Treasurer. The County Administrative Officer's review was principally focused on ensuring that the agenda item was consistent with both the adopted budget and the Board's policies.

The Supervisors' executive assistants reviewed the Agenda Item Transmittals and occasionally the back-up documentation. The level of review performed by an executive assistant varied considerably, ranging from mere receipt of the Agenda Item Transmittal to reviewing and summarizing both the Agenda Item Transmittal and back-up documentation, when such documentation was available.

The level of review performed by each Supervisor varied. For example, some of the Supervisors reviewed the Agenda Item Transmittal and summaries of the Agenda Item Transmittal back-up documentation; however, no Supervisor recalled reading any of the draft Preliminary Official Statements or related documents. At least one Supervisor did not review any written documentation and instead relied on the County Administrative Officer and his staff and that Supervisor's executive assistant for advice on how to vote.

Each of the six offerings was placed on the Board's "consent calendar" which contained the vast majority of the agenda items. Each of the subject offerings was approved by consent.

IV. THE SUPERVISORS FAILED TO TAKE STEPS TO ASSURE THAT THE COUNTY'S FINANCIAL CONDITION WAS DISCLOSED WHEN THEY AUTHORIZED THE ISSUANCE OF MUNICIPAL SECURITIES IN 1994

Through the formulation and adoption of the County budget, the Supervisors were aware of the County's increasing use of interest earnings from County funds invested in the County Pools as a source of revenue to balance the discretionary portion of the County's budget.

In connection with the budget approval process in fiscal years 1993-94 and 1994-95, the Supervisors were copied on reports from the County Auditor-Controller (the "County Auditor") to the County Administrative Officer discussing the availability of discretionary funds. These documents reported that interest income was a significant factor in balancing the discretionary budget, particularly in 1994.-[21]-

The first report in 1994 was distributed in February, and referred to the County's use of interest earnings to offset decreases in other revenue sources. Similarly, the May 1994 County Auditor's report cautioned that the projected budget included interest earnings that were "significant," and that the County could not rely on that source "for the long term." The report further stated that interest earnings had "become an increasingly important source of revenue" and were subject to a variety of factors that may cause such revenue to fluctuate significantly." The May County Auditor's report concluded by advising that "prudent management of one-time revenues [e.g., certain kinds of interest income] is critical to our investment policies and bond rating."

In the August 1994 County Auditor's report, which was copied to the Supervisors prior to the Pension Bond Offering, the County Auditor asserted that "we should be concerned that interest income . . . [is] financing a significant portion of the budget. The [fiscal year] 1995 interest income projection represents 35 percent of the available financing and is our single largest source of discretionary revenue." Further, the report advised that "[i]nterest income is projected based on increased earnings due to increased taxable and nontaxable borrowings," making clear that, in order to balance the budget, the County was issuing an increasing number of municipal securities offerings in order to obtain increased interest earnings on the investment of such funds.-[22]-

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-[21]- In the 1993 County Auditor's reports, the County Auditor stated that one-time revenues, such as certain types of interest earnings, were increasingly being used to balance the County budget and that it was "not fiscally responsible to continue budgeting in this manner any longer."

Despite the use of investment income to balance the County's discretionary budget, the Supervisors testified that they did not understand the investment strategy, the risks of that strategy or the potential risk of loss to the County Pools' principal.-[23]- However, the Board was provided with certain information regarding the County Pools. This information consisted of the Treasurer's annual financial statements, which statements discussed in general terms the County Pools, including the investment strategy and results. For example, in the September 1993 annual financial statement addressed to, and received by the Board, the Treasurer reported to the Supervisors that the County Pools' strategy involved the use of leverage of approximately 2 to 1 and structured or floating rate securities, and was predicated on interest rates remaining low over the next three years. The Treasurer further advised that the County's investment returns were higher than other local investment pools because of the use of reverse repurchase agreements which added an additional two and one-half percent to the yield. Additionally, the Treasurer also stated that it was his investment policy to hold all securities purchased to maturity, that it was his opinion that interest rates could not be sustained at a high rate and that it was also his opinion that there was no risk of principal loss. In September 1994, the Treasurer reported to the Board that he continued to use reverse repurchase agreements which added an additional two percent yield to the portfolio.

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-[22]- The six offerings, raising a total of approximately $1.3 billion, were authorized by the Supervisors during a three-month period in 1994 --the same three months during which the Supervisors were also in the process of adopting the County's final budget. Further, the municipal securities issued in all but one of the offerings matured one year from the date of their issuance, thereby increasing the significance of the County's current financial condition as it related to the County's ability to repay the securities.

-[23]- During the course of the Treasurer's re-election campaign in the Spring of 1994, the Treasurer's

investment strategy was criticized by his opponent as too risky for public funds. The Supervisors were aware of the criticism. The public criticism, however, did not prompt any inquiry or review by the Supervisors.

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The Treasurer had in prior years submitted to the Board monthly reports of investment transactions, as required by California law; however, he ceased submitting such reports in 1991. The Board took no steps to require the Treasurer to comply with State law and produce the reports.

As a result, the Supervisors failed to have sufficient information concerning the investment of County funds and the impact of the investment of those funds on the financial condition of the County and its ability to repay investors in Orange County's municipal securities.

When the Supervisors approved the 1994 offerings of municipal securities discussed above, they were well aware of the increasing budgetary pressure caused by the declining availability of property tax revenues and other discretionary revenues. Indeed, at least one of the offerings was conducted for the sole purpose of providing additional income to the County. Moreover, the Supervisors were informed that interest projections were based on increased amounts of borrowing.

Despite their knowledge of the County's increasing use of interest income from the County Pools to balance the discretionary budget, the Supervisors approved the Official Statements for the various offerings without taking steps to assure disclosure of this information. They never received or asked to receive a copy of any Preliminary Official Statement once finalized, or any final Official Statement; nor did they question the County's officials, employees or other agents concerning the disclosure regarding the County's financial condition. Thereafter, the Supervisors chose to authorize and approve approximately $1.3 billion of municipal securities offerings.

V. CONCLUSION

In addition to the responsibilities imposed on issuers of municipal securities, the antifraud provisions of the federal securities laws impose responsibilities on a public official who authorizes the offer and sale of securities. A public official who approves the issuance of securities and related disclosure documents may not authorize disclosure that the public official knows to be materially false or misleading; nor may the public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

The Supervisors were aware of the financial condition of the County and that interest income from the County Pools had become a major component of the County's discretionary budget in an environment of increasing budgetary pressure. The Supervisors also knew that the increase in such interest income was connected to the increased amount of County municipal securities offerings and approved at least one offering conducted solely to raise funds for reinvestment. Based on the Supervisors' significant knowledge relating to the County's finances, they should have understood the materiality of that information to the County's ability to repay the municipal securities. The Supervisors therefore had a duty to take steps appropriate under the circumstances to assure accurate disclosure was made to investors regarding this material information. The Supervisors, however, failed to take appropriate steps. For example, while the Supervisors believed that they could rely on the County's officials, employees or other agents with respect to these offerings, they never questioned these officials, employees or other agents regarding the disclosure

of this information; nor did they become familiar with the disclosure regarding the County's financial condition. Had they taken such or similar steps, it should have been apparent to each Supervisor, in light of his or her knowledge, that the disclosure regarding the County's financial condition may have been materially false or misleading.

Consequently, the Supervisors failed to assure appropriate disclosure of these matters by authorizing and approving the dissemination of misleading disclosure documents. This failure denied investors the fair and accurate disclosure required under the federal securities laws.

By the Commission.

Injunctive Proceedings

Securities and Exchange Commission v. Larry K. O'Dell, Civ. Action No. 98-948-CIV-ORL-18A (M.D. Fla.); Litigation Release No. 15858 (August 24, 1998) (settled final order).

The Securities and Exchange Commission today announced the filing of a Complaint against Larry K. O'Dell, the former Director of Public Works for Osceola County, Florida, for failing to disclose his receipt of bribes for assisting a brokerage firm in its selection to sell County bonds.

The Complaint, filed in the Middle District of Florida, alleges the following: In 1992, while the Director of Public Works, O'Dell entered into a secret arrangement with a consultant working for a brokerage firm. The arrangement provided that, in exchange for O'Dell's assistance with the brokerage firm's selection as one of the firms to sell the $149,999,313 Osceola Parkway Project bonds (dated July 15, 1992), the consultant would share his compensation from the firm with O'Dell. After entering into the arrangement, O'Dell persuaded the Osceola County Manager to put the firm in the selling group for the bonds, without disclosing his economic interest in the matter to the County Manager. Following closing of the bond offering, the consultant gave O'Dell money and other things of value totaling $1,755.82. Neither the arrangement nor the benefits conferred thereunder were disclosed to the issuer of, or investors in, the bonds. O'Dell's failure to disclose the arrangement, the payments, and the actual and potential conflicts of interest created thereby, violated the following antifraud provisions of the federal securities laws: Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.

Simultaneously with the filing of the Complaint, and without admitting or denying the allegations contained in the Complaint, O'Dell agreed to the entry of a final judgment permanently enjoining him from future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and ordering him to pay (1) disgorgement to Osceola County totaling $2,649.57, consisting of the $1,755.82 O'Dell received pursuant to the undisclosed arrangement, plus prejudgment interest thereon, and (2) a civil penalty of $5,000.

Also today, the United States Attorney for the Middle District of Florida filed a criminal plea agreement with O'Dell, pursuant to which O'Dell has agreed to plead guilty to a single felony count of bribery in violation of 18 U.S.C. § 666, arising from the conduct that is the subject of the Commission's Complaint.

The Commission's investigation concerning pay-to-play practices in Florida continues.

SEC v. Robert L. Citron and Matthew R. Raabe, Civ. Action No. SACV 96-74 GLT (C.D. Cal.), Litigation Release No. 14792 (January 24, 1996) (complaint).

The United States Securities and Exchange Commission announced that on January 24, 1996, the Commission brought its first enforcement actions relating to the Commission's investigation into the financial collapse of Orange County, California and the Orange County Investment Pools (the "County Pools"). Specifically, the enforcement actions taken by the Commission today are:

- the filing of a complaint in the United States District Court against former Orange County Treasurer-Tax Collector Robert L. "Bob" Citron and former Assistant Treasurer Matthew R. Raabe

- the institution of a cease and desist administrative proceeding and the entry of a cease and desist order against Orange County, the Orange County Flood Control District and the Orange County Board of Supervisors

All of the above parties were charged with violations of the antifraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Citron and Raabe, without admitting or denying the allegations in the complaint, consented to the entry of final judgments of permanent injunction, enjoining them from future violations of the antifraud provisions. Orange County, the Flood Control District and the Board of Supervisors submitted an Offer of Settlement, in which, without admitting or denying the findings, they consented to the entry of an Order which makes findings and orders them to cease and desist from committing or causing any violation and any future violation of the antifraud provisions. In addition, all of the parties agreed to cooperate with the Commission staff in the continuing investigation and any resulting litigation.

Also on January 24, the Commission issued a Report of Investigation concerning the conduct of individual members of the Board of Supervisors, namely, Thomas F. Riley, William G. Steiner, Roger R. Stanton, Gaddi H. Vasquez and Harriett M. Wieder. The Report of Investigation does not constitute an adjudication of any fact or issue addressed in the Report. The Supervisors have consented to the issuance of the Report without admitting or denying any of the statements or conclusions addressed therein. The enforcement proceedings concern the fraudulent offer and sale of over $2.1 billion in municipal securities issued in 1993 and 1994 by Orange County, the Flood Control District and a school district located within Orange County, which was not named in the actions. Raabe, acting in his capacity as a County employee, was principally responsible for the two offerings by the school district.

THE MUNICIPAL SECURITIES OFFERINGS

The following eleven municipal securities offerings are the subject of the enforcement actions taken today:

- the $400,000,000 COUNTY OF ORANGE, CALIFORNIA 1993-94 TAXABLE NOTES issued on July 1, 1993 ("Reinvestment Notes")

- the $600,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAXABLE NOTES issued on July 8, 1994 ("Reinvestment Notes")

- the $299,660,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 POOLED TAX AND REVENUE ANTICIPATION NOTES, issued on July 1, 1994 ("TRANs")

- the $169,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES A issued on July 5, 1994 ("TRANs")

- the $31,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 TAX AND REVENUE ANTICIPATION NOTES, SERIES B issued on August 11, 1994 ("TRANs")

- the $111,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAXABLE NOTES issued on July 20, 1994 ("Teeter Notes")

- the $64,000,000 COUNTY OF ORANGE, CALIFORNIA 1994-95 (TEETER PLAN) TAX-EXEMPT NOTES issued on August 18, 1994 ("Teeter Notes")

- the $209,840,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994A and the $110,200,000 COUNTY OF ORANGE, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS SERIES 1994B both issued on September 28, 1994 ("Pension Bonds")

- the $100,000,000 ORANGE COUNTY FLOOD CONTROL DISTRICT TAXABLE NOTES issued on August 2, 1994 ("Reinvestment Notes")

- the PLACENTIA-YORBA LINDA UNIFIED SCHOOL DISTRICT $50,000,000 TAXABLE NOTES issued on August 26, 1993 ("Reinvestment Notes")

- the PLACENTIA-YORBA LINDA UNIFIED SCHOOL DISTRICT $50,000,000 TAXABLE NOTES issued on August 1, 1994 ("Reinvestment Notes")

THE COUNTY POOLS AND THEIR RELATION TO THE MUNICIPAL SECURITIES OFFERINGS

Each of the municipal securities offerings was significantly dependent upon the County Pools such that accurate disclosure about the County Pools was material to investors. The County Pools operated as an investment fund managed by Orange County in which the County and various local governments or districts invested or deposited public funds. The County Pools consisted of the Commingled Pool, the Bond Pool and Specific Investments. Each of the municipal securities offerings was connected to the County Pools in one or more ways:

- the proceeds from certain offerings were reinvested in the County Pools to obtain interest earnings;

- the funds pledged to repay certain of the securities were invested in the County Pools;

- the County Pools agreed to repurchase or repay certain of the securities; and/or

- the County's economic reliance on the County Pools materially affected its ability to repay the securities.

MISSTATEMENTS AND OMISSIONS ALLEGED IN THE COMMISSION'S ACTIONS

As set forth below, the County, the Flood Control District, the Board of Supervisors, Citron and Raabe variously made material misstatements and omissions of fact in the Official Statements for the eleven offerings, regarding:

- the County Pools, including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield and investment in the County Pools of the funds pledged to repay the municipal securities. These matters affected the issuer's ability to repay the securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the securities;

- Orange County's financial condition, including its economic reliance on interest income from the County Pools as a source of funds to repay the purchasers of the securities;

- the tax-exempt status of the offering;

- an undisclosed interest rate cap on certain variable rate securities sold in the offerings; and

- the unauthorized use of an audit report prepared by an outside accounting firm.

In addition, in connection with the offer and sale of certain of the securities, misrepresentations were made to national securities rating agencies concerning the County Pools.

Misstatements and Omissions Regarding the County Pools

The Official Statements for the eleven offerings misrepresented or omitted to disclose material information concerning the County Pools, despite their significance to each of the offerings. Where the funds pledged to repay the noteholders were invested in the County Pools, the issuer looked to that investment to satisfy its repayment obligations. Any risks that those pledged funds would decrease affected the issuer's ability to repay the noteholders. Similarly, in the offerings where the County Pools agreed to repurchase the securities, disclosure regarding the County Pools was important so that investors could evaluate the County Pools' financial strength and ability to perform under the agreement. In addition, in certain Orange County offerings in which other County funds were a source of repayment, disclosure regarding the County Pools was important to investors because availability of such other funds depended upon the County Pools' performance.

Citron and Raabe caused the County Pools to engage in a very risky investment strategy. The strategy involved using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days), and investing in securities with a longer maturity (generally two to five years), many of which were volatile derivative securities.

The County Pools' investment return was to result principally from the interest received on the securities in the County Pools. Leverage enabled the County Pools to purchase more securities for the purpose of generating increased interest income. This strategy was profitable as long as the County Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

The Official Statements variously contained false or misleading disclosure regarding the County Pools in four areas:

1. Investment Strategy and the Risks of That Strategy

The Official Statements for all eleven offerings misrepresented and/or failed to disclose material information concerning the County Pools' investment strategy and the risks of that strategy. With respect to the investment strategy, the Official Statements failed adequately to disclose that the strategy: 1) was risky; 2) was predicated upon the assumption that prevailing interest rates would remain at relatively low levels; 3) involved a high degree of leverage through the use of reverse repurchase agreements; 4) involved a substantial investment in derivative securities, including inverse floaters that are negatively affected by a rise in interest rates; and 5) was very sensitive to changes in the prevailing interest rate because of the leverage.

During 1993 and 1994, Citron and Raabe leveraged the County Pools to amounts ranging from 158% to over 292%. Moreover, volatile derivative securities comprised from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. From January 1993 through November 1994, from 24.89% to 39.84% of the County Pools' total portfolio consisted of inverse floaters. In contrast, the County Pools invested only sparingly in securities that paid interest rates directly related to the prevailing interest rate (variable rate securities) or securities that paid interest rates that rose at certain stated intervals to certain stated rates (step-up securities). From January 1993 through November 1994, only 1.84% to 5.59% of the County Pools' portfolio consisted of such securities. Accordingly, the County Pools invested in inverse floaters to speculate on the direction of short and long-term interest rates.

The Official Statements also failed to adequately disclose the risks of the investment strategy. Specifically, if interest rates rose, as they did in 1994, it would have a substantial negative impact on the County Pools and, because of its dependence on the County Pools, the County itself.

First, the reverse repurchase costs would increase and the income that the County Pools earned from the inverse floaters in the portfolio would decrease, creating lower earnings for the County Pools. Second, the County Pools' securities would decline in market value. Third, as the value of the County Pools' securities fell, the County would suffer collateral calls from broker-dealers and reductions in loan amounts on the reverse repurchase agreements. All three events would reduce the income that Orange County would receive from the County Pools, with the possible loss of principal of invested funds as well. None of these risks were disclosed.

2. Investment Results

The Official Statements for the nine offerings conducted in 1994 failed to disclose material information concerning the County Pools' investment results. During 1994, the County Pools' investment income declined because reverse repurchase costs had increased while the income that the County Pools earned from inverse floaters had decreased. Additionally, the County Pools had suffered substantial market losses in the overall value of the portfolio. The declining market value of securities in the County Pools resulted in collateral calls and reductions in amounts obtained under reverse repurchase agreements and liquidity. These results were not disclosed to investors in the 1994 offerings.

3. Manipulation of the Yield

The Official Statements for eight offerings--the three 1994 Reinvestment Notes, the $169 Million and the $31 Million TRANs, the two Teeter Notes and the Pension Bonds--misrepresented that the County Pools' yield would be distributed pro rata to the Participants. Citron and Raabe had in fact diverted interest income from certain Commingled Pool Participants to an account for the benefit of Orange County. As a result, the Commingled Pools' yield was misrepresented in the Official Statements for these offerings. In late 1994, Citron and Raabe used a portion of the misappropriated funds to supplement the Commingled Pools' yield. The "supplemented" yield was then falsely reported in the Official Statement for the Pension Bonds.

Citron and Raabe also shifted market losses from some Specific Investment Participants, including the County, to the Commingled Pool, causing the Commingled Pool Participants to suffer losses that should have been borne by others. This information was not disclosed and also rendered false the representations regarding the pro rata distribution.

4. Investment in the County Pools

The Official Statements for the $400 Million Reinvestment Notes, the 1993 $50 Million Reinvestment Notes and the $299.66 Million Pooled TRANs stated that the funds pledged to repay the Notes would be invested as permitted by the resolutions authorizing the issuance and sale of the Notes and by California law. None of the Official Statements for these three offerings disclosed that the issuer intended to invest such funds in the County Pools. In fact, there is no narrative discussion of the Pools in the Official Statements for the two reinvestment offerings.

Misstatements and Omissions Regarding the Financial Condition of the County

The Official Statements for six of Orange County's offerings failed to disclose Orange County's true financial condition, in particular, that the County was using interest income from the County Pools as the largest single source of revenue for its discretionary budget. These offerings are the $600 Million Reinvestment Notes, the $169 Million and $31 Million TRANs, the two Teeter Notes and the Pension

Bonds. Further, the County's use of this interest income as a revenue source was increasing while other traditional revenue sources, such as property taxes, were decreasing. The funds invested to generate investment income came from two sources, the County's own funds and proceeds from the reinvestment offerings. Orange County had invested essentially all of its liquid assets in the County Pools, including funds to repay its municipal securities. In addition, the investment of virtually all of the County's liquid assets in the County Pools exposed Orange County to the volatility of the County Pools, including the potential loss of not only interest income, but of principal as well. The failure to disclose this information rendered disclosure regarding the County's financial condition and its ability to repay its securities materially misleading.

This information regarding Orange County's financial condition was important as it related to Orange County's ability to repay its obligations, including the municipal securities debt. Moreover, with the exception of the Pension Bonds, these County offerings were short-term general obligations, which, under California law, the County could repay only with funds received or accrued during fiscal year 1994-95. Therefore, given the County's use of interest income from the County Pools, if the County Pools' investments performed poorly, as eventually occurred, the County would have a budget deficit and could not repay the securities and meet its other expenses. The County's financial condition was also material to the County's ability to perform under certain agreements to repurchase or provide for repayment of the securities.

Misstatements and Omissions Regarding the Tax-Exempt Status of the Offering

The Official Statements for the $169 Million and $31 Million TRANs represented that these securities offerings were tax-exempt. These TRAN offerings were to fund the County's cash flow deficit. In order to qualify for tax-exempt status, the offerings must comply with certain IRS regulations that limit the amount that may be raised through tax-exempt offerings. With respect to both of these offerings, the County jeopardized the tax-exempt status of these offerings by increasing the size of its cash flow deficit, and, thereby, the size of the offering, through artificial means. None of the facts relating to the County's artificial increase of the size of its cash flow deficit were disclosed in the Official Statements for these offerings.

Misstatements and Omissions Regarding an Undisclosed Cap on the Interest Rate Payable to Investors

The Official Statements for the $600 Million Reinvestment Notes, the $111 Million Teeter Notes and the $100 Million Reinvestment Notes each stated that they paid a variable interest rate connected to the one-month LIBOR. Undisclosed, however, was the fact that the Notes for each of these offerings contained a 12% cap on the maximum variable interest rate that would be paid by the County. While the existence of this cap was indicated on the face of the Notes, no disclosure was made to noteholders prior to purchase.

Misstatements and Omissions Regarding the Unauthorized Use of an Audit Report

The Official Statements for seven offerings falsely represented that the County's auditor "consented to the inclusion . . . of the County's audited financial statements. . ., together with the report accompanying the audited financial statements." The offerings which contained the false statement were the $600 Million Reinvestment Notes, the $400 Million Reinvestment Notes, the two Teeter Notes, the $169 Million TRANs, the $31 Million TRANs and the $100 Million Reinvestment Notes. This report and Orange County's audited financial statements were included as exhibits to the Official Statements for these offerings.

In fact, the auditors did not consent to the inclusion of their report, did not conduct any post-audit review and were not even aware that the Official Statements represented that they consented to the inclusion of the report until after the County filed for bankruptcy.

Misrepresentations to Rating Agencies

In presentations to national rating agencies relating to eight offerings--the $600 Million, the $100 Million and the 1994 $50 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs, the two Teeter Notes and the Pension Bonds--Raabe misrepresented the County Pools' holdings. These misrepresentations ultimately ran to the purchasers of these securities. Raabe represented that only 20% of the County Pools' portfolio consisted of derivative securities. In fact, derivative securities comprised from 27.6% to 42.2% of the combined County Pools' portfolio and from 31% to 53% of the Commingled Pool's portfolio. In particular, inverse floaters comprised from 24.89% to 39.84% of the County Pools' holdings.

Raabe also misrepresented to rating agencies that money in an Orange County account designated the "Economic Uncertainty Fund" was available to pay the principal and interest on five offerings--the $600 Million Reinvestment Notes, the $169 Million and the $31 Million TRANs and the two Teeter Notes--and omitted to disclose that such funds had been misappropriated from the Commingled Pool Participants.

REPORT OF INVESTIGATION ISSUED CONCERNING INDIVIDUAL MEMBERS OF THE BOARD OF SUPERVISORS

Additionally, the Commission issued a Report of Investigation pursuant to Section 21(a) of the Exchange Act with respect to the conduct of the individual members of the Board of Supervisors in authorizing six of the Orange County offerings. The individual members of the Board of Supervisors have consented to the issuance of the Report, without admitting or denying any of the statements or conclusions contained in the Report.

In 1993 and 1994, the individual members of the Board included:

- Thomas F. Riley, age 83, who was appointed Supervisor in 1974, elected to the Board two years later, and served continuously through 1994, after which he retired. Riley was the Chairman of the Board in 1994.

- William G. Steiner, age 58, who was appointed Supervisor in 1993, elected in 1994, and is currently a member of the Board. His term expires on December 31, 1998.

- Roger R. Stanton, age 58, who was first elected Supervisor in 1980, and is currently a member of the Board and its Chairman. His term expires on December 31, 1996.

- Gaddi H. Vasquez, age 40, who was appointed to the Board in 1987, elected in 1988, and served continuously until his resignation on September 27, 1995. Prior to his resignation, Vasquez was the Chairman of the Board in 1995.

- Harriett M. Wieder, age 75, who was first elected Supervisor in 1978, was Chairman of the Board in 1993 and a member through 1994.

The Commission is issuing this Report to emphasize the responsibilities under the federal securities laws of local government officials who authorize the issuance of municipal securities and related disclosure documents and the critical role such officials play with respect to the representations contained in the Official Statements for those securities.

In authorizing the issuance of securities and related disclosure documents, a public official may not authorize disclosure that the official knows to be false; nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading. When, for example, a public official has knowledge of facts bringing into question the issuer's ability to repay the securities, it is reckless for that official to approve disclosure to investors without taking steps appropriate under the circumstances to prevent the dissemination of materially false or misleading

information regarding those facts. In this matter, such steps could have included becoming familiar with the disclosure documents and questioning the issuer's officials, employees or other agents about the disclosure of those facts.

In this case, the Supervisors approved Official Statements that, among other things, failed to disclose certain material information about Orange County's financial condition that brought into question the County's ability to repay its securities absent significant interest income from the County Pools. The Supervisors were aware of material information concerning Orange County's financial condition; this information called into question the County's ability to repay its securities. Nevertheless, the Supervisors failed to take appropriate steps to assure disclosure of these facts. In light of these circumstances, the Board members did not fulfill their obligations under the antifraud provisions of the federal securities laws in authorizing the issuance of the municipal securities and related disclosure documents.

The Commission's investigation remains ongoing.

SEC v. Robert L. Citron and Matthew R. Raabe, Litigation Release No. 14913 (May 17, 1996) (settled final orders).

The United States Securities and Exchange Commission announced that on May 9, 1996, the Honorable Gary L. Taylor, United States District Court for the Central District of California, entered final judgments of permanent injunction against Robert L. Citron and Matthew R. Raabe. In its Complaint filed January 24, 1996, the Commission charged former Orange County Treasurer-Tax Collector Robert L. Citron and former Assistant Treasurer Matthew R. Raabe with violations of the antifraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Citron and Raabe, without admitting or denying the allegations in the Complaint, consented to the entry of final judgments of permanent injunction, enjoining them from future violations of the antifraud provisions. In addition, they agreed to cooperate with Commission staff in the continuing investigation and any resulting litigation.

The Complaint concerned the fraudulent offer and sale of over $2.1 billion in municipal securities issued in 1993 and 1994 by Orange County, the Orange County Flood Control District, and a school district located within Orange County. The Complaint alleged that Citron and Raabe made material misstatements and omissions of fact in the Official Statements for eleven municipal securities offerings, regarding:

- the Orange County Investment Pools, including the County Pools' investment strategy and investment results, manipulation of the County Pools' yield and investment in the County Pools of the funds pledged to repay the municipal securities. These matters affected the issuer's ability to repay the securities and the County Pools' ability to perform under agreements to repurchase or provide for repayment of the securities;

- Orange County's financial condition, including its economic reliance on interest income from the County Pools as a source of funds to repay the purchasers of the securities;

- the tax-exempt status of certain offerings;

- an undisclosed interest rate cap on variable rate securities sold in certain offerings; and

- the unauthorized use of an audit report in certain offerings.

In addition, Raabe made misrepresentations to national securities rating agencies concerning the County Pools in connection with certain offerings.

Securities and Exchange Commission v. Louis Bethune, Charles L. Howard and John Jackson, Civ. Action No. CV:95-B2509 (N.D. Ala.), Litigation Release No. 14675 (October 2, 1995) (complaint).

The United States Securities and Exchange Commission ("Commission") announced that on September 29, 1995, a complaint was filed in the United States District Court for the Northern District of Alabama seeking to permanently enjoin Louis Bethune ("Bethune"), Charles Howard ("Howard") and John Jackson ("Jackson") from further violations of the antifraud provisions of the federal securities laws. Bethune and Howard are longtime residents of Birmingham. Jackson is the mayor of a White Hall, a small town in central Alabama. The complaint alleges that the defendants participated in a fraudulent scheme to pledge $300 million in revenue bonds purportedly issued by the Redevelopment Authority of White Hall ("Authority") in an attempt to obtain a $255 million margin loan from a Sarasota, Florida office of Smith Barney, Inc. ("Smith Barney"). The complaint also alleges that prime bank securities do not exist and that all series of the bonds issued by the Authority contained multiple misrepresentations, including fundamental misrepresentations that the bonds were "Bank Guaranteed," and that they were backed by "Prime Bank Securities, issued by an acceptable institution in good standing, rated AA+ or higher by Standard & Poors. "The complaint seeks a permanent injunction, an order imposing civil monetary penalties on the defendants and other equitable relief.

Securities and Exchange Commission v. Louis Bethune, Charles L. Howard and John Jackson, Litigation Release No. 15024 (August 26, 1996) (settled final order).

The United States Securities and Exchange Commission ("Commission") announced that on August 8, 1996, the Honorable Sharon Lovelace Blackburn of United States District Court for the Northern District of Alabama entered a final judgment of permanent injunction against defendant John Jackson, Mayor of White Hall, Alabama, prohibiting Jackson from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934. Jackson consented to the entry of the permanent injunction against him without admitting or denying the allegations of the complaint.

The Commission's complaint, filed September 29, 1995, alleged that the defendants participated in a fraudulent scheme to pledge $300 million in revenue bonds purportedly secured by prime bank securities and issued by the Redevelopment Authority of White Hall ("Authority") in an attempt to obtain a $255 million margin loan from a Sarasota, Florida office of Smith Barney, Inc. ("Smith Barney"). The complaint also alleges that prime bank securities do not exist and that all series of the bonds issued by the Authority contained multiple misrepresentations, including fundamental misrepresentations that the bonds were "Bank Guaranteed," and that they were backed by "Prime Bank Securities, issued by a an acceptable institution in good standing." See also, LR.-14675/October 2, 1995.

Securities and Exchange Commission v. Louis Bethune, Charles L. Howard and John Jackson, Litigation Release No. 15271 (February 28, 1997) (settled final order).

The Securities and Exchange Commission announced today that on February 20, 1997, the Honorable Sharon Lovelace Blackburn, United States District Judge for the Northern District of Alabama, entered a final judgment of permanent injunction against defendant Charles L. Howard ("Howard"), enjoining him from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Upon sworn representations of a financial inability to pay a fine, no civil penalties were imposed. Howard consented to the relief without admitting or denying the allegations set forth in a complaint filed by the Commission on September 29, 1995. The complaint alleged that Howard, along with codefendants Louis Between and John Jackson, violated the antifraud provisions of the securities laws in the offer and sale of municipal bonds, the proceeds of which were to be used for downtown redevelopment projects in White Hall, Alabama. Howard and codefendant Bethune persuaded city officials to allow them to sell the bonds at face values disproportionate to the costs of the projects being funded by the bonds. The complaint also alleged that Howard and his codefendants misrepresented to investors that the bonds were backed by "Prime Bank Securities. "In fact, none of the

bonds offered for sale by Howard were ever guaranteed or secured by any financial instrument which could be described as a prime bank security.

<u>Securities and Exchange Commission v. Terry D. Busbee and Preston C. Bynum</u>, Civ. Action No. 95-30024 RV (N.D. Fla.), Litigation Release No. 14387 (January 23, 1995) (complaint).

The Securities and Exchange Commission ("Commission") announced today that it filed a Complaint for Injunctive and Other Equitable Relief and Civil Money Penalties ("Complaint") in the United States District Court for the Northern District of Florida against Terry D. Busbee ("Busbee"), an elected public official of the Escambia County Utilities Authority ("ECUA") from approximately 1984 through 1994, and Preston C. Bynum ("Bynum"), an employee of Stephens Inc. ("Stephens"), a municipal securities underwriter. The Complaint alleges that from at least 1990 through at least 1993, the defendants defrauded the ECUA and investors in three offerings of municipal securities issued by the ECUA. According to the Complaint, Busbee and Bynum entered into certain financial arrangements, pursuant to which Busbee received certain benefits from Bynum, during a time when Busbee had an important role in selecting the underwriter for municipal securities issued by the ECUA. The Complaint alleges that Bynum caused the following benefits to be provided to Busbee: 1) the extension and guarantee of four loans totaling $36,700 from an Arkansas bank; 2) repayment of approximately $27,000 in principal and interest on three of the loans; and 3) payment of approximately $3,500 to Busbee directly. The Complaint further alleges that Busbee voted to select, and otherwise participated in the selection of Bynum's employer as the underwriter or senior managing underwriter for three ECUA municipal securities offerings.

According to the Complaint, Busbee and Bynum each had a duty to disclose the financial arrangements to the ECUA in connection with Stephens' selection as underwriter in the three offerings and to investors in the three offerings. The Complaint alleges that Busbee's and Bynum's failure to disclose the financial arrangements and the actual and potential conflicts of interest created by those arrangements, at the time Bynum's employer was selected as underwriter and at the time those ECUA securities were offered and sold to the public, violated the following antifraud provisions of the federal securities laws: Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. In addition, the Complaint alleges that Bynum also violated Rules G-17 and G-20 of the Municipal Securities Rulemaking Board ("MSRB"), which prohibit unfair practices in the conduct of municipal securities business and place limitations on gifts in relation to certain municipal securities activities, and Section 15B(c)(1) of the Exchange Act, which prohibits effecting transactions in municipal securities in contravention of any rule of the MSRB.

In its Complaint, the Commission seeks permanently to enjoin both defendants from violating the antifraud provisions described above, and to enjoin Bynum from violating MSRB Rules G-17 and G-20, as well as Section 15B(c)(1) of the Exchange Act. In addition, the Commission seeks orders requiring each of the defendants to pay civil money penalties.

Also today, the United States Attorney for the Northern District of Florida announced that a federal grand jury indicted Busbee and Bynum on charges relating to the conduct alleged in the Complaint.

The Commission's investigation continues as to the conduct of other individuals and entities involved in this matter.

<u>Securities and Exchange Commission v. Terry D. Busbee and Preston C. Bynum</u>, Litigation Release No. 14508 (May 24, 1995) (settled final order).

The Securities and Exchange Commission announced today that Terry D. Busbee and Preston C. Bynum agreed to settle the civil action brought by the Commission in United States District Court for the Northern District of Florida on January 23, 1995. Without admitting or denying the allegations contained

in the Complaint, Busbee, an elected public official of the Escambia County Utilities Authority ("ECUA") from approximately 1984 through 1994, and Bynum, formerly an employee of the public finance department of Stephens Inc., consented to the entry of final judgments of permanent injunction providing for all of the equitable relief sought by the Commission.

The Complaint filed by the Commission alleges that from at least 1990 through at least 1993, the defendants defrauded the ECUA and investors in three offerings of municipal securities issued by the ECUA. According to the Complaint, Busbee and Bynum entered into certain financial arrangements, pursuant to which Busbee received certain benefits from Bynum, during a time when Busbee had responsibility for selecting the underwriter for municipal securities issued by the ECUA. The Complaint alleges that Bynum caused the following benefits to be conferred on Busbee: (1) the extension and guarantee of four loans totaling $36,700 from an Arkansas bank; 2) repayment of approximately $27,000 in principal and interest on three of the loans; and 3) payment of approximately $3,500 to Busbee directly. The Complaint further alleges that Busbee voted to select, and otherwise participated in the selection of Bynum's employer as the underwriter or senior managing underwriter for three ECUA municipal securities offerings. See Litigation Rel. No. 14387 (January 23, 1995).

Bynum has consented to the entry of a final judgment that permanently enjoins him from future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-20 of the Municipal Securities Rulemaking Board. In addition, Bynum also has agreed to pay a civil money penalty in the amount of $25,000. Busbee also has consented to the entry of a final judgment that permanently enjoins him from future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that notes that no penalty is imposed on Busbee based on his demonstrated inability to pay.

As part of the settlement, Bynum has also agreed to the issuance by the Commission of an Order Instituting Proceedings, Making Findings and Imposing Sanctions, that bars him permanently from association with any entity regulated by the Commission.

Last week, H. Michael Patterson, the United States Attorney for the Northern District of Florida, announced that in related criminal proceedings, on May 17 Busbee was sentenced to twenty-seven months in prison, with three years probation for his violations of *18 U.S.C. § 666* (bribery concerning programs receiving federal funds) and *26 U.S.C. § 7206* (false statement on an income tax return); and that on May 18 Bynum was sentenced to a prison term of twenty-four months with two years probation, for his violation of *18 U.S.C. § 666.* Both defendants had previously pleaded guilty to those charges, on March 3, 1995.

The Commission acknowledges the assistance of the United States Attorney for the Northern District of Florida and the Criminal Investigation Division of the Internal Revenue Service.

The Commission's investigation continues as to the conduct of other entities and individuals involved in this matter.

SEC v. Whatcom County Water District No. 13, et al., Civ. Action No. C77-103, (W.D. Wash.), Litigation Release No. 7810 (March 7, 1977) (complaint); Litigation Release No. 7592 (May 10, 1977) (settled final orders).

See "THE ISSUER" section.

SEC v. Washington County Utility District, et al., Civ. Action No. CA-2-77-15 (E.D. Tenn.), Litigation Release No. 7782 (February 15, 1977) (complaint).

See “THE ISSUER” section.

<u>SEC v. Washington County Utility District, et al.</u>, Litigation Release No. 7868 (April 14, 1977) (settled final orders).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on March 30, 1977, the Honorable Charles G. Neese, Judge of the United States District Court for the Eastern District of Tennessee, Northeastern Division in Greeneville, issued orders of preliminary and permanent injunction from further violations of the anti-fraud provisions of the federal securities laws against Washington County Utility District ("WCUD"), of Washington County, Tennessee, a "municipality or public corporation", Commissioners Paul G. Puckett of Johnson City, Tennessee, and Stella B. Harwood of Jonesboro, Tennessee and Hertz N. Henkoff of Boston, Massachusetts, an attorney who served as bond counsel for several issues of revenue bonds of WCUD.

WCUD was further directed to make an accounting of the receipt and disbursement of all funds received in connection with all revenue bonds it has issued.

Puckett and Harwood were ordered to disgorge certain bonds of WCUD in their possession and to pay over to the Clerk of the Court for the benefit of bondholders the proceeds from the sale of certain other bonds of WCUD.

In addition, Judge Neese signed an order of preliminary injunction with respect to Wade H. Patrick of Johnson City, Tennessee, the manager of WCUD and ordered that a trust be impressed upon all of his assets and that he make an accounting of all income, property or other assets received by him from WCUD or from other source as a result of activities involving WCUD.

Between 1965 and 1975 WCUD had made seven different bond offerings; four for its garbage division ($2,175,000) and three for its cable antenna television division ($1,500,000).

The complaint alleged numerous untrue statements of material facts concerning, among other things, the use of the proceeds obtained from the sale of revenue bonds issued by WCUD; the purposes for which the bonds were issued; the priority of liens of the bondholders on property owned by WCUD or its divisions; and the sufficiency of revenues in each division of WCUD to meet expenses including debt service. The complaint also alleged numerous omissions to state material facts including the following: that WCUD bonds were sold at substantial discounts, ranging from 10 to 42 percent; that WCUD prior to 1975 failed to have audited financial statements prepared; that WCUD was not making payments into a sinking fund to retire the bonds outstanding; that proceeds from the sale of bonds were used for purposes other than represented in prospectuses or authorized in the bond resolutions, such as loans to Patrick and companies controlled by Patrick or his relatives, payment of interest on prior issues of bonds, and loans or advances to other divisions of WCUD.

The individual defendants consented to the relief requested; the decree against WCUD was entered by default. For further information, see Litigation Release No. 7782.

<u>SEC v. Washington County Utility District, et al.</u>, Litigation Release No. 8410 (May 15, 1978) (settled final order).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on May 5, 1978, the Honorable Charles G. Neese, Judge of the United States District Court for the Eastern District of Tennessee, Northeastern Division, in Greenville, issued an order of permanent injunction from further violations of the anti-fraud provisions of the federal securities laws against Henry C. Miller of Johnson City, Tennessee, in connection with the offer and sale of revenue

bonds of Washington County Utility District, Washington County, Tennessee (WCUD) or any other security.

Miller was further ordered to waive claim to a bond of WCUD and monies paid over to the Clerk of the Court.

Between 1965 and 1975 WCUD had made seven different bond offerings; four for its garbage division ($2,175,000) and three for its cable antenna television division ($1,500,000).

The complaint alleged numerous untrue statements of material facts concerning, among other things, the use of the proceeds obtained from the sale of revenue bonds issued by WCUD; the purposes for which the bonds were issued; the priority of liens of the bondholders on property owned by WCUD or its divisions; and the sufficiency of revenues in each division of WCUD to meet expenses including debt service. The complaint also alleged numerous omissions to state material facts including the following: the WCUD bonds were sold at substantial discounts, ranging from 10 to 42 percent; that WCUD prior to 1975 failed to have audited financial statements prepared; that WCUD was not making payments into a sinking fund to retire the bonds outstanding; that proceeds from the sale of bonds were used for purposes other than represented in prospectuses or authorized in the bond resolutions, such as loans to the manager of WCUD or companies controlled by him or his relatives, and loans or advances to other divisions of WCUD.

Miller consented to the relief requested without admitting or denying the allegations in the Complaint. For further information, see Litigation Release Nos. 7782 and 7868.

SEC v. Washington County Utility District, et al., 1982 U.S. Dist. LEXIS 17316 (E.D. Tenn. Dec. 2, 1982).

OPINION: NEESE, Senior District Judge: The Court hereby ADOPTS, as its own, the findings of fact and conclusions of law proposed jointly by the remaining parties and filed herein on November 3, 1982.

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Plaintiff, Securities and Exchange Commission, and the Defendant, Wade H. Patrick, pursuant to order of this Court dated May 25, 1982, jointly present the following proposed Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

I.

BACKGROUND

1. Washington County Utility District ("District") was organized under the laws of the State of Tennessee in 1955 as the Garbage Disposal District of Washington County, Tennessee. Its name was changed to its present form in 1966. (Stipulation)

2. Wade H. Patrick has, since at least 1956, been manager of the District and has dominated and controlled its affairs. (Stipulation; Ex. 104B pp. 18-19, 78-80, 84-85; 105, p. 17; Alcock Tr. 51)

3. HPO Services, Inc ("HPO") is a company owned by Wade H. Patrick. (Ex. 102B pp. 64-65; Patrick Tr. 42-44)

4. Diversified Securities, Inc. ("Diversified") is a New York corporation owned by Thomas R. Alcock. (Stipulation)

5. Thomas R Alcock through Diversified Securities, Inc. or doing business as T.R. Alcock & Co. has acted as underwriter of all the bonds sold by the District since 1965 and as its fiscal agent. (Stipulation)

II.

BOND OFFERINGS

6. From 1965 through 1975 the District issued seven different bond issues; three were for its Community Antenna Television System Division (CATV), and four issues were for its Garbage Division. (Stipulation)

7. The total amount of the bonded indebtedness for the Utility District as a result of the bond offerings was $3,675,000. The bonds issued by the CATV Division total $1,500,000; the Garbage Division has issued a total of $2,175,000. (Stipulation)

8. Each of the issues of bonds was payable solely from revenue generated from the particular division which issued the bonds. (Stipulation)

9. Each of the bond resolutions authorizing the issuance of bonds by the District specified the purposes for which the funds were being raised. (Stipulation) The major purposes specified in the bond resolutions were as follows:

(a) The 1965 Garbage Division offering was to refund a prior bond issuance; (Ex. 4)

(b) The 1968 CATV Division offering was to construct a CATV system; (Prel. Ex. 11)

(c) The 1970 Garbage Division offering was to pay for the cost of constructing and acquiring extensions and improvements to the garbage disposal system including the acquisition of an additional landfill site; (Prel. Ex. 11)

(d) The 1971 CATV bond offering was to provide for the acquisition, construction and operation of extensions to the system; (Prel. Ex. 11)

(e) The 1972 Garbage Division bond offering was to provide funds for the cost of constructing and acquiring extensions and improvements to that system; (Prel. Ex. 11)

(f) The 1973 CATV bond offering was for the acquisition, construction and operation of extensions to that system; (Ex. 3)

(g) The 1974 Garbage Division bond offering was for the purchase and operation of a landfill. (Prel. Ex. 11)

10. Monies from each bond offering, with the possible exception of the 1965 Garbage Division Offering, were used for purposes other than those provided in the bond resolutions.

11. The bonds specifically stated that the District covenanted to charge sufficient fees to provide for the operation of the particular divisions including the payment of interest on the bonds and to provide for the retirement thereof. (Stipulation) The bonds further provided that the Tennessee laws required revenue to be sufficient to meet all such items. (Prel. Ex. 11, 12)

12. Even though the bonds specifically represented that the District would charge sufficient fees to cover the cost of operations, including the payment of interest and principal on the bonds issued, the District never charged sufficient fees to cover costs including amortization of the bonded indebtedness, and the

only way it was able to continue its operations was through the fraudulent sale of additional bonds to cover the cost of operations, particularly interest on prior issues of bonds. (Tr. 80, 180-181)

13. It was expressly provided in the bond resolution that funds would be disbursed solely for the purposes for which the bonds were authorized and remaining funds would be put into a sinking fund which constituted a trust fund. (Stipulation)

14. Funds received from the sale of the bonds were regularly and routinely disbursed for purposes not disclosed in the bond resolutions, and no funds were ever put into a sinking fund for the retirement of the bonds as represented in the bond resolutions. (Prel. Tr. 40, Tr. 145-146, 158-159)

15. Each of the bond resolutions required that accurate records would be kept. (Prel. Ex. 11; Ex. 4)

16. Patrick knew that the records being kept by the District were totally inadequate and not accurate so as to reflect the use of funds and was repeatedly advised of the inadequacies of the books and records by the accountant engaged by the District. (Prel. Tr. 35-36; Tr. 84-86) Despite being told by the accountant for the District that the records were not accurate and not adequate, Patrick continued to make representations as to the accuracy of the records in all of the bond resolutions, which resolutions were incorporated by reference in each of the bonds. (Prel. Ex. 11; Ex. 4)

17. Each of the bond resolutions provided that the Utility District would have certified financial statements prepared yearly. The bonds incorporated by reference the resolutions authorizing the issuance thereof together with the representations contained therein. (Stipulation)

18. Patrick knew that the above representations contained in the bond resolutions, and in the bonds by incorporation, were false because the Utility District never had an audited financial statement prepared until 1975. (*Tr. 84-85 Ex. 102, pp. 37-38* [6-29-76])

19. The law under which the Utility District was organized required that the Utility District have annual financial statements prepared. (Stipulation)

20. Although Patrick knew that the laws of the State of Tennessee required the Utility District to have annual financial statements prepared, he never advised or required that each purchaser of the bonds be advised that the Utility District was not complying with State law in that respect. (Tr. 193-196, Ex. 129)

21. Each bond resolution provided that the bondholders would have a lien on the assets owned or thereafter acquired by the Division of the District offering the particular bonds. (Stipulation; Ex 3; and Prel. Ex. 11)

22. Knowing full well that the first three issues of the Garbage Division had granted a lien on the assets owned or thereafter acquired by the Garbage Division of the Utility District, the District, with Patrick's knowledge, nevertheless falsely represented, in connection with the fourth issue of the Garbage Division's bonds, that the bondholders would have a first lien on certain properties which the Garbage Division had already acquired and to which a lien had attached in favor of the bondholders of the three previous bond offerings. (Tr. 166-167)

III.

FINANCIAL CONDITION OF THE DISTRICT

23. The Garbage Division operated at a loss for the fiscal years 1969 and 1970. (Prel. Tr. 26; Prel. Ex. 1)

24. Washington County Utility District is and has been insolvent since at least June 30, 1973, in that its assets are less than its liabilities. (Stipulation)

25. For the fiscal year ending June 30, 1973, its liabilities exceeded its assets by over $200,000. For the fiscal year ending June 30, 1974, the liabilities of the District exceeded its assets by over $337,000. (Stipulation)

26. The deficit for the fiscal year ended June 30, 1975, increased to over $550,000, and by the year ended June 30, 1976, the liabilities exceeded the assets by over $656,000. This excess of liabilities over assets has increased for the year ending June 30, 1977, to over $813,600. (Stipulation)

27. As of June 30, 1974, the total bonds payable by the District exceeded the total assets by over $225,000; by June 30, 1976, the total bonds payable exceeded the total assets by over $300,000; and by June 30, 1977, the total bonds payable exceeded total assets by over $338,000. (Prel. Ex. 5 & 17; Ex. 1; Prel. Tr. 53)

28. If the amount of depreciation and amortization could be calculated, the effect would be to further increase the deficit. (Prel. Tr. 38-39, 53; Tr. 80-81)

29. The Statute of the State of Tennessee requiring utility districts to prepare annual financial statements was ignored by the District until at least 1974. (Stipulation) J. B. Holt, a certified public accountant, did accounting work for the District from 1958 through 1974, and repeatedly told Patrick that the District's books and records were inaccurate and inadequate. (Prel. Tr. 23-24; Tr. 84-86) Holt, in 1975, completed an audit of the District for the fiscal years ending June 30, 1973, and June 30, 1974. (Prel. Tr. 37; Prel. Ex. 5)

30. The financial statements prepared by Holt were not certified as required by the bond resolutions and the laws of Tennessee because, among other deficiencies, depreciation of fixed assets and amortization of bond costs could not be calculated since records were incomplete. (Stipulation; Prel. Tr. 35-36; Tr. 80-81, 100-101)

31. The District's liabilities exceeded its assets by approximately $230,000 at June 30, 1973 (Stipulation); this was not disclosed in the bond resolution dated April 1, 1974, for the fourth issue of Garbage Division Bonds. (Prel. Ex. 11)

32. There was no disclosure that the District was not and had not been charging sufficient fees to meet all expenses. (Lamberson Tr. 29, 33-35; Carty Tr. 19, 23-24; Glidden Tr. 9, 12-13, 32, 35; Ex. 47, 102 p. 25; Prel. Ex. 5, 16, 17)

33. Patrick signed and caused to be issued an unaudited earnings statement for the Garbage Division for the six months ending December 31, 1973, to be utilized in the offering and sale of the Garbage Division's fourth issue of bonds which earnings statement represented that the Garbage Division was operating at a profit. (Tr. 181-182, Ex. 47)

34. Patrick, subsequent to April 1974, falsely represented to William Carty, a principal of the broker-dealer selling the Fourth issue of bonds of the Garbage Division, that "the District was operating profitably and everything was all right" when Carty called and expressed concern about the market for the bonds. (Carty Tr. 19) Patrick omitted to tell him material facts, including but not limited to the following: that the District had never had an audited financial statement prepared, and consequently, could not ascertain what its condition was; that records of receipts and expenditures were not appropriately maintained; that the District's assets were less than its liabilities; that the District's Divisions were not operating at a profit; that funds of one Division were used for another Division without receiving interest; that such inter-division transfers were used to keep outstanding bonds current by payment of interest; and that funds were loaned to Patrick, his friends and relatives. (Carty Tr. 20-32)

35. Broker-dealers would not have purchased bonds of the District or sold the District's bonds to their customers if apprised that the District was insolvent in that its liabilities exceeded its assets, or if purchased, it would only be for clients who were absolute speculators who purchased such bonds at five cents on the dollar. (Michaels Tr. 14; Carty Tr. 30, 32; Glidden Tr. 35-36; Lamberson Tr. 22-23)

IV.

MISUSE OF BOND PROCEEDS

36. Patrick caused the District to use proceeds from one bond offering to pay interest on other bond offerings (Prel. Tr. 43, Ex. 1); even though the bond resolutions required that the funds be expended only for the purpose for which such bonds were issued and any funds remaining were to be put in a sinking fund which was to constitute a trust fund. (Stipulation; Tr. 85-86; Prel. Tr. 28-29, 42-43) Patrick as manager and controlling person caused this course of business. He handled all receipts and disbursements of funds by the District without direction or authority from the Commission except in a few instances. (Ex. 103, p. 80; Ex. 104, p. 97; Ex. 105, p. 41, 59, 75)

37. Despite the fact that each of the bond resolutions required sinking fund payments to be made for the purposes of retiring the bonds as they came due, the Utility District has not made any sinking fund payments and Patrick did not disclose such information to purchasers of the District's bonds. (Prel. Ex. 5, 11, 16, 17; Ex. 1; Prel. Tr. 54-55)

38. Despite the fact that the bonds issued by the CATV Division and the Garbage Division are revenue bonds payable solely from revenues generated by the appropriate Division, monies have been advanced from one Division of the District to another Division of the District without the payment of interest by the borrower Division. In fact, no interest has ever been paid on advances from one Division to another. (Stipulation)

39. Broker-dealers would not have sold the District's bonds to their customers if they had known that proceeds of the bond offerings of one Division were being loaned to another Division without interest or documentation. (Michaels Tr. 15; Glidden Tr. 18-19)

A. 1970 Garbage Division Bond Offering

40. The 1970 bond offering by the Garbage Division was for the purpose of acquiring a landfill for the District. The offering of $650,000 in bonds was authorized by the Commissioners on July 20, 1970. (Stipulation; Prel. Ex. 11)

41. An offering circular utilized in the sale of these bonds by T. R. Alcock represented that the cost of the property to be acquired by the District was $297,500, fraudulently omitting the material fact that the property was to be acquired from Patrick and Alcock at a profit to them of approximately $225,000. (Prel. Ex. 20)

42. No disclosure was made in the bonds, the bond resolution nor the sales literature that of the $297,500 approximately $228,000 in bonds were to be issued to Patrick and Alcock for the transfer of an option to purchase the property for $70,000. (Prel. Tr. 64-65; Prel. Ex. 10, 11 & 12; Alcock Tr. 56-68, 97-98)

43. Patrick omitted to disclose that 6 months prior to transferring the option to the Utility District he paid only $2,000 or $3,000 for the option. (Ex. 102 pp. 35-36; Ex. 102B pp. 8-9; Prel. Tr. 63-65)

44. While the District, in fact, did not pay Patrick $228,000 for the transfer of the option, Patrick did receive approximately $70,000 in bonds, the cancellation of indebtedness, payment of debt and other consideration. (Prel. Tr. 66-67; Ex. 102B pp. 9-10; 102A pp. 107) This was never disclosed. (Prel. Ex. 11 & 12; Glidden Tr. 28-29; Lamberson Tr. 43) $40,000 par value bonds were given by Patrick to

Commissioners Harwood, Miller and Puckett, which have subsequently been disgorged pursuant to the Commissions' settlements. (Tr. pp. 122, 158-159)

45. Bonds or a part thereof received by Patrick in connection with the sale of the option to the District were transferred to the Commissioners without consideration. (Ex. 102 pp. 28-29; 102B pp. 9-10; 103 pp. 70-71) Bondholders were never advised of this fact. (Prel. Ex. 11 & 12)

46. Alcock was paid $32,500 in fiscal agent's fees of which one-half or $16,250 was paid to Patrick. (Alcock Tr. 22-25)

47. Commissioners are prohibited by statute from receiving compensation for their services unless specifically authorized and then they are limited to $600 per year. (Judicial Notice -- Tenn. Annotated Statute Ch. 26, Sec. 6-2615; Stipulation)

B. 1971 CATV Division Bond Offering

48. Holt prepared and sent to Patrick a schedule of receipts and disbursements for the 1971 CATV Division bond offering which reflected that the District realized only a total of $378,000 including over $10,000 in accrued interest from the sale of bonds with a face amount of $500,000. (Prel. Tr. 32-34; Prel. Ex. 4)

49. Despite the fact that the fiscal agent's fees were excessively set at five or six percent of face rather than the net amount received, Alcock was paid $38,000, of which one-half or $19,000 was paid to Patrick, from the 1971 CATAV Division bound offering which is almost eight percent of par. In addition, over $82,000 was paid in interest on bonds from the proceeds, and the maximum amount which could have been paid by July 31, 1973, on the 1971 bonds was only $49,500; thus pursuant to Patrick's direction there was a diversion of over $32,000 for other issues. (Prel. Ex. 4; Alcock Tr. 22-23)

C. 1972 Garbage Division Bond Offering

50. In July 1972, the District authorized the issuance and sale of $500,000 in Revenue Bonds for the Garbage Division for the purpose of "constructing and acquiring extensions and improvements to the system." (Prel. Ex. 11) The District received $400,000 for the $500,000 face amount of the bonds. (Prel. Ex. 5 & 16) All of the bonds were acquired by Alcock at a discount of twenty (20) percent. (Prel. Tr. 27, 41; Prel. Ex. 2; Ex. 21) In addition, the District paid to Alcock or Diversified $57,000 as a fiscal agent's fee, of which one-half or $28,500 was paid to Patrick. Also, it paid legal and auditing expenses of $7,247.11. From the bond proceeds, bond interest and fees of $11,191 were paid. Moreover, from the bond proceeds, funds were diverted in the form of loans directly to Patrick of $11,500 and to D & P Development Co., a partnership in which he had an interest, of $125,000. Bullington Enterprises, an entity controlled by Patrick's son and son-in-law also received $45,000 as a loan. All of the aforesaid loans have been repaid with interest. From the $400,000 of proceeds realized by the District in this bond offering only $65,874.55 was actually expended for the acquisition of equipment and the construction of improvements to the Garbage Division System. (Prel. Ex. 5, 16; Prel. Tr. 41-45)

51. At Patrick's direction at least $189,000 of the proceeds of the 1972 Garbage Division bond offering was eventually used for a proposed sewer project contrary to the provisions of the bond resolution. (Prel. Ex. 2; Prel. Tr. 28-29; Tr. 160-161)

52. Only one month after misapplying bond proceeds in the form of loans to Bullington Enterprises and D & P Development, the District borrowed funds from a finance company to purchase a truck for the District. (Stipulation; Prel. Ex. 8; Tr. 159-160)

D. 1973 CATV Division Bond Offering

53. Only $309,000 was realized by the District from the sale of $400,000 face amount of the 1973 CATV Division bonds. The proceeds together with the $6,135.27 of interest thereon were commingled with $7,000 transferred from the Garbage Division. From such funds and at Patrick's direction $90,375 was used to pay interest on prior bond issues, including Garbage Division issues; $21,875 was used to pay fiscal agent's fees, of which one-half or $10,937.50 was paid to Patrick; and $3,825 was used to pay legal, printing and audit costs. The sum of $5,500 was transferred to the Sewer Division, and $1,000 was transferred to the Transit Division. (Prel. Ex. 5, 16)

54. Alcock knew, before all bonds of the 1973 CATV issue were sold, that the District was about to default by non-payment of interest and conspired with Patrick to pay the interest to conceal the District's financial plight. As consideration for agreement to pay the interest, Alcock was permitted to buy $50,000 of the bonds at a forty-two (42) percent discount with payment for the bonds being deferred over a period of nine months. (Prel. Ex. 6; Ex. 21, 102B p. 55; Alcock Tr. 76-78)

55. Bonds of the third issue of the CATV Division were sold to Carty & Co., Inc., a Memphis broker-dealer, for $990,000 per hundred in 1973 and then resold to customers and other brokers for prices ranging from $89.00 to $97.15. (Michaels Tr. 5-7; Carty Tr. 24-27; Ex. 46)

56. Broker-dealers were not told the above-mentioned material facts and would not have solicited purchases of the District's third issue of CATV Division's bonds at $90.00 per hundred if they had known that the underwriter had paid only $58.00 per hundred for some of the bonds and even in unsolicited trades would have advised purchasers of the fact that the underwriter had paid substantially less for some of the bonds. (Michaels Tr. 18; Carty Tr. 27-28)

E. 1974 Garbage Division Bond Offering -- Landfill

57. The 1974 Bond Offering by the Garbage Division was in the amount of $675,000. Alcock sold, by the end of June, 1974, bonds with the face amount of $500,000 at seventy-five (75) percent of par; the District thus realized $375,000 before expenses. (Prel. Ex. 5; Ex. 21)

58. Patrick and Alcock agreed to use proceeds for purposes other than stated in the bond resolution. (Stipulation; Ex. 55-61, 64, 109, 114; Prel. Ex. 5 & 16)

59. The District paid Alcock $33,750 in fiscal agent's fees of which one-half or $16,875 was paid to Patrick. (Alcock Tr. 22-25)

60. Diversified deposited through May 14, 1975 proceeds of $481,641.94 in its client's funds account from the sale of the Garbage Division's 1974 bond issue from the sale of $635,000 face amount of bonds at seventy-five (75) percent of par. (Ex. 114)

61. Alcock personally handled the distribution of funds from the 1974 Garbage Division bond offering. With Patrick's consent over $140,000 was used for the CATV Division contrary to the provisions of the bond resolution. (Ex. 114; Stipulation; Tr. 166-168)

62. Patrick received a loan of $9,000 and Bullington Enterprises received a loan of $10,000 from funds diverted from the bond proceeds (Prel. Ex. 5), both of which have been repaid.

63. In addition to the $64,000 bond interest paid for CATV Division, Patrick paid bond interest on earlier issues of the Garbage Division of over $40,000 contrary to the provisions of the bond resolution. (Prel. Ex. 5, 16; Ex. 114)

64. The Sewer Division received $9,000 from the proceeds of the 1974 bond offering at Patrick's direction. (Prel. Ex. 5 & 16)

65. Although the purported purpose of the 1974 bond offering was to purchase a landfill, only $20,550 was used to partially pay for the Bowers' property, after Patrick caused the District to issue bonds with a face amount of $675,000. (Prel. Ex. 5, 16)

66. Michaels, a representative of Carty & Co., Inc. a broker-dealer, understood proceeds from the Fourth Issue of Bonds of the Garbage Division were to be utilized only for purposes stated in the offering circular. (Michaels Tr. 14)

67. Because of the information furnished to it, Carty & Co., Inc. purchased $600,000 face amount of the Fourth Issue of the Garbage Division at $80.00 per $100 face amount from Cecil Lamberson. The bonds were then resold to the public at prices ranging from $82 to $89 per $100 face amount. (Ex. 46; Michaels Tr. 11; Carty Tr. 8-14)

68. At the time the purchase of the Fourth issue of bonds of the Garbage Division was agreed upon between Lamberson and Carty & Co., an offering circular and an up-to-date financial statement of the District was requested by representatives of Carty & Co. (Michaels Tr. 11; Carty Tr. 15)

69. Broker-dealers would not have purchased the bonds or sold the bonds of the Fourth Issue of the Garbage Division had they known that proceeds of the bond offering were to be used to pay interest on prior bond issues. Such information was considered material. (Michaels Tr. 14; Glidden Tr. 18-19)

70. The offering circular for the Fourth Issue of the Garbage Division of the District represented that $68,000 of the proceeds were to be used to purchase land and $204,000 was to be used to pay off equipment notes and was so understood by representatives of Carty & Co. who sold the bonds to the public. (Ex. 47; Michaels Tr. 19) With the benefit of all inferences to the defendants only $37,350 could have been used to pay for real estate and only $167,093.97 was used to pay for equipment. (Prel. Ex. 16; Ex. 114)

V.

FALSE REPRESENTATION THAT BONDHOLDERS OF THE GARBAGE DIVISION'S FOURTH BOND OFFERING WOULD HAVE A SUPERIOR LIEN

71. The Utility District's Garbage Division has utilized only one landfill since its organization in which it had a beneficial interest, that being the landfill commonly referred to as the Jonesboro site. The Garbage Division at no time had a special landfill for the refuse of residential users of the service as opposed to refuse of commercial or industrial users of the service. (Stipulation)

72. As early as 1973 the State of Tennessee was demanding that the Utility District take steps to close its Jonesboro site. At the time of trial the Utility District had closed its Jonesboro site and was utilizing the landfill site owned by the City of Johnson City. (Stipulation)

73. The resolutions for the 1965, 1970 and 1972 Garbage Division bond offerings, which were made at Patrick's direction, provided that the bondholders would have a lien on all property then owned by the Garbage Division or thereafter acquired by the District for the Garbage Division. (Stipulation; Prel. Ex. 11; Ex. 4)

74. The fourth issue of the Garbage Division, in 1974 in the face amount of $675,000, was for the specific purpose of acquiring a landfill. (Prel. Ex. 11) In fact, no properties were acquired by the District subsequent to the offer and sale of such bonds. (Prel. Ex. 9, 16 & 17; Ex. 102B pp. 27 & 35)

75. The bond resolution, for the fourth issuance of bonds for the Garbage Division provided, with Patrick's knowledge and consent, that the bondholders would have a first lien on the property to be acquired for the District. Since the prior shareholders already had a lien on the property owned by the

District for the Garbage Division, this representation was false and totally misleading. (Stipulation; Prel. Ex. 11)

VI.

OMISSIONS OF MATERIAL FACTS CONCERNING FISCAL AGENTS FEES PAID BY THE DISTRICT AND THE FINANCIAL FEASIBILITY OF THE OFFERINGS

76. Customary discount in municipal bond underwritings are one and one-half (1 1/2) to two and one-half (2 1/2) percent of par. Discounts of three (3) to five (5) percent are unusual but at times are given. (Prel. Tr. 14)

77. The cost of a bond offering requiring discounts of ten (10) percent and fiscal agent's fees of five (5) percent plus the issuer paying the cost of the issue is exhorbitant as a general rule. (Prel. Test. pp. 15-16)

78. A revenue bond offering providing for a twenty (20) percent discount is very risky, fiscally not feasible nor advisable. (Prel. Tr. 17)

79. Increasing the discount to twenty-five (25) percent results in an exhorbitant cost and a discount of thirty (30) percent becomes disastrous. (Prel. Tr. 17)

80. When Patrick's knowledge and consent, bonds of the second Garbage Division offering were sold by the District at prices ranging from sixty-five (65) percent to ninety (90) percent of par value, or at discounts ranging from ten (10) percent to thirty-five (35) percent and $445,000 of the par value of bonds of this issue were exchanged at par value for certificates of indebtedness. (Ex. 116)

81. With Patrick's knowledge and consent, the third Garbage Division issue was sold by the District at a discount of twenty (20) percent. (Ex. 116)

82. With Patrick's knowledge and consent, the fourth Garbage Division issue was sold by the District at discounts from seventeen and one-half (17 1/2) percent to twenty-five (25) percent of par value. (Ex. 116)

83. With Patrick's knowledge and consent, the first CATV Division issue was sold by the District at discounts from twenty (20) percent to fifty (50) percent of par value. (Ex. 116)

84. With Patrick's knowledge and consent, the second CATV Division issue was sold by the District at discounts from twenty-five (25) percent to forth (40) percent of par value.

85. With Patrick's knowledge and consent, the third CATV Division issue was sold by the District at discounts of twenty (20) percent and forty-two (42) percent of par value. (Ex. 5)

86. Of the $400,000 face amount 1973 CATV Division bond offering with Patrick's knowledge and consent, $350,000 were sold at $80 per hundred and the balance, namely $50,000, was sold to Alcock at $58 per hundred which was a discount of forty-two (42) percent. (Prel. Tr. 47; Prel. Ex. 5) Only one-half of the consideration, $14,500, was paid by June 30, 1974 although the sale was in January, 1974. The other $14,500 was not paid until December 13, 1974. (Prel. Ex. 6; Alcock Tr. 71-83)

87. The purported reason Alcock was getting such a substantial discount on the 1973 bond offering was his agreement to pay interest on the 1973 CATV Division bonds coming due in March and September 1974 to prevent default on the bonds which Patrick knew was not being told to purchasers of the bonds. (Prel. Ex. 6)

88. From the difference between the par value and the price paid by the underwriter (discount) the underwriter usually pays all legal, accounting and fiscal agent's fees; however, the District paid all legal,

accounting and fiscal agent's fees in addition to the tremendous discounts. (Prel. Tr. p. 14-15) (Prel. Ex. 5, 16, 17; Ex. 116)

89. The District, at Patrick's direction, agreed to pay Diversified fiscal agent's fees from 1965 to 1975, as follows: 1965 Garbage Division 5% of $350,000 or $17,500; 1968 CATV Division 5% of $600,000 or $30,000; 1970 Garbage Division 5% of $650,000 or $32,000; 1971 CATV Division 5% of $500,000 or $25,000; 1972 Garbage Division 6% of $500,000 or $30,000; 1973 CATV Division $25,000 and 1974 Garbage Division 5% of $675,000 or $33,750. (Prel. Ex. 5, 16, & 17; Ex. 9, 10, 11, 116; Alcock Tr. 22-23)

90. For the fiscal year ending June 30, 1973, Alcock received fiscal agent's fees from the 1972 Garbage Division bond offering of $57,000 rather than the $30,000 per agreement. For the fiscal year ending June 30, 1974, Alcock received fees of $46,875 as fiscal agent and $8,208.54 for the fiscal year ending June 30, 1975, or a total of $55,083.54. (Prel. Ex. 5, 16, 17)

91. Patrick unlawfully received one-half of such fiscal agent's fees. (Alcock Tr. 22-23; Tr. 145-156)

92. Patrick authorized Alcock to obtain the bonds of the District at discounts ranging between ten (10) and forty-two (42) percent. Most of the bonds were at discounts of twenty (20) percent or more. The Commissioners were not advised by Patrick prior to the issuance of the bonds what discount would be granted to Alcock. (Alcock Tr. 76-80; Prel. Ex. 5, 6, 11, 13, 15, 16 and 17; Ex. 8 [4/30/68], 16, 17, 21, 50, 89, 93 102B pp. 51-57)

93. The discounts permitted by Patrick were not disclosed. (Lamberson Tr. 18-19; Alcock Tr. 83; Glidden Tr. 20)

94. Despite the abnormal discounts authorized by Patrick the bonds of the District were offered and sold at substantial markups including par or face value by Alcock and others. (Ex. 2, 20, 30, 33, 38, 40, 42, 45, 46, 72, 110, 111; Prel. Ex. 13)

VII.

THE DISTRICT EXCEEDED THE STATUTORY INTEREST LIMIT

95. The interest rate on Utility District revenue bonds cannot exceed eight (8) percent. (Judicial Notice -- Tenn. Annotated Statute Ch. 26, Sec. 6-2620; Prel. Tr. 17-19; Stipulation)

96. Patrick caused the CATV Division to exceed the statutory rate of interest limitation; the interest being eight and eighty-two one hundredths (8.82) percent. (Prel. Tr. 17-18)

VIII.

MISREPRESENTATIONS AND OMISSIONS OF MATERIAL FACTS CONCERNING THE DISTRICT'S FINANCIAL CONDITION, RECORDS AND MANAGEMENT'S CONFLICTS OF INTEREST

97. The District did not maintain accurate books and records. (Prel Ex. 5, 16, Ex. 1; Stipulation)

98. The District bond resolutions presented to the Commissioners by Patrick in 1970, 1972 and 1974 directing the issuance and sale of bonds for the Garbage Division do not disclose that the required sinking fund payments were not met on the prior issues. (Prel. Ex. 11)

99. The District bond resolutions for the CATV Division in 1971 and 1973 presented to the Commissioners by Patrick do not disclose that the required sinking fund payments had not been made as required by the prior bond resolution for the CATV Division. (Prel. Ex. 11; Ex. 3)

100. The conflicts of interest of Patrick and Alcock, including but not limited to the division of fiscal agent's fees with Patrick and Patrick's misapplication of bond proceeds, were not disclosed to investors. (Carty Tr. 21-22, Michael Tr. 15-17, Lamberson Tr. 34-35, Glidden Tr. 12-14, 20, 26-29, 41-42; Prel. Ex. 11 & 12; Ex. 2, 20 & 47)

IX.

FUNDS UNLAWFULLY DIVERTED TO PATRICK OR AFFILIATES

101. Patrick dominated and controlled the District and its affairs. (Ex. 104B pp. 78-80, 84-85; 105 p. 17; Alcock Tr. 51)

102. Patrick obtained payments from Alcock of one-half the fiscal agent's fees which totaled $96,604.27. (Prel. Tr. pp. 73-74; Ex.102B p. 44; Alcock Tr. 24-28; Prel Ex. 5, 16, 17, Ex. 9. 10, 11, 116, 117)

103. Broker-dealers would not have purchased bonds of the District or sold such bonds to customers if they had been apprised that Alcock, the fiscal agent and underwriter, was making kickbacks to Patrick, the District manager. (Michaels Tr. 15; Glidden Tr. 13-14)

104. From January 1, 1970 to June 30, 1977 Patrick received $97, 450 in salary from the District. (Ex. 117)

105. Diversified with Patrick's knowledge and consent improperly paid from the proceeds of the District's 1974 Garbage Division offering, which proceeds had been deposited in its clients' funds account, $712.50 in legal fees and $2,500.00 in accounting fees in connection with an Internal Revenue Service inquiry into the personal tax returns of Patrick and Alcock. (Ex. 94, 95, 114, 133; and Alcock Tr. 126-128, 130-131)

106. Patrick authorized Diversified to pay from the proceeds of the District's 1974 Garbage Division bond offering, legal and professional fees of $865.00 and $250.00 in connection with Eastern TV Cable Corp., a company owned by Alcock. (Ex. 94, 114, 133; Alcock Tr. 128-130)

107. Property of the District was commingled with property of Patrick. (Patrick Tr. pp. 57-66)

108. There was no disclosure in the bonds or in the bond resolutions of the loans to Patrick or his affiliates. (Stipulation; Prel. Ex. 11, 12; Ex. 3, 4)

109. Broker-dealers would not have purchased the bonds of the District or sold them to their customers if aware that Patrick was causing the District to loan proceeds of the bond offerings to himself, relatives or entities in which he or his relatives had a beneficial interest. (Michaels Tr. 15; Glidden Tr. 26-32; Lamberson Tr. 21-22)

110. Patrick's self-dealing, besides making and receiving loans and selling land to the District, included obtaining $23,316.66 in commissions for the sale of equipment to the District (Prel. Tr. 72; Ex. 102 pp. 33-35; 117; Patrick Tr. 35-38)

111. The District paid $10,000 to General Electric for D & P Development Company at Patrick's direction in connection with the sale to the District of the option to purchase the Milhorn property. (Ex. 117)

112. Patrick received four (4) $4,500 bonds with a total face value of $20,000 of the 1970 Garbage Division issue in connection with the sale to the District of the option to purchase the Milhorn property. (Ex. 117)

113. Patrick received four (4) $4,500 bonds with a total face value of $20,000 of the 1971 CATV Division issue which were sold for total proceeds of $13,316.66. (Ex. 117)

114. Patrick sold 15,000 par value of the CATV Division's first issue of bonds to T.R. Alcock & Co. on April 26, 1973 for $10,500. (Ex. 49, 50) On May 3, 1973, the District deposited $10,500 from T.R. Alcock & Co. to its bank account and credited Patrick for monies he had previously received from the District. (Ex. 118)

115. Patrick and his wife jointly owned four (4) lots in Johnson City, Tennessee, which they leased to the District at a rental of $400 per month since about 1968. The District at such a rate has paid Patrick $34,000 from December 1, 1968 through December 1975. (Ex. 102B pp. 49-50)

116. No accounting was made by Patrick or the District for the proceeds of the sale of the District's bonds and certificates of indebtedness or transactions between Patrick and the District prior to January 1, 1970, nor of any rents that may have been paid by the District to Patrick. (Ex. 102B pp. 49-50; Ex. 116, 117, 118, 119 & 121)

117. Patrick's brother, a sister, a son, a son-in-law, a daughter and sister-in-law were on the payroll of the District (Ex. 102A p. 108; 103 p. 81; 104B p. 4, 45, 67, 81; 105 p. 68-69; Patrick Tr. p. 13-14)

118. The District at Patrick's direction paid $1,250 to J. B. Holt for accounting fees in connection with the Internal Revenue Service Audit of Patrick personally. (Ex. 118)

119. Simple interest computed at the rate of eight (8) percent on half the fiscal agent's fees received by Patrick from Alcock or Diversified is as follows:

1965 Garbage	$8,750.00 at 8%	From 6/30/66 to 6/30/79 = 13 yrs.	$9,100.00
1968 CATV	$15,000.00 at 8%	From 6/30/69 to 6/30/79 = 10 yrs.	$12,000.00
1970 Garbage	$16,250.00 at 8%	From 6/31/71 to 6/30/79 = 8 yrs.	$10,400.00
1971 CATV	$12,500.00 at 8%	From 6/30/72 to 6/30/79 = 7 yrs.	$7,000.00
1972 Garbage	$15,000.00 at 8%	From 6/30/73 to 6/30/79 = 6 yrs.	$7,200.00
1973 CATV	$12,500.00 at 8%	From 6/30/74 to 6/30/79 = 5 yrs.	$5,000.00
1974 Garbage	$16,604.27 at 8%	From 6/30/75 to 6/30/79 = 4 yrs.	$5,313.36

Total	$56,013.36 interest

120. Simple interest computed at the rate of 8% on accounting and attorney fees paid by the District for Patrick's personal matters from June 30, 1975 to June 30, 1979 amounts to $1,428.

CONCLUSIONS OF LAW

From the foregoing facts, the Court adopts the following conclusions of Law:

1. This Court has jurisdiction of this action under Section 22(a) of the Securities Act of 1933, as amended *(15 U.S.C. 77v*[a] and Section 27 of the Securities Exchange Act of 1934, as amended *(15 U.S.C. 78aa),* and it has in personam jurisdiction of the defendants.

2. Defendant Patrick has violated the antifraud provisions of the Federal Securities Laws, namely Section 17(a) of the Securities Act of 1933 *(15 U.S.C. 77q*[a]0 and Section 10(b) of the Securities Exchange Act of 1934 *(15 U.S.C. 78j*[b]) and Rule 10(b)5 promulgated thereunder (17 C.F.R. 240.10b-5). As part of his scheme all bond resolutions, bond certificates, and bond offering circulars misrepresented or failed to disclose:

(1) The payments made by Diversified to HPO (Patrick) of half of the fiscal agent's fees;

(2) Commissions paid to HPO (Patrick) on the sale of equipment to the District;

(3) Excessive fiscal agent's fees paid by the District;

(4) Loans and other payments by the District to Patrick and relatives or entities controlled by them;

(5) That accurate books and records were not maintained as required by the bond resolutions;

(6) That the District failed to have audited financial statements as required by the bond resolutions and state law;

(7) Excessive discounts given on the sale of the bonds;

(8) The purchase by the District from Patrick of an option to purchase land;

(9) That Patrick and not the Board of Commissioners controlled the District;

3. A duty to disclose material information arises when a person possessing that information has direct contact with investors. Such direct contact does not require physical presence or face-to-face conversation but is satisfied when an agent of an entity undertakes to transmit, for use of investors, information concerning that entity's securities or the entity itself. *Securities and Exchange Commission v. Coffey, 493 F.2d 1304 (6th Cir. 1974);* Securities and Exchange Commission v. Washington County Utility District, Case No. 80-1261, slip opinion, pp. 7-9.

4. The Securities Act "was intended to cover any fraudulent scheme in an offer or sale of securities, whether in the course of an initial distribution or in the course of ordinary market trading" *U.S. v. Naftalin, 99 S.Ct. 2077, 2084 (1979).*

5. The repeated and continuous securities offerings from 1969 through 1974 without complying with any of the promises and representations contained in the resolutions and the bonds; the disregard of State law; the active concealment of the financial condition of the District; the payment and concealment of fiscal agent's fees and other payments made in connection with the sales; and the self-dealing by Patrick,

particularly the accepting of one-half of commissions from Alcock, sales of property and loans to himself and entities controlled by him, constitute a violation of the anti-fraud provisions of the Federal Securities Laws.

Securities and Exchange Commission v. Blatt, *583 F.2d 1325 (5th Cir. 1978);* Securities and Exchange Commission v. Commonwealth Chemicals Securities, Inc., *574 F.2d 90, 100 (2nd Cir. 1978).*

6. "Disgorgement is remedial" and forces the wrongdoer "to give up . . . the amount by which he was unjustly enriched. "Thus, the Court has the power "to order disgorgement . . . with interest" of the amount the person "profited from his wrongdoing."

Securities and Exchange Commission v. Blatt, supra at 1335.

7. Injunctive actions brought by the Securities and Exchange Commission are not governed by state statutes of limitations or laches.

United States v. Summerlin, *310 U.S. 414, 416 (1940)*; Costello v. United States, *365 U.S. 265, 281 (1961)* ; United States v. Kellum, *523 F.2d 1284, 1286 (5th Cir. 1975).*

8. Utility Districts are prohibited from paying interest over eight per cent.

Tennessee Code Annotated, Chapter 26, Sec. 6-2620

9. A final judgment of permanent injunction should be granted.

10. Disgorgement to prevent Patrick from being unjustly enriched and benefited should be ordered as follows:

A. One-half of the fiscal agent's fee received from Alcock or Diversified	$96,604.27
B. Amount misappropriated by Patrick for payment to General Electric on behalf of D & P Development Company	10,000.00
C. Amount received by Patrick as commission on the sale of packers to the District	23,316.66
D. Amount credited to Patrick from the sale $15,000 face amount of the CATV Division's first issue of bonds to T.R. Alcock & Co. on April 26, 1973	10,500.00
E. Amount paid to J. B. Holt for accounting services in connection with the Internal Revenue Service audit of Patrick personally	1,250.00

F. Amounts misappropriated from the proceeds of the District's 1974 Garbage Division offering for payment of legal ($712.50) and accounting ($2,500) fees in connection with an Internal Revenue Service inquiry into the personal tax returns of Patrick and Alcock 3,212,50

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11. In view of the fact that Patrick worked for the District, disgorgement of the salary received by Patrick will not be ordered; and because the District obtained the use of Patrick's property, disgorgement of the rental payments received by Patrick is, similarly, not ordered, nor the amounts paid on behalf of Eastern TV Cable Corp. or the proceeds obtained by Puckett from bonds given to him by Patrick because he, Patrick, did not get the use or benefit of such funds.

TABLE OF ABBREVIATIONS

Alcock Tr.	Alcock Transcript
Carty Tr.	Carty Transcript
Ex.	Exhibit admitted at the pre-trial hearing
Glidden Tr.	Glidden Transcript
Lamberson Tr.	Lamberson Transcript
Michael Tr.	Michael Transcript
Patrick	Patrick Transcript
Prel. Ex.	Exhibit admitted at hearing on motion for Preliminary Injunction
Prel. Tr.	Transcript of testimony at hearing on motion for Preliminary Injunction

SEC v. Reclamation District No. 2090, et al., Civ. Action No. C76-1231-SAW (N.D. Cal.), Litigation Release No. 7460 (June 22, 1976) (complaint).

See "THE ISSUER" section.

SEC v. Reclamation District No. 2090, et al., Litigation Release No. 7547 (September 2, 1976) (settled final order).

Gerald E. Boltz, Regional Administrator of the Los Angeles Regional Office, and Michael J. Stewart, Acting Associate Regional Administrator of the San Francisco Branch Office, announced that on August 27, 1976, the Honorable Robert H. Schnacke, United States District Judge for the Northern District of California, on motion of the Commission, entered an Order of Preliminary Injunction against James H. Dondich of Santa Ana, California, and Roy J. Jackson of Ogden, Utah, proscribing violations of the anti-

fraud provisions of the federal securities laws in connection with offers and sales of securities issued by Reclamation District No. 2090 ("the District") and any other security of any other issuer.

Judge Schnacke also entered Final Judgments of Permanent Injunction against Max H. Mortensen of Oakland, California, All-States Tax Exempt Securities, Inc., and Pasquale "Pat" Tamburri, of Clearwater, Florida on August 18, 1976; against Norton McGiffin of Largo, Florida, George E. Grills of Dunedin, Florida, and Jules L. Steele of Clearwater, Florida, on August 16, 1976; against Robert D. Lewis of Palo Alto, California, and John B. Schoenfeld and Lowell C. Lundell of Atherton, California, on August 19, 1976; and against National Municipal Bond Co., Inc. and Roger W. Osness of St. George, Utah on August 24, 1976. The permanent injunctions enjoin these defendants from violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder in connection with offers and sales of any securities issued by the District and any other issuer. These defendants consented to the entry of the permanent injunctions without admitting or denying the allegations of the Commission's complaint.

The Commission's complaint alleged that the defendants' activities in violation of the anti-fraud provisions of the federal securities laws resulted in the sales of approximately $2.2 million of the notes issued by the District to approximately 161 persons residing in at least 12 states. Pursuant to Court approval, the Commission is also participating as a party in interest in a proceeding commenced by the District under Chapter IX of the Federal Bankruptcy Act. For further information, see Litigation Release No. 7460.

Commission Orders - Settled Administrative Proceedings

In re City of Syracuse, New York, Warren D. Simpson, and Edward D. Polgreen, Securities Act Release No. 7460, Exchange Act Release No. 39149, AAE Release No. 970, A.P. File No. 3-9452 (September 30, 1997).

See “THE ISSUER” section.

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OBLIGATED PERSONS

Report under Section 21(a) of the Exchange Act

SEC, Staff Report on Transactions in the Marine Protein Corporation Industrial Development Revenue Bonds, Exchange Act Release No. 15719 (April 11, 1979).

INTRODUCTION

The staff of the Division of Enforcement pursuant to a formal order of investigation authorized by the Commission on April 13, 1976, conducted a private investigation In the Matter of Marine Protein Corporation Industrial Development Revenue Bonds, Mammoth Spring, Arkansas. The Commission now

makes this report of that investigation. n1 This case is another in the series of investigations which focuses on abuses in connection with the issuance of IDR bonds. n2 It focuses on, among other things: (1) the standards of disclosure required in an industrial revenue bond offering, and (2) the responsibility of the corporate lessee, the underwriter and the financial adviser to the issuer for full disclosure, in connection with the offer of industrial revenue bonds.

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n1 Commissioner Karmel dissented from this determination of the Commission for the reasons set forth in her statement which follows this release.

n2 Industrial Development Revenue Bonds are popular financing vehicles because they are used by municipalities to attract new industry to their area. The proceeds of these industrial development revenue bonds are used by the issuing municipality to erect an industrial facility which is then leased to a private corporation for business use. The principal and interest on the bond issue is paid only from the revenues of the private corporation.

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According to monthly statistical bulletins edited by the Public Securities Association, the number of tax exempt industrial development bond issues (excluding pollution control issues) since 1972 were: 1972 -- 125 issues totaling $296 million; 1973 -- 280 issues totaling $573 million; 1974 -- 274 issues totaling $493 million; 1975 -- 263 issues totaling $455 million; 1976 -- 285 issues totaling $487 million; 1977 -- January-May, 79 issues totaling $237 million.

The staff's inquiry principally focused on the period from January 1972 when the bond offering was conceived through 1976 when the bonds were declared to be in default. During the investigation, the staff obtained numerous documents and compiled 3,000 pages of transcribed investigative testimony. The staff's Report is a summary of the evidence that has been obtained to date. The Commission has decided to release this Report in the public interest pursuant to Section 21(a) of the Securities Exchange 1934. This is not to be construed as an adjudicative determination. Nor is the investigation or this Report a determination of the rights or liabilities of any person.

BACKGROUND

This matter involves two successive efforts of a small, newly formed corporation, Marine Protein Corporation ("Marine") to raise financing for the establishment of facilities for Marine's operations. During 1972 the company raised $3.5 million through the offering of common stock to the public. This offering was registered with the Commission pursuant to the Securities Act of 1933. Later in 1972, through an offering of industrial development revenue bonds that were sold pursuant to a claimed exemption from registration with the Commission (pursuant to Section 3(a)(2) of the Securities Act), Marine raised an additional $2.5 million. The striking contrast between the disclosure of material matters contained in the prospectus utilized for the offering of common stock registered with the Commission and the material omissions contained in the offering circular used to promote the sale of the industrial development revenue bonds makes it clear that the participants in the bond underwriting failed to comply with the standards of disclosure that are required by the antifraud provisions in connection with the offering and sale of any securities. The information gathered in the Commission's investigation, demonstrates that Marine fell short of its obligation to public investors by failing to assure that the information being disseminated to the public in connection with the sale of the industrial development revenue bonds was adequate, accurate and consistent with the information it had provided to the bond underwriters.

Marine is a Delaware corporation with headquarters formerly in New York City. The company was incorporated in 1969 and its primary business venture was to perfect a method to breed fish under environmentally controlled, high density conditions (Silo Fish Farms) for ultimate commercial sale. The controlling persons of the company which comprised its executive-managerial staff possessed varied

business backgrounds unrelated to the fish industry and Marine's claimed advance research and development relating to the commercial growth of fish was based upon the invention principally of one marine biologist whose theories had never been tested beyond two pilot programs.

At its inception in 1969-1970 the company raised approximately $2.5 million through private placements of securities. In February 1972, the company raised $3.5 million through a public offering of securities registered with the Commission pursuant to the Securities Act of 1933. Prior to Marine's public offering, its activities had been limited to research and development at a pilot facility in Pennsylvania. The proceeds from the sale of the common stock were to be used primarily to begin construction of a trout farm in Mammoth Spring, Arkansas. Because the company was using a completely new technique for raising fish which had not yet been proven commercially feasible, the Commission's Division of Corporation Finance required Marine to make full disclosure of the risks involved in the purchase by investors. Marine's registration statement and prospectus ("stock prospectus") enumerated certain risk factors which prospective investors were warned to "carefully consider". Disclosure of these risk factors and other statements about the company's processes followed closely those disclosures which were included previously by the company in its private placement memoranda that was utilized to raise financing for the company's 1969-70 placement of securities referred to above.

Sale of Industrial Development Revenue Bonds

On May 16, 1972, some three months following issuance of the registered common stock, the City of Mammoth Spring, Arkansas, held a special election for the purpose of authorizing a total of $4 million of Industrial Development Revenue Bonds for the benefit of Marine. On the advice of the bond underwriter, it initially was decided that bonds in the amount of $2.5 million would be offered to the public and that the remaining $1.5 million would be sold whenever Marine requested it. On October 6, 1972, Marine announced to its shareholders the signing of an agreement with the bond underwriter for the sale of $2.5 million of 26-year maturity industrial revenue bonds. This underwriter purchased the bonds from the City of Mammoth Spring, Arkansas, on December 1, 1977, at a discount price of 91 and wholesaled the bonds at 97 to the now defunct municipal bond broker-dealer, Seaney Jones & Co. of Atlanta, Georgia, ("Seaney"). Seaney sold most of the bonds to Paragon Securities of New Jersey ("Paragon") at 99. n1 Paragon retailed most of the issue to individual investors all over the United States at premium prices as high as 116. The bond underwriter had characterized the issue as "speculative" to its trading desk and elected not to allow its trading desk to make retail sales of the bonds to their own customers. This underwriter's role in the offering was that of structuring the issue and preparing the "offering prospectus." For its efforts, the underwriter collected a fee of $142,500 or the difference between purchasing the bonds at 91 from the issuing authority and selling them to Seaney at 97.

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n1 As the result of a civil injunctive action brought by the Commission, Paragon and its principals were enjoined by consent from further violations of the antifraud provisions of the federal securities laws. (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder.) Paragon is no longer in business.

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The "offering prospectus" was prepared in-house by the bond underwriter's staff and was given to Seaney, Paragon and another bond house in New York that retailed a small percentage of the bonds. The finished document was used by Paragon to prepare a brief two-page summary of the offering which included pertinent facts about the bonds including: Denominations; Date; Interest; Security; Bond Counsel; Marine net worth, etc. Paragon disseminated this information sheet to its retail customers.

The "offering prospectus" was prepared only some eight months after the company's common stock offering. Material about Marine and its operational plans and projections was copied from advertising brochures, news articles and the 1972 Annual Report to Shareholders which had previously been furnished to the underwriter by Marine. In addition to this material, Marine also provided the bond

underwriter with a copy of the common stock prospectus. The bond concerning the risks of fish farming or the risks involved in investing in Marine (discussed more fully under "Comparison of Disclosure") that were contained in the common stock prospectus. The bond prospectus did contain misleading bullish information as described below but failed to include disclosures concerning the use of the proceeds of the bond offering. The bond offering prospectus also included excerpts from the bond indenture.

Events Subsequent to Bond Sale

Marine's commercial application of its silo system from research laboratory to its anticipated production site at Mammoth Spring, Arkansas, experienced a variety of problems which over a two-year period contributed to the ultimate collapse of the company. From the date of the bond closing on December 1, 1972, the company had a 10-month grace period in which to complete its major facility in Arkansas and begin marketing fish because first payments for principal on the bonds became due on October 1, 1974. Site preparation at Mammoth Spring began in June 1972 which was several months before the bond financing was obtained. The bond money enabled the company to develop its site in a more grandiose style with the immediate installation of 36 silos and plans for an additional 36 silos if the first set proved the process to be a commercial success. A combination of natural disasters and faulty planning delayed completion of the facility by over seven months.

By October 1973, the first set of 36 silo tanks was in place. But, even at this time, the system was far from final working order. The first harvest, which was smaller than anticipated, did not begin until late February 1974. When the fish were ready for harvesting, the company did not have adequate facilities at the site to dress, package, freeze and ship the product to established markets. Therefore, excessive costs were incurred because the fish had to be air freighted to New York from Arkansas. This requirement diminished whatever advantages the company hoped to obtain through use of the silo systems.

Marine's indebtedness continued to increase and on January 20, 1976, the trustee for bondholders filed a complaint in Arkansas federal court asking that the court decree Marine in default on the bonds. The court appointed a receiver to take custody and control over Marine's only real asset -- the silo farm at Mammoth Spring, Arkansas.

Comparison of Disclosure

The disclosures of information contained in the bond prospectus differ significantly from and in some respects are inconsistent with the disclosures in the common stock prospectus. Risk factors and other Important information relating to the speculative nature of an investment in Marine that were included in the common stock prospectus are absent from the bond "offering prospectus" and that document contains considerable bullish promotional information that is inappropriate in a prospectus used to sell securities. A comparison of some of these matters follows:

(1) Fish Production -- The bond prospectus states that Marine "has developed one of the most important breakthroughs in fish production since the ancient Chinese" and that "Marine is able to produce over 3,000 times as many pounds of fish in the same surface area as a farmer can raise in a fish pond. "It also states that "A Marine Protein Silo Fish Farm is capable of producing 1,000,000 pounds of fish per surface area per year, even after deducting space for road and equipment."

In fact, these figures were mere estimates which were predicted by the company's scientists based on a pilot project, and were never the result of actual silo production. The common stock prospectus states that "Because of the variety of circumstances under which fish were grown, the Company is unable to state the length of time it takes fish to grow in their natural environment or to be farmed and harvested by conventional means."

(2) Advantages of the Silo System -- The bond prospectus states 11 advantages of Marine's silo system as compared to conventional systems. There is no mention of these advantages in the common stock

prospectus. The advantages cited include location, non-pollution, predator control, healthy fish, economy in feeding, fast growth, uniform fish sizes, year-round availability, harvesting economy, processing savings and brood stock and spawning.

In fact, Marine's own scientists did not regard these advantages to be particularly unique to the silo system. The same results were achieved by fish farmers using conventional raceway techniques.

(3) Fast Growth/Uniform Fish Sizes -- The bond offering prospectus emphasizes particularly the silo's advantage in achieving fast growth and uniform sizes in fish.

As stated under #1 above, scientists are unable to compare fish growth under natural and under artificial conditions with any degree of accuracy.

(4) Harvesting Economy/Processing Savings -- The bond prospectus states that Marine's larger harvests are economical because fish can be easily transferred to the "Marine processing plant "Also, it is stated that "Large production facilities make it economically feasible to locate processing plants adjacent to Marine Protein Silo Fish Farms."

In fact, the company never had the type of processing facilities alluded to in the bond prospectus although they had plans for the development. The common stock prospectus does state the company's intention to erect a processing plant in Mammoth Spring but also states with respect to "the commercial feasibility of its operations" that "it is not certain, however, that such processing plants will function according to plan."

(5) Fish Mortality -- The bond offering prospectus states that conventional fish rearing systems suffer from considerable mortality because of imposed environmental stresses and that Marine's silo system protects fish from their natural enemies and the stresses of intensive fish culture are reduced to a minimum.

In fact, early tests did not prove that the system could limit the environmental stresses. Moreover, the common stock prospectus specifically stated that Marine's fish are not immune from disease, and their main research facility had experienced losses of fish resulting from temperature changes and poor water quality.

(6) Silo Farm Location -- The bond prospectus boasted that the silo system was capable of being installed close to major markets thereby reducing excessive transportation costs.

In fact, the silo system, much like the traditional systems, still depended upon a sufficient supply of water of adequate quality which naturally limited the potential location to land areas where such water is available. As is stated in the common stock prospectus: "The water supply at any existing or future site must be of adequate quality and is always subject to the danger of drought and pollution."

CONCLUSION

The process by which industrial development revenue bonds are brought to the market place depends upon many persons, including the issuer, underwriter, fiscal agents, bond counsel, company executives and registered representatives. The antifraud provisions of the federal securities laws, while not imposing a structured form of disclosure as required for the offering of non-exempt securities pursuant to the Securities Act of 1933, do prohibit the deception of investors in connection with the offering of exempt securities. In preparing and disseminating the bond offering prospectus, the bond underwriter failed to include the material information referred to above, and Marine failed to accept or assume any responsibility to insure that information being disseminated by bond underwriters in connection with the bond offering was complete and not false and misleading.

Statement of Commissioner Karmel

Commissioner Karmel, dissenting

I object to the issuance of this staff report because, as more fully explained in my dissent In the Matter of Spartek, Inc., n1 and my separate statement to the Commission's recent announcement relating to reports of investigations, n2 I do not believe that publication based on Section 21(a) of the Securities Exchange Act of 1934 should be used as a sanction to dispose of investigated matters.

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n1 Securities Exchange Act Release No. 15567 (February 14, 1979).

n2 Securities Exchange Act Release No. 15664 (March 21, 1979).

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Injunctive Proceedings

Securities and Exchange Commission v. Lee F. Sutliffe, Civ. Action No. 95-0867-CV-W-BD (W.D. Mo.), Litigation Release No. 14658 (September 28, 1995) (complaint).

The Securities and Exchange Commission today announced the filing of a Complaint on September 27, 1995, in the United States District Court for the Western District of Missouri, in Kansas City, seeking an order of permanent injunction against Lee F. Sutliffe (Sutliffe). The Commission's Complaint alleges that Sutliffe, by participating in the preparation of false and misleading municipal bond offering circulars, violated the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Complaint alleges, among other things, that during the years 1984 through 1989, Sutliffe was the undisclosed promoter and control person of two not-for-profit corporations, First Humanics Corp. (First Humanics) and its successor, International Elderly Care, Inc. (IEC), which participated in 26 public offerings of municipal and corporate bonds raising over $107 million. The purpose of these offerings was to acquire, renovate and operate nursing homes.

The Complaint further alleges that, in connection with two such offerings, First Humanics' 1987 offering to acquire the Medicos Recovery Care Center nursing home in Detroit, Michigan (Medicos) and IEC's 1988 offering to acquire the Colonial Gardens Convalescent Center in Boonville, Missouri (Colonial Gardens), Sutliffe promoted the offerings and participated in the preparation of false and misleading offering circulars. Specifically, the Complaint alleges that the Medicos offering circular contained material misrepresentations and omissions concerning: Sutliffe's role as a promoter of the offering; Sutliffe's control over First Humanics as well as his regulatory history and numerous prior bond and business failures; the commingling of revenues from existing First Humanics nursing homes and the resulting financial interdependence of all First Humanics nursing homes; and First Humanics' ongoing ponzi scheme.

In addition, the Complaint alleges that the Colonial Gardens offering circular contained material misrepresentations and omissions concerning: Sutliffe's role in the offering and his control over IEC as well as his background; the nexus between IEC and First Humanics; and First Humanics' prior bond defaults.

Securities and Exchange Commission v. Lee F. Sutliffe, Litigation Release No. 14707 (November 1, 1995) (settled final order).

The Securities and Exchange Commission today announced that on October 27, 1995 the United States District Court for the Western District of Missouri, in Kansas City, entered an Order of Permanent Injunction (Order) against Lee F. Sutliffe (Sutliffe). The Order enjoins Sutliffe from future violations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Sutliffe consented to the entry of the Order without admitting or denying the allegations in the Commission's Complaint.

The Commission's Complaint, filed on September 27, 1995, alleged, among other things, that during the years 1984 through 1989, Sutliffe was the undisclosed promoter and control person of two not-for-profit corporations, First Humanics Corp. (First Humanics) and its successor, International Elderly Care, Inc. (IEC), which participated in 26 public offerings of municipal and corporate bonds raising over $107 million. The purpose of these offerings was to acquire, renovate and operate nursing homes.

The Complaint further alleged that, in connection with two such offerings, First Humanics' 1987 offering to acquire the Medicos Recovery Care Center nursing home in Detroit, Michigan (Medicos) and IEC's 1988 offering to acquire the Colonial Gardens Convalescent Center in Boonville, Missouri (Colonial Gardens), Sutliffe promoted the offerings and participated in the preparation of false and misleading offering circulars. Specifically, the Complaint alleged that the Medicos offering circular contained material misrepresentations and omissions concerning: Sutliffe's role as a promoter of the offering; Sutliffe's control over First Humanics as well as his regulatory history and numerous prior bond and business failures; the commingling of revenues from existing First Humanics nursing homes and the resulting financial interdependence of all First Humanics nursing homes; and First Humanics' ongoing ponzi scheme.

In addition, the Complaint alleged that the Colonial Gardens offering circular contained material misrepresentations and omissions concerning: Sutliffe's role in the offering and his control over IEC as well as his background; the nexus between IEC and First Humanics; and First Humanics' prior bond defaults.

<u>SEC v. Calhoun County Medical Facility, Inc., et al.</u>, Civ. Action No. WC-81-61 WK-P (N.D. Miss.), Litigation Release No. 9366 (June 1, 1981) (settled final order).

Jule B. Greene, Regional Administrator of the Commission's Atlanta Regional Office, announced the filing of a Complaint, alleging violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 against Calhoun County Medical Facility, Inc. ("the Issuer"), a Mississippi corporation; Bullington-Schas & Co., Inc. ("Bullington-Schas"), a Memphis, Tennessee broker-dealer; A. Dulaney Tipton ("Tipton") of Memphis, Tennessee, President of Bullington-Schas; Terry Allen Frost ("Frost") of Memphis, Tennessee, a registered representative associated with Bullington-Schas; and Jerald H. Sklar ("Sklar"), an attorney in Memphis, Tennessee.

The Commission's Complaint alleged that the Issuer offered and sold $1.8 million of its first mortgage revenue bonds to finance the acquisition of the Calhoun County Hospital in Calhoun County, Mississippi; that Bullington-Schas served as underwriter for the bond issue; that Tipton and Frost performed Bullington-Schas' underwriting duties and participated in the sale of the bonds; and that Sklar acted as bond counsel. The Complaint further alleges that annual financial statements concerning the past operations of the Hospital, which indicated an inability to defease the bond offering, were not included in the offering circular; rather, pro forma financials were included without discussion of the significantly divergent prior financial history.

The Commission's Complaint further alleged that defendants made untrue statements and omitted to state material facts concerning, among other things, the role, duties and responsibilities of counsel to the underwriter and bond counsel.

On May 28, 1981, the Honorable William C. Keady, Chief Judge of the United States District Court for the Northern District of Mississippi, entered final judgments permanently enjoining the defendants from further violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. The defendants consented to the relief without admitting or denying the allegations of the Commission's Complaint. Defendant Sklar was ordered also to comply with the undertakings contained in his Stipulation and Consent concerning procedures to be followed in connection with future bond issues.

For further information concerning (i) a related administrative proceeding involving Bullington-Schas, Tipton and Frost, see Securities Exchange Act Release No. 17832; and (ii) a Section 21(a) Report involving the role of underwriter's counsel, see Securities Exchange Act Release No. 17831.

SEC v. San Antonio Municipal Utility District No. 1, et al., Civ. Action No. H-77-1868 (S.D. Tex.), Litigation Release No. 8195 (November 18, 1977) (settled final order).

See "THE ISSUER" section.

SEC v. Astro Products of Kansas, Inc., et al., Civ. Action No. 76-359-LG (D. C. Kans.), Litigation Release No. 7557 (September 13, 1976) (complaint).

Richard M. Hewitt, Administrator of the Fort Worth Regional Office of the Securities and Exchange Commission, announced today the filing on August 31, 1976 of a civil injunctive complaint in federal district court at Wichita, Kansas naming 19 corporate and individual defendants. The complaint charged violation of the securities registration and antifraud provisions of the federal securities laws and the Trust Indenture Act in connection with the offer and sale of industrial development revenue bonds issued by Astro Products of Kansas, Inc., Haysville, Kansas, and the City of Haysville.

The defendants were charged with violations of the following provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939:

Astro Products of Kansas, Inc., Los Angeles, California -- antifraud; securities registration; trust indenture qualification.

Canter Line Tool Company, Inc., Los Angeles, California -- antifraud.

The Vern Hunt Co., Los Angeles, California -- antifraud.

The National Bank of Wichita, Wichita, Kansas -- antifraud.

Sima Walding Supply Co., Inc., Los Angeles, California -- antifraud.

Tower Brokerage, Inc., St. Petersburg, Florida -- antifraud.

Hugh Bell, St. Petersburg, Florida -- antifraud.

Bruce Bressman, Los Angeles, California -- antifraud.

Roman A. Dimeo, Los Angeles, California -- antifraud, securities registration; trust indenture qualifications.

Theodore F. Dubowik, Memphis, Tennessee -- antifraud.

George B. Flowers, Los Angeles, California -- antifraud.

Richard T. Heagy, Memphis, Tennessee -- antifraud.

Vern Hunt, Los Angeles, California -- antifraud.

Herbert M. Kohn, Kansas City, Missouri -- antifraud; securities registration; trust indenture qualification.

Stephen A. Lancaster, Memphis, Tennessee -- antifraud.

Ray W. Lipper, Los Angeles, California -- antifraud.

James J. Russ, Memphis, Tennessee -- antifraud; securities registration; trust indenture qualification.

Walter A. Sawhill, Wichita, Kansas -- antifraud; securities registration; trust indenture qualification.

M. Kelley Sims, Los Angeles, California -- antifraud.

The complaint charged the defendants with a scheme to violate the federal securities laws. The Commission alleged in the complaint that James J. Russ, Roman A. Dimeo and Walter A. Sawhill engaged in a scheme to promote an industrial development revenue project in Haysville, Kansas. The alleged scheme involved procuring the issuance by the City of Haysville of $2,200,000 industrial development revenue bonds of which the proceeds were to be used to acquire equipment for a plant to assemble vehicular wheel. As part of the alleged scheme, Russ misrepresented his background and the economic potential to Haysville of the proposed assembling plant and bond counsel, Herbert A. Kohn, by furnishing an opinion that the bonds were duty authorized made it possible for the issue to be marketed and issued and tax exempt.

Further, the complaint charged that following the issuance of the bonds, Russ, Dimeo and Sawhill arranged for the bonds to be sold to several underwriters, including Richard T. Heagy, Stephon A. Lancaster, Theodore F. Dubowik and Hugh Bell. The complaint further alleged that these underwriters than sold the bonds through misrepresentation to various broker-dealers, including Bruce Bressman, who ultimately sold the bonds to the public. In selling the bonds, the underwriters, relying ostensibly upon unverified information supplied by Russ, and without exercising due diligence, misrepresented;

(1) The security behind the investment;

(2) The financial condition of the corporate issuer;

(3) The use of the project's proceeds;

(4) The background of those involved in the project;

(5) The likelihood of success for the project;

(6) The lead time necessary for beginning operations; and

(7) The tax exempt status of the bonds; and omitted to state:

(1) The high risk nature of the investment;

(2) The diversion of the project's proceeds; and

(3) The lack of security available to the bondholders.

Approximately $400,000 of the issue was sold to public investors and approximately $1,800,000 was used as part of an alleged scheme to defraud the First Federal Savings and Loan, Utica, New York.

During and after the issuance of the bonds (which were issued in five increments between December 21, 1973 and May 6, 1974), Russ and Dimeo allegedly in a scheme to misappropriate proceeds of the issue, or approximately $1,700,000, with four of the project's equipment suppliers, Ray W. Lipper, Center Line Tool Company, Inc., M. Kelley Sims, Sims Walding Supply Company, Vern Hunt, Vern Hunt Company, and George Flowers. The complaint alleges that each of these suppliers had done business with defendant Russ prior to the Haysville project and that through the suppliers submission of false invoices, many of which were allegedly prepared by or at the direction of Russ, in excess of $800,000 of the proceeds were diverted through fraud from the project.

According to the complaint this fraud was made possible because Haysville and the National Bank of Wichita, the fiscal agent, violated express duties which they had agreed to perform for the protection of the bondholders. The complaint charged that these breaches of duty occurred, in part, because Kohn gave incorrect advice to officials of both Haysville and the fiscal agent concerning their duties. In addition to this alleged scheme involving the four suppliers and their companies, Russ allegedly submitted a number of purportedly false and forged invoices to the National Bank of Wichita for which he paid over $200,000.

The complaint states that the project never began operation. Over a year and a half after the last closing in May 1974, a committee of the bondholders assumed control over the project and liquidated it. The liquidation value of the bonds has been set at $.037 on the dollar. The bondholders' committee is now distributing the liquidated proceeds to the bondholders.

SEC v. Astro Products of Kansas, Inc., et al., Litigation Release No. 7774 (February 10, 1977) (settled final orders).

Richard M. Hewitt, Administrator of the Fort Worth Regional Office of the Securities and Exchange Commission, announced today that on January 19, 1977, Federal District Judge Frank G. Theis of Wichita, Kansas, granted the Commission's motion for preliminary injunction enjoining defendants Tower Brokerage, Inc.; Hugh Bell, both of St. Petersburg, Florida; Richard T. Heagy of Memphis, Tennessee; and Theodore DuBowik of Phoenix, Arizona, from future violations of the anti-fraud provisions of the federal securities laws. Judge Theis also granted the Commission's motion for preliminary injunction against Roman A. DiMeo of Santa Ana, California, enjoining him from future violations of the registration, anti-fraud, and trust indenture qualification provisions of the federal securities laws.

On January 18, 1977, Judge Theis issued a default order preliminary enjoining defendants Vern Hunt and the Vern Hunt Company, both of West Covina, California, from future violations of the anti-fraud provisions of the federal securities laws.

On November 29, 1976, defendants James J. Russ and Astro Products of Kansas, Inc., both of Memphis, Tennessee, consented, without admitting or denying the Commission's allegations, to the entry of a permanent injunction enjoining them from future violations of the registration, anti-fraud, and trust indenture qualification provisions of the federal securities laws. For further information, see Litigation Release No. 7557.

SEC v. Astro Products of Kansas, Inc., et al., Litigation Release No. 8613 (December 8, 1978) (defaults entered).

Michael J. Stewart, Administrator of the Fort Worth Regional Office, announced that on October 31, 1978, Federal District Judge Frank Theis, chief judge for the District of Kansas at Wichita, entered orders of permanent injunction by default against Theodore F. DuBowik, Phoenix, Arizona; Vern Hunt, and The Vern Hunt Company, both of Los Angeles, California. These orders enjoin the defendants from future

violations of the anti-fraud provisions of the securities laws. For further information, see Litigation Release No. 8574.

SEC v. The Senex Corporation, et al., Civ. Action No. 74-53 (E.D. Ky.), Litigation Release No. 6451 (July 24, 1974) (complaint).

The Securities and Exchange Commission today announced the filing of a complaint in the U.S. District Court for the Eastern District of Kentucky seeking a preliminary and permanent injunction against The Senex Corporation, a Delaware corporation; Arthur Jay Tarley, Wyoming, Ohio; Mentor Corporation, a Kentucky corporation; A.J. Jolly, Alexandria, Kentucky; Alison, Jay, Malcolm & Company (formerly known as Stemac Management Corporation), a Delaware corporation; BFT, Inc., an Ohio corporation; and Thomas N. Street, Jr., Memphis, Tennessee, from engaging in further violations of certain anti-fraud provisions of the federal securities laws [Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder] in connection with the offer and sale of certain municipal revenue bonds.

The Commission's complaint alleges that the defendants engaged in a fraudulent scheme pursuant to which they promoted with officials of the City of Covington, Kentucky, the concept of building in Covington a nursing home to house the indigent, the infirm and the elderly and that they induced the City of Covington, Kentucky, to authorize the issuance of $4,415,000 City of Covington Health Care Project Revenue Bonds to provide funds to finance the construction of the proposed nursing home.

The complaint alleges that the defendants caused a corporation controlled by certain of the defendants to be appointed to construct the facility for a contract price of approximately $2.9 million and subsequently entered into a contract with a local contractor to construct the same facility for approximately $2.3 million; that when a question arose as to the need for such a facility in the Covington area, the defendants convinced City officials of the need for and the feasibility of the project by withholding and/or endeavoring to discredit two contemporaneous studies which reflected adversely on the need for such a nursing home in the Covington area. In this connection, the complaint alleged that the defendants refused to make available to the Northern Kentucky Health and Welfare Planning Council a copy of an adverse feasibility report stating that the report was "the private domain of the underwriter" when in fact no such underwriter was in existence at that time; and that certain of the defendants stated that the best indication of the project's feasibility was that a sophisticated investment banker was willing and anxious to invest in excess of $4,000,000 in the project when in fact that statement was untrue, and the defendants had been unable to locate any independent securities dealer to underwrite the proposed bond issue.

The complaint alleges that as a further part of the scheme, the defendants caused a purportedly independent feasibility consultant to render a report bearing favorably on the feasibility of the project when in fact the feasibility consultant was not independent but was a promoter and a developer of the nursing home project who expected to share in the developer's profits; and further that the defendants caused a broker-dealer controlled by certain of the defendants to be appointed as financial adviser for the project and as underwriter of the bond issue.

The complaint further alleges that as a further part of the scheme, an offering prospectus was prepared and distributed to investors which failed to disclose, among others, the above material facts, and that the misleading prospectus was used by the defendants in securing an "A" rating for the bonds, which rating was used along with the prospectus to facilitate the sale of the bonds to other dealers and ultimately to individual investors.

SEC v. The Senex Corporation, et al., Litigation Release No. 6769 (March 5, 1975) (settled final orders.)

The Securities and Exchange Commission announced the entry on March 3, 1975, of an order of preliminary injunction in the U.S. District Court for the Eastern District of Kentucky against A.J. Jolly, Mentor Corp. and Thomas N. Street, Jr. enjoining them from engaging in further violations of certain of the antifraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with the offer, sale or purchase of City of Covington Health Care Project Revenue Bonds, Series 1972, or any other securities.

After an eleven day hearing on the Commission's motion for preliminary injunction, the Court in its opinion found that in connection with a new offering of municipal bonds issued to finance the construction of a health care facility in Covington, Kentucky, the defendants violated the antifraud provisions by, among other things, failing to disclose: (1) that the defendant Mentor Corporation which issued a consultant's report demonstrating the desirability of the proposed project would share in 50 percent of the developer's profit; (2) that there was a difference of opinion among experts concerning the need for the proposed project as evidenced by the existence of other feasibility reports bearing adversely on the proposed project; and (3) that the project's financial adviser and underwriter were owned and controlled by the developer.

The Court stated in its opinion that "Notwithstanding his biased position, Jolly prepared and permitted use of the Mentor report in the prospectus and as part of a 'package' designed to impress securities dealers" and that "At no time during the lengthy period involved in the promotion did the defendants make any effort to afford an accurate depiction of the experts' disagreements or the financial entanglement among involved entities."

Previously, Judgments of Permanent Injunction in this matter were entered by the U.S. District Court for the Eastern District of Kentucky against The Senex Corporation, Arthur Jay Tarley, Alison, Jay, Malcolm & Company formerly known as Stemac Management Corporation, and BFT, Inc., permanently enjoining them from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 in connection with the offer, sale or purchase of City of Covington Health Care Project Revenue Bonds, Series 1972 or any other securities. These defendants consented to the entry of permanent injunctions without admitting or denying the allegations of the Commission's complaint.

SEC v. The Senex Corporation, et al., Litigation Release No. 8651 (January 23, 1979) (settled final orders).

The Securities and Exchange Commission announced the entry on December 5, 1978, of a Judgment of Permanent Injunction upon consent in the United States District Court for the Eastern District of Kentucky against A J Jolly, and Mentor Corporation, enjoining them from engaging in further violations of certain of the anti-fraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with the offer, sale or purchase of CITY OF COVINGTON HEALTH CARE PROJECT REVENUE BONDS, SERIES 1972, or any other securities.

The Commission charged that in connection with a new offering of municipal bonds in 1972 issued to finance the construction of a health care facility in Covington, Kentucky, the defendants violated the anti-fraud provisions by, among other things, failing to disclose: (1) that the defendant Mentor Corporation which issued a consultant's report demonstrating the desirability of the proposed project would share in 50 percent of the developer's profit; (2) that there was a difference of opinion among experts concerning the need for the proposed project as evidenced by the existence of other feasibility reports bearing adversely on the proposed project; and (3) that the project's financial adviser and underwriter were owned and controlled by the developer.

Previously, Judgments of Permanent Injunction in this matter were entered by the United States District Court for the Eastern District of Kentucky against Thomas N. Street, The Senex Corporation, Arthur Jay Tarley, Alison, Jay Malcolm & Company formerly known as Stemac Management Corporation, and BFT, Inc., permanently enjoining them from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 in connection with the offer, sale or purchase of CITY OF COVINGTON HEALTH CARE PROJECT REVENUE BONDS, SERIES 1972 or any other securities. All defendants consented to the entry of permanent injunctions without admitting or denying the allegations of the Commission's complaint.

SEC v. The Senex Corporation, et al., 399 F. Supp. 497 (E.D. Ky. 1975).

See Federal Reporter.

Commission Orders - Settled Administrative Proceedings

In re Joseph LeGrotte, Securities Act Release No. 7200, Exchange Act Release No. 36036, A.P. File No. 3-8763 (July 31, 1995).

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings be instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 2lC of the Securities Exchange Act of 1934 ("Exchange Act") against Joseph LeGrotte ("LeGrotte").

In anticipation of the institution of these administrative proceedings, LeGrotte has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to jurisdiction, which is admitted, LeGrotte consents to the entry of this Order Instituting Proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Making Findings and Imposing a Cease and Desist Order.

Accordingly, it is ordered that proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act be, and hereby are, instituted.

II.

On the basis of this Order and the Offer of Settlement submitted by LeGrotte, the Commission makes the following findings:

ENTITY INVOLVED

A. First Humanics Corp. ("First Humanics" or "the company"), a not-for-profit corporation, was in the business of acquiring, renovating and operating nursing homes. From 1984 through 1989, First Humanics renovated and operated 21 nursing homes acquired through 21 separate offerings totalling approximately $82 million in publicly sold municipal and corporate bonds. On October 15, 1987, the Economic Development Corporation of the City of Detroit, Michigan, for the benefit of First Humanics, acquired the Medicos Recovery Care Center (Medicos) through the issuance of $6,955,000 in tax-exempt bonds. This was First Humanics' last offering.

RESPONDENT

B. LeGrotte was an officer and director of First Humanics from 1986 to 1988. LeGrotte reviewed and signed the Medicos offering circular, participated in earlier First Humanics offerings and bond closings and was involved in the operations of First Humanics.

BACKGROUND

C. In connection with each offering, First Humanics contracted to purchase a particular nursing home. To finance the purchase, the Company arranged for a municipality to issue tax free municipal bonds. However, the Company remained liable for all payments to bondholders. To finance the issuance costs on certain of the above offerings, the Company, in some instances, also issued a modest amount of corporate bonds in conjunction with the tax exempt bonds. Again, the Company was liable for all payments to bondholders.

D. Each prospective nursing home was initially located by Lee F. Sutliffe ("Sutliffe"), the undisclosed control person of First Humanics and the undisclosed promoter of' First Humanics' offerings. If Sutliffe decided the nursing home was acceptable for acquisition, the First Humanics Board of Directors then voted to acquire the facility. Sutliffe received an acquisition fee of between $100,000 and $300,000 in connection with each nursing home purchased by First Humanics.

E. Subsequent to the Board's approval, Sutliffe initiated the offering process, through which First Humanics obtained the funds necessary to purchase the nursing home. In connection therewith, Sutliffe assembled an offering "working group" which coordinated the offering process and was responsible for preparing the offering circulars. The activities of the First Humanics working group were largely directed by Sutliffe. In this manner, Sutliffe acted as the promoter of the offerings. LeGrotte also sometimes participated in working group meetings and reviewed offering materials prepared by the working group.

F. In connection with each offering, an offering circular was prepared. The offering circular typically contained sections describing First Humanics, the nursing home to be acquired, the bonds, sources and uses of bond proceeds, risk factors and, as appendices, a financial feasibility study and the Company's audited financial statements. The primary purpose of the offering circular was to provide the investing public with all material facts pertaining to the offering. LeGrotte reviewed offering circular drafts and executed numerous supporting documents which were used in connection with the drafting of the offering circular. In some instances, LeGrotte also signed the offering circulars on behalf of First Humanics. Thus, he participated in the preparation of the offering circulars.

G. Upon completion of the offering process, Sutliffe coordinated the bond closings. In connection therewith, Sutliffe prepared closing documents and directed the wiring and disbursement of bond proceeds from which were paid most of the issuance costs. At each bond closing, the municipal issuer sold the bonds to an underwriter who, in turn, resold them to the investing public through various retail broker dealers. Upon receiving the bond proceeds from the underwriter, the municipal issuer either lent such proceeds to First Humanics so that the Company could purchase the nursing home, or the issuer purchased the nursing home and leased it back to the Company. A certain amount of bond proceeds were also set aside as working capital for the benefit of First Humanics.

H. Immediately after closing, First Humanics assumed the municipal issuer's repayment obligation to the bondholders. Thereafter, the Company was required to make monthly bond payments to the indenture trustee sufficient for the trustee to meet semi-annual interest payments to the bondholders. At all times, effective control of the nursing homes remained with First Humanics. Pursuant to various bond and trust indentures, the Company was also required to allocate a certain amount of the offerings proceeds to a debt service reserve fund. The debt service reserve fund was used to offset any insufficiencies in funds available for the semi-annual interest payments to bondholders. However, the Company was required to pay back any monies withdrawn from this account.

I. Prior to promoting the First Humanics offerings, Sutliffe was involved in the promotion of numerous other bond issues. Most of these earlier offerings, however, had experienced financial problems and some eventually defaulted prior to the Medicos offering. Furthermore. in March 1985, the State of Missouri found that Sutliffe had participated in the making of false filings, and issued a cease and desist order against him. LeGrotte was aware of Sutliffe's business and regulatory history.

J. In addition to Sutliffe's promoting activities, he also controlled First Humanics. The First Humanics officers and Board of Directors, including LeGrotte, allowed Sutliffe to dictate virtually all significant First Humanics' decisions. Sutliffe even served on various First Humanics sub-committees, including a management sub-committee. As such, Sutliffe determined which nursing homes First Humanics would acquire and was involved in the day-to-day operations of the nursing homes. Sutliffe's control was openly displayed at Board of Directors meetings and reflected in the pertinent minutes and in First Humanics internal memoranda and correspondence. Thus, although LeGrotte was an officer and director of First Humanics and was actively involved in the management of the Company, he followed the directions of Sutliffe.

K. Revenues from First Humanics' nursing homes were generally paid directly to the company and, from 1984 on, First Humanics freely and openly commingled all such revenues in a central bank account located in
Dixon, Illinois (Dixon account). First Humanics then used the revenues from any one nursing home to pay the expenses of other homes, as the need arose. When a nursing home's revenues were insufficient to meet a bond payment[1] money was simply taken from available funds in the Dixon account, whatever the source. Each nursing home's expenses were paid according to the urgency of the bill and not limited by the amount of
revenue generated by the particular nursing home. From 1986 onward, however, most of the nursing homes failed to generate an amount of revenues sufficient to meet their own expenses. As a result, commingling
became essential to the operation and survival of First Humanics. The success or failure of any one nursing home was thereby dependent upon the success or failure of all the other nursing homes. Therefore, each municipal offering was, in fact, a de facto investment into First Humanics and its existing nursing homes. LeGrotte was, in fact, aware that the use of one nursing home's revenues to pay anothers expenses was essential to the operation of First Humanics. Thus, LeGrotte acknowledged that a problem in any one nursing home would have an effect on the other nursing homes.

L. In addition, the vast majority of First Humanics' nursing homes were located in Illinois and heavily dependent on Illinois' Medicaid reimbursements, which were often insufficient and continually late. Given the nursing homes interdependence, as the result of the commingling discussed above, such late and insufficient payments affected all nursing homes, even those located outside of Illinois. Thus, largely because of the medicaid problems in late 1985 First Humanics became late in its required monthly bond payments to the indenture trustees for certain bond issues. Therefore, First Humanics began using the funds from some of these delinquent nursing homes' debt service reserve accounts to offset the insufficiencies. Although First Humanics was required to pay back monies withdrawn from such accounts, these payments were often late and insufficient. LeGrotte was aware of both the Medicaid problems and the late and insufficient payments to the debt service reserve funds.

M. As a result of First Humanics' cash flow shortages, First Humanics also became reliant on the working capital generated from new bond offerings as a source of funds for current operations. Additionally, a procedure was developed whereby Sutliffe "kicked-back" a portion of his acquisition fee to First Humanics at or shortly after, each bond closing. Thus, the success of existing nursing homes and the payments to existing bondholders became largely dependent on First Humanics' ability to obtain funds from future offerings. In this manner, First Humanics operated a Ponzi scheme in which LeGrotte participated.

N. Nonetheless, First Humanics continued to be late in its monthly bond payments to the trustees. As a result, First Humanics also continued to deplete certain bond issues' debt service reserve funds. In August

1986, one of the trustees, in fact, informed First Humanics that based on its continued failure to repay these funds it was in violation of four of its bond indentures and, therefore, in technical default. First Humanics experienced a $912,946 loss before depreciation for its fiscal year ended November 30, 1986, even including Sutliffe's kickbacks. Furthermore, none of the nursing homes had met their cash flow projections as stated in their offering circulars. In December 1986, one of the trustees again informed First Humanics that it was in technical default on two of its municipal bonds. However, Sutliffe caused six new bond issues to close on December 18, 1986. As a result, and in connection with the First Humanics Ponzi scheme, additional working capital was 7 generated and, undisclosed to investors, $500,000 of Sutliffe's acquisition fee was kicked-back to First Humanics. These funds were immediately applied to cure First Humanics' monthly bond payment deficits and to pay its pact due bills. Nonetheless, First Humanics' cash flow problems continued.

MEDICOS OFFERING

O. Despite First Humanics' financial problems, in 1987 Sutliffe directed First Humanics to acquire Medicos. Connection therewith, Sutliffe arranged to have the City of Detroit issue $6,955,000 in tax-exempt bonds. Sutliffe directed LeGrotte and other First Humanics board members to issue $530,000 in taxable bonds to cover the issuance expenses; series of bonds were issued pursuant to one offering circular.

P. Sutliffe, acting as the promoter, then began the offering process by assembling the working group which provided the Medicos offering circular. LeGrotte attended these group meetings. Again, Sutliffe largely directed the women group's activities as the undisclosed promoter for Medicos. Although LeGrotte was not primarily responsible for drafting Medicos offering circular, he assisted with its preparation. Furthermore, LeGrotte signed the offering circular on behalf of First Humanics.

Q. Upon completion of the offering process, Sutliffe coordinated the Medicos bond closing. The Medicos offering closed on October 15, 1987 and the municipal and corporate bonds were sold to the public through underwriters and various broker-dealers. Upon receiving the proceeds from the underwriters, municipal
issuer purchased Medicos and thereafter leased the facility back to First Humanics. At closing, LeGrotte signed pertinent acquisition and closing documents. In addition, LeGrotte signed certifications stating that the Medicos offering circular did not misrepresent or omit to state any material facts. Finally, Sutliffe kicked-back approximately $200.00 of his Medicos acquisition fee to First Humanics as part of Humanics' ongoing Ponzi scheme.

R. The Medicos offering circular omitted to disclose numerous material facts. For instance, the Medicos offering circular failed to adequately disclose Sutliffe's promotion of the Medicos offering, his control over First Humanics, his bond failures and his past securities law sanctions. Additionally, the Medicos offering circular portrayed Medicos as a "stand alone" nursing home. Thus, the Medicos offering was simply presented as an investment into Medicos. In connection therewith, the offering circular stated that the bondholders’ ability to receive interest and principal payments was dependent on the revenues derived from the operation of Medicos, not First Humanics' other nursing homes. As a result, nothing adequately describing the commingling of nursing home revenues or resulting financial interdependence among First Humanics' homes was disclosed. Thus, Medicos bondholders were also not informed that Medicos revenues would be used to pay Humanics existing nursing homes’ expenses. Consequently, bondholders were not informed that, in fact, their investments constituted de facto investments into First Humanics and its existing nursing homes and not merely Medicos.

S. Similarly, the serious Illinois Medicaid problem which at the time was adversely affecting all First Humanics' nursing homes was not disclosed. Thus, Medicos bondholders were not informed that, given the

nursing homes' financial interdependence, their future bond payments were largely dependent on First Humanics' ability to secure the late Medicaid payments from the State of Illinois. The offering circular also
failed to disclose both the August and December 1986 defaults which related directly to First Humanics' ability to pay bondholders.

T. Finally, neither Sutliffe's $200,000 kick-back nor first Humanics' dependence on the capital generated from future offerings to finance its existing nursing homes, as part of its ongoing ponzi scheme, were disclosed. Thus, Medicos bondholders were not informed that their ability to receive payments was also dependent on First Humanics' ability to secure funds from, future offerings.

U. Through LeGrotte's role as an officer and director and his participation in the Medicos offering process LeGrotte was aware of the above material facts. In addition, through his participation in the drafting of the
Medicos offering circular LeGrotte knew or should have known that the Medicos offering circular omitted these facts. However, despite this knowledge, LeGrotte actively encouraged the sale of the Medicos bonds to
the public by voting to approve the acquisition, signing the offering circular, signing pertinent bond closing documents and certifying that the offering circular contained no material misrepresentations or omissions.

V. Respondent LeGrotte caused violations of Section 17(a) of the Securities Act in that he, in the offer or sale
of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O. above, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, caused the: employing of devices, schemes or artifices to defraud; obtaining of money or property by means of untrue statements of material facts or omissions 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; or engaging in transactions, practices or courses of business which operated as a fraud or deceit upon purchasers or prospective purchasers. As part of the aforesaid conduct, Respondent caused misrepresentations and omissions of material fact to be made to purchasers and prospective purchasers regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting
financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and First Humanics' on-going ponzi scheme.

W. Respondent LeGrotte caused violations of Section 10(b) of the Exchange Act and, Rule 10b-5 promulgated thereunder in that he, in connection with the purchase or sale of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O above. by use of the means or instrumentalities of interstate commerce or by the use of the mails. directly or indirectly, caused the: employing of devices, schemes or artifices to defraud; making of untrue statements of material facts or omissions 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 or engaging in acts, practices or courses of business which operated as a fraud or deceit. As part of the aforesaid conduct. Respondent caused misrepresentations and omissions of material fact to be made to purchasers and sellers concerning, among other things, Sutliffe's role in promoting the offering. his control over First Humanics as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and, First Humanics' on-going ponzi scheme.

III.

In view of the foregoing, it is in the public interest to impose the sanctions agreed to in the Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED THAT, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Joseph LeGrotte cease and desist from committing or causing any violation, and committing or causing any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10-b promulgated thereunder.

In re Sidney Gould, Securities Act Release No. 7201, Exchange Act Release No. 36037, A.P. File No. 3-8764 (July 31, 1995).

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings be instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Sidney Gould ("Gould").

In anticipation of the institution of these administrative proceedings, Gould has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to jurisdiction, which is admitted, Gould consents to the entry of this Order Instituting Proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Making Findings and Imposing a Cease and Desist Order.

Accordingly, it is ordered that proceedings pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act be, and hereby are, instituted.

II.

On the basis of this Order and the Offer of Settlement submitted by Gould, the Commission makes the following findings: n1

ENTITY INVOLVED

A. First Humanics Corp. ("First Humanics" or "the company"), a not-for-profit corporation, was in the business of acquiring, renovating and operating nursing homes. From 1984 through 1989, First Humanics renovated and operated 21 nursing homes acquired through 21 separate offerings totalling approximately $82 million in publicly sold municipal and corporate bonds. On October 15, 1987, the Economic Development Corporation of the City of Detroit, Michigan, for the benefit of First Humanics, acquired the Medicos Recovery Care Center (Medicos) through the issuance of $6,955,000 in tax-exempt bonds. This was First Humanics' last offering.

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n1 The findings herein are made pursuant to Gould's offer of settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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RESPONDENT

B. Gould was an officer and director of First Humanics from 1986 to 1989. Gould reviewed the Medicos offering circular, participated in earlier First Humanics offerings and bond closings and was involved in the operations of First Humanics.

BACKGROUND

C. In connection with each offering, First Humanics contracted to purchase a particular nursing home. To finance the purchase, the Company arranged for a municipality to issue tax-free municipal bonds. However, the Company remained liable for all payments to bondholders. To finance the issuance costs on certain of the above offerings, the Company, in some instances, also issued a modest amount of corporate bonds in conjunction with the tax-exempt bonds. Again, the Company was liable for all payments to bondholders.

D. Each prospective nursing home was initially located by Lee F. Sutliffe ("Sutliffe"), the undisclosed control person of First Humanics and the undisclosed promoter of First Humanics' offerings. If Sutliffe decided the nursing home was acceptable for acquisition, the First Humanics Board of Directors then voted to acquire the facility. Sutliffe received an acquisition fee of between $100,000 and $300,000 in connection with each nursing home purchased by First Humanics.

E. Subsequent to the Board's approval, Sutliffe initiated the offering process, through which First Humanics obtained the funds necessary to purchase the nursing home. In connection therewith, Sutliffe assembled an offering "working group" which coordinated the offering process and was responsible for preparing the offering circulars. The activities of the First Humanics working group were largely directed by Sutliffe. In this manner, Sutliffe acted as the promoter of the offerings. Gould sometimes participated in working group meetings and also reviewed offering materials prepared by the working group.

F. In connection with each offering, an offering circular was prepared. The offering circular typically contained sections describing First Humanics, the nursing home to be acquired, the bonds, sources and uses of bond proceeds, risk factors and, as appendices, a financial feasibility study and the Company's audited financial statements. The primary purpose of the offering circular was to provide the investing public with all material facts pertaining to the offering. Gould reviewed offering circular drafts, commented on certain drafts, and executed numerous supporting documents which were used in connection with the drafting of the offering circular. Thus, he was involved in the process of preparing offering circulars.

G. Upon completion of the offering process, Sutliffe coordinated the bond closings. At each bond closing, the municipal issuer sold the bonds to an underwriter who, in turn, re-sold them to the investing public through various retail broker-dealers. Upon receiving the bond proceeds from the underwriter, the municipal issuer either lent such proceeds to First Humanics so that the Company could purchase the nursing home and leased it back to the Company. A certain amount of bond proceeds were also set aside as working capital for the benefit of First Humanics.

H. Immediately after closing, First Humanics assumed the municipal issuer's repayment obligation to the bondholders. Thereafter, the Company was required to make monthly bond payments to the indenture trustee sufficient for the trustee to meet semi-annual interest payments to the bondholders. At all times, effective control of the nursing homes remained with First Humanics. In addition, pursuant to various bond and trust indentures, the Company was required to allocate a certain amount of each offering's proceeds to a debt service reserve fund. The debt service reserve fund was used to offset any insufficiencies in funds available for the semi-annual interest payments to bondholders. However, the Company was required to pay back any monies withdrawn from this account.

I. Prior to promoting the First Humanics offerings, Sutliffe was involved in the promotion of numerous other bond issues. Most of these earlier offerings, however, had experienced financial problems and some eventually defaulted prior to the Medicos offering. Furthermore, in March 1985, the State of Missouri found that Sutliffe had participated in the making of false filings, and issued a cease and desist order against him. Gould was aware of Sutliffe's business and regulatory history.

J. In addition to Sutliffe's promoting activities, he also controlled First Humanics. The First Humanics officers and Board of Directors, including Gould, allowed Sutliffe to dictate virtually all significant First

Humanics' decisions. Sutliffe even served on various First Humanics' Board sub-committees, including a management sub-committee. As such, Sutliffe determined which nursing homes First Humanics would acquire and was involved in the day-to-day operations of the nursing homes. Sutliffe's control was openly displayed at Board of Directors meetings and reflected in the pertinent minutes and in First Humanics internal memoranda and correspondence. Thus, although Gould was an officer and director of First Humanics and was involved in the management of the Company, he followed the directions of Sutliffe.

K. Revenues from First Humanics' nursing homes were generally paid directly to the company and, from 1984 on, First Humanics freely and openly commingled all such revenues in a central bank account located in Dixon, Illinois (Dixon account). First Humanics then used the revenues from any one nursing home to pay the expenses of other nursing homes, as the need arose. When a nursing home's revenues were insufficient to meet a bond payment, money was simply taken from available funds in the Dixon account, whatever the source. Thus, each nursing home's expenses were paid according to the urgency of the bill and not limited by the amount of revenue generated by the particular nursing home. From 1986 on, however, most of the nursing homes failed to generate an amount of revenues sufficient to meet their own expenses. As a result, commingling became essential to the operation and survival of First Humanics. The success or failure of any one nursing home was thereby dependent upon the success or failure of all the other nursing homes. Therefore, each municipal offering was, in fact, a de facto investment into First Humanics and its existing nursing homes. Gould was, in fact, aware that the use of one nursing home's revenues to pay another's expenses was essential to the operation of First Humanics.

L. In addition, the vast majority of First Humanics' nursing homes were located in Illinois and heavily dependent on Illinois' Medicaid reimbursements, which were often insufficient and continually late. Given the nursing homes interdependence, as the result of the commingling discussed above, such late and insufficient payments affected all nursing homes, even those located outside of Illinois. Thus, largely because of the Medicaid problems, in late 1985 First Humanics became late in its required monthly bond payments to the indenture trustees for certain bond issues. Therefore, First Humanics began using the funds from some of these delinquent nursing homes' debt service reserve accounts to offset the insufficiencies. Although First Humanics was required to pay back monies withdrawn from such accounts, these payments were often late and insufficient. Gould was aware of both the Medicaid problems and the late and insufficient payments to the debt service reserve funds.

M. As a result of First Humanics' cash flow shortages, First Humanics also became reliant on the working capital generated from new bond offerings as a source of funds for current operations. Additionally, a procedure was developed, of which Gould was aware, whereby Sutliffe "kicked-back" a portion of his acquisition fee to First Humanics at, or shortly after, each bond closing. Thus, the success of existing nursing homes and the payments to existing bondholders became largely dependent on First Humanics' ability to obtain funds from future offerings. In this manner, First Humanics operated a Ponzi scheme in which Gould participated.

N. Nonetheless, First Humanics continued to be late in its monthly bond payments to the trustees. As a result, First Humanics also continued to deplete certain bond issues' debt service reserve funds. In August 1986, one of the trustees, in fact, informed First Humanics that based on its continued failure to repay these funds it was in violation of four of its bond indentures and, therefore, in technical default. First Humanics experienced a $912,946 loss before depreciation for its fiscal year ended November 30, 1986, even including Sutliffe's kick-backs. Furthermore, none of the nursing homes had met their cash flow projections as stated in their offering circulars. In December 1986, one of the trustees again informed First Humanics that it was in technical default on two of its municipal bonds. However, Sutliffe caused six new bond issues to close on December 18, 1986. As a result, and in connection with the First Humanics Ponzi scheme, additional working capital was generated and, undisclosed to investors, $500,000 of Sutliffe's acquisition fee was kicked-back to First Humanics. These funds were immediately applied to cure First Humanics' monthly bond payment deficits and to pay its past due bills. Nonetheless, First Humanics' cash flow problems continued.

MEDICOS OFFERING

O. Despite First Humanics' financial problems, in early 1987 Sutliffe directed First Humanics to acquire Medicos. In connection therewith, Sutliffe arranged to have the City of Detroit issue $6,955,000 in tax-exempt bonds. Sutliffe also directed Gould and other First Humanics board members to issue $530,000 in taxable bonds to cover the issuance expenses. Both series of bonds were issued pursuant to one offering circular.

P. Sutliffe, acting as the promoter, then began the offering process by assembling the working group which prepared the Medicos offering circular. Again, Sutliffe largely directed the working group's activities as the undisclosed promoter for Medicos. Gould reviewed the Medicos offering circular and the related offering documents. Although Gould was not primarily responsible for drafting the Medicos offering circular, as an officer he was involved in its preparation.

Q. Upon completion of the offering process, Sutliffe then coordinated the Medicos bond closing. The Medicos offering closed on October 15, 1987 and the municipal and corporate bonds were sold to the public through underwriters and various broker-dealers. Upon receiving the proceeds from the underwriters, the municipal issuer purchased Medicos and thereafter leased the facility back to First Humanics. At closing, Gould, signed pertinent acquisition and closing documents necessary for the offering to close. In addition, Gould signed certifications stating that the Medicos offering circular did not misrepresent or omit to state any material facts. Finally, Sutliffe kicked-back approximately $200,000 of his Medicos acquisition fee to First Humanics as part of First Humanics' ongoing Ponzi scheme.

R. However, the Medicos offering circular omitted to disclose numerous material facts. For instance, the Medicos offering circular failed to adequately disclose Sutliffe's promotion of the Medicos offering, his control over First Humanics, his prior bond failures and his past securities law sanction. Additionally, the Medicos offering circular portrayed Medicos as a "stand alone" nursing home. Thus, the Medicos offering was simply presented as an investment into Medicos. In connection therewith, the offering circular stated that the bondholders' ability to receive interest and principal payments was dependent on the revenues derived from the operation of Medicos, not First Humanics' other nursing homes. As a result, nothing adequately describing the commingling of nursing home revenues or the resulting financial interdependence among First Humanics' nursing homes was disclosed. Thus, Medicos bondholders were also not informed that Medicos revenues would be used to pay First Humanics existing nursing homes' expenses. Consequently, bondholders were not informed that, in fact, their investments constituted de facto investments into First Humanics and its existing nursing homes and not merely Medicos.

S. Similarly, the serious Illinois Medicaid problem which at the time was adversely affecting all First Humanics' nursing homes was not disclosed. Thus, Medicos bondholders were not informed that, given the nursing homes' financial interdependence, their future bond payments were largely dependent on First Humanics' ability to secure the late Medicaid payments from the State of Illinois. The offering circular also failed to disclose both the August and December 1986 defaults which related directly to First Humanics' ability to pay bondholders.

T. Finally, neither Sutliffe's $200,000 kick-back nor First Humanics' dependence on the capital generated from future offerings to finance its existing nursing homes, as part of its ongoing ponzi scheme, were disclosed. Thus, Medicos bondholders were not informed that their ability to receive payments was also dependent on First Humanics' ability to secure funds from future offerings.

U. Through Gould's role as an officer and director and his participation in the Medicos offering process Gould was aware of the above material facts. In addition, through his participation in the Medicos offering process, Gould knew or should have known that the Medicos offering circular omitted these facts. However, despite this knowledge, Gould actively encouraged the sale of the Medicos bonds to the public by voting to approve the acquisition, signing pertinent bond closing documents and certifying that the offering circular contained no misrepresentations or omissions of material fact.

V. Respondent Gould caused violations of Section 17(a) of the Securities Act in that he, in the offer or sale of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O. above, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, caused the employing of devices, schemes or artifices to defraud; obtaining of money or property by means of untrue statements of material facts or omissions 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; or engaging in transactions, practices or courses of business which operated as a fraud or deceit upon purchasers or prospective purchasers. As part of the aforesaid conduct, Respondent caused misrepresentations and omissions of material fact to be made to purchasers and prospective purchasers concerning, among other things, Sutliffe's role in promoting the offering, his control over First Humanics as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and, First Humanics' on-going ponzi scheme.

W. Respondent Gould caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that he, in connection with the purchase or sale of certain securities, namely Medicos municipal bonds and First Humanics corporate bonds described in paragraphs II. A. and O. above, by use of the means or instrumentalities of interstate commerce or by the use of the mails, directly or indirectly, caused the: employing of devices, schemes or artifices to defraud; making of untrue statements of material facts or omissions 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; or engaging in acts, practices or courses of business which operated as a fraud or deceit. As part of the aforesaid conduct, Respondent caused misrepresentations and omissions of material fact to be made to purchasers and sellers concerning, among other things, Sutliffe's role in promoting the offering, his control over First Humanics as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; and, First Humanics' on-going ponzi scheme.

III.

In view of the foregoing, it is in the public interest to impose the sanctions agreed to in the Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED THAT, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Sidney Gould cease and desist from committing or causing any violation, and committing or causing any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

THE UNDERWRITER

Report under Section 21(a) of the Exchange Act

SEC, Staff Report on Transactions in the Marine Protein Corporation Industrial Development Revenue Bonds, Exchange Act Release No. 15719 (April 11, 1979).

See "OBLIGATED PERSONS" section.

Injunctive Proceedings

<u>Securities and Exchange Commission v. William C. Bethea</u>, Civ. Action No. 3:98CV-457-LAC-MD (N.D. Fl.), Litigation Release No. 15985 (November 23, 1998) (settled final order).

The Securities and Exchange Commission today filed and settled a pay-to-play case against William C. Bethea, the former head of Stephens Inc.'s Public Finance Department, for giving secret payments to certain Florida public officials in exchange for municipal securities business.

The Complaint, filed in the Northern District of Florida, alleges the following: While serving as head of the Public Finance Department of Stephens, Bethea authorized secret payments to one Florida public official (Terry Busbee of the Escambia County Utilities Authority) and facilitated the secret compensation of another (Larry O'Dell of Osceola County), for the purpose of obtaining or retaining municipal securities business for Stephens. Bethea's failure to disclose the arrangements, the payments, and the actual and potential conflicts of interest they created, violated the antifraud provisions as well as fair dealing and gratuities rules of the Municipal Securities Rulemaking Board. Bethea also defrauded the issuer and purchasers of a 1992 Walton County, Florida bond issue by failing to disclose-in the face of a duty to do so-Stephens' compensation of a consultant and an employee of another underwriting firm, in violation of the same provisions. In addition, Bethea: endorsed the conferral of an undisclosed favor upon a third Florida public official; enlisted third parties to serve as conduits for campaign contributions; and created false and misleading books and records at Stephens to cover up the illicit payments, in further violation of fair-dealing rules.

Simultaneous with the filing of the Complaint, and without admitting or denying the allegations contained in the Complaint, Bethea agreed to the entry of a final judgment of permanent injunction barring future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and MSRB rules G-17 and G-20; and ordering him to pay a civil penalty of $30,000. As part of his settlement with the Commission, Bethea has agreed to the entry of a Commission order barring him from the securities business.

The Commission's Complaint against Bethea includes certain conduct alleged in the civil actions styled Securities and Exchange Commission v. Preston C. Bynum and Terry D. Busbee, Civil Action No. 95-30024-RV (N.D. Fla.); Lit. Rel. No. 14387/January 23, 1995; and Securities and Exchange Commission v. Larry K. O'Dell, Civil Action No. 98-948-Civ-Orl-18A (M.D. Fla.); Lit. Rel. No. 15858/August 24, 1998; and in the administrative proceeding styled, In the Matter of Stephens Inc., Exchange Act Rel. No. 40699/Nov. 23, 1998.

Also today, the United States Attorney for the Northern District of Florida ("USAO") announced a civil settlement with Stephens, and the Commission instituted and settled an administrative proceeding against Stephens. Both the USAO's civil settlement, and the Commission's administrative settlement, are based on some of the same conduct alleged in the Commission's Complaint against Bethea. As part of the USAO's civil settlement, Stephens has agreed to forfeit to the Department of Justice $2.25 million in revenues of its Public Finance Department, to make payments to three Florida issuers in the aggregate amount of $886,672.16, to refrain from conducting municipal securities business in Florida for five years; and to refrain indefinitely and throughout the United States from utilizing consultants within the meaning of MSRB rule G-38. The Commission's pay-to play investigation in the Southeastern United States continues.

<u>Securities and Exchange Commission v. First California Capital Markets Group, Inc., H. Michael Richardson and Derrick Dumont</u>, Civ. No. 97-2761-SI (N.D. Cal.), Litigation Release No. 15423 (July 28, 1997) (complaint).

The Securities and Exchange Commission today sued a securities brokerage and two of its executives for defrauding investors who bought $69 million worth of municipal bonds in five municipal bond offerings in California. The Commission's Complaint alleges that Defendants lied to investors and omitted to tell them important information in the offering materials for each bond offering about the risks connected with the bonds.

The Commission filed its lawsuit against First California Capital Markets Group, Inc. ("First California"), a broker-dealer formerly headquartered in San Francisco (now located in San Diego), H. Michael Richardson, a principal of the firm who lives in the Bay Area, and Derrick Dumont, the former manager of the firm's land-based financing department who now lives in Calistoga. The Complaint was filed in the United States District Court for the Northern District of California.

The Complaint alleges that the fraud was committed in connection with the Defendants' underwriting of municipal bonds issued by the County of Nevada ("Nevada County"), the City of Ione ("Ione"), the Avenal Public Financing Authority ("Avenal"), and the Wasco Public Financing Authority ("Wasco"), all located in Central California.

The six-count Complaint asks the court to enjoin permanently the Defendants from violating the law, order them to return all ill-gotten gains plus interest, and impose civil penalties.

Nevada County raised $9 million, and Ione in two offerings raised a total of $14 million, through the sale of "Mello-Roos" municipal bonds. Such bonds are issued to finance real estate development. The Complaint alleges that in the Official Statement for the Nevada County offering, the Defendants overstated the value of the property, misrepresented the developer's ownership interest in the property and overstated the developer's experience and financial condition. The Complaint alleges that in the Official Statement for the Ione offerings, the Defendants misrepresented that all of the listed improvements could be built with the offerings proceeds, overstated the value of the property to be developed, and failed to disclose that the developer had insufficient capital to complete the development. These misrepresentations and omissions were important to investors because they made the projects and the bonds seem less risky than they actually were.

The Avenal and Wasco offerings, which raised $11 million and $35 million respectively, involved the sale of "Marks-Roos" municipal bonds. Such bonds are issued to form pools of money to finance a number of local projects. The Complaint alleges that First California and Richardson lied to investors or omitted to tell them important information in the Official Statements for these offerings about the need for the amount of money raised and the certainty of the intended use of the proceeds. The Complaint alleges that the Defendants failed to disclose that some of the projects listed in the Avenal Official Statement and nearly all of the projects in the Wasco Official Statement were highly contingent, if not speculative. These misrepresentations were important to investors because they falsely created the impression that the pools were fully subscribed. When a bond issue is not fully subscribed, investors could be exposed to the risk that the bonds would not be able to pay principal and interest.

All of this conduct violated the antifraud provisions of the federal securities laws, including Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 issued thereunder. Defendants also violated Section 1B(c)(1) of the Exchange Act and Rule G-17 of the Municipal Securities Rulemaking Board ("MSRB"), which require a municipal securities broker to deal fairly with its customers.

The Complaint further alleges that First California and Richardson, when underwriting the Nevada County and Ione offerings, advised Wasco and Avenal to buy large blocks of the Nevada County and Ione bonds, even though they knew that these bonds did not meet certain requirements for Wasco and Avenal which investors had been told would be followed. In addition, First California and Richardson--aware of a representation to Wasco investors that proceeds not invested within a three-year period would be returned to bondholders--advised Wasco to purchase several low quality securities (for one of which First

California acted as the underwriter) after the close of the three-year period. All this conduct violated Section 15B(c)(1) of the Exchange Act and MSRB Rule G-19, which require municipal securities brokers to recommend only suitable investments to its clients.

Finally, the Complaint alleges that in February 1994, when Nevada County offered to redeem roughly half of its bonds with its remaining proceeds, First California and Richardson recommended to Wasco and Avenal that they not tender their bonds. This advice allowed First California's other clients holding Nevada County bonds to redeem at par while leaving Wasco and Avenal holding Nevada County's troubled bonds. This conduct violated Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17.

<u>Securities and Exchange Commission v. First California Capital Markets Group, Inc., H. Michael Richardson and Derrick Dumont</u>, Litigation Release No. 16107 (April 7, 1999) (settled final orders).

The Securities and Exchange Commission ("Commission") announced today that the Honorable Charles R. Breyer of the U.S. District Court, Northern District of California, entered judgment by consent against the San Francisco underwriting firm First California Capital Markets Group, Inc. ("First California"), now known as Badger Technologies, Inc., and bankers, H. Michael Richardson ("Richardson"), formerly of Lafayette, California, and Derrick P. Dumont ("Dumont") of Calistoga, California. The Court order permanently enjoins and restrains First California, Richardson and Dumont from violating or committing future violations of the anti-fraud provisions of the federal securities laws and Municipal Securities Rulemaking Board rules requiring fair dealing with investors. Richardson and First California agreed to jointly pay $600,000 in disgorgement and prejudgment interest, and civil penalties totaling $100,000.

In addition, Richardson and Dumont have consented to the entry of administrative orders by the Commission barring them from association with any broker, dealer, investment adviser, investment company or municipal securities dealer, with the right to reapply for registration in three years and two years, respectively. The Commission did not seek to deregister First California because First California had withdrawn its registration as a broker-dealer in 1997 shortly after the Commission filed its district court action.

The Commission's Complaint alleges that First California, Richardson, its CEO, and Dumont, Manager of its Assessment District/Mello-Roos Department, made numerous misrepresentations and omissions in offering material it distributed to investors which undermined the feasibility and security of $69 million in California municipal bonds. Between July 1989 and February 1994, First California underwrote five municipal bond offerings for four California municipalities: the Country of Nevada, City of lone, City of Wasco, and City of Avenal. Two of the bond offerings involved Marks-Roos bonds (pool bonds). The misrepresentations and omissions in those offerings involved oversizing of the pools and failure to disclosed the speculative nature of the intended projects to be funded. The three remaining bond offerings involved Mello-Roos bonds (land development bonds). In these bonds, the background, experience, and financial status of the developers, as well as the valuation of the underlying land and improvements securing the bonds were misrepresented. In addition, Richardson, acting as financial consultant to Wasco and Avenal, advised the cities to invest in the Nevada County and lone bonds, despite the fact that the bonds did not meet Avenal's and Wasco's minimum credit requirements for investment. Richardson also advised Wasco to invest more than half of its pooled funds after the three year limitation period at which time uninvested funds were to be returned to investors. The Commission's Complaint alleged that this conduct violated Sections 17(a) of the Securities Act, Sections 10(b) and 15B(c) of the Exchange Act, Rule 10b-5 promulgated thereunder, and Municipal Securities Rulemaking Board Rules G-17 and G-19.

The Commission previously brought, and settled, administrative proceedings against Nevada County, City of lone, and City of Wasco, as well as numerous other individuals involved with the five bond offerings. An administrative ruling remains pending against Virginia Horler, the financial adviser to Nevada County.

Securities and Exchange Commission v. Robert D. Gersh, Boston Municipal Securities, Inc., and Devonshire Escrow and Transfer Corp., Civ. Action No. 95-12580 (RCL) (D. Mass.), Litigation Release No. 14742 (November 30, 1995) (complaint); Litigation Release No. 15310 (March 31, 1997) (settled final order).

See "THE ISSUER" section.

Securities and Exchange Commission v. Robert M. Cochran, Michael B. Garrett and Randall W. Nelson, Civ. Action No. 95-1477T (W.D. Okla.), Litigation Release No. 14644 (September 20, 1995) (complaint) consolidated with Securities and Exchange Commission v. James V. Pannone and Sakura Global Capital, Inc., Civ. Action No. CIV98-146L (W.D. Okla.), Litigation Release No. 15630 (January 29, 1998) (complaint).

The Securities and Exchange Commission ("Commission") announced today that it filed a Complaint in the United States District Court for the Western District of Oklahoma against Robert M. Cochran, Michael B. Garrett and Randall W. Nelson, former employees of Stifel, Nicolaus and Company, Incorporated, ("Stifel") a broker-dealer headquartered in St. Louis. The Complaint alleges that from 1989 through 1993, Stifel received millions of dollars in undisclosed payments from third parties that sold or brokered investments to municipal issuers, and that Stifel undermined the integrity of the bidding process set up for the purchase of certain of those investments. According to the Complaint, the defendants, who worked in Stifel's former Oklahoma Public Finance Office, had a duty to disclose conflicts of interest while advising the issuers about the purchase of the investments. The defendants breached their duty and defrauded the issuers in failing to disclose that Stifel received the payments from the investment providers or investment brokers. The Complaint further alleges that the defendants defrauded investors by failing to disclose the payments to participants in the bond issues, including the issuer, bond counsel and/or special tax counsel, thereby depriving investors of information material to an assessment of the tax exempt status of the bonds.

The Complaint alleges that these actions by the defendants violated Section 17(a) of the Securities Act of 1933, Sections 10(b), and 15B(c)(1) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder and Rule G-17 of the Municipal Securities Rulemaking Board (MSRB). The Complaint seeks relief including final judgments of permanent injunction barring future violations of those provisions, imposition of civil penalties, and against defendant Cochran, disgorgement of bonuses related to the improper payments made to Stifel.

Last month the Commission filed a related action against the defendants' former employer, Stifel. Simultaneously, without admitting or denying the allegations contained in the Complaint, Stifel consented to the entry of a Final Judgment enjoining it from future violations of antifraud and books and records provisions of the federal securities. In addition, Stifel agreed to disgorge $922,741, pay prejudgment interest on that amount of $263,637 and pay a civil money penalty pursuant to Section 20(d) of the Securities Act and Section 21(d)(3) of the Exchange Act of $250,000. See Litigation Release No. 14587 (August 3, 1995).

Also today, the United States Attorney for the Western District of Oklahoma announced that a federal grand jury indicted Cochran and Garrett on charges relating to the conduct alleged in the Complaint.

The Commission's investigation continues as to the conduct of other entities and individuals involved in this matter.

The Securities and Exchange Commission announced that on January 29, 1998, it filed a Complaint in the United States District Court for the Western District of Oklahoma against James Pannone, a former vice president of the Oklahoma Public Finance Office of Stifel, Nicolaus & Company, Inc. ("Stifel"), a

broker-dealer registered with the Commission, and Sakura Global Capital, Inc. ("Sakura"), a subsidiary of Sakura Bank that is engaged in the business of selling derivatives. The Complaint alleges that the defendants committed fraud in connection with the sale of municipal securities. The Complaint alleges that in two municipal bond transactions underwritten by Stifel, Pannone engaged in bid-rigging to ensure Sakura's selection as the provider of the forward purchase agreements ("forwards") to the issuers. The Complaint also alleges that in those same securities transactions, Pannone and Sakura made materially misleading statements and/or affirmative misrepresentations to the issuers with respect to undisclosed payments that Sakura made to Stifel. The Complaint alleges that these undisclosed payments jeopardized the tax-exempt status of the bonds.

The Complaint alleges that in a 1992 transaction for the Oklahoma Turnpike Authority, despite bond counsel's requirement that three competitive bids be obtained for the forward, Pannone rigged the bidding to ensure Sakura's selection as the forward provider. The Complaint also alleges that Pannone subsequently negotiated with Steven Strauss, Sakura's then managing director in charge of municipal securities transactions, a $6.593 million undisclosed brokerage fee to be paid by Sakura to Stifel, and that Pannone falsely described to the Turnpike Authority the bidding and negotiation process of the forward. The Complaint further alleges that the forward purchase agreement stated that Sakura did not intend to take any actions which would jeopardize the tax-exempt status of the bonds. The Complaint alleges that at the time Sakura executed the forward it was planning to pay a $6.593 million brokerage fee to Stifel, and that Sakura knew or was reckless in not knowing that such a brokerage fee would jeopardize the tax-exempt status of the bonds.

The Complaint also alleges that in a 1992 transaction for the Sisters of St. Mary's Health Care Obligated Group, despite bond counsel's requirement that three competitive bids be obtained for the forward, Pannone rigged the bidding to ensure Sakura's selection as the forward provider. The Complaint further alleges that at the request of bond counsel, Pannone and Strauss provided certificates stating that Sakura would not make any payments, other than certain payments to the issuer, in connection with the forward. The Complaint alleges that Sakura made a $100,000 payment to Stifel and that Pannone concealed the payment by booking it to a different transaction.

The Complaint alleges that by their conduct, Pannone and Sakura violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and that Pannone also violated Section 15B(c)(1) of the Exchange Act and Rule G-17 of the Municipal Securities Rulemaking Board. The Complaint seeks relief including a permanent injunction barring Pannone and Sakura from future violations of those provisions and the imposition of civil monetary penalties.

The Commission previously sued Stifel, Robert Cochran, Stifel's former executive vice president in charge of its Oklahoma Public Finance Office, and Steven Strauss in connection with these transactions. The Commission settled its action against Stifel. The Commission's litigation is ongoing with respect to Cochran and Strauss. See Lit. Rel. No. 15569 (Nov. 24, 1997); Lit. Rel. No. 14644 (Sept. 20, 1995); and Lit. Rel. No. 14587 (Aug. 3, 1995).

Securities and Exchange Commission v. Robert M. Cochran, Randall W. Nelson, James V. Pannone, Steven Strauss, and Sakura Global Capital, Inc., (Order granting in part and denying in part motions for summary judgment of defendants)(January 28, 1999).

See Attachment.

Securities and Exchange Commission v. Robert Cochran, James Pannone, Sakura Global Capital, Inc. and Steven Strauss, Litigation Release No. 16063 (February 17, 1999) (settled final orders).

The Securities and Exchange Commission announced settlements with Robert Cochran, James Pannone, Sakura Global Capital, Inc. and Steven Strauss with respect to alleged fraud in connection with the sale of

municipal securities underwritten by Stifel, Nicolaus & Company, Inc. Cochran was a former executive vice president of Stifel, in charge of its Oklahoma public finance office. Pannone was a former vice president of Stifel. Sakura, a subsidiary of Sakura Bank, was engaged in the business of selling derivatives, including forward purchase agreements ("forwards"). Strauss was a managing director of Sakura. All of the defendants consented to the entry of injunctions prohibiting them from violating the antifraud provisions of the federal securities laws, and collectively they agreed to pay $430,000 in monetary penalties.

The Complaint alleges that in a 1992 transaction for the Oklahoma Turnpike Authority, despite bond counsel's requirement that three competitive bids be obtained for the forward, Cochran and Pannone rigged the bidding to ensure Sakura's selection as the forward provider. The Complaint also alleges that Cochran and Pannone subsequently negotiated with Strauss a $6.593 million undisclosed brokerage fee to be paid by Sakura to Stifel, and that Pannone falsely described to the Turnpike Authority the bidding and negotiation process of the forward. The Complaint further alleges that the forward purchase agreement stated that Sakura did not intend to take any actions which would jeopardize the tax-exempt status of the bonds. The Complaint alleges that at the time Strauss executed the forward on behalf of Sakura, Sakura was planning to pay a $6.593 million brokerage fee to Stifel. The Complaint alleges that Sakura and Strauss knew or were reckless in not knowing that such a brokerage fee would jeopardize the tax-exempt status of the bonds.

The Complaint also alleges that in a 1992 transaction for the Sisters of St. Mary's Health Care Obligated Group, despite bond counsel's requirement that three competitive bids be obtained for the forward, Pannone rigged the bidding to ensure Sakura's selection as the forward provider. The Complaint further alleges that at the request of bond counsel, Pannone, at Cochran's direction, and Strauss provided certificates stating that Sakura would not make any payments, other than certain payments to the issuer, in connection with the forward. The Complaint alleges that Sakura made a $100,000 payment to Stifel and that Cochran and Pannone concealed the payment by booking it to a different transaction. The Complaint alleges that the $100,000 payment from Sakura to Stifel jeopardized the tax-exempt status of the bonds.

Finally, the Complaint alleges that in a 1990 transaction for the Pottawatomie County Development Authority, Cochran recommended that the bond proceeds be invested in a guaranteed investment contract ("GIC"). The Complaint alleges that Cochran did not disclose to the issuer that Stifel received a payment of $87,220 in connection with the GIC. The Complaint alleges that this payment jeopardized the tax-exempt status of the bonds.

Without admitting or denying the allegations in the Complaint, Pannone, Sakura and Strauss consented to the entry of injunctions prohibiting them from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. Pannone further consented to the entry of injunctions prohibiting them from future violations of Section 15B(c)(1) of the Exchange Act and Rule G-17 of the Municipal Securities Rulemaking Board. Pannone, Sakura and Strauss also consented to the entry of final judgments ordering them to pay monetary penalties of $30,000, $250,000 and $50,000, respectively. In addition, Pannone consented to the entry of an administrative order suspending him from association with any broker, dealer or municipal securities dealer for twelve months.

On January 28, 1999, the Court entered an order dismissing the Commission's securities fraud claims against Cochran with respect to the Oklahoma Turnpike Authority and Pottawatomie County Development Authority transactions. Without admitting or denying the remaining allegations in the Complaint with respect to the Sisters of St. Mary's transaction, Cochran consented to the entry of a final judgment enjoining him from future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and Rule G-17 of the Municipal Securities Rulemaking Board, and ordering him to pay a monetary penalty of $100,000. The settlement with Cochran preserves the Commission's ability to appeal the dismissal of the Oklahoma Turnpike Authority and Pottawatomie County Development Authority transactions.

See also, Lit. Rel. No. 15630 (Jan. 29, 1998); Lit. Rel. No. 15569 (Nov. 24, 1997); Lit. Rel. No. 14644 (Sept. 20, 1995); and Lit. Rel. No. 14587 (Aug. 3, 1995).

<u>Securities and Exchange Commission v. Michael Goodman and Harold Tzinburg</u>, Civ. Action No. 95CV 71563 (E.D. MI.), Litigation Release No. 14471 (April 19, 1995) (settled final order).

The Securities and Exchange Commission announced that on April 14, 1995, a Complaint was filed in the U.S. District Court for the Eastern District of Michigan against Michael Goodman (Goodman) and Harold Tzinberg (Tzinberg) seeking a Permanent Injunction, based on their violations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act of 1933 (Securities Act), Section 10(b) of the Securities Exchange Act or 1934 (Exchange Act) and Rule 10b-5 promulgated thereunder.

The Commission's Complaint alleges, among other things, that during the years 1984 through 1989, two not-for-profit corporations, First Humanics Corp. (First Humanics) and its successor, International Elderly Care, Inc. (IEC), participated in 26 public offerings of municipal bonds raising over $107 million. The purpose of these offerings was to acquire, renovate and operate nursing homes. In connection with two such offerings, First Humanics' 1987 offering to acquire the Medicos Recovery Care Center nursing home in Detroit, Michigan (Medicos) and IEC's 1988 offering to acquire the Colonial Gardens Convalescent Center in Boonville, Missouri (Colonial Gardens), Goodman served as the representative for the underwriter and Tzinberg served as the underwriter's counsel. During these offerings, however, both Goodman and Tzinberg participated in the preparation of false and misleading offering circulars. Specifically, the Medicos offering circular contained material misrepresentations and omissions concerning: the promoter of the offering, the promoter's control over First Humanics as well as his regulatory history and numerous prior bond and business failures; the prevalent commingling of revenues from existing First Humanics nursing homes and the resulting financial interdependence of all First Humanics nursing homes; and, First Humanics' on-going ponzi scheme. In addition, the Colonial Gardens offering circular contained material misrepresentations and omissions concerning the above promoter's role in the offering and his control over IEC as well as his background; the nexus between IEC and First Humanics; and First Humanics' prior bond defaults.

Simultaneous with the filing of the Commission's Complaint, Goodman and Tzinberg, without admitting or denying the Commission's allegations, consented to the entry of a final judgment enjoining them from violations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

<u>Securities and Exchange Commission v. Nicholas A. Rudi, Joseph C. Salema, Public Capital Advisors, Inc., George L. Tuttle Jr. and Alexander S. Williams</u>, Civ. Action No. 95 Civ. 1282 (S.D.N.Y.), Litigation Release No. 14421 (February 23, 1995) (settled final orders against Tuttle & Williams).

The Commission announced that it filed a Complaint today alleging violations of the federal securities laws and the Municipal Securities Rulemaking Board ("MSRB") Rules arising out from the payment of more than $300,000 in kickbacks in connection with the Camden County Municipal Utilities Authority's ("CCMUA") February 1990 offering of approximately $237,000,000 of debt securities ("Offering").

Named in the Complaint were:

<u>Nicholas A. Rudi</u>, age 46, a resident of Haddon Township, New Jersey. During the period of the conduct alleged in the Complaint, Nicholas A. Rudi was the President and a fifty percent owner of Consolidated Financial Management, Inc., the financial advisor to the CCMUA for the offering Nicholas A. Rudi had been Camden County, New Jersey's ("Camden County") administrator during the early 1980s;

Joseph C. Salema, age 46, a resident of Wenonah, New Jersey. During the period of the conduct alleged in the Complaint, Joseph C. Salema was the Executive Vice President and owned the other fifty percent of Consolidated Financial Management, Inc. In October 1990, Joseph C. Salema sold his interest in Consolidated Financial Management, Inc. to Nicholas A. Rudi;

Public Capital Advisors. Inc., a financial advisory firm that until September 1993, was known as Consolidated Financial Management, Inc.. Consolidated Financial Management, Inc. was incorporated in New Jersey in 1985 and maintains its offices in Clementon, New Jersey. Consolidated Financial Management, Inc. was the CCMUA's financial advisor since February 1985. Nicholas A. Rudi is now the sole owner of Public Capital Advisors, Inc.;

George L. Tuttle. Jr., age 47, who resides in Varnck, New York, and who was a senior vice president at First Fidelity Bank, N.A. ("FFB") during the period of the conduct alleged in the Complaint. In November 1994, George L. Tuttle, Jr. resigned from FFB;

Alexander S. Williams, age 63, resides in Westfield, New Jersey, and who was an executive vice-president at FFB from 1970 until he retired in December 1994. During the period of the conduct alleged in the Complaint[1] Alexander S. Williams was also the head of First Fidelity Securities Group ("First Fidelity"), and George L. Tuttle, Jr. reported to Alexander S. Williams.

The Complaint alleges that:

Consolidated Financial Management, Inc. was the financial advisor to the CCMUA on the Offering. Nicholas A. Rudi told George L. Tuttle, Jr. that the CCMUA had reduced Consolidated Financial Management, Inc.'s financial advisory fee on the Offering to a flat fee of $15,000. In prior offerings, Consolidated Financial Management, Inc. had received one dollar per $1,000 face value of bonds ("one dollar per bond"). Nicholas A. Rudi said that he thought Consolidated Financial Management, Inc. should still get paid one dollar per bond for working on the Offering and told George L. Tuttle, Jr. that he wanted First Fidelity to pay Consolidated Financial Management, Inc the difference.

At the time of this conversation, George L. Tuttle, Jr. and Nicholas A. Rudi anticipated that the CCMUA would issue approximately $215 million in debt. George L. Tuttle, Jr. understood that Nicholas A. Rudi wanted to receive $215,000 for Consolidated Financial Management, Inc.'s work on the Offering, $15,000 from the CCMUA and the remaining $200,000 from First Fidelity. Accordingly, George L Tuttle, Jr. and Alexander S. Williams caused their employer, First Fidelity, of pay a kickback of over $200,000 between February and April 1990 to Consolidated Financial Management, Inc. The kickback was shared by Nicholas A. Rudi and Joseph C. Salema.

Joseph C. Salema solicited and received an additional $90,000 kickback from Robert J. Jablonski ("Jablonski"), currently a Commissioner of the New Jersey Highway Authority. In exchange for Joseph C. Salema's assistance in securing for First Fidelity the lead underwriter position on the Offering, Jablonski agreed to pay Joseph C. Salema a portion of the finder's fee that First Fidelity paid to Jablonski in connection with the Offering. Joseph C. Salema and Jablonski agreed that Jablonski's kickback to Salema would be reduced by any political contributions that Jablonski chose to make in the interim.

To conceal the kickback to Consolidated Financial Management, Inc., George L. Tuttle, Jr. and Alexander S. Williams paid the kickback to Consolidated Financial Management, Inc. through Jablonski and disguised these payments on First Fidelity's municipal securities dealer books and records. At Joseph C. Salema's direction, Jablonski in turn paid to Armacon Investment Co., a company owned by Joseph C. Salema, First Fidelity's kickback to Consolidated Financial Management, Inc. and Jablonski's kickback to Joseph C. Salema.

George L. Tuttle, Jr. caused First Fidelity to make an additional $22,000 kickback to Consolidated Financial Management, Inc. in connection with the Offering through a fictitious invoice on another municipal securities transaction and concealed this payment on First Fidelity's municipal securities dealer books and records.

George L. Tuttle, Jr. also caused First Fidelity to pay Armacon Securities, Inc., a broker-dealer jointly owned by Nicholas A. Rudi and Joseph C. Salema, a finder's fee for First Fidelity's role in a 1991 CCMUA Guaranteed Investment Contract. The payment was made in response to a series of false invoices that Nicholas A. Rudi submitted to First Fidelity on unrelated municipal offerings. George L Tuttle, Jr., who knew of the falsity of the invoices, improperly recorded these payments on First Fidelity's municipal securities dealer books and records.

Each of the Defendants violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule l0b-5.

In addition, George L. Tuttle, Jr. and Alexander S. Williams violated Section 15B(c)(1) of the Exchange Act, which prohibits effecting transactions in municipal securities in contravention of any rule of the MSRB, and MSRB Rules G-8 (books and records), G-17 (fair dealing) and G-20 (gifts and gratuities).

In the Complaint, the Commission seeks a final judgment permanently enjoining each of the defendants from violating Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5, and enjoining George L Tuttle, Jr. and Alexander S. Williams from violating Section 15B(c)(1) of the Exchange Act and MSRB Rules G-8, G-17 and G-20. In addition, the Commission seeks disgorgement and prejudgment interest from each of the defendants.

Joseph C. Salema consented, without admitting or denying the allegations of the Complaint, to the entry of a final judgment permanently enjoining him from violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule l0b-5. Joseph C. Salema also agreed to pay $324,764.55, representing disgorgement of the money he received as a result of the conduct alleged in the Complaint and prejudgment interest.

George L. Tuttle, Jr. and Alexander S. Williams, without admitting or denying the allegations of the Complaint, have each consented to the entry of a final judgment permanently enjoining them from violating Section 17(a) of the Securities Act, Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5, and MSRB Rules G-8, G-17, and G-20. George L. Tuttle, Jr. and Alexander S. Williams have agreed to disgorge $l8,171.48 and $4,684.14, respectively, representing the money each received as a result of the conduct alleged in the Complaint. George L. Tuttle, Jr. has also agreed to cooperate with the Commission.

The Commission's investigation is continuing. The litigation is pending as to defendants Nicholas A. Rudi and Public Capital Advisors, Inc.

The Commission thanks the National Association of Securities Dealers Inc. for its assistance on this investigation.

<u>Securities and Exchange Commission v. Terry D. Busbee and Preston C. Bynum</u>, Civ. Action No. 95-30024 RV (N.D. Fla.), Litigation Release No. 14387 (January 23, 1995); Litigation Release No. 14508 (May 24, 1995) (settled final order).

See “PUBLIC OFFICIALS” section.

<u>Securities and Exchange Commission v. Matthews & Wright Group, Inc. et al.,</u> Civ. Action No. 89-2877 (S.D.N.Y.), Litigation Release No. 12072 (April 27, 1989) (settled final orders).

The Securities and Exchange Commission ("Commission") today announced the filing of a Complaint for Injunctive Relief in the United States District Court for the Southern District of New York against Matthews & Wright Group, Inc. ("M&W"), Matthews & Wright, Inc. ("M&W Inc."), a wholly owned, registered broker-dealer subsidiary of M&W, M&W's President and Chairman, George W. Benoit ("Benoit"), M&W's Executive Vice President, Arthur Abba Goldberg ("Goldberg") and M&W's Chief Financial Officer, Roger J. Burns ("Burns"), and M&W's outside counsel, Bernard A. Althoff ("Althoff"). M&W is a Delaware corporation with its principal offices at 100 Broadway, New York, New York. During the period covered by the Complaint, M&W engaged in investment banking through its subsidiaries by underwriting, trading, brokering and selling municipal securities.

The Commission's Complaint charges the defendants with numerous violations of the antifraud, reporting, books and records and internal controls provisions of the Securities Act of 1933 (the "Securities Act"), the Securities Exchange Act of 1934 (the "Exchange Act"), the Commission's rules promulgated thereunder, and related rules of the Municipal Securities Rulemaking Board.

In December 1985, the Complaint alleges, at a time when M&W's and M&W Inc.'s capital resources were grossly inadequate to perform the dollar volume of underwriting of new issue, tax exempt municipal securities which M&W and M&W Inc. were attempting to underwrite, M&W, M&W Inc., Benoit, Goldberg and Burns devised and carried out a fraudulent scheme to perform the underwritings through a series of sham closings. The Complaint alleges that the invalid closings were conducted as part of an effort to retain favorable tax treatment for the municipal securities by avoiding the scheduled effective dates of certain provisions in then pending federal tax legislation. Those provisions imposed or expanded certain restrictions applicable to tax-exempt municipal securities.

On December 31, 1985, the Complaint alleges, the last day before the first of the scheduled effective dates in the pertinent tax legislation, defendant Goldberg wrote at least twenty-two checks totalling approximately $768 million on a nonexistent checking account at a credit union he had earlier helped to form and which he controlled. The checks were ostensibly used to purchase approximately $768 million of municipal bonds for M&W and M&W Inc., all with the advance knowledge and approval of defendants Benoit and Burns and the knowledge and assistance of defendant Althoff. M&W and M&W Inc. subsequently sold these twenty-two issues of municipal bonds to the public throughout 1986 using offering materials which affirmatively and falsely represented that the bonds had been "issued" on December 31, 1985, and omitted to disclose that the invalid closings created a special increased risk that interest on such bonds may be taxable.

Throughout 1986, the Complaint alleges, as seventeen of the twenty-two bond issues "closed" on December 31, 1985 were actually issued and sold to the public by M&W and M&W Inc., the proceeds of the offerings were not used for the purposes stated in the bond offering materials. The offering materials for these bonds affirmatively and falsely stated that the bonds were issued to finance the construction of various projects, primarily multi-family housing to be occupied in part by low income families. In fact, the Complaint alleges, substantially all of the proceeds of the offerings were intended to be used, and were actually used, to purchase investment contracts to serve as credit enhancement instruments for the bonds, and not for the projects. The Complaint alleges that M&W and M&W Inc. sold these bonds to the public with the advance knowledge of Benoit and Goldberg that the proceeds were intended to be used for purposes other than those stated in the bond offering materials, and that defendant Althoff also knew about the possible misapplication of proceeds. The use of proceeds for such undisclosed purposes created a further special increased risk that interest on such bonds might not be exempt from federal income taxation because it prevented or impeded the use of the proceeds for the projects as required by the Internal Revenue Code.

The Complaint also charges that in August 1986 M&W sold 1.5 million shares of its common stock to the public through the use of a materially false and misleading Registration Statement and Prospectus filed with the Commission. The Registration Statement and Prospectus were false and misleading because they included a description of M&W's business operations and financial condition which omitted to disclose

that M&W, M&W Inc., Benoit, Goldberg and Burns had devised and carried out the foregoing invalid closing and misuse of proceeds schemes, and the consequences thereof. In connection with M&W's sale of its common stock to the public, defendant Althoff supervised the preparation and filing of M&W's false and misleading Registration Statement and Prospectus. Following the public offering, M&W failed to file a required report with the Commission on Form S-R to disclose the use M&W made of the proceeds of the public offering.

The Complaint further alleges that, in August 1986, contemporaneously with the public offering of stock and just before the last of the scheduled effective dates in the pertinent federal tax legislation, M&W, M&W Inc., Benoit, Goldberg and Burns once again conducted additional invalid closings using worthless credit union checks. Specifically, Benoit and Burns signed at least four worthless credit union checks aggregating $554 million to purchase four bond offerings, and M&W and M&W Inc. thereafter sold such bonds to the public through the use of affirmatively false and misleading offering materials which stated that the bonds had been issued before the tax law changes, and which omitted to disclose the special increased risk, caused by the invalid closings, that interest on such bonds might not be exempt from federal income taxation.

In furtherance of the foregoing scheme to defraud, the Complaint alleges that M&W thereafter failed to disclose any of the above-described events in reports filed with Commission and suspended or overrode its internal controls to prevent the accurate recording of these events in M&W's books and records. Benoit, Goldberg and Burns falsified M&W's business records, and Benoit and Burns made, or caused to be made, statements containing material omissions to M&W's outside auditors, all to conceal the scheme.

M&W, M&W Inc., Benoit and Burns have consented, without admitting or denying the allegations of the Commission's Complaint, to the entry of final judgments permanently restraining and enjoining M&W, M&W Inc., Benoit and Burns from future violations of, or aiding and abetting future violations of, (1) the antifraud provisions contained in section 17(a) of the Securities Act and section 10(b) of the Exchange Act and rule 10b-5 thereunder; (2) the periodic reporting provisions contained in section 13(a) of the Exchange Act and rules 12b-20 and 13a-1 thereunder; (3) the provisions relating to books and records and representations to auditors contained in section 13(b)(2) of the Exchange Act and rules 13b2-1 and 13b2-2 thereunder; and (4) the antifraud and reporting provisions applicable to municipal securities broker-dealers contained in sections 15(c)(1) and 15B(c)(1) of the Exchange Act and rule 15c1-2 thereunder and related Rules G-8, G-9, G-14 and G-17 of the Municipal Securities Rulemaking Board.

M&W Inc. has also consented, based upon and following the entry of the final judgment, to the institution by the Commission of administrative proceedings revoking M&W Inc.'s broker-dealer license. Benoit and Burns have also consented, based upon and following the entry of the final judgments, to the institution by the Commission of administrative proceedings barring Benoit and Burns from association with any broker, dealer, government securities broker or dealer, investment adviser or municipal securities dealer with the provisos that Benoit may make application to become reassociated with any such entity after four years, and Burns may make application to become reassociated with any such entity after two years.

The Commission's litigation with Goldberg and Althoff of the allegations in the Complaint is pending. The Commission's investigation of related municipal securities matters is continuing.

SEC v. William H. Crossman, et al., Civ. Action No. 79C-2550 (N.D. Ill.), Litigation Release No. 8809 (July 2, 1979) (complaint).

William D. Goldsberry, Administrator of the Chicago Regional Office of Securities and Exchange Commission, announced that on June 20, 1979, the Commission filed a complaint in the United States District Court for the Northern District of Illinois, Eastern Division, seeking injunctive relief against William H. Crossman (Crossman) of Crystal Lake, Illinois, William H. Crossman and Associates (Crossman and Associates) of Crystal Lake, Illinois, a sole proprietorship, and Norman M. McDougall,

Jr., of Wayne, Illinois, alleging violations of the anti-fraud provisions and municipal broker-dealer registration provisions of the Federal securities laws.

The Commission's complaint alleges that the defendants made misrepresentations and omitted to state material facts in connection with the offer and sale of three separate offerings of bonds of the Hanover Park Park District (Park District) of Hanover Park, Illinois. The complaint alleges that the defendants falsely represented that a new recreational complex would be built by the Park District from the funds obtained in the sale of its bonds which complex would contain ice skating and ice hockey facilities; that earnings and revenue and debt service coverage would come from the ice skating and ice hockey facilities.

The complaint further alleges that the defendants omitted to disclose that the construction of the ice skating facility had been completely abandoned; that the construction of the ice hockey facility would be constructed sometime after the completion of the recreational complex.

The complaint further alleges that in the offer and sale of one of the three bond issues, the defendants failed to disclose that the bonds were issued and sold in a two-step process to circumvent an Illinois statute limiting the interest which a municipal issuer could pay on its bonds.

Finally, the complaint alleges that after December, 1975, Crossman and Crossman and Associates failed to register as municipal broker-dealers, in violation of the Securities Exchange Act of 1934.

SEC v. William H. Crossman, et al., Litigation Release No. 8956 (December 18, 1979) (settled final orders).

William D. Goldsberry, Administrator of the Chicago Regional Office of the Securities and Exchange Commission announced that on November 29, 1979, the Honorable Marvin Aspen, Judge of the United States District Court for the Northern District of Illinois, Eastern Division, entered a final judgment of permanent injunction against Norman McDougall, Jr. (McDougall), of Kildeer, Illinois, enjoining him from violating the anti-fraud provisions in the offer and sale of municipal securities. The final judgment was entered with the consent of the defendant, who neither admitted nor denied the allegations of the complaint.

In addition, final judgments of permanent injunction were entered against William H. Crossman (Crossman) and William H. Crossman and Associates (Crossman and Associates) of West Dundee, Illinois on October 23, 1979. These final judgments enjoined the defendants from violating the anti-fraud provisions of the federal securities laws in the offer and sale of any securities and from violating the municipal broker-dealer registration provisions of the Securities Act of 1934. These final judgments were entered by default as these defendants failed to answer the complaint or appear.

The Commission commenced this action on June 20, 1979, by filing a complaint which alleged, among other things, that Crossman, Crossman and Associates and McDougall violated the anti-fraud provisions of the federal securities laws in the offer and sale of revenue bonds, refunding revenue bonds and junior lien bonds of the Hanover Park District (Park District) concerning, among other things, the construction of ice skating facilities in a recreation complex to be built by the Park District, the projected revenues from the facility and the bond amortization schedule for repayment of bond principal and interest. In addition, the complaint alleged violations by Crossman and Crossman and Associates of the municipal broker-dealer registration requirement of the Securities Exchange Act of 1934. For further information, see Litigation Release No. 8809.

SEC v. Shelby Bond Service Corp., et al., Civ. Action No. C-77-2236 (W.D. Tenn.), Litigation Release No. 7888 (April 27, 1977) (complaint).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on April 18, 1977, a civil injunctive complaint was filed in United States District Court for the Western District of Tennessee, Memphis Division, naming Shelby Bond Service Corporation (Shelby Bond), a municipal securities dealer, Precision Optical Laboratory, Inc. (Precision Optical), both Tennessee corporations, Max J. Baer, Robert E. Hawks, Charles M. West, Donald E. Helms, Richard C. Flick, Edward J. Blumenfeld, and Patrick Lawyer, all of Memphis, and Charles M. Beale of Cardova, Tennessee, Manuel W. Yopp of Germantown, Tennessee, and Richard Lutz of Southaven, Mississippi.

The complaint alleges that Shelby Bond, Beale, Baer, West, Helms, Yopp, Flick, Lutz, Blumenfeld, and Lawyer violated the anti-fraud provisions of the federal securities laws in connection with the offer, purchase and sale of municipal securities by making numerous misrepresentations and omissions of material facts to prospective investors. The complaint also alleges that these defendants omitted to state to investors that they were being charged prices for their securities which were not reasonably related to the then current market price for the securities. Undisclosed mark-ups as high as 166 percent over the contemporaneous cost to Shelby Bond are alleged.

The complaint further alleges that Shelby Bond, Precision Optical, Baer, Beale and Hawks violated the anti-fraud provision of federal securities laws by making numerous misrepresentations and omissions of material facts in connection with the offer and sale of municipal securities, namely industrial development revenue bonds issued by the Gallaway Industrial Development Board of Gallaway, Tennessee, underwritten by Shelby Bond, in which Precision Optical is the lessee. The misrepresentations alleged relate to the safety and merits of investment in these bonds and the financial status of Precision Optical.

SEC v. Shelby Bond Service Corp., et al., Litigation Release No. 7965 (June 9, 1977) (settled final orders).

Jule B. Greene, Administrator of the Atlanta Regional Office, announced that on May 20, 1977, the Honorable Robert M. McRae, Jr., United States District Judge for the Western District of Tennessee, Memphis Division, issued orders of permanent injunction from further violations of the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder against Shelby Bond Service Corporation ("Shelby Bond"), a now defunct Memphis, Tennessee, municipal securities broker-dealer, Precision Optical Laboratory, Inc. ("Precision Optical") of Gallaway, Tennessee, a Tennessee corporation, Max J. Baer, Charles M. West, Richard C. Flick, Patrick Lawyer, Donald E. Helms, all of Memphis, Tennessee, Manual W. Yopp of Germantown, Tennessee, and Richard Lutz of Southaven, Mississippi. Precision Optical, West, Flick, Lawyer, Helms, and Yopp consented to the entry of the orders of injunction. The judgments against Shelby Bond, Baer, and Lutz were by default.

In addition, on May 27, 1977, Judge McRae issued orders of preliminary injunction from further violations of the anti-fraud provisions of the federal securities laws against Charles M. Beale of Cardova, Tennessee, and Robert E. Hawks and Edward J. Blumenfeld, both of Memphis, Tennessee, based upon findings set out in a memorandum opinion filed on that date.

In addition, on May 27, 1977, Judge McRae issued orders of preliminary injunction from further violations of the anti-fraud provisions of the federal securities laws against Charles M. Beale of Cardova, Tennessee, and Robert E. Hawks and Edward J. Blumenfeld, both of Memphis, Tennessee, based upon findings set out in a memorandum opinion filed on that date.

The first two counts of the complaint alleged fraud in the offer, purchase, and sale of municipal securities by Shelby Bond, its principals, and its salesmen by making misrepresentations and omitting to state material facts concerning the nature and merits of the securities, charging prices for securities which were unrelated to the market price of the securities, selling securities without regard to the investment objectives or financial status of investors, recommending securities without an adequate basis upon which to make the recommendation, and using sales techniques which amounted to a course of conduct which

operated as a fraud upon purchasers of securities. Hawks was chairman of the board of directors of Shelby Bond, Beale was president and a director of Shelby Bond, and Baer was vice-president and a director of Shelby Bond.

The third and fourth counts of the complaint alleged fraud in the offer and sale of municipal securities issued to finance Precision Optical (first mortgage industrial development revenue bonds of the Gallaway Industrial Development Board of Gallaway, Tenn., issued November 29, 1974) which were underwritten by Shelby Bond, unconditionally guaranteed by Shelby Bond, Precision Optical, Hawks, Baer and Beale, sold through Shelby Bond using the alleged fraudulent methods outlined in the first two counts of the complaint, and which defaulted in payments of interest and principal on November 1, 1976. (For further information see Litigation Release No. 7888.)

SEC v. Shelby Bond Service Corp., et al., Litigation Release No. 8578 (October 27, 1978) (settled final order).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on October 2, 1978, Honorable Robert M. McRae, Jr., Judge of the United States District Court for the Western District of Tennessee, at Memphis, entered an order permanently enjoining Charles M. Beale of Memphis from further violations of the anti-fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. Beale consented to the entry of the order without admitting or denying the allegations of the complaint. Beale has been subject to a preliminary injunction since May 27, 1977. The complaint charged that Beale, while president and a director of Shelby Bond Service Corp., offered and sold municipal securities at excessive mark-ups, engaged in adjusted trades, and misrepresented the financial condition of issuers of securities and the speculative nature of an investment in such securities. (For additional information see Litigation Release No. 7965.)

SEC v. Washington County Utility District, et al., Civ. Action No. CA-2-77-15 (E.D. Tenn.), Litigation Release No. 7782 (Feb. 15, 1977) (complaint).

See "THE ISSUER" section.

SEC v. Washington County Utility District, et al., Litigation Release No. 8466 (July 17, 1978) (settled final orders).

Jule B. Greene, Administrator of the Atlanta Regional Office, announced that on June 29, 1978, the Honorable C. G. Neese, Judge of the U.S. District Court in Greenville, Tennessee, entered an order permanently enjoining Thomas R. Alcock of Hingham, Mass., and Diversified Securities, Inc., a New York corporation, from further violations of the anti-fraud provisions of the federal securities laws in connection with the offer, purchase, and sale of municipal bonds by the Washington County Utility District. Alcock and Diversified consented to the entry of the order, without admitting or denying the allegations in the Commission's complaint. For further information see Litigation Release Nos. 7782, 7868, 7983, 7984, and 8410.

SEC v. Astro Products of Kansas, Inc., et al., Civ. Action No. CA-76-359-L6 (D.C. Kan.), Litigation Release No. 7557 (September 13, 1976) (complaint); Litigation Release No. 7774 (February 10, 1977) (settled final orders); Litigation Release No. 8613 (December 8, 1978) (defaults entered).

See "OBLIGATED PERSONS" section.

<u>SEC v. Reclamation District No. 2090, et al.</u>, Civ. Action No. C76-1231-SAW (N.D. Cal.), Litigation Release No. 7460 (June 22, 1976) (complaint).

See “THE ISSUER” section.

<u>SEC v. Reclamation District No. 2090, et al.</u>, Litigation Release No. 7688 (December 7, 1976) (settled final orders).

Gerald E. Boltz, Regional Administrator of the Los Angeles Regional Office, and Leonard H. Rossen, Associate Regional Administrator of the San Francisco Branch Office, announced that on November 11, 1976, the Honorable Robert H. Schnacke, United States District Judge for the Northern District of California, entered a Final Judgment of Permanent Injunction against MFAL Associates, a registered broker-dealer, and Lawrence A. Luebbe, its president, both of Los Angeles, California. The injunction proscribes violations of the anti-fraud provisions of the federal securities issued by Reclamation District No. 2090 ("the District") and any other security of any other issuer. MFAL and Luebbe consented to the entry of the Permanent Injunctions without admitting or denying the allegations of the Commission's Complaint.

The Commission's Complaint alleged that the defendants' conduct resulted in the fraudulent sales of approximately $55,000 of bond anticipation notes issued by the District of eight purchasers. For further information see Litigation Release No. 7460.

<u>SEC v. The Senex Corporation, et, al.</u>, Civ. Action No. 74-53 (E.D. Ky.), Litigation Release No. 6451 (July 24, 1974) (complaint), Litigation Release No. 6769 (March 5, 1975) (settled final order); Litigation Release No. 8651 (January 23, 1979) (settled final order).

See “OBLIGATED PERSONS” section.

Administrative Proceedings - Commission Decisions

<u>In re Boettcher and Company</u>, Exchange Act Release No. 8393, A.P. File No. 3-544 (August 30, 1968).

TEXT: FINDINGS, OPINION AND ORDER CENSURING BROKER-DEALER

In these proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), we granted petitions for review of the hearing examiner's initial decision in which he concluded that Boettcher and Company ("registrant"), a registered broker and dealer, should be censured, and that David F. Lawrence and Alfred A. Wiesner, general partners of registrant, and Bruce C. Newman, an employee of registrant, should each be suspended from association with any broker or dealer for 15 days. Briefs were filed, and we heard oral argument. On the basis of our review of the record and for the reasons set forth herein and in the initial decision, we make the following findings.

Markups on Government Bonds in connection with "Advance Refunding" Transactions

Registrant acted as manager of an underwriting syndicate in connection with the "advance refunding" in 1963 of bonds of two Colorado school districts, Jefferson County District No. R-1 ("Jeffco") and Adams County District No. 50 ("Adams"). The "advance refunding" technique entails the issuance by a school district of new bonds for the purpose of "refunding" existing bonds which may not be due or callable. Under such technique, as here relevant, the proceeds of the new bonds issued by the school district are invested in United States Government obligations ("Governments") maturing at such times and in such

amounts as to insure prompt payments of the "refunded" bonds. The Governments are then placed in escrow, and the "refunded" bonds are no longer deemed outstanding. The objective of these steps is to secure savings to the school district by enabling it to issue its "refunding" bonds at a lower interest rate than it receives on the Governments; and it may also be able to reduce the principal amount of its debt by purchasing Governments at a discount. In negotiated sales of refunding bonds, as here, the form of the underwriter's compensation may include a markup on the new bonds issued by, or on the Governments sold to, the school district, or cash paid by the district. In this case the syndicate purchased the refunding bonds from and sold the Governments to Jeffco and Adams, charging Jeffco a markup on the Governments over the syndicate's cost. The Governments involved in both transactions were acquired by the syndicate from registrant's wholly-owned subsidiary which, pursuant to syndicate authorization, had purchased such securities and charged the syndicate a markup of $1.25 per bond. The hearing examiner found that registrant failed to make adequate disclosure to Jeffco and Adams of the markups taken on the Governments, and respondents controvert this finding.

1. Jeffco Transaction

Registrant reached an agreement with Jeffco on July 30, 1963, giving it the right to form a selling group to buy Jeffco refunding bonds for resale to the general public, the proceeds of which Jeffco would use to buy Governments from the underwriters at the prices paid by the latter, who undertook to acquire the Governments at the "best possible" price. The objective by Jeffco was to achieve net savings estimated at approximately $2,500,000. The option given registrant was not exercised by its extended expiration date of September 30, but negotiations with Jeffco continued. Registrant concluded that because of changed market conditions the gross profit it had anticipated could not be realized under the terms of the July 30 proposal, and determined to make up the deficiency in part by taking a markup on the Governments. It entered into a new agreement with Jeffco as of October 10, under which the syndicate formed by registrant would purchase $38,873,000 of Jeffco refunding bonds in exchange for which the underwriters would supply Jeffco with specified Governments sufficient to refund $39,757,000 of outstanding Jeffco bonds. The transaction was consummated on November 1, 1963. The prices paid the syndicate by Jeffco for the Governments, however, included a markup of $394,469 over the prices paid for such securities by registrant's subsidiary. Following a 1964 audit Jeffco instituted legal action against registrant to recover that amount, and the case was thereafter settled by the parties by a payment to Jeffco of $200,000.

At the outset we note that no finding was made by the hearing examiner that registrant's underwriting compensation was in fact excessive or improper per se, and that Jeffco attained substantially the estimated savings of about $2,500,000. Our inquiry here relates solely to the question of the disclosure of the underwriting compensation. Respondents assert that in 1963 Jeffco was concerned only with the over-all compensation involved, and that in any event Jeffco was informed by registrant, but unreasonably failed to understand, that part of such compensation under the October 10 contract consisted of a markup on the Governments. It is certainly incumbent upon an underwriter to exercise care to make full and clear disclosure to issuers, both public and private, with respect to the nature and amount of the underwriting expense and profit involved. We are unable to find, however, that registrant failed in this duty in the Jeffco situation.

Jeffco was experienced and knowledgeable in financial matters and was advised by counsel in connection with the transaction in question. The October 10 agreement, pursuant to which the transaction was consummated, repeated provisions of the July 30 proposal but did not include the earlier provision barring a markup on the Governments. In addition, an exhibit attached to the October 10 agreement prepared by registrant, which summarized the estimated underwriting costs and expenses per $100 bond issued, listed "U.S. Government bond underwriting" at $.893 (on which basis the markup on Governments would aggregate around $350,000) as well as "refunding bond underwriting" at $1.376. Moreover, a letter signed by Wiesner addressed to bond counsel, dated November 1, stated that the costs of the Governments included at least $394,469 for "underwriting, obtaining and maintaining physical availability" of such securities. Not only are these items inconsistent with an intent on registrant's part to conceal the markup on the Governments but at least the exhibit should have alerted Jeffco to the possibility of such a markup.

In view of the integrated nature of a refunding transaction, it would have been reasonable to evaluate its fairness on the basis of overall results. The markup on the Governments of $394,469 was one aspect of a transaction involving the issuance of $38,873,000 of refunding bonds in which Jeffco achieved its estimated savings of around $2,500,000. The record as a whole indicates, as recognized by the parties in settling the civil action based on the issues now before us, a "mutual misunderstanding" with respect to registrant's compensation engendered by the "complicated nature" of the negotiations and transactions.

2. Adams Transaction

Registrant entered into an agreement in August 1963 with Adams for an advance refunding of $7,735,000 of Adams bonds. That agreement, which was modeled after the July 30 Jeffco proposal, provided that registrant and its associates would purchase the necessary Governments at the "best possible" price and resell them to Adams at their purchase price. The transaction was consummated on September 30, 1963, around which time registrant's subsidiary acquired the Governments. The syndicate purchased the Governments from the subsidiary for $7,760,100, and sold them to Adams for the same price. However, unknown to Adams that price included a markup of $1.25 per $1,000 bond or a total of $9,031 taken by the subsidiary in the sale of the Governments to the syndicate.

Newman, registrant's employee who prepared the Adams contract, contemplated that the markup would not be passed on to Adams but would be absorbed by the syndicate. However, he turned over the transaction to another employee without advising him of that intention, and the latter interpreted the contract to mean that Adams would purchase the Governments at the syndicate's cost (which included the markup charged by registrant's subsidiary). Upon discovering the markup after the closing date Adams claimed it was an improper charge, and around April 1966 registrant repaid the full amount.

Respondents assert, and we find, that the markup was charged Adams through inadvertence. However, neither the inadvertence of the undisclosed markup nor the restitution following complaint can absolve registrant of the failure to carry out its responsibility to review transactions, particularly of the size here involved, and make certain that no unauthorized or undisclosed charges are imposed. It cannot by its own carelessness shift such burden to its customer. Under the circumstances we conclude that registrant failed to exercise reasonable supervision to prevent overcharging its customer in violation of the securities acts. n1

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n1 During 1966 registrant used certain newspaper and radio advertisements containing statements which conveyed the impression that in every over-the-counter transaction registrant's traders try to get for the customer "the best possible price. "Although they also indicated that registrant maintained an inventory of some securities, nothing was said specifically about pricing in sales from inventory. Prior to the use of the advertisements registrant in accordance with the requirements of the New York Stock Exchange, of which it is a member, had submitted them to that Exchange for approval of their manner and form of presentation and the Exchange had raised no questions as to their use.

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Registrant effected some of its over-the-counter transactions with customers on a principal basis, disclosing its principal capacity but not always disclosing the markups included in the prices. The hearing examiner held that under the circumstances registrant should have made clear what procedures and pricing policies it followed when it filled orders from inventory, and that the failure to do so made the advertisements false and misleading. The record does not show that the prices charged in the principal transactions referred to were not in fact the best possible prices, it being stipulated merely that the undisclosed markups in some instances exceeded the minimum commissions that would have been charged on transactions executed on the New York Stock Exchange. On the record before us we are unable to find that registrant violated the anti-fraud provisions. We also note that registrant discontinued the use of the advertisements after being alerted to the problems they created.

Public Interest

In determining what remedial action is appropriate in the public interest, we have taken into account the facts that registrant has been in business for over 50 years without any prior disciplinary action; that it has settled the claims of both Jeffco and Adams; and that it has made changes in its operations and forms designed to prevent a repetition of the problems respecting refundings that arose in this case. Nevertheless we consider that registrant should be censured for the failure to exercise proper supervision in the Adams situation.

Since we have made no adverse findings with respect to the individual respondents, we shall enter an order dismissing the proceedings as to them.

Accordingly, IT IS ORDERED that Boettcher and Company be, and it hereby is, censured;

IT IS FURTHER ORDERED that the proceedings herein as to David F. Lawrence, Alfred A. Wiesner and Bruce C. Newman be, and they hereby are, dismissed.

By the Commission (Chairman Cohen and Commissioners Owens, Budge, Wheat and Smith).

Commission Orders - Settled Administrative Proceedings

In re John E. Thorn, Jr., and Thorn Welch & Co., Inc., Securities Act Release No. 7663; A.P. No. 3-8400 (March 31, 1999).

This Order incorporates both an Order Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Order in proceedings currently pending before the Commission and an Order Instituting Public Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order (Part II, below).[1]

The Commission deems it appropriate and in the public interest that public proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 19(h) and 21C of the Exchange Act of 1934 ("Exchange Act") be, and they hereby are, instituted against against John E. Thorn, Jr. ("Thorn") and Thorn, Welch & Co., Inc., formerly known as Thorn, Alvis, Welch, Inc. ("TWC") (Collectively "Respondents").

In anticipation of the institution of these proceedings, and in connection with pending proceedings, File No. 3-8400, previously instituted against Thorn and TWC pursuant to Section 8A of the Securities Act and Sections 15(b), 19(h) and 21C of the Exchange Act, the Respondents have submitted an Offer of Settlement ("Offer") solely for the purposes of those proceedings or any other proceeding brought by or on behalf of the Commission or in which the Commission is a party. In the Respondents' Offer, which the Commission has determined to accept, Thorn and TWC, without admitting or denying any of the factual assertions, findings, or conclusions contained herein, except as to the jurisdiction of the Commission over them and over the subject matter of these proceedings and as to the matters contained in findings 1 and 2, below which are admitted, consent to the entry of this Order Instituting Public Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Order and this Order Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Order (collectively "Order").

I.

Pending Proceedings

On the basis of this Order, the Order Instituting Public Proceedings Pursuant to Sections 8A of the Securities Act and Sections 15(b), 19(h) and 21C of the Exchange Act, and the Offer, the Commission finds that:

1. TWC. TWC is a registered broker-dealer located in Jackson, Mississippi. TWC has been registered with the Commission pursuant to Section 15(b) of the Exchange Act since on or about March 10, 1977. On November 22, 1993, the firm changed its name to Thorn, Welch & Co., Inc. TWC's business consisted primarily of underwriting and trading municipal securities.

2. Thorn. Thorn is a resident of Jackson, Mississippi. During the period relevant to these proceedings, Thorn was the president and a director of TWC and also served as TWC's municipal securities principal since approximately 1975.

3. From August 1992 through October 1993, TWC, as underwriter, raised $19,464,541 from hundreds of investors nationwide through seven offerings of nonrated municipal urban renewal revenue bonds ("the bonds") designed to finance the purchase and rehabilitation of existing low-income housing projects located in and about Jackson and Vicksburg, Mississippi.

4. Thorn, on behalf of TWC, assisted in preparing, reviewed and distributed to potential investors, Official Statements for each of the TWC offerings. The Official Statements were the disclosure documents provided to prospective investors.

5. The bonds were offered and sold to investors as qualified tax exempt private activity bonds.

6. Pursuant to Section 147(g) of the Internal Revenue Code ("IRC"), no more than two percent of the bond proceeds could be used to finance issuance costs, such as bond counsel fees and the underwriter's spread. Pursuant to Section 142(a) of the IRC, at least ninety-five percent of the bond proceeds were required to have been used to provide the financed facility. Failure to comply with either Section 147(g) or Section 142(a) of the IRC could have resulted in interest on the bonds losing its exemption from gross income for federal income tax purposes. The TWC bonds failed to comply with both IRC §§ 147(g) and 142(a).

7. The Official Statements represented that the bond projects were financed by bond proceeds and a cash contribution from the development company. The development company for each project was a limited partnership formed to develop the project. The purported contribution from the development company was disclosed in the Sources of Funds section of the Official Statements of the bond offerings as a "Developer's Contribution." The amount described as a Developer's Contribution was determined by Thorn and others for each of the bond offerings and was based solely on the amount required to cover issuance costs which exceeded two percent of the proceeds of the bond offerings. The purported Developer’s Contributions ranged from approximately $48,000 to approximately $404,000 and with respect to each offering consisted of more than 5% of the offering proceeds.

8. The purported Developer's Contribution was not paid with separate funds from the development company, but was paid exclusively with funds received from the bond proceeds by the contractor which renovated the projects. The compensation to the contractor, in exchange for its services on each project, was artificially inflated in an amount equal to the purported Developer's Contribution. The contractor received bond proceeds, in addition to those required by the contractor for construction in exchange for its services, for the purpose of making what was referred to as the Developer's Contribution. The purported Developer's Contribution was utilized in each of the bond offerings solely to pay issuance costs exceeding two percent of the bond proceeds. The use of offering proceeds to pay the purported Developer's Contribution in each offering was not disclosed to investors or prospective investors.

9. The manner in which proceeds derived from the bond offerings, in amounts equivalent to approximately 7 to 9 percent of the proceeds of each offering, were utilized to make the purported Developer's Contribution, created a substantial risk that the bond offerings failed to comply with the requirements of Sections 147(g) and 142(a) of the IRC and a substantial risk that interest payments on the bonds were not tax exempt as represented in the Official Statements. Thorn, and through him TWC, knew, or was reckless in not knowing, that a substantial risk existed as to the tax exempt status of interest payment on the bonds. The substantial risk to the tax exempt status of interest on the bonds was not disclosed in the Official Statements or otherwise.[2]

10. TWC, through Thorn and others, continued to offer, buy and sell the bonds in the aftermarket as qualified tax exempt, private activity bonds without disclosure of the substantial risk that interest on the bonds may not have been exempt from the federal income tax.

11. During the period from in or about August 1992 through at least February 1994, Thorn and TWC willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, directly and indirectly, using the means and instrumentalities of interstate commerce and the mails to: (1) employ devices, schemes and artifices to defraud; (2) make untrue statements of material facts and to omit 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; and (3) engage in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, in connection with the purchase and sale of securities, as more particularly described in paragraphs one through ten, above.

12. During the period from in or about August 1992 through at least February 1994, Thorn and TWC willfully violated Section 17(a) of the Securities Act by, directly and indirectly, using the means and instruments of transportation and communication in interstate commerce and the mails to: (1) employ devices, schemes and artifices to defraud purchasers; (2) obtain money and property by means of untrue statements of material facts and omissions 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; and (3) engage in acts, practices and a course of business which operated or would have operated as a fraud and deceit upon purchasers, in the offer and sale of securities, as more particularly described in paragraphs one through ten, above.

13. During the period from in or about August 1992 through at least February 1994, TWC willfully violated and Thorn willfully aided and abetted violations of, Section 15B(c)(1) of the Exchange Act and Rule G-17 of the Municipal Securities Rulemaking Board, by, in the conduct of the municipal securities business of TWC, not dealing fairly with other persons and engaging in deceptive, dishonest and unfair practices, as more particularly described in paragraphs one through ten, above.

14. Respondent Thorn has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest. The Commission has reviewed the sworn financial statement and other evidence provided by Respondent Thorn and has determined that Respondent Thorn does not have the financial ability to pay complete disgorgement of $116,432, plus his equity interest in the partnerships which own the projects financed by the bond offerings, or any proceeds from the sale of such interests, plus prejudgment interest.

15. Respondent TWC has submitted a sworn financial statement and other evidence and has asserted its financial inability to pay disgorgement plus prejudgment interest. The Commission has reviewed the sworn financial statement and other evidence provided by Respondent TWC and has determined that Respondent TWC does not have the financial ability to pay complete disgorgement of $234,203 plus prejudgment interest.

16. The Respondents have submitted sworn financial statements and other evidence and have asserted their financial inability to pay a civil penalty. The Commission has reviewed the sworn financial

statements and other evidence provided by Respondents and has determined that neither Respondent has the financial ability to pay a civil penalty.

II.

Proceedings Being Instituted

Based on his Order and the Respondents' Offer, the Commission finds the following.

1. TWC, between November 1987 and May 1996, was the underwriter for 74 offerings of urban renewal revenue notes ("notes") issued by 39 Mississippi political subdivisions, including counties, cities and towns ("municipalities"). The offerings raised a total of approximately $287,300,000.

2. In each offering, the notes were sold based upon a representation that bond counsel had concluded that interest on the notes would be excludable from gross income for federal income tax purposes. The disclosure documents used in connection with the note offerings represented that the note proceeds would be utilized within three years on various public projects. In fact, the municipalities had no intention of spending more than a small percentage of the proceeds on public projects. That percentage, generally close to one percent of the proceeds, was received by the municipality as a "premium" or "fee" for issuing the notes. The remaining proceeds were invested in guaranteed investment contracts ("GICs") or certificates of deposit ("CDs") yielding a higher rate of return than the notes. Those instruments provided the cash flows to pay the debt service required by the notes. This financing structure resulted in a significant risk to the tax exempt status of interest on the notes.

3. Internal Revenue Code ("IRC") Section 103(b) provides that gross income includes interest on any state or local bond which is an "arbitrage bond" as that term is defined by IRC Section 148. IRC Section 148 (a) defines an arbitrage bond as "any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments...."

4. IRC Section 148(c)(1) allows the proceeds of certain issues to be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which the bonds were issued. This provision is known as the "temporary period exception." It provides that the bonds will not be treated as taxable arbitrage bonds if the net sale proceeds and investment proceeds of an issue are reasonably expected to be allocated to expenditures for capital projects within specified time periods. Treas. Reg. Sec. 1.148-2(b)(1) and 2(e)(2)(i)(1993); Treas. Reg. Sec. 1.103-13(a)(2) (1979). When statements regarding reasonable expectations with respect to the amount and use of the proceeds are not made in good faith, the notes are deemed to be taxable arbitrage bonds. Revenue Ruling 85-182, 1985-2 C.B. 39.

5. Although all the note offerings were purportedly structured to comply with the requirements of the temporary period exception, at the time of the offerings, none of the issuers had the resources, intent or expectation to utilize any proceeds from the offerings, other than the premium or fee, for capital projects. Subsequent to the offerings, none of the issuers utilized any of the offering proceeds, other than the premium or fee, for any capital project. The lack of a reasonable expectation to utilize more than a small portion of the proceeds for capital projects would violate the reasonable expectation requirements of IRC Section 148(c)(1) and Treas. Reg. 1.148-2(e)(2). Therefore, a substantial risk exists that the issuers did not satisfy the requirements of the temporary period exception, making the structure of these transactions a prohibited arbitrage scheme that violates IRC Sections 103(b) and 148(a)(1). The violation of these sections created a substantial risk that the IRS would declare interest on the notes includable in gross income for federal income tax purposes.

6. The substantial risk to the tax exempt status of interest on the notes was not disclosed to investors or prospective investors in any of the offerings. The official statements and arbitrage certificates for each

offering, among other documents, without exception, represented that the issuers intended to spend the full amount of the offering proceeds within three years on various capital projects, such as roads, parks, a courthouse, and other projects. Each official statement also represented that the issuer was negotiating with a specified firm for "architectural services." These statements were not true. Although the investors were under no duty to independently evaluate the degree of risk to the tax exemption, the false representations dealing with the municipalities' intentions to spend the proceeds and their current negotiations for services in that regard, would have made it difficult for investors, even those with access to tax advice, to ascertain the risk to the tax exemption.

7. TWC, through Thorn and others, sold the notes from each of the offerings using the official statements. Thorn knew, or was reckless in not knowing, that the official statements misrepresented the issuers' intent to spend the proceeds of the offerings on municipal projects. Thorn also knew, or was reckless in not knowing, that the tax exempt status of the notes was contingent on the issuers having a bona fide intent to utilize the note proceeds on municipal projects within three years from the date of the offering. Thorn, and through him TWC, knew, or was reckless in not knowing, that a substantial risk existed as to the tax exempt status of interest payment on the notes. That risk was not disclosed to purchasers of the notes.

8. During the period from November 1987 through May 1996, Thorn and TWC willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, directly and indirectly, using the means and instrumentalities of interstate commerce and the mails to: (1) employ devices, schemes and artifices to defraud; (2) make untrue statements of material facts and to omit 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; and (3) engage in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, in connection with the purchase and sale of securities, as more particularly described in paragraphs one through seven, above.

9. During the period from November 1987 through May 1996, Thorn and TWC willfully violated Section 17(a) of the Securities Act by, directly and indirectly, using the means and instruments of transportation and communication in interstate commerce and the mails to: (1) employ devices, schemes and artifices to defraud purchasers; (2) obtain money and property by means of untrue statements of material facts and omissions 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; and (3) engage in acts, practices and a course of business which operated or would have operated as a fraud and deceit upon purchasers, in the offer and sale of securities, as more particularly described in paragraphs one through seven, above.

10. Respondent Thorn has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest. The Commission has reviewed the sworn financial statement and other evidence provided by Respondent Thorn and has determined that Respondent Thorn does not have the financial ability to pay disgorgement of $1,761,770, plus prejudgment interest.

11. Respondent TWC has submitted a sworn financial statement and other evidence and has asserted its financial inability to pay disgorgement plus prejudgment interest. The Commission has reviewed the sworn financial statement and other evidence provided by Respondent TWC and has determined that Respondent TWC does not have the financial ability to pay disgorgement of $1,513,418 plus prejudgment interest.

12. The Respondents have submitted sworn financial statements and other evidence and have asserted their financial inability to pay a civil penalty. The Commission has reviewed the sworn financial statements and other evidence provided by Respondents and has determined that neither Respondent has the financial ability to pay a civil penalty.

III.

ACCORDINGLY, IT IS HEREBY ORDERED:

1. That the broker-dealer registration of TWC be revoked;

2. That Respondent Thorn be barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company;

3. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that Thorn cease and desist from committing or causing any violation or any future violation of Section 17(a) of the Securities Act or Sections 10(b) or 15B(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and Rule G-17 of the MSRB;

4. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act that TWC cease and desist from committing or causing any violation or any future violation of Section 17(a) of the Securities Act or Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and Rule G-17 of the MSRB;

5. That Respondent Thorn shall pay disgorgement of $1,878,202 plus any equity interest Thorn owns in the seven limited partnerships which own the projects that were the subject of the bond offerings, plus prejudgment interest, provided that Thorn shall pay $10,000 within sixty (60) days of this order to the United States Treasury. Such payment shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered or delivered by overnight delivery service to the Comptroller, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (d) submitted under a cover letter which identifies Thorn as a respondent in these proceedings. Thorn is further ordered to comply with his undertaking to forego on any personal income tax return all unused income tax credits which have accrued and to which he may be entitled arising from his interest in the seven limited partnerships which own the projects that were the subject of the bond offerings. Payment of the remainder of the disgorgement is waived based upon Respondent Thorn's demonstrated financial inability to pay;

6. That the Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Thorn provided accurate and complete financial information at the time such representations were made; and (2) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent Thorn's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by Respondent Thorn was fraudulent, misleading, inaccurate or incomplete in any material respect and whether any additional remedies should be imposed. Respondent Thorn may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding;

7. That TWC shall pay disgorgement of $1,747,621 plus prejudgment interest, provided that TWC shall pay $15,000 within thirty (30) days of this order to the United States Treasury. Such payment shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered or delivered by overnight delivery service to the Comptroller, Stop 0-3, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (d) submitted under a cover letter which identifies TWC as a respondent in these proceedings. Payment of the remaining disgorgement is waived based upon Respondent TWC's demonstrated financial inability to pay;

8. That the Division may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether TWC provided accurate and complete financial information at the time such representations were made; and (2) seek any additional remedies that the Commission would be

authorized to impose in this proceeding if TWC's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by TWC was fraudulent, misleading, inaccurate or incomplete in any material respect and whether any additional remedies should be imposed. TWC may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding.

FOOTNOTES

[1]: The findings herein are made pursuant to the Offer of Settlement of Thorn and TWC and are not binding on any other person or entity named as a respondent in this or any other proceeding.

[2]: In July 1997 the political subdivisions which issued the bonds announced a settlement with the Internal Revenue Service ("IRS") with respect to the bond offerings. In return for payments of $1.182 million, the IRS agreed not to seek to tax the interest earnings of investors who purchased the bonds.

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In re Eugene J. Yelverton, Jr., Securities Act Release No. 7662, Exchange Act of Release No. 41232, A.P. No. 3-9859 (March 31, 1999).

I.

The Commission deems it appropriate and in the public interest that public proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") be, and they hereby are, instituted against Eugene J. Yelverton, Jr. ("Yelverton" or "Respondent").

II.

In anticipation of the institution of these proceedings, the Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, the Respondent, without admitting or denying the findings set forth herein, except as contained in Section III 1 and 2, below, and as to the jurisdiction of the Commission over the Respondent and over the subject matter of these proceedings, which are admitted, consents to the entry of this Order Instituting Public Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b), 19(h) and 21C of the Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Order ("Order").

III.

Based on this Order and the Respondent's Offer, the Commission finds the following. [1]

1. Thorn, Welch & Co., Inc., ("TWC"). TWC is a registered broker-dealer located in Jackson, Mississippi. TWC has been registered with the Commission pursuant to Section 15(b) of the Exchange Act since on or about March 10, 1977. On November 22, 1993, the firm changed its name to Thorn, Welch & Co., Inc. TWC's business consisted primarily of underwriting and trading municipal securities.

2. Yelverton. Yelverton is a resident of Jackson, Mississippi. From 1987 through 1990, Yelverton was a consultant to TWC. From 1990 through the present, Yelverton has been a shareholder of TWC. Yelverton was a municipal securities principal of TWC from January 1991 through 1996.

3. Between November 1987 and May 1996, TWC was the underwriter for 74 offerings of urban renewal revenue notes ("notes") issued by 39 Mississippi political subdivisions, including counties, cities and towns ("municipalities"). The offerings raised a total of approximately $287,300,000.

4. In each offering, the notes were sold based upon a representation that bond counsel had concluded that interest on the notes would be excludable from gross income for federal income tax purposes. The disclosure documents used in connection with the note offerings represented that the note proceeds would be utilized within three years on various public projects. In fact, the municipalities had no intention of spending more than a small percentage of the proceeds on public projects. That percentage, generally close to one percent of the proceeds, was received by the municipality as a "premium" or "fee" for issuing the notes. The remaining proceeds were invested in guaranteed investment contracts ("GICs") or certificates of deposit ("CDs") yielding a higher rate of return than the notes. Those instruments provided the cash flows to pay the debt service required by the notes. This financing structure resulted in a significant risk to the tax exempt status of interest on the notes.

5. Internal Revenue Code ("IRC") Section 103(b) provides that gross income includes interest on any state or local bond which is an "arbitrage bond" as that term is defined by IRC Section 148. IRC Section 148 (a) defines an arbitrage bond as "any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly (1) to acquire higher yielding investments...."

6. IRC Section 148(c)(1) allows the proceeds of certain issues to be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which the bonds were issued. This provision is known as the "temporary period exception." It provides that the bonds will not be treated as taxable arbitrage bonds if the net sale proceeds and investment proceeds of an issue are reasonably expected to be allocated to expenditures for capital projects within specified time periods. Treas. Reg. Sec. 1.148-2(b)(1) and 2(e)(2)(i)(1993); Treas. Reg. Sec. 1.103-13(a)(2) (1979). When statements regarding reasonable expectations with respect to the amount and use of the proceeds are not made in good faith, the notes are deemed to be taxable arbitrage bonds. Revenue Ruling 85-182, 1985-2 C.B. 39.

7. Although all the note offerings were purportedly structured to comply with the requirements of the temporary period exception, at the time of the offerings, none of the issuers had the resources, intent or expectation to utilize any proceeds from the offerings, other than the premium or fee, for capital projects. Subsequent to the offerings, none of the issuers utilized any of the offering proceeds, other than the premium or fee, for any capital project. The lack of a reasonable expectation to utilize more than a small portion of the proceeds for capital projects would violate the reasonable expectation requirements of IRC Section 148(c)(1) and Treas. Reg. 1.148-2(e)(2). Therefore, a substantial risk exists that the issuers did not satisfy the requirements of the temporary period exception, making the structure of these transactions a prohibited arbitrage scheme that violates IRC Sections 103(b) and 148(a)(1). The violation of these sections created a substantial risk that the IRS would declare interest on the notes includable in gross income for federal income tax purposes.

8. The substantial risk to the tax exempt status of interest on the notes was not disclosed to investors or prospective investors in any of the offerings. The official statements and arbitrage certificates for each offering, among other documents, without exception, represented that the issuers intended to spend the full amount of the offering proceeds within three years on various capital projects, such as roads, parks, a courthouse, and other projects. Each official statement also represented that the issuer was negotiating with a specified firm for "architectural services. "These statements were not true. Although the investors were under no duty to independently evaluate the degree of risk to the tax exemption, the false representations dealing with the municipalities' intentions to spend the proceeds and their current negotiations for services in that regard, would have made it difficult for investors, even those with access to tax advice, to ascertain the risk to the tax exemption.

9. TWC, through Yelverton and others, sold the notes from each of the offerings using the official statements. Yelverton knew, or was reckless in not knowing, that the official statements misrepresented the issuers' intent to spend the proceeds of the offerings on municipal projects. Yelverton also knew, or was reckless in not knowing, that the tax exempt status of the notes was contingent on the issuers having a bona fide intent to utilize the note proceeds on municipal projects within three years from the date of the offering. Yelverton knew, or was reckless in not knowing, that a substantial risk existed as to the tax exempt status of interest payment on the notes. That risk was not disclosed to purchasers of the notes.

10. During the period from November 1987 through May 1996, Yelverton willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by, directly and indirectly, using the means and instrumentalities of interstate commerce and the mails to: (1) employ devices, schemes and artifices to defraud; (2) make untrue statements of material facts and to omit 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; and (3) engage in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, in connection with the purchase and sale of securities, as more particularly described in paragraphs one through nine, above.

11. During the period from November 1987 through May 1996, Yelverton willfully violated Section 17(a) of the Securities Act by, directly and indirectly, using the means and instruments of transportation and communication in interstate commerce and the mails to: (1) employ devices, schemes and artifices to defraud purchasers; (2) obtain money and property by means of untrue statements of material facts and omissions 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; and (3) engage in acts, practices and a course of business which operated or would have operated as a fraud and deceit upon purchasers, in the offer and sale of securities, as more particularly described in paragraphs one through nine, above.

12. Respondent Yelverton has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest. The Commission has reviewed the sworn financial statement and other evidence provided by Respondent Yelverton and has determined that Respondent Yelverton does not have the financial ability to pay completely disgorgement of $877,350, plus prejudgment interest.

13. Yelverton has submitted sworn financial statements and other evidence and has asserted his financial inability to pay a civil penalty. The Commission has reviewed the sworn financial statements and other evidence provided by Yelverton and has determined that Yelverton does not have the financial ability to pay a civil penalty.

ACCORDINGLY, IT IS HEREBY ORDERED:

1. That Respondent Yelverton be barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company;

2. That Respondent Yelverton cease and desist from committing or causing any violation or any future violation of Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

3. That Respondent Yelverton shall pay disgorgement of $877,350, plus prejudgment interest, provided that Yelverton shall pay $3,000 within thirty (30) days of this order and shall pay an additional $27,000 within 270 days to the United States Treasury. Such payment shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered or delivered by overnight delivery service to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (d) submitted under a cover letter which identifies Yelverton as a respondent in these proceedings. Yelverton is further ordered to comply with his undertaking to forego on

any personal income tax return all unused income tax credits which have accrued and to which he may be entitled as of the date of this Order arising from his interest in the seven limited partnerships which own low-income housing projects financed by urban renewal revenue bonds underwritten by TWC between August 1992 and October 1993. Payment of the remainder of the disgorgement is waived based upon Respondent Yelverton's demonstrated financial inability to pay;

4. That the Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Yelverton provided accurate and complete financial information at the time such representations were made; and (2) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent Yelverton's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by Respondent Yelverton was fraudulent, misleading, inaccurate or incomplete in any material respect and whether any additional remedies should be imposed. Respondent Yelverton may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding;

FOOTNOTES

[1]: The findings herein are made pursuant to the Offer of Settlement of the Respondent and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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<u>In re James V. Pannone,</u> Exchange Act Release No. 41065, A.P. File No. 3-9830 (February 17, 1999).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Sections 15(b)(6), 15B(c)(4) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act"), against James V. Pannone ("Pannone").

II.

In anticipation of the institution of these proceedings, Pannone has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Pannone, without admitting or denying the findings contained in this Order Instituting Public Administrative Proceedings Pursuant to Section 15(b)(6), 15B(c)(4) and 19(h) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions ("Order"), except that Pannone admits: (i) that the Commission has jurisdiction over him and over the subject matter of these proceedings, and (ii) the entry of the injunction set forth in paragraph III.D below, consents to the entry of the findings and the imposition of the remedial sanctions set forth herein.

III.

FINDINGS

On the basis of this Order and the Offer, the Commission finds that:[1]

A. At all times relevant, Pannone was associated with Stifel, Nicolaus & Company, Inc. ("Stifel"), a broker-dealer and municipal securities dealer registered with the Commission.

B. On September 21, 1998, the Commission filed its Second Amended Complaint ("Complaint") against Pannone [Securities and Exchange Commission v. Robert Cochran, et al., Case No. CIV-95-1477-A (W.D. Okla.)], alleging that Pannone violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and Rule G-17 of the Municipal Securities Rulemaking Board ("MSRB").

C. The Complaint alleged that Pannone, in conjunction with others, defrauded two municipal bond issuers and the respective municipal bond purchasers by failing to disclose and/or making false statements concerning: (i) the rigging of the bidding process to ensure the selection of a certain entity as the investment agreement provider; and (ii) the resulting payments Stifel received from the investment agreement provider.

D. On February 17, 1999, pursuant to a consent agreement in which Pannone neither admitted nor denied any of the allegations contained in the Complaint, the federal district court in the Western District of Oklahoma entered a Final Judgment of Permanent Injunction and Other Relief as to Defendant James Pannone, permanently enjoining Pannone from violations of Section 17(a) of the Securities Act, Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5 thereunder, and Rule G-17 of the MSRB.

IV.

ORDER

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer and impose the sanctions specified therein.

ACCORDINGLY, IT IS HEREBY ORDERED that:

A. Pannone be, and hereby is, suspended from association with any broker or dealer or municipal securities dealer for twelve months, effective on the second Monday following the entry of this Order; and

B. Pannone shall provide to the Commission, within three days after the end of the twelve-month suspension period described above, an affidavit that he has complied fully with the sanctions described in Section IV A above.

FOOTNOTES

[1]: The findings in this Order are made pursuant to Pannone's Offer and are not binding on any other person or entity in this or any other proceeding.

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In re Randall W. Nelson, Securities Act Release No. 7635, Exchange Act Release No. 40984, A.P. File No. 3-9819 (January 27, 1999).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b)(6) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act"), against Randall W. Nelson ("Nelson").

II.

In anticipation of the institution of this proceeding, Nelson has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of this proceeding, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Nelson, without admitting or denying the findings contained in this Order Instituting Public Administrative Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b)(6) and 19(h) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), except that Nelson admits that the Commission has jurisdiction over him and over the subject matter of this proceeding, consents to the entry of the findings and the imposition of the remedial sanctions set forth herein.

III.

On the basis of this Order and the Offer, the Commission finds that:[1]

A. RESPONDENT

Nelson is a resident of Tulsa, Oklahoma. From April 1991 until April 1993, Nelson was associated with Stifel, Nicolaus & Company, Inc. ("Stifel"), employed in its Oklahoma Public Finance Office in Oklahoma City.

B. OTHER RELEVANT ENTITIES

1. Stifel is a broker-dealer and municipal securities dealer registered with the Commission and headquartered in St. Louis, Missouri. On August 3, 1995, the Commission filed a settled civil injunctive action against Stifel. The Commission's complaint against Stifel included allegations concerning Stifel's restructuring of the Grand River Dam Authority's debt service fund, as described below. Without admitting or denying the allegations in the complaint, Stifel consented to the entry of a final judgment which enjoined Stifel from violating certain provisions of the federal securities laws, and ordered Stifel to disgorge certain unjust gains plus prejudgment interest thereon, and to pay a civil monetary penalty. See SEC v. Stifel, Nicolaus & Co., Inc., Lit. Rel. No. 14587 (Aug. 3, 1995).

2. The Grand River Dam Authority ("GRDA") is a conservation and reclamation district and an agency of the state of Oklahoma. The directors of the GRDA are appointed by the Governor of Oklahoma, with the advice and consent of the Oklahoma Senate. The GRDA provides electrical service to a defined area in Oklahoma. The GRDA has a limited staff, and relies substantially on outside professionals in issuing municipal securities and related financial matters.

C. THE GRDA RETAINS STIFEL AND NELSON TO RESTRUCTURE THE DEBT SERVICE FUND

For several years prior to joining Stifel, Nelson was a trust department officer at an Oklahoma commercial bank which served as the trustee for certain GRDA bond issues. As a result, Nelson developed a relationship of trust and confidence with the GRDA and its staff.

After joining Stifel's Oklahoma Public Finance Office in April 1991, Nelson approached the GRDA and proposed that the GRDA restructure a debt service fund associated with a previous bond issue. Nelson told the GRDA that he believed that Stifel could obtain for the GRDA a higher yield on the moneys in its debt service fund than it was then receiving, plus a one time, up-front cash payment of at least $1 million.

In June 1991, based upon Nelson's proposal, the GRDA hired Stifel to act as its financial adviser in restructuring the debt service fund for a total fee of $75,000. Acting as financial adviser, Nelson proposed an investment contract for the GRDA's debt service fund. The investment contract, as proposed by Nelson, provided for an interest rate of seven percent. The winning bidder would be the bidder willing to make the largest up-front payment to the GRDA in excess of $1 million, in addition to paying the requested rate of interest.

D. STIFEL RECEIVES A BROKERAGE FEE THAT IS NOT DISCLOSED TO THE GRDA

Nelson and James Pannone ("Pannone"), another member of Stifel's Oklahoma Public Finance Office, contacted a then vice president (the "Vice President") at Pacific Matrix Financial Group, Inc. ("Pacific Matrix"), an investment contract broker, and requested that he solicit bids for the investment contract. Nelson and Pannone demanded, and the Vice President agreed, that Stifel would receive ninety percent of whatever brokerage fee was paid by the winning provider.

Steven Strauss ("Strauss"), a then managing director of Sakura Global Capital, Inc. ("Sakura"), told Nelson, Pannone and the Vice President that Sakura was willing to pay the seven percent interest rate requested in the bid solicitation, plus an up-front payment in the amount of $1.4 million, which was the largest up-front payment offered by any of the bidders. Nelson, Pannone, the Vice President and Strauss agreed that Sakura would pay, from the amount of its gross bid, the sum of $283,500 directly to Stifel, as well as the sum of $31,500 to Pacific Matrix. After discussions within the Oklahoma Public Finance Office, Nelson told the GRDA that Sakura's bid included an up-front payment in the amount of $1.085 million and failed to disclose that the figure was net of the $283,500 Sakura paid to Stifel and the $31,500 Sakura paid to Pacific Matrix.

About one week after the closing of the GRDA transaction, a member of Stifel's compliance department asked Nelson if Stifel's payment from Sakura had been disclosed to the GRDA. Because Nelson had not disclosed to the GRDA the payment from Sakura, Nelson wrote a letter to the GRDA advising the GRDA that Stifel would receive a payment from Sakura. Nelson gave the letter to his supervisor who acknowledged that the payment had not been disclosed. Nelson's supervisor told Nelson he would take care of the matter. Nelson's supervisor never sent the letter to the GRDA.

E. NELSON CAUSED STIFEL'S VIOLATIONS OF SECTION 17(a)(2) AND (3) OF THE SECURITIES ACT

As the financial adviser to the GRDA, Stifel had a duty to disclose conflicts of interest. Receiving a payment from Sakura was a conflict of interest which should have been disclosed to the GRDA at the time the potential conflict arose. Stifel violated Section 17(a)(2) and (3) of the Securities Act by not disclosing to the GRDA the payment it received from Sakura. By failing to disclose the conflict of interest to the GRDA, Nelson willfully aided and abetted and caused Stifel's violations of Section 17(a)(2) and (3) of the Securities Act.

IV.

FINDINGS

From April 1991 until April 1993, Nelson was associated with Stifel, Nicolaus & Company, Inc., a broker-dealer and municipal securities dealer registered with the Commission.

Based on the foregoing, the Commission finds that Nelson willfully aided and abetted and caused Stifel's violations of Section 17(a)(2) and (3) of the Securities Act.

V.

ORDER

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer and impose the sanctions specified therein.

ACCORDINGLY, IT IS HEREBY ORDERED that:

A. Nelson, pursuant to Section 8A of the Securities Act, cease and desist from committing or causing any violation and any future violation of Section 17(a)(2) and (3) of the Securities Act;

B. Nelson pay a civil monetary penalty in the amount of $20,000, pursuant to Section 21B of the Exchange Act, to the United States Department of Treasury, within ten days after the entry of this Order. Payment shall be: (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (iv) submitted under cover letter which identifies Nelson as the Respondent in this proceeding and the file number of this proceeding, a copy of which cover letter and money order or check shall be sent to Kevin J. Harnisch, Senior Counsel, Division of Enforcement, Securities and Exchange Commission, 450 Fifth Street, N.W., Stop 7-2, Washington, D.C. 20549;

C. Nelson be, and hereby is, suspended from association with any broker or dealer for one month, effective on the third day following the entry of this Order; and

D. Nelson provide to the Commission, within three days after the end of the one-month suspension period described above, an affidavit that he has complied fully with the sanctions described in Section V.C above.

FOOTNOTES

[1]: The findings in this Order are made pursuant to Nelson’s Offer and are not binding on any other person or entity in this or any other proceeding.

<u>In re Stephens Inc</u>., Securities Act Release No. 7612, Exchange Act Release No. 40699, A.P. File No. 3-9781 (November 23, 1998).

The Commission deems it appropriate and in the public interest to institute public administrative proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77h-1] and Sections 15(b)(4), 15B(c)(2) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78o(b)(4), 78o-4(c)(2), 78s(h) and 78u-3] against Stephens Inc. ("Stephens" or "Respondent").

In anticipation of the institution of these proceedings, Stephens has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, Stephens, without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of these proceedings, which is admitted, consents to the entry of the findings, and the imposition of the remedial sanctions set forth below.

The Commission finds[1] that:

FACTS

Respondent

Stephens Inc. Stephens is an Arkansas corporation with its principal place of business in Little Rock, Arkansas. At all relevant times, Stephens was a broker-dealer and municipal securities dealer, and was registered with the Commission pursuant to Sections 15(b) and 15B(a) of the Exchange Act.

Summary

This matter involves undisclosed payments to three Florida public officials, and other improper practices in connection with Stephens' pursuit of municipal securities business between 1989 and 1995, including the failure to disclose to a Georgia issuer Stephens' receipt of a brokerage commission on a Guaranteed Investment Contract ("GIC") in 1993.

William C. Bethea--a former senior vice-president of Stephens who served as head of its Public Finance Department from June 1991 until March 1994--authorized secret payments to one Florida public official, facilitated secret payments to another, and endorsed the conferral of an undisclosed favor on a third, all for the purpose of obtaining or retaining municipal securities business for Stephens.[2] In addition, Bethea, who from 1987 until 1991 served as a member of Stephens' Political Action Committee ("PAC") with authority to sign PAC checks: (1) enlisted third parties to serve as conduits for approximately $10,000 in Stephens campaign contributions between 1989 and 1992; and (2) created materially false and misleading books and records. In much of the aforementioned activity, Bethea was assisted by Preston C. Bynum, a former Stephens banker from its Little Rock office. In connection with the conferral of the undisclosed favor referenced above, Bethea was also assisted by a former Stephens vice-president from its Atlanta office who had supervisory responsibility over the Public Finance Department bankers in that office (the "Atlanta Supervisor"). Following Bethea's tenure as department head, the Atlanta Supervisor also took part in the secret compensation of a Florida state official as an inducement and reward for that official's support of Stephens' selection for certain state securities business.

As a result of the misconduct of these former members of its Public Finance Department, Stephens is responsible for (1) defrauding three different issuers in six different offerings of municipal securities; (2) defrauding investors in those offerings; and (3) violating books and records provisions and the gifts and fair-dealing rules of the Municipal Securities Rulemaking Board ("MSRB").

Payments to Escambia County Utilities Authority ("ECUA")[3] Official Terry D. Busbee

During 1992 and 1993, Bethea authorized, and assisted Bynum with, the payment of at least $18,000 to Terry D. Busbee, an elected public official of the ECUA, for the purpose of securing underwriting business for Stephens in two ECUA bond issuances: a $16 million offering used to finance the upgrade of a sewage treatment plant, that closed on October 29, 1992 ("Plant Upgrade issue"); and a $20 million offering used to acquire and upgrade the existing sanitation system, that closed on February 11, 1993 ("Sanitation issue").

On Thursday, July 30, 1992, after casting the deciding vote to select Stephens as senior managing underwriter for the ECUA's Plant Upgrade issue, Busbee demanded of Bynum that Stephens pay an associate in excess of $15,000 to (1) prevent the rescinding of Stephens' selection for the Plant Upgrade underwriting; and (2) ensure Stephens' selection as lead underwriter for the upcoming Sanitation issue. When informed by Bynum of this demand, Bethea agreed to it, despite knowing, having reason to know, or recklessly disregarding the fact that the payments to Busbee's associate were meant for Busbee. Shortly thereafter, Bethea learned from Bynum that the payments would, in fact, be funneled to Busbee.

On September 29, 1992, Busbee again cast the deciding vote for Stephens' selection as lead underwriter, this time for the Sanitation issue. Thereafter, in November 1992 and September 1993, respectively, Bethea and Bynum caused Stephens to issue checks of $10,000 and $7,500 payable to an entity owned by Busbee's associate, in accordance with the payment arrangement Bethea had approved. Bethea caused the mischaracterization of these payments on Stephens' books and records as payments to Busbee's associate for consulting services; they, in fact, were payments to Busbee. Moreover, no such consulting services had been rendered by Busbee's associate.

In order to conceal the payment scheme, Bethea caused the delay in the issuance of the second ($7,500) check until after the completion of a state grand jury investigation into the ECUA's underwriter selections.

A further payment of $6,000 was disbursed in October 1993, at Bynum's request. In addition, Bynum gave Busbee $8,935.84 more in December 1993, by paying off certain loans on Busbee's behalf.

At no time during the selection or offering process for the Plant Upgrade or Sanitation bonds was the payment arrangement with Busbee and the resulting conflicts of interest created thereby disclosed.

Payments to Osceola County[4] Official Larry K. O'Dell

By the Summer of 1992, a municipal securities business development consultant to Stephens (the "Consultant") had entered into a secret agreement with Larry K. O'Dell, then Director of Public Works for Osceola County, Florida, that if O'Dell would help Stephens obtain a selling group position for an upcoming bond issue of Osceola County, the Consultant would share his compensation from Stephens with O'Dell. The bond issue in question was the $150 million Osceola County, Florida, Transportation Improvement Bonds (Osceola Parkway Project), dated July 15, 1992 ("Parkway Bonds").

Also by the Summer of 1992, Bethea had agreed with the Consultant that, if Stephens were selected as a selling group member for the Parkway Bonds, Stephens would pay the Consultant one-half the Public Finance Department's net profits on that bond issue. Although Bethea lacked actual knowledge of the payment arrangement between the Consultant and O'Dell, he ignored indications that the Consultant would (and did) share his compensation with O'Dell in the approximate amount of $1,700.

By July 1992, with O'Dell's help, Stephens was named a selling group member for the Parkway Bonds. The bond issue closed on August 6, 1992. By December 1992, Stephens' Public Finance Department had recorded net profits of $35,739.54 for the Parkway Bonds. At that time, in accordance with his agreement with the Consultant, Bethea caused Stephens to issue a check to the Consultant for $17,869.77--exactly half of $35,739.54--ostensibly for "special compensation" relating to "Florida transactions." In fact, this check was solely for the Parkway Bonds.

Shortly thereafter, concerned that the arithmetical relationship between the $17,869.77 check and the amount of his department's profits from the Parkway Bonds might cause the uncovering of its connection to that bond issue, Bethea directed the voiding of the $17,869.77 check, and its replacement by another check, in a different amount, with different supporting documentation. The replacement check, for $17,800, was mischaracterized on Stephens' books and records at Bethea's direction as a "bonus" pursuant to the Consultant's contract with Stephens.

At no time during the selling-group selection or offering process for the Parkway bonds was the payment arrangement with O'Dell and the resulting conflicts of interest created thereby disclosed.

FOOTNOTES

[1]: The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in these or any other proceedings.

[2]: The Commission has filed separate enforcement actions related to some of the matters discussed herein. SEC v. Bynum, Civil Action No. 95-30024-RV (N.D. Fla.); Lit. Rel. No. 14387/January 23, 1995; SEC v. O'Dell, Civil Action No. 98-948-Civ-Orl-18A (M.D. Fla.); Lit. Rel. No. 15858/August 24, 1998.

[3]: The ECUA is a local government body that was established by the Florida legislature in 1981, for the purpose of managing, financing and improving the water and sewer systems of Escambia County, Florida. At all relevant times, the ECUA was empowered to issue revenue bonds to finance the acquisition, construction and improvement of water, sewer, sanitation and (with certain limitations) natural gas systems within Escambia County and some adjacent areas. The ECUA had an elected board comprised of five members who served staggered four-year terms.

[4]: Osceola County is a political subdivision of the State of Florida. Its governing body is the Osceola County Board of Commissioners. At all relevant times, the Osceola County Board of Commissioners consisted of five elected members, and was empowered to issue bonds and to select underwriters and selling group members in connection with such bond issuances. The authority to select selling group members was delegated to the Osceola County Manager.

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Conferral of Undisclosed Favor on Florida Housing Finance Agency ("FHFA")[5] Official W. Jay Ramsey

In or about early March 1993, the Consultant assisted W. Jay Ramsey, an FHFA official, in obtaining a $90,000-per-year post with an architecture firm the Consultant represented, by giving Ramsey a favorable recommendation. Bethea learned of the Consultant's help with Ramsey's employment at the time it occurred. Shortly thereafter, the Atlanta Supervisor enlisted the Consultant to assist Stephens with its effort to be named remarketing agent for a $6 million remarketing issue of the FHFA that closed on August 19, 1993 ("Remarketing issue"), by advocating Stephens' selection to Ramsey. Bethea approved the hiring of the Consultant for this purpose. The Consultant then persuaded Ramsey to drop his prior opposition to Stephens' selection. In June 1993, Stephens was selected as remarketing agent for the Remarketing issue, with Ramsey's support.

Following closing of the Remarketing issue, Bethea caused Stephens to issue a $10,000 check to the Consultant for his assistance in that issue. At Bethea's direction, however, false books and records were created at Stephens concerning the $10,000 payment, including an invoice mischaracterizing the payment as relating to other matters.

Payments to FHFA Official W. Jay Ramsey

In April 1994, the FHFA invited interested underwriting firms to seek positions on its Approved List of Senior Managing Underwriters (the "Senior Manager Rotation") by issuing a Request for Proposals (the "Rotation RFP"). The Senior Manager Rotation was a list specifying which firms were approved as lead (i.e., "senior managing") underwriters for FHFA bond issues; once the Senior Manager Rotation was established, underwriters for particular FHFA bond issues were selected from it. Stephens submitted a proposal in response to the Rotation RFP. At the time, it had been nearly three years since Stephens held a spot in the FHFA's Senior Manager Rotation. By June 1994, the selection process pursuant to the Rotation RFP was completed. Stephens was not among the sixteen firms ultimately selected; nor did Stephens make the FHFA's short list of firms invited for interviews.

By November 1994, one of the sixteen firms indicated it would resign, causing an opening in the rotation. Also by November 1994, Ramsey, who served not only on the FHFA's board but also on its Professional Services Selection Committee, asked the Consultant for supplemental income of $1,500 per month.

On November 21, 1994, in Tampa, Ramsey, the Consultant, and two Stephens bankers (one of whom was the Atlanta Supervisor), met. At that meeting, the three Stephens representatives asked Ramsey to help Stephens fill the opening in the FHFA's Senior Manager Rotation. Ramsey agreed to help. At or about the same time, the Consultant agreed to arrange for the $1,500 in supplemental monthly income.

By December 5, 1994, the Atlanta Supervisor had enlisted the Consultant to assist with Stephens' naming as remarketing agent for certain FHFA securities offerings. The Consultant did so by, among other things, advocating Stephens' selection to Ramsey.

On December 9, 1994--less than three weeks after the Tampa meeting--the FHFA's Professional Selection Committee and full board both met. Ramsey was present at the meetings. One item of business taken up at both meetings was Stephens' addition to the FHFA's Senior Manager Rotation. Both the Professional Selection Committee and the full board, including Ramsey, voted unanimously to take this action.

By early January 1995, less than a month after Stephens' addition to the Senior Manager Rotation, the Consultant arranged to furnish Ramsey with his first $1,500 payment. This payment was made through a conduit, under cover of documentation falsely characterizing it as for consulting work. On February 3, 1995, just one week after Ramsey deposited the $1,500, the full board, including Ramsey, voted unanimously to select Stephens as remarketing agent for a $32 million FHFA remarketing issue--the same issue for which the Consultant had previously advocated Stephens' selection to Ramsey. Because the Consultant and Ramsey became aware of the Commission's investigation regarding this matter, no additional monthly payments were made to Ramsey.

By mid-February 1995, the Consultant, with the assistance of the Atlanta Supervisor, entered into a contract with Stephens for consulting services. Although this contract purported to be for future services outside the municipal securities arena, the contract and all payments thereunder were in fact exclusively for the Consultant's assistance with FHFA matters, and principally for Stephens' addition to the Senior Manager Rotation.

On October 13, 1995, the full board, including Ramsey, voted unanimously to select Stephens as remarketing agent for another FHFA issue: A $23 million remarketing that closed in December 1995. Subsequently, solely as a result of its inclusion in the Senior Manager Rotation, Stephens was named a co-manager for a $13.5 million FHFA bond issue dated March 1996.

Neither during the selection of Stephens for any of the FHFA issues identified above, nor during the offering process, were the payment arrangement with Ramsey and the resulting conflicts of interest created thereby disclosed.

Non-disclosure of GIC Commission to Cherokee County (Georgia) Water and Sewerage Authority ("Cherokee WSA")[6] In December 1993, Stephens served as sole underwriter for a $46 million refunding bond issue of the Cherokee WSA ("Cherokee WSA Refunding Bonds"). Contemporaneously with the closing of the bonds, and on the advice of Stephens, the Cherokee WSA entered into a GIC. The Cherokee WSA reasonably believed and understood at the time that Stephens' underwriting fees and sales commissions on the bonds were all the compensation Stephens would receive. It was never disclosed to the Cherokee WSA that Stephens received $75,482.28, which was a portion of the GIC broker's commission paid by the GIC provider.

Books and Records Violations

The payments to public officials and the consulting payments referenced above were accompanied and facilitated by false and misleading entries in the books and records of Stephens. The payments to the officials and payments to the Consultant were mischaracterized in check request forms and accounting records, and never designated as relating to the items of business for which they were paid. Numerous other instances of misbookings of payments and disbursements occurred at Stephens as well; these are described below.

1. Invoicing the ECUA for a Fishing Trip

In 1992, Stephens invoiced the ECUA for "communications and regulatory expenses." Although never paid by ECUA, included within this invoice as a "regulatory" expense was $2,130.75 that Stephens paid toward a Stephens-sponsored golf and fishing outing for Busbee and others. By so characterizing this expense, the invoice was false and misleading.

2. Misbookings of Consultant Compensation relating to a Walton County, Florida Bond Issue

In connection with a $17 million Florida Community Services Corporation of Walton County ("FCS-Walton")[7] bond issue closing in February 1992, for which Stephens served as sole underwriter (the "South Walton Bonds"), Stephens' books and records contained false and misleading entries. In

particular, the Consultant's invoice for $35,000 in fees relating to the South Walton Bonds included an itemization of expenses that was fictional and that was created at Bethea's direction to make the invoice appear legitimate. In fact, the Consultant had incurred no such expenses. In addition, following closing of the South Walton Bonds, Bethea and the Consultant executed a misleading "contract" between Stephens and the Consultant. This contract was purportedly for consulting services to be performed over the ensuing nine months throughout the state of Florida, and provided for compensation of $9,500 per month plus $7,000 in "start-up expenses." In fact, the contract and all payments thereunder were exclusively for the Consultant's activities in connection with the South Walton Bonds.

3. Misbookings of Campaign Contribution Reimbursements

Finally, in 1992, by or at the direction of Bethea, false books and records were created at Stephens concerning the reimbursement of campaign contributions. In particular, during the Summer of 1992, the Consultant, at Bethea's request, acted as a conduit for $700 in Stephens campaign contributions to ECUA candidates. At Bethea's direction, the Consultant invoiced Stephens for these contributions, as "expenses" relating to the Consultant's contract with Stephens. Bethea also directed the creation of materially misleading accounting records at Stephens mischaracterizing the true nature of these payments.

Between 1989 and 1992, inclusive of the $700 in reimbursed ECUA campaign contributions referenced above, Bethea and Bynum enlisted Stephens employees and outside vendors to make approximately $10,000 in campaign contributions to state and local candidates in connection with Stephens' efforts to obtain municipal securities business. With respect to these contributions, Bethea and Bynum caused the reimbursement of the employees and outside vendors, and in some cases, the advancing of funds to them, for the contributions. Again, in some instances Stephens' books and records failed to accurately reflect the true nature of these payments.

LEGAL ANALYSIS

Violations of the Antifraud Provisions

By virtue of the above-described conduct of Bethea, Bynum, the Atlanta Supervisor and the Consultant, Stephens is responsible for violating Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Nondisclosure to Issuers

The failure to disclose the arrangements with and payments to Busbee, O'Dell and Ramsey constituted and operated as a scheme to defraud the issuers of the ECUA, Osceola County, and FHFA bonds. See First Fidelity Securities Group, Exchange Act Rel. No. 36694, 61 S.E.C. Docket 68 (Jan. 9, 1996) (underwriter defrauded issuers by paying undisclosed kickbacks to fiduciary for underwriting business).

Moreover, as an underwriter of ECUA and FHFA securities, and as a selling group member for Osceola County securities, Stephens was a purchaser of securities from those issuers. Bethea, Bynum and the Atlanta Supervisor, knew and understood that Stephens, as a broker-dealer, had an obligation to deal fairly with the issuers. See Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944); see also MSRB rule G-17.[8] The undisclosed arrangements with and payments to Busbee, O'Dell and Ramsey breached that duty. See, e.g., SEC v. Feminella, 947 F. Supp. 722, 732 (S.D.N.Y 1996) (kickback paid to agent of broker-dealer's customer should have been received by the customer, and not the agent). The ECUA, Osceola County and the FHFA were entitled to impartial advice from their respective officials, and in evaluating that advice were entitled "to judge for themselves what significance to attribute" to the payments their officials received. See Wilson v. Great American Industries, Inc., 855 F.2d 987, 994 (2d Cir. 1988). This is "not because such [arrangements] are always corrupt but because they are always corrupting." Mosser v. Darrow, 341 U.S. 267, 271 (1951).[9]

Nondisclosure to Investors

As underwriter on the ECUA and FHFA offerings, Stephens delivered the Official Statements for the offerings to investors, and had a duty to review the key representations in those Official Statements. [10] The Official Statements for the ECUA and FHFA offerings failed to disclose the payments to Busbee and Ramsey. Because the existence of these payments cast doubt on the integrity of the offering process for the respective bond issues, they were material to investors. In the Matter of Lazard Freres & Co. LLC., Exchange Act Rel. No. 39388/Dec. 3, 1997.

Scienter

Bethea, Bynum and the Atlanta Supervisor, acted with the requisite scienter.[11] This is evidenced by their efforts to keep hidden the arrangements with and payments to Busbee, O'Dell and Ramsey, including by making the payments through an indirect channel, and under the guise of false and misleading documentation. By virtue of their positions with Stephens, the mental states of Bethea, Bynum and the Atlanta Supervisor may be imputed to Stephens.

Jurisdiction

The arrangements for, and payments of the monies to public officials, violated the antifraud provisions because they "touch[ed]" on the ECUA's, Osceola County's and the FHFA's sale of the securities. Superintendent of Insurance of New York v. Bankers Life & Cas. Co., 404 U.S. 6, 12-13 (1971). The information withheld was material to the issuers' decision to select Stephens as underwriter and as selling group member, and the selection of underwriters and selling group members had a direct nexus with the issuers' sale, and in turn, the public's purchase of the issuers' securities.

Violations of Section 15B(c)(1) of the Exchange Act and MSRB rules G-17 and G-20

As associated persons of a broker-dealer, Bethea, Bynum and the Atlanta Supervisor were bound by the MSRB rules.[12] By virtue of their above-described conduct in connection with the ECUA, Osceola County, and FHFA transactions, and by virtue of the failure to disclose the GIC commission in the Cherokee WSA transaction, Stephens is responsible for violating Section 15B(c)(1) of the Exchange Act and MSRB rules G-17 and G-20.

MSRB rule G-17

The failure to disclose financial and other relationships between Stephens and fiduciaries of its issuer clients, and its issuer-client's GIC broker, created potential or actual conflicts of interest and violated MSRB rule G-17, a fair-dealing rule. See Lazard Freres & Co. LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Exchange Act Rel. No. 36419 (Oct. 26, 1995); SEC v. Ferber, Lit. Rel. No. 15193 (December 19, 1996); First Fidelity Securities Group, supra; SEC v. Busbee, Lit. Rel. Nos. 14387 (January 23, 1995) and 14508 (May 24, 1995)); SEC v. Rudi, Lit. Rel. Nos. 14421 (February 23, 1996) and 15202 (December 30, 1996). In addition, the use of third parties as conduits for campaign contributions made in connection with municipal securities business development efforts likewise violated rule G-17. See In the Matter of FAIC Securities, Inc., Exchange Act Rel. No. 36937 (March 7, 1996) (imposing liability under Rule G-17 where broker dealer, among other things, failed to disclose its non-compliance with state law regarding campaign contributions made in furtherance of municipal securities business development efforts).

FOOTNOTES

[5]: At all relevant times, the FHFA was a public body, established under Florida law, empowered, among other things, to issue revenue bonds to provide financing for mortgage loans to assist in alleviating the shortage in safe, sanitary, affordable housing for low-, middle- and moderate-income persons or families.

The FHFA was headed by a nine-member board of directors. Eight of the nine members were appointed by the Governor and confirmed by the state senate; the ninth member, the Secretary of the Department of Community Affairs, was an ex-officio, voting member of the board.

[6]: Cherokee WSA was at all relevant times a public body established under Georgia law and empowered, among other things, to operate, expand and improve sources of water supply, water utility and sewage treatment facilities both within and without the territorial boundaries of Cherokee County, Georgia. The Cherokee WSA was headed by a seven-member board, appointed by the grand jury of Cherokee County. The Cherokee WSA was empowered to issue bonds to finance the construction, operation, maintenance, expansion and improvement of facilities within its system, and to refinance prior bonds issued for such purposes.

[7]: FCS-Walton was at all relevant times a non-profit corporation which provided central wastewater and water service through a regional utilities system for South Walton County,

In re Merrill Lynch, Pierce, Fenner & Smith Inc., Securities Act Release No. 7566, Exchange Act Release No. 40352, A.P. File No. 3-9683 (August 24, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that a public administrative and cease-and-desist proceeding be and hereby is instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch").

II.

In anticipation of the institution of this proceeding, Merrill Lynch has submitted an Offer of Settlement, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Merrill Lynch admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, Merrill Lynch, by its Offer of Settlement, consents to the entry of this Order Instituting a Public Administrative and Cease-And-Desist Proceeding Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Sanctions and Cease-and-Desist Order ("Order") and to the entry of the findings, sanctions, and cease-and-desist order set forth below.

Accordingly, IT IS HEREBY ORDERED that a proceeding pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offer of Settlement submitted by Merrill Lynch, the Commission finds that:[1]

A. RESPONDENT

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act [15 U.S.C. 78o(b)] and is headquartered in New York, New York. Merrill Lynch was the underwriter or co-manager of $875 million in notes (the "Notes") issued through four offerings (the "Note Offerings") by the County of Orange, California ("Orange County" or the "County") and the Orange County Flood Control District (the "Flood Control District") in July and August 1994.

B. FACTS

1. Introduction

Merrill Lynch was the underwriter or co-manager of the Note Offerings conducted by Orange County and the Flood Control District in July and August 1994.[2] Merrill Lynch sold the Notes to institutional investors through Official Statements that omitted material facts about the Orange County Investment Pools' (the "Pools") investment strategy, the risks of that strategy, and the Pools' investment losses. Accurate and complete disclosure about the Pools was material to investors because, in all four offerings, the funds pledged to repay the notes were invested in the Pools and, in two of the offerings, the Pools guaranteed repayment of the notes in that the Orange County Treasurer-Tax Collector ("Treasurer"), on behalf of the Pools, agreed that, if the funds pledged to repay the notes were insufficient, the Treasurer would purchase the notes at maturity at face value plus interest.

The Official Statements for three of the Note Offerings also omitted to disclose that the variable interest rate paid on the Notes was statutorily capped at 12%. This information was material to investors that had adopted policies against investing in securities with an interest rate cap.

As a result of a business relationship with the County, certain Merrill Lynch personnel knew substantial information about the Pools. The firm, however, unreasonably failed to assure that such information was conveyed to the Merrill Lynch employees who were responsible for reviewing and approving the Official Statements. The Merrill Lynch employees who were responsible for reviewing the Official Statements also knew or should have known material information about the Pools and the interest rate cap. These employees, from a reasonable review of the Official Statements, knew or should have known that the Official Statements omitted such information.

2. The Orange County Investment Pools

The Pools operated as an investment fund managed by the Treasurer, in which the County and various local governments or districts (“Participants") deposited public funds. As of December 6, 1994, the Pools held approximately $7.6 billion in Participant deposits, which the County had leveraged to an investment portfolio with a book value of over $20.6 billion.

a. The Pools' Investment Strategy

From at least April 1992 until December 1994, the Treasurer's investment strategy for the Pools involved: (1) using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days); and (2) investing the Participants' deposits and funds obtained through reverse repurchase agreements in debt securities (issued by the United States Treasury, United States government sponsored enterprises, and highly-rated banks and corporations) with a maturity of two to five years, many of which were derivative securities. The Pools' investment return was to result principally from the interest received on the securities in the Pools. Leverage enabled the Pools to purchase more securities with the anticipation of increasing interest income. This strategy was profitable as long as the Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

b. The Pools' Portfolio

During 1993 and 1994, the Treasurer, using reverse repurchase agreements, leveraged the Participants' deposits to amounts ranging from 158% to over 292%. As of the end of June 1994, the Pools held $19.8 billion in securities, with approximately $7.2 billion in Participant deposits and about $12.6 billion in reverse repurchase agreements, resulting in leverage of about 274%. During 1993 and 1994, the amount of derivatives in the Pools' portfolio ranged from 27.6% to 42.2% of the portfolio. As of the end of June

1994, 38.2% of the Pools' securities were derivatives. Most of the Pools' derivative securities were inverse floaters, which paid interest rates inversely related to the prevailing interest rate. From January 1993 through November 1994, 24.89% to 39.84% of the Pools' portfolio consisted of inverse floaters. As of the end of June 1994, 35% of the Pools' portfolio was invested in inverse floaters. From January 1993 through November 1994, only 1.84% to 5.59% of the Pools' portfolio consisted of securities that paid interest rates directly related to the prevailing interest rate (variable rate securities) or securities that paid interest rates that rose at certain stated intervals to certain stated rates (step-up securities). As of the end of June 1994, about 3.17% of the Pools' portfolio was invested in variable and step-up securities.

c. The Pools' Sensitivity To Interest Rate Changes And The Rise In Interest Rates During 1994

The composition of the Pools' portfolio made it sensitive to interest rate changes. As interest rates rose, the market value of the Pools' securities fell, and the interest received on the Pools' inverse floaters also declined. Thus, the Treasurer's investment strategy was profitable so long as interest rates, including the cost of obtaining funds through reverse repurchase agreements, remained low, the market value of the Pools' securities did not decline, and the Pools had the ability to hold securities to maturity.

From April 1992 through 1993, U.S. interest rates remained low and relatively stable. Due to the low interest rates and the Pools' investment strategy, the Pools earned a relatively high yield of approximately 8%. Beginning in February 1994, interest rates began to rise. This rise in interest rates resulted in: (1) an increase in the cost of obtaining funds under reverse repurchase agreements; (2) a decrease in the interest income on inverse floaters; (3) a decrease in the market value of the Pools' debt securities; (4) collateral calls and reductions in amounts obtained under reverse repurchase agreements; and (5) a decrease in the Pools' yield.

d. Orange County's Bankruptcy

By early December 1994, the Pools had an unrealized decline in market value of about $1.5 billion. Shortly thereafter, on December 6, 1994, Orange County filed Chapter 9 bankruptcy petitions on behalf of itself and the Pools (the petition filed on behalf of the Pools was later dismissed). Between early December 1994 and January 20, 1995, the Pools' securities portfolio was liquidated, incurring a loss of almost $1.7 billion on the Participants' deposits of $7.6 billion, a 22.3% loss.

FOOTNOTES

[1]: The findings herein are made pursuant to the Offer of Settlement of Merrill Lynch and are not binding on any other person or entity named as a respondent in this or any other proceeding.

[2]: Orange County and the Flood Control District were charged with disclosure violations concerning these offerings in a settled cease-and-desist proceeding. See In re County of Orange, California, Securities Act Release No. 7260 (Jan. 24, 1996).

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3. The Note Offerings

a. The Taxable Note Offerings

In July and August 1994, Merrill Lynch underwrote or co-managed the underwriting of municipal securities offerings for Orange County and the Flood Control District. The issuers conducted these offerings (the "Taxable Note Offerings") for the purpose of generating an anticipated profit by reinvesting the proceeds (together with funds equal to the estimated interest on the notes) in the Pools to earn an investment return that would be higher than the rate of interest payable to the Taxable Note investors. The issuers pledged these invested funds to secure repayment of the Taxable Notes, and, if the pledged funds were insufficient to pay principal and interest, the issuers would satisfy any deficiency with other

moneys lawfully available to repay the notes in the respective issuer's general fund attributable to the fiscal year in which the notes were issued.

The County issued $600 million in notes (the "$600 Million Taxable Notes") on July 8, 1994, described in an Official Statement dated July 1, 1994. These notes earned a variable interest rate reset monthly at the one-month London Interbank Offered Rate ("LIBOR") not to exceed 12% per annum. The $600 Million Taxable Notes were originally due on July 10, 1995. On June 27, 1995, the County and the noteholders entered into Rollover Agreements under which the maturity of the notes was extended from July 10, 1995, to June 30, 1996, and the interest rate paid on the notes was increased. On June 12, 1996, as part of its emergence from bankruptcy, the County repaid the notes with a portion of the proceeds from another County municipal securities offering.

On August 2, 1994, the Flood Control District issued $100 million in notes (the "$100 Million Taxable Notes") described in an Official Statement dated July 27, 1994. These notes earned a variable interest rate reset monthly at the one-month LIBOR plus .03% not to exceed 12% per annum. The notes matured, and were repaid, on August 1, 1995.

b. The Teeter Note Offerings

In July and August 1994, Merrill Lynch underwrote two Orange County offerings of Teeter Notes (the "Teeter Note Offerings"). The purpose of the Teeter Note Offerings was to fund the County's Teeter Plan, an alternate method of property tax distribution whereby the County pays local taxing entities (such as school districts) their share of property taxes upon levy rather than actual collection and the County then retains all property taxes, and the penalties and interest thereon, upon collection.

The first Teeter Note Offering was conducted on July 20, 1994, for $111 million (the "$111 Million Teeter Notes"). These notes were described in an Official Statement dated July 13, 1994. These notes earned a variable interest rate reset monthly at one-month LIBOR not to exceed 12% per annum. The second Teeter Note Offering was conducted on August 18, 1994, for $64 million (the "$64 Million Teeter Notes"). These notes were described in an Official Statement dated August 12, 1994. These notes earned a variable interest rate reset monthly at 70% of one-month LIBOR not to exceed 12% per annum. The $111 Million
and $64 Million Teeter Notes matured, and were repaid, in part with proceeds from a June 30, 1995 Teeter bond offering.

The Official Statements for the Teeter Note Offerings represented that the County planned to deposit certain delinquent tax payments, penalties, and interest collections in accounts pledged to repay the Teeter Notes and to then invest those funds in the Pools. The Official Statements for the Teeter Note Offerings represented that the County anticipated that the funds in the repayment account would not be sufficient to pay the principal and interest on the Teeter Notes at maturity and that the County estimated that, at maturity of the Teeter Notes, approximately $70 million would be available in the repayment account to pay the principal and interest on the $175 million in Teeter Notes. The Official Statements further represented that this anticipated deficiency in the repayment account would be satisfied from moneys received under Standby Note Purchase Agreements, which agreements obligated the Treasurer (as "fund manager" of the Pools) to purchase the Teeter Notes, and from other moneys lawfully available to the County for repayment from revenues received or attributable to the fiscal year in which the notes were issued.

4. Omissions Of Material Facts In The Official Statements

Merrill Lynch offered and sold the Notes through Official Statements that omitted material facts regarding the Pools. The Official Statements for three of the Note Offerings also omitted to disclose the statutory 12% cap on the interest rate payable to noteholders.

a. Omissions Of Material Facts Regarding The Pools

i. The Pools' Investment Strategy

The disclosure in the Official Statements for the Note Offerings regarding the Pools' investment strategy was misleading because it failed to disclose material information, including:

(1) the Pools' investment strategy was predicated upon the assumption that prevailing interest rates would remain at relatively low levels; (2) the Pools' use of leverage through reverse repurchase agreements was constant, high, and a major part of the Pools' investment strategy; and (3) the Pools had a substantial investment in derivative securities, particularly inverse floaters.

ii. The Risks Of The Pools' Investment Strategyz

The disclosure in the Official Statements regarding the risks of the Pools' investment strategy was misleading because it omitted material information about the Pools' sensitivity to rises in interest rates. Specifically, the Official Statements failed to disclose that because of the Pools' high degree of leverage and substantial investment in inverse floaters, rising interest rates would have a negative effect on the Pools, including: (1) the Pools' cost of obtaining funds under reverse purchase agreements would increase; (2) the Pools' interest income on the inverse floaters would decrease; (3) the Pools' securities would decline in market value; (4) as the value of the securities fell, the Pools would be subject to collateral calls and reductions in amounts obtained under reverse repurchase agreements; (5) the Pools' earnings would decrease; (6) the Pools would suffer losses of principal at certain interest rate levels; and (7) if the Pools' began to suffer lower earnings or losses of principal, certain Participants may withdraw their invested funds, leaving the County and other Participants such as the Flood Control District who were required to deposit their funds with the Treasurer to absorb any losses.

iii. The Pools' Investment Results

The disclosure in the Official Statements regarding the Pools' historic investment results was misleading because it omitted material information regarding the Pools' investment results during the first half of 1994 when interest rates were rising. Specifically, the Official Statements omitted to disclose that as a result of rising interest rates in 1994, the market value of the Pools' securities was declining, the Pools were subject to collateral calls and reductions in amounts obtained under reverse repurchase agreements, and the Pools' costs of obtaining funds under reverse repurchase agreements were increasing.

b. Omission Of The Interest Rate Cap

The Official Statements for the Taxable Notes and the $111 Million Teeter Notes each represented that the notes paid a variable interest rate connected to one-month LIBOR. These Official Statements were misleading because they omitted to disclose the material information that the notes contained a statutory 12% cap on the maximum variable interest rate.

5. Merrill Lynch's Knowledge About The Pools

a. Merrill Lynch's Securities Business With Orange County

Merrill Lynch engaged in significant securities business with Orange County in the years prior to the Note Offerings. From 1992 to December 1994, Orange County was one of Merrill Lynch's largest accounts. As of June 1994, just prior to the Note Offerings, approximately two-thirds of the securities in the Pools' portfolio, including inverse floaters, had been purchased from Merrill Lynch and almost one-fifth of the Pools' reverse repurchase agreements were entered into with Merrill Lynch. Merrill Lynch conducted this securities business with Orange County through trading and sales personnel, who as a result knew substantial information about the Pools.

b. Merrill Lynch's Receipt Of Information Concerning The Pools From Orange County

Merrill Lynch, through trading and sales personnel, received from the County several documents that provided detailed information about the Pools, including the Pools' Annual Financial Statements (the "Annual Reports") for fiscal years 1991-1992 and 1992-1993.

The 1991-1992 Annual Report stated that: the Pools' investment strategy was to obtain funds through reverse repurchase agreements and reinvest the proceeds in securities that paid an interest rate higher than the interest paid on those funds; the Pools would "vigorously continue" this reverse investment policy; the Pools invested in derivative securities; and the Treasurer "expected interest rates to stay in or near these [low] levels for at least the next two or three years."

The 1992-1993 Annual Report stated that: the Pools' investment strategy utilized leverage through reverse repurchase agreements and derivative securities, particularly inverse floaters; the Pools' leverage ratio was approximately 2 to 1; the Pools' leverage strategy had "been predicated on interest earning rates to continue to remain low for a minimum of the next three years"; and if interest rates were to rise materially, it would be "reasonable to expect that the overall performance of the portfolio would decline."

c. Merrill Lynch's Derivatives Pricing Reports

From 1992 to late 1994, Merrill Lynch, through trading and sales personnel, provided Orange County with a monthly report, called the Derivatives Pricing Report, that marked to market the derivatives that Merrill Lynch had sold to Orange County. The Derivatives Pricing Reports for March through June 1994 priced about $3.7 billion to $4.2 billion in derivative securities, which constituted 17% to 21% of the Pools' total portfolio and 47% to 56% of the Pools' derivative securities. During March through July 1994, a period of rising interest rates, the Derivatives Pricing Reports showed that these derivative securities, marked to market, had declined by between 7.59% and 8.36%.

d. Merrill Lynch's Mid-1992 Review Of The Pools

In mid-1992, Merrill Lynch conducted a review of the Pools' securities, leverage position, and sensitivity to interest rate changes. The review showed that as of mid-1992, the Pools had a $6.15 billion portfolio, including $4 billion in derivative securities, which was purchased with $3.5 billion in deposits and $2.5 billion in funds borrowed under reverse repurchase agreements (indicating leverage of 175%) and that, for each 1% increase (or decrease) in the interest rate, the equity in the Pools would decrease (or increase) by 7%. The review noted that the duration of the Pools' portfolio was relatively long and was more typical of a portfolio with a maturity of ten to twenty years. The review suggested that the account representative responsible for the Orange County account ("account representative") ensure that the County was aware of how sensitive the portfolio was to changes in interest rates and explore with the County ways of reducing its overall leverage by limiting its amount of reverse repurchase agreements.

In an October 1992 letter, Merrill Lynch advised the Treasurer of the results of its mid-1992 review. This letter stated that the Pools' duration indicated more price volatility than would be expected from a portfolio with such a short average maturity of 1.4 years and that the Pools' use of leverage through reverse repurchase agreements and investment in inverse floaters made maturity of the portfolio a less reliable indicator of the price sensitivity of the portfolio. Merrill Lynch trading and sales personnel knew the results of this review and participated in communicating the results to the Treasurer.

e. Merrill Lynch Discussions In November 1992 Regarding The Risks Of The Pools

In November 1992, the Merrill Lynch account representative reported to the Treasurer that a number of Merrill Lynch trading and sales personnel and other officials had met to discuss the Pools. The account representative reported to the Treasurer that these officials had discussed: (1) the fact that the Pools

already owned about $3 billion in inverse floaters and was planning on investing another $1 billion in these derivatives; (2) the belief of these Merrill Lynch officials that the Treasurer was too concentrated in inverse floaters and that a significant rise in interest rates would have a negative effect on the Pools' investment performance; and (3) that Merrill Lynch intended to review the derivative structures that Merrill Lynch could offer to Orange County that might serve as a hedge against changes in interest rates. In late 1992, Merrill Lynch established a mechanism by which a separate department would consult with trading personnel regarding the purchase of certain derivatives by the County.

f. Merrill Lynch Urges The Treasurer To Provide The County Board Of Supervisors With Additional Disclosure About The Pools

Also in November 1992, Merrill Lynch urged the Treasurer to make greater disclosure to the County Board of Supervisors regarding the Pools' investment strategy and the risks of that strategy. Subsequently, in an April 1993 letter, Merrill Lynch provided to the Treasurer bullet points to include in the Treasurer's next Annual Report regarding the Pools. These bullet points included: the Pools' investment strategy used leverage; the Pools' use of reverse repurchase agreements and purchase of derivative securities resulted in a leverage ratio of 2 to 1; if interest rates were to rise, it was reasonable to expect that the overall performance of the portfolio would decline; and if a sudden rise in interest rates were to recur, there could be an erosion of principal. Merrill Lynch trading and sales personnel knew that Merrill Lynch was urging the Treasurer to make such greater disclosure and participated in communicating the bullet points to the Treasurer.

g. Merrill Lynch's January 1993 Meeting With The Treasurer Regarding The Pools

In January 1993, Merrill Lynch trading and sales personnel discussed the Pools with the Treasurer. At this meeting, the Merrill Lynch trading and sales personnel discussed with the Treasurer: the Pools' "distinct" investment strategy; the amount of leverage in the Pools; the risks associated with the strategy; and that, at certain interest rate levels, the Pools would lose principal because the Pools' financing costs would exceed the yield. The Merrill Lynch trading and sales personnel also suggested at this meeting that the Treasurer should report to the County Board of Supervisors about these matters and that the Pools should reduce the leverage ratio to no more than 2 to 1 and should not invest in derivatives in excess of the Pools' long-term deposits.

h. The February 1993 Memorandum Regarding Certain Risks Of The Pools

In February 1993, a Merrill Lynch trader distributed to certain other Merrill Lynch trading personnel a memorandum in which he expressed certain concerns about the Pools' risks and made specific recommendations concerning Merrill Lynch's ongoing relationship with the Orange County account. The memorandum explained that a substantial amount in the Pools had been voluntarily deposited by Participants seeking the Pools' higher return and stated the trader's views that these voluntary Participants could withdraw their funds at par with little restriction and were, therefore, not bearing any of the risks accompanying the high yields and that the County and other long term investors were bearing that risk associated with higher yields. The memorandum then stated that if interest rates rose and the Pools' yield decreased, these voluntary Participants would withdraw their funds, causing adverse consequences for Orange County.

i. Merrill Lynch's Offer To Repurchase Derivatives Sold To The Pools

In March 1993, Merrill Lynch made an offer to the Treasurer to repurchase certain securities that it had sold to the Pools. These securities had a book value of $4.09 billion (36% of the portfolio) and were comprised of $3.8 billion in inverse floaters (34% of the portfolio), $175 million in floating rate securities (2% of the portfolio), and $100 million in fixed rate securities (1% of the portfolio).

In March 1993, Merrill Lynch told the Treasurer that it was making the offer to assist the Treasurer in reducing the Pools' risk profile in the event of changes in interest rates. In a June 1993 letter, Merrill Lynch reiterated its position, stating that it had made the offer to allow the County the opportunity to lower its risk profile in derivative securities and to reduce leverage so that the Pools would be better positioned to perform in the event of interest rate changes.

In April 1993, the Treasurer refused Merrill Lynch's offer, stating that he believed that because of future low interest rates, the securities may be even more valuable in the future. Merrill Lynch trading and sales personnel knew of this offer and the Treasurer's rejection of the offer and participated in these communications with the Treasurer.

j. Merrill Lynch's February 1994 Review Of The Pools

In February 1994, Merrill Lynch trading and sales personnel presented to the Treasurer their review of certain of the Pools' securities as of late 1993-early 1994. This review presented information showing that the Pools held $5 billion in inverse floaters and $6.8 billion in fixed rate securities, and found that the Pools' aggregate derivative portfolio had declined in value to a price of 99.50. The review further specifically discussed the sensitivity of the portfolio to changes in interest rates, noting that: (1) the Pools' performance was dependent upon continued low interest rates; (2) each basis point (.01%) change in the interest rates would result in a change in the market value of the derivatives in the portfolio of $2.7 million; (3) the portfolio held approximately $5.3 billion in derivative securities with an average duration of about five years; (4) if interest rates were to rise, the inverse floaters would pay lower coupons; (5) rising interest rates would result in significant movements in the market value of the portfolio due to the Pools' investment in inverse floaters; and (6) continued rising rates could have a severe impact on the market value of the Pools' securities.

The review also discussed future interest rates, stating that it was difficult to predict future interest rates but that historically initial increases by the Federal Reserve Bank of interest rates led to further increases. Finally, the review presented certain recommendations that the Treasurer could implement in light of the interest rate environment.

6. Merrill Lynch's Underwriting Of The Notes

Merrill Lynch trading personnel were principally responsible for Merrill Lynch's obtaining the underwriting of the first Note Offering, the $600 Million Taxable Note Offering. The Merrill Lynch trading personnel referred the underwriting to Merrill Lynch investment bankers. The account representative knew that Merrill Lynch obtained the underwriting. These Merrill Lynch trading and sales personnel knew much of the information about the Pools stated above, but Merrill Lynch failed to assure that such information was conveyed to the investment bankers.

Merrill Lynch participated in the review and approval of the Official Statements for the Note Offerings through the investment bankers. As stated below, the investment bankers knew or reasonably should have known information about the Pools and/or about the interest rate cap and that such information was omitted from the Official Statements.

a. The Investment Bankers' Knowledge

As stated below, the investment bankers knew or reasonably should have known information about the Pools from media coverage in the first half of 1994 and from Merrill Lynch's business relationship with Orange County. As a result of participating in Merrill Lynch's underwriting of a large taxable note offering conducted in 1993 by another local government located in Southern California (the "Prior Offering"), one of the investment bankers also knew or reasonably should have known of disclosure issues relating to the Pools. One of the investment bankers also knew or reasonably should have known of the interest rate cap on the Taxable Notes and the $111 Million Teeter Notes.

i. Media Coverage Regarding The Pools

From January 31 through June 30, 1994, articles appeared in the media regarding the Pools. The articles reported that the Treasurer stated that: he used reverse repurchase agreements to leverage the Pools' $7.5 billion in deposits to $19.5 billion in investments; 20% of the $19.5 billion portfolio was invested in derivative securities; his strategy was to obtain funds through short-term reverse repurchase agreements and invest in medium-term securities; the value of the Pools' portfolio had "been hit by rising interest rates"; and as a result of rising interest rates and the declining market value of the Pools' securities, the County had recently experienced up to $300 million in collateral calls under reverse repurchase agreements. These articles also reported that the County's portfolio had incurred a decline in market value of "an estimated $1.2 billion" and that many believed that the investment strategy was too risky for public funds and exposed the Pools to the risk of very large losses.

The investment bankers knew that there were a number of articles published in the first half of 1994 regarding the Pools and read at least some of these articles. In addition, in late April 1994, one of the investment bankers received a memorandum from Merrill Lynch municipal research personnel about recent municipal securities offerings by issuers located in Southern California. The memorandum attached an article about the Pools that was published on April 15, 1994. In referring to the article, the memorandum stated that, although the research personnel had no additional information about the Pools and the article was perhaps one-sided, it implied there may be a great potential for losses in the fund due to recent market trends. The memorandum further stated this development may have implications for how Merrill Lynch addressed future note underwritings, in particular during the upcoming California note season.

ii. Merrill Lynch's Business Relationship With Orange County

The investment bankers knew that Orange County was a client of Merrill Lynch and, therefore, should have known that the firm had information about Orange County. The investment bankers further knew the account representative was responsible for the Orange County account and that the account representative had information regarding the Pools. In the Spring of 1994, even though Merrill Lynch did not have an underwriting relationship with the County at that time, one of the investment bankers contacted the account representative to ascertain the validity of the concerns about the Pools raised in the media reports. The account representative told the investment banker that the Pools were okay and taking a more defensive posture and that the County was selling securities to increase the cash position.

iii. The Prior Offering

The Merrill Lynch investment bankers also knew of the Prior Offering; one of the investment bankers had even participated in the underwriting. The preliminary official statement for the offering stated that the proceeds would be invested in the issuer's investment pool (the "Prior Pool") and contained disclosure about the Prior Pool that was similar to portions of the disclosure regarding the Orange County Pools in the Official Statements for the Note Offerings. Because of certain market rumors about the Prior Pool, Merrill Lynch requested additional information and disclosure about the Prior Pool's derivative investments before pricing the offering. A detailed comparison of the Prior Offering and the Note Offerings and their related disclosure would have shown at least two differences. First, with respect to reverse repurchase agreements, both offerings stated that "[f]rom time to time" the pools engaged in reverse repurchase transactions. The Prior Offering, however, disclosed that the Prior Pool had engaged in no reverse repurchase agreements as of the end of the prior quarter and that the maximum amount of the Prior Pool's portfolio that could be pledged under reverse repurchase agreements was 25%. In contrast, the Note Offerings only disclosed that "a significant portion" of the Pools' securities was pledged under reverse repurchase agreements but did not disclose that the Pools were leveraged by about 274% and that the Pools' investment strategy was based on such leverage. Second, with respect to derivative

investments, the Prior Offering specifically disclosed the dollar amount of derivative securities held by the pool and the structure of the derivatives. In contrast, the Note Offering only disclosed the Pools' investment in fixed and floating rate securities but did not disclose the Pools' dollar investment in inverse floaters.

iv. The Interest Rate Cap

The existence of the interest rate cap on the Taxable Notes and the $111 Million Teeter Notes was stated in three documents relating to the issuance of those Notes: the resolutions of the Boards of Supervisors of Orange County and the Flood Control District authorizing the issuance of the notes; the issuers' certificates stating that the offering amounts complied with state law; and the sample notes. These documents were included in the official transcript of the Taxable Note and $111 Million Teeter Note Offerings, which were provided to all professionals participating in the offering, including one of the Merrill Lynch investment bankers.

b. Merrill Lynch's Review Of The Official Statements

Merrill Lynch's review of the Official Statements was conducted through the investment bankers. One of the investment bankers reviewed and approved the disclosure for all of the Note Offerings. The only change that this investment banker made to the disclosure related to the interest reset language. Another investment banker also read, and did not object to, the Pool disclosure and directed a third investment banker who was not otherwise assigned to the underwriting to review the Pool disclosure.

The investment bankers took no further action to determine whether the disclosure was accurate and complete. At the time of the Note Offerings, Merrill Lynch had a written policy stating that the underwriter cannot ignore the underwriter's "`independent reservoir' of knowledge" about the issuer. After Merrill Lynch obtained the underwriting, the investment bankers did not discuss the Pool disclosure with anyone at Merrill Lynch other than with each other, even though the investment bankers knew that Orange County was a Merrill Lynch client and other Merrill Lynch personnel had been involved in obtaining the underwriting for the firm.

The investment bankers also did not make inquiries into the media coverage about the Pools, even though the investment bankers knew of the reports and one of the investment bankers had received a memorandum stating that the Pools' reported losses could have implications for Merrill Lynch's future underwriting of municipal note offerings in California. The investment banker who had previously spoken to the account representative about the media coverage regarding the Pools did not question whether the Treasurer had taken a more defensive position. The investment bankers also did not conduct a detailed comparison between the disclosure in the Note Offerings and the disclosure in the Prior Offering, which would have shown that the Prior Offering had additional disclosure regarding derivatives and leverage.

C. LEGAL DISCUSSION

1. Merrill Lynch Violated Sections 17(a)(2) And (3) Of The Securities Act In The Offer and Sale of the Notes

Sections 17(a)(2) and (3) of the Securities Act make it unlawful for any person, through the means or instruments of interstate commerce or the mails, in the offer or sale of any security:

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Scienter is not required to prove violations of Sections 17(a)(2) or (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 697 (1980). Violations of these sections may be established by showing negligence. SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997); SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992).

Accordingly, Merrill Lynch, through negligent conduct, violated Sections 17(a)(2) and (3) of the Securities Act in the offer and sale of the Notes.

a. The Omissions Were Material

Information about the Pools' investment strategy, the risks of that strategy, and the Pools' declining investment results and about the cap on the Notes' variable interest rates was material to the Note investors. Information is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information made available. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

Accurate and complete disclosure about the Pools was material to investors because it affected the sources of repayment for the Notes. In particular, in all of the Note Offerings, the funds pledged to repay the securities were invested in the Pools, and, in the two Teeter Note Offerings, the Pools guaranteed repayment of the securities. Disclosure of the interest rate cap was material to investors that had adopted policies against investing in securities with an interest rate cap.

b. Merrill Lynch Should Have Known That The Official Statements Were Materially Misleading

Merrill Lynch, as underwriter of the Note Offerings, had a duty to conduct a professional review of the Official Statements, including an assessment of the information in its possession or reasonably accessible to it, sufficient to form a reasonable basis for believing in the accuracy and completeness of the key representations in the Official Statements. Merrill Lynch, through its trading and sales personnel, knew substantial material information about the Pools. Merrill Lynch, however, unreasonably failed to assure that such information was conveyed to the investment bankers responsible for reviewing and approving the Official Statements for the Note Offerings.

In addition, Merrill Lynch, through its investment bankers responsible for reviewing and/or approving the Official Statements for the Note Offerings, also knew or reasonably should have known material information about the Pools and/or the Notes' interest rate. From such a professional review of the Official Statements, Merrill Lynch, through its investment bankers, knew or reasonably should have known that the Official Statements omitted to disclose material information that was in its possession or reasonably accessible to it about the Pools and the Notes' interest rates.[3]

2. Merrill Lynch Violated Section 15B(c)(1) Of The Exchange Act And MSRB Rule G-17

Under Section 15B(c)(1) of the Exchange Act, a broker, dealer, or municipal securities dealer is prohibited from using the mails or any instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in violation of any rule of the Municipal Securities Rulemaking Board ("MSRB"). As a broker-dealer conducting a municipal securities business, Merrill Lynch was subject to Section 15B(c)(1) of the Exchange Act and the MSRB rules.

MSRB Rule G-17 provides that: "In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive,

dishonest, or unfair practice." For the reasons set forth above in Section E.1. with respect to the violations of Sections 17(a)(2) and (3) of the Securities Act, Merrill Lynch violated MSRB Rule G-17.

3. Conclusion

Accordingly, based on the foregoing, the Commission finds that Merrill Lynch willfully violated Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17.

IV.

Merrill Lynch has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's entry of this Order, which: (1) makes findings, as set forth above; (2) orders Merrill Lynch to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17; and (3) orders Merrill Lynch to pay a civil penalty in the amount of $2,000,000.

V.

Prior to the date of this Order, Merrill Lynch revised its policies and procedures relating to municipal securities underwriting.

VI.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Merrill Lynch.

Accordingly, IT IS HEREBY ORDERED that, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act:

1. Merrill Lynch shall, effective immediately, cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17.

2. Merrill Lynch shall, within thirty (30) days of the date of this Order, pay a civil money penalty in the amount of $2,000,000 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the United States Securities and Exchange Commission; (3) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312; and (4) submitted under cover letter that identifies Merrill Lynch as a Respondent in these proceedings, and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kelly Bowers, Assistant Regional Director, Pacific Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

3. Merrill Lynch shall comply with the undertakings specified in its Offer as follows: Merrill Lynch undertakes to maintain the policies and procedures referred to in Section V above; provided, however, that Merrill Lynch may modify such policies and procedures with alternative policies and procedures designed to achieve the same purposes.

FOOTNOTES

[3]:/ For purposes of Merrill Lynch's violations, the conduct of the Merrill Lynch officials and employees may be imputed to the firm. See SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

In re Meridian Securities, Inc., and Corestates Capital Markets, Securities Act Release No. 7525, Exchange Act Release No. 39905, A.P. File No. 3-9582 (April 23, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that administrative proceedings be instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 15B and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Meridian Securities, Inc. ("Meridian Securities"), a broker-dealer registered with the Commission, CoreStates Capital Markets ("CoreStates Capital"), a municipal securities dealer registered with the Commission, and Martin J. Stallone ("Stallone").

In anticipation of the institution of these proceedings, Meridian Securities, CoreStates Capital and Stallone have submitted Offers of Settlement which the Commission has determined to accept. Solely for purposes of these proceedings and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, without admitting or denying the findings contained herein, except that Meridian Securities, CoreStates Capital and Stallone admit that the Commission has jurisdiction over them and over the subject matter of these proceedings, Meridian Securities, CoreStates Capital and Stallone consent to the entry of an Order Instituting Public Proceedings, Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Order ("Order") as set forth below.

Accordingly, IT IS ORDERED that proceedings against Meridian Securities, CoreStates Capital and Stallone be, and hereby are, instituted.

II.

On the basis of this Order, and the Offers of Settlement submitted by Meridian Securities, CoreStates Capital and Stallone, the Commission finds that: [1]

A. At all times relevant to this proceeding, Meridian Securities, headquartered in Reading, Pennsylvania, was registered with the Commission as a broker-dealer. It is the successor, in form, to the municipal securities dealer registration of Meridian Capital Markets, Inc. ("Meridian Capital").[2]

B. At all times relevant to this proceeding, CoreStates Capital, a division of CoreStates Bank, N.A. ("CoreStates Bank"), was registered with the Commission as a municipal securities dealer pursuant to Section 15B(a)(2) of the Exchange Act.[3] CoreStates Capital is the de facto successor to Meridian Capital and is named as a Respondent solely on that basis. It has continued the operations of Meridian Capital, including advance refunding transactions. Meridian Capital's customer accounts have been transferred to CoreStates Capital. Although certain key personnel, formerly associated with Meridian Capital, are now employed by CoreStates Capital, the senior management of Meridian Capital and the senior officers of Meridian Capital's Public Finance Department with primary responsibility for the transactions described herein were not employed by CoreStates Capital or any of its affiliates following the merger between CoreStates Bank and Meridian Bank.

C. At all times relevant to this proceeding, Stallone was registered as a municipal securities representative with Meridian Capital. Stallone joined Meridian Capital in 1989 at age 24 and became a vice-president of Meridian Capital's Public Finance Department in 1993. Despite his title, Stallone did not have a managerial position at any time during his employment at Meridian Capital, and he voluntarily resigned from Meridian Capital prior to the merger between CoreStates Bank and Meridian Bank.

D. From at least March 1993 through December 1995, Meridian Capital, Stallone and another employee of Meridian Capital willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the offer and sale and in connection with the purchase and sale, of securities in that they, directly and indirectly, by the use of the means or instruments of transportation or communication in interstate commerce, or the means and instrumentalities of interstate commerce, or of the mails, employed devices, schemes, or artifices to defraud obtained money and property by means of, or otherwise made, untrue statements of material fact or omitted to state material facts necessary to make the statements made, in the light of the circumstances under which they were made, not misleading; or engaged in acts, transactions, practices or courses of business which would and did operate as a fraud or deceit upon the purchasers of such securities and on other persons, such as the issuers of municipal securities.

E. Meridian Capital, Stallone and another employee of Meridian Capital engaged in a scheme to generate substantial profits by charging various Pennsylvania and West Virginia municipalities excessive, undisclosed mark-ups on U.S. Treasury securities ("Treasury securities") sold in connection with various tax-exempt advance refunding transactions and in two other cases involving another type of refinancing. They increased the prices of Treasury securities in order to reduce the yield, thereby purporting to comply with the federal tax laws governing tax-exempt advance refunding transactions. This practice is commonly known as "yield burning." Meridian Capital, Stallone and another employee of Meridian Capital calculated mark-ups on a portfolio basis and, as a result, charged excessive mark-ups on individual Treasury securities ranging as high as 13.78 percent in connection with various advance refunding transactions and as high as 46.29 percent in two other cases involving another type of refinancing. The mark-ups were excessive based upon all of the relevant facts and circumstances surrounding the sales of the particular Treasury securities. On five occasions, Meridian Capital, Stallone and/or another employee of Meridian Capital also falsely certified in writing that the prices charged for the Treasury securities were in essence fair market prices, as defined by federal tax regulations. In addition, Meridian Capital and others engaged in an undisclosed payment arrangement in order to secure Meridian Capital's selection as escrow provider in certain transactions. As a result of this pattern of conduct, Meridian Capital earned substantial profits and Stallone and another employee of Meridian Capital earned substantial commissions.

F. Excessive Mark-ups

1. Beginning in 1988, Meridian Capital solicited various municipalities to undertake various financing transactions, including advance funding transactions. In an advance refunding transaction, a municipality issues tax-exempt municipal securities (the "refunding bonds") in order to defease a pre-existing issue of bonds usually bearing higher interest rates. Because the pre-existing bonds cannot be paid off immediately, the proceeds of the refunding bonds are invested in Treasury securities, which are deposited into an escrow account established on behalf of the municipality and irrevocably pledged to pay the principal and interest on the old bonds as they become due. Advance refunding transactions generally enable municipalities to realize savings, in part because the refunding bonds are issued at lower interest rates.

2. Meridian Capital's Public Finance Department ("Public Finance"), in which Stallone and others were employed, handled many advance refunding transactions in addition to other types of municipal financings. In connection with these advance refunding transactions, Meridian Capital often acted as the underwriter for the municipal issuer as well as the escrow provider. As the underwriter, Meridian Capital sold the bonds that were issued by the municipalities. As the escrow provider, the firm selected the Treasury securities for the escrow account and sold them to the municipalities.

3. The Pennsylvania Public Finance Group ("Pennsylvania Group"), which primarily conducted business in Pennsylvania, New Jersey and Delaware, was a part of Public Finance. The employees of the Pennsylvania Group, which included Stallone, were compensated through commissions based upon a

percentage of the profits earned by Public Finance, including mark-ups on Treasury securities sold in connection with advance refunding transactions.

4. Stallone and another employee of Meridian Capital were primarily responsible for selecting and pricing the Treasury securities that Meridian Capital sold to the municipalities. Specifically, they identified the Treasury securities needed for the escrow accounts and set the prices at which Meridian Capital sold these securities. Although an entire portfolio of securities selected for an escrow account was sold to the municipality, Meridian Capital generated a separate confirmation slip for each individual Treasury security.

5. In accordance with the Internal Revenue Code and Internal Revenue Service ("IRS") regulations in effect during the relevant time period, where a municipality issued tax-exempt advance refunding bonds, the overall yield on the investments held in the escrow account could not materially exceed (which under the tax regulations essentially meant that it could not be more than one-thousandth of one percentage point higher than) the yield on the refunding bonds. If the overall yield on the escrow securities materially exceeded the yield on the bonds, the bonds would be deemed "arbitrage bonds" and the tax-exempt status of the refunding bonds would be jeopardized. If the yield on the open market escrow securities, purchased at fair market value, were to materially exceed the yield on the refunding bonds (a "positive arbitrage" situation), the IRS regulations effectively required that the excess yield (known as "arbitrage profit") be reduced by investing a portion of the escrow account in State and Local Government Series ("SLGS") - customized securities issued by the U.S. Treasury at below market interest rates specifically for the purpose of allowing municipal issuers to comply with the IRS yield restrictions. A mix of Treasury securities and SLGS in the escrow account can be used to ensure that the yield on the escrow account will not be higher than the yield on the refunding bonds.

6. One way to circumvent these yield limitations is through a practice commonly known as "yield burning" - that is, lowering the yield earned on escrow securities by excessively increasing the price an issuer pays for those securities. Such an increase in the price paid by the issuer has no direct economic impact on the issuer in a positive arbitrage situation, because any increased markup paid by the issuer would otherwise have to be transferred to the U.S. Treasury through the purchase of SLGS. Thus, this practice enriches the seller of the escrow securities at the expense of the U.S. Treasury, which otherwise would receive the arbitrage profit. It also exposes the issuer and its investors to the risk of losing the bonds' tax-exempt status. In a negative arbitrage situation (i.e., when the yield of the open market escrow securities, when purchased at fair market value, would not exceed the yield on the refunding bonds), any increase in the price paid for the escrow securities directly harms the issuer, but does not have federal tax implications.

7. Applicable provisions of the IRS regulations in effect at the time of the transactions at issue here generally required that the escrow investments be purchased at fair market value. In particular, the Treasury securities had to be valued at the price at which a willing buyer would purchase the investment from a willing seller in a bona fide, arm's-length transaction. 26 C.F.R. 1.148-5(d)(6), T.D. 8476, 58 F.R. 33510 (June 18, 1993).

8. Pursuant to the IRS regulations, municipalities issuing tax-exempt bonds were required to certify, based on their reasonable expectations, that the bonds were not arbitrage bonds. In various advance refundings handled by Meridian Capital during the relevant time period, the municipalities made such certifications.

9. Meridian Capital, Stallone and another employee of Meridian Capital improperly retained the arbitrage profits generated from the sale of Treasury securities without the knowledge or consent of the municipalities. The conduct entailed inflating the prices for certain individual Treasury securities in order to reduce the overall yield earned on the portfolio of Treasury securities, thereby meeting the yield restrictions. The undisclosed mark-ups charged on the individual Treasury securities (which reached as

high as 13.78 percent) in the various advance refundings were excessive based upon all of the relevant facts and circumstances surrounding the sales of the particular Treasury securities.

10. In two instances, Meridian Capital, Stallone and another employee of Meridian Capital charged municipalities excessive, undisclosed mark-ups in advance refunding transactions which, notwithstanding the size of the mark-ups, did not exceed applicable yield restrictions and, therefore, did not raise any issue of compliance with IRS regulations. The mark-ups charged on these securities transactions were excessive based upon all of the relevant facts and circumstances, and, as a result, the municipalities involved in these two transactions (the Reading School Authority and the Borough of Ambler) were financially harmed.

G. Misrepresentations and Omissions

1. In connection with the sale of Treasury securities to the municipalities, Meridian Capital, Stallone and/or another employee of Meridian Capital also made certain material misrepresentations and omissions. In 5 instances, they provided documents in the form of certifications that in essence represented that the prices on the Treasury securities were at fair market value and established without an intent to reduce yield. In fact, the prices on the Treasury securities in those transactions exceeded their fair market value by reason of the mark-ups that were charged, and were established with an intent to reduce the yield on the Treasury securities. The municipalities relied upon these representations in making their certifications that the bonds were not arbitrage bonds.

2. In certain advance refunding transactions, Meridian Capital served as both underwriter and escrow provider. In such transactions, Stallone and others advised municipalities with respect to how the transactions should be structured, including, but not limited to, the investment of the refunding bond proceeds. The municipalities relied upon Meridian Capital, Stallone and others to provide Treasury securities that were suitable for retiring the pre-existing issue of municipal bonds in accordance with IRS yield restriction requirements.

3. Meridian Capital, Stallone and another employee of Meridian Capital failed to disclose to the municipalities that they had sold the Treasury securities to the municipalities for more than their fair market value by reason of the mark-ups that were charged and, thereby, jeopardized the tax-exempt status of the refunding bonds.

4. As underwriter of various advance refunding bonds, Meridian Capital had an obligation to have a reasonable basis for belief in the truthfulness and completeness of the key representations made in the disclosure documents used in the securities offerings. Exch. Act Rel. No. 26100 (Sept. 22, 1988). In addition, employees of Meridian Capital participated in the preparation of those offering documents, and were responsible for various representations contained in those documents. The offering documents did not disclose to potential bond purchasers that Meridian Capital, Stallone and another employee of Meridian Capital had sold the Treasury securities to the municipalities for more than their fair market value by reason of the mark-ups that were charged. Nor did the documents disclose that they did so in order to receive arbitrage profits in those advance refundings and had, thereby, placed the tax-exempt status of the refunding bonds in jeopardy. Therefore, Meridian Capital, Stallone and another employee of Meridian Capital also failed to disclose material facts in the offering documents which were distributed to the bond purchasers in those advance refunding transactions.

H. Undisclosed Payments

1. Meridian Capital and others also engaged in an undisclosed financial arrangement involving three advance refundings with municipalities in West Virginia. In these advance refundings, Meridian Capital was responsible for providing the Treasury securities sold to the municipalities, but was not the underwriter. Meridian Capital secured its role as the escrow provider by paying undisclosed fees to two financial consultants.

2. One of the financial consultants, an independent contractor, provided services to the underwriter on the three West Virginia advance refunding transactions. Among other things, he was responsible for selecting a broker or a dealer to provide the Treasury securities needed for the escrow accounts.

3. During the fall of 1993, before Meridian Capital became involved in the West Virginia advance refunding transactions, the two financial consultants contacted an employee of Meridian Capital about Meridian Capital becoming the escrow provider in the first of the three advance refundings. In order to ensure Meridian Capital's selection, an employee of Meridian Capital entered into an undisclosed arrangement with the two financial consultants whereby it was agreed that Meridian Capital would pay them a pre-determined percentage of the profits generated from Meridian Capital's sale of Treasury securities to the West Virginia municipality. In addition to securing Meridian Capital's selection in the first advance refunding, the arrangement ensured Meridian Capital's selection as the escrow provider in future advance refundings in which the two financial consultants were involved.

4. In the same manner as they had done in the other advance refundings, Meridian Capital, Stallone and another employee of Meridian Capital charged excessive mark-ups on the Treasury securities sold to the West Virginia municipalities in order to retain the arbitrage profits.

5. After the Treasury securities were sold to the municipalities, Meridian Capital made payments to the two financial consultants, as previously agreed. In addition, an employee of Meridian Capital directed the two financial consultants to generate invoices, which falsely reflected that they had provided services to Meridian Capital in exchange for the payments. Neither of the consultants performed any services in exchange for the payments, other than securing Meridian Capital's selection as escrow provider.

6. In each of the three West Virginia advance refundings, Meridian Capital, Stallone and another employee of Meridian Capital provided certificates directly to the municipalities in which they made affirmative misrepresentations concerning the suitability of the Treasury securities and compliance with the IRS yield restriction requirements. The West Virginia municipalities were unaware of the financial arrangement.

I. Other Excessive Mark-ups

1. In June 1994 and May 1995, Meridian Capital, Stallone and another employee of Meridian Capital handled two refinancings that involved the establishment of sinking funds on behalf of two Pennsylvania municipalities. In these refinancings, the municipalities sought to defease prior offerings of tax-exempt municipal bonds. However, rather than using proceeds from the issuance of refunding bonds, the municipalities used other sources of funds to defease the old bonds.

2. Meridian Capital, Stallone and another employee of Meridian Capital were responsible for providing the Treasury securities that were deposited into escrow accounts established on behalf of the municipalities in these two transactions. As with advance refunding transactions, the Treasury securities in the escrow account were subject to yield restriction requirements under the federal tax laws.

3. With respect to these two refinancings, Meridian Capital, Stallone and another employee of Meridian Capital calculated mark-ups on a portfolio basis and, as a result, charged excessive mark-ups on individual Treasury securities that reached as high as 46.29 percent. Neither the mark-ups nor the fact that Meridian Capital had earned arbitrage profits in these refinancings, was ever disclosed to the municipalities. The mark-ups were excessive based upon all of the relevant facts and circumstances.

III.

On the basis of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in the Offers of Settlement submitted by Meridian Securities, CoreStates Capital, and Stallone:

Accordingly, IT IS ORDERED that:

A. Meridian Securities' registration as a broker-dealer is revoked;

B. Stallone be, and hereby is, censured;

C. CoreStates Capital and Stallone shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

D. CoreStates Capital and Stallone are directed to comply with their undertakings to pay an aggregate of $3,820,884, to be apportioned as follows: $3,720,884 shall be paid by CoreStates Capital, and $100,000 shall be paid by Stallone;

1. Of the aggregate amount, $414,070 shall be paid to the Reading School Authority and $6,814 shall be paid to the Borough of Ambler within ten days of the date of entry of this Order;

2. The remaining $3.4 million shall be paid to the United States Treasury pursuant to an agreement simultaneously entered into between Meridian Securities, CoreStates Financial Corp., the Internal Revenue Service and the United States Attorney for the Southern District of New York;

3. CoreStates Capital and Stallone shall provide written confirmation to Ronald C. Long, District Administrator, Securities and Exchange Commission, Philadelphia District Office, 601 Walnut Street, Suite 1120E., Philadelphia, PA 19106, that the payments specified in sub-paragraphs D.1. and D.2. above, have been duly made;

E. Stallone shall pay a civil penalty of $15,000 to the United States Treasury. Such payment shall be: (1) paid within thirty days of the date of the entry of this Order; (2)made by United States postal money order, certified check, bank cashier's check, or bank money order; (3) made payable to the Securities and Exchange Commission; (4) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Mail Stop 0-3, 450 Fifth Street, N.W., Washington, D.C. 20549; and (5) submitted under cover letter which identifies Stallone as a Respondent in this proceeding and the file number of this proceeding. A copy of the cover letter and money order or check shall be simultaneously sent to Ronald C. Long, District Administrator, Securities and Exchange Commission, Philadelphia District Office, 601 Walnut Street, Suite 1120E., Philadelphia, Pa 19106;

F. Stallone be, and hereby is, suspended from association with any broker, dealer, municipal securities dealer, investment adviser, or investment company, for a period of twelve months, effective on the second Monday following the entry of this Order; and G. Stallone shall provide to the Commission, within thirty days after the end of the twelve month suspension period described in paragraph F. above, an affidavit that he has complied fully with the suspension.

FOOTNOTES

[1]: The findings herein are made pursuant to the Offers of Settlement of Meridian Securities, CoreStates Capital, and Stallone and are not binding on any other person or entity named as a respondent in this or any other proceeding.

[2]: Meridian Capital was a municipal securities dealer registered with the Commission pursuant to Section 15B(a)(2) of the Exchange Act from February 1987 through November 1996, when the entity officially ceased operations.

[3]: On April 9, 1996, CoreStates Financial Corp., the holding company for CoreStates Bank, N.A. merged with Meridian Bancorp, Inc., the holding company for Meridian Bank. By operation of the merger, on June 27, 1996, Meridian Bank, together with its division Meridian Capital, was dissolved, and its operations and personnel became part of CoreStates Bank and CoreStates Capital.

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In re CS First Boston Corp., Jerry L. Nowlin and Douglas J. Montague, Securities Act Release No. 7498, Exchange Act Release No. 39595, A.P. File No. 3-9535 (January 29, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that a public administrative and cease-and-desist proceeding be and hereby is instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Credit Suisse First Boston Corporation ("First Boston"), Jerry L. Nowlin ("Nowlin"), and Douglas S. Montague ("Montague").

II.

In anticipation of the institution of this proceeding, First Boston, Nowlin, and Montague each has submitted an Offer of Settlement, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except that First Boston, Nowlin, and Montague each admit the jurisdiction of the Commission over them and over the subject matter of this proceeding, First Boston, Nowlin, and Montague, by their Offers of Settlement, consent to the entry of this Order Instituting a Public Administrative And Cease-And-Desist Proceeding Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Sanctions and Cease-and-Desist Order ("Order") and to the entry of the findings, sanctions, and cease-and-desist order set forth below.

Accordingly, IT IS HEREBY ORDERED that a proceeding pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offers of Settlement submitted by First Boston, Nowlin, and Montague the Commission finds that:<(1)>

A. RESPONDENTS

1. Credit Suisse First Boston Corporation ("First Boston") is registered with the Commission as a broker-dealer (File No. 8-00422) and is based in New York, New York. First Boston was the senior underwriter for the County of Orange, California's ("Orange County") 1994 $320,040,000 offering of Pension Obligation Bonds (the "Pension Bonds"). First Boston ceased participating as an underwriter in municipal securities offerings in early 1995.

2. Jerry L. Nowlin ("Nowlin") is a resident of Park City, Utah, and was employed by First Boston from 1990 to February 1995. In 1994, Nowlin was a Vice President in the Public Finance Department of the Municipal Securities Division in First Boston's San Francisco office and was an investment banker assigned to the Pension Bond underwriting.

3. Douglas S. Montague ("Montague") is a resident of La Canada, California, and was employed by First Boston from 1993 to March 1995. In 1994, he was a Vice President in the Public Finance Department of the Municipal Securities Division in First Boston's Los Angeles office and was an investment banker assigned to the Pension Bond underwriting.

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<(1)>The findings herein are made pursuant to the Offers of Settlement of First Boston, Nowlin, and Montague and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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B. FACTS

1. Introduction

First Boston was the underwriter of Orange County's 1994 Pension Bonds. <(2)>The Official Statement for the Pension Bond offering misrepresented and omitted material facts regarding the Orange County Investment Pools (the "Pools"). Accurate and complete disclosure regarding the Pools was material to investors in a $110,200,000 portion of the offering (the "Series B Bonds"), because the Pools provided liquidity for these bonds.

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<(2)>The County of Orange, California, was charged with disclosure violations concerning this offering in a settled cease-and-desist proceeding instituted on January 24, 1996. See In re County of Orange, California, Securities Act Release No. 33-7260 (Jan. 24, 1996).

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2. The Orange County Investment Pools

The Pools operated as an investment fund managed by the County Treasurer-Tax Collector (the "Treasurer") in which the County and various local governments or districts (the "Pool Participants" or the "Participants") deposited public funds. As of December 6, 1994 (the date the County and the Pools filed bankruptcy petitions), the Pools held approximately $7.6 billion in Participant deposits, which the County had leveraged to an investment portfolio with a book value of over $20.6 billion.

a. The Pools' Investment Strategy

The Pools' investment policy as stated by the Treasurer to the Pool Participants was, in order of importance: (1) preservation of investment capital; (2) liquidity; and (3) investment yield. Contrary to that policy, the Treasurer caused the Pools to engage in a risky investment strategy. This strategy involved using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days), and investing in securities with a longer maturity (generally two to five years), many of which were derivative securities known as inverse floaters. At the time of the Pension Bond Offering, First Boston had $1.58 billion in reverse repurchase agreements outstanding with the County. During 1993 and 1994, First Boston sold securities to the County. Neither Nowlin nor Montague was aware of or inquired into First Boston's reverse repurchase agreements with the County or sale of securities to the County.

The Pools' investment return was to result principally from the interest received on the securities in the Pools. Leverage enabled the Pools to purchase more securities to generate increased interest income. This strategy was profitable as long as the Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

b. The Pools' Portfolio

During 1993 and 1994, the Treasurer, using reverse repurchase agreements, leveraged the Participants' deposits to amounts ranging from 158% to over 292%. The Treasurer then typically invested the Participants' deposits and the funds obtained through reverse repurchase agreements in debt securities issued by the United States Treasury or United States government sponsored enterprises.

Many of the Pools' securities were derivative securities, comprising from 27.6% to 42.2% of the portfolio. In particular, the Pools were heavily invested in derivative instruments known as inverse floaters which paid interest rates inversely related to the prevailing market interest rate. Inverse floaters are negatively affected by a rise in interest rates.

c. The Rise in Interest Rates During 1994 and its Effect on the Pools

The composition of the Pools' portfolio made it highly sensitive to interest rate changes. As interest rates rose, the market value of the Pools' securities fell, and the interest received on the Pools' inverse floaters also dropped. Thus, the Treasurer's investment strategy was profitable so long as interest rates, including the cost of borrowing through reverse repurchase agreements, remained low and the market value of the Pools' securities remained stable. Indeed, the Treasurer's 1992-93 Financial Statement for the Pools stated that the investment strategy was "predicated on interest rates to continue to remain low for a minimum of the next three years."

During 1993, interest rates remained low and relatively stable. Due to the low interest rates and the Pools' investment strategy, the Pools earned a relatively high yield of approximately 8% during 1993. Beginning in February 1994, interest rates began to rise. This rise in interest rates caused the Pools' yield to decrease, the reverse repurchase costs to increase, the Pools' interest income on inverse floaters to decrease, and the market value of the Pools' debt securities to decline. Month-end reports generated by the Treasurer reflected that the Pools' securities that were marked-to-market (up to 43% of the entire portfolio) experienced a sharp drop in value, ranging from over $26 million in January 1994 (or .45% loss in value), to over $565 million in September 1994 (or 6.27% loss in value). From January through August 1994, the rising interest rates and the declining value of the Pools' securities caused the Pools to suffer collateral calls and reductions in loan amounts totalling over $1 billion.

3. The Pension Bond Offering

On September 28, 1994, First Boston underwrote Orange County's offering of $320,040,000 in Pension Bonds. The proceeds of this offering were used to fund the County's accrued, but unfunded, pension liability to the Orange County Employees Retirement System. Nowlin and Montague were First Boston's lead investment bankers assigned to this offering. During the underwriting, First Boston, through Nowlin and Montague, participated in drafting the Official Statement. First Boston then offered and sold the Pension Bonds through that Official Statement. The Official Statement was the document that should have provided investors with accurate and complete disclosure of material facts regarding the Pension Bonds upon which they could rely to make an informed investment decision.

The Series B Bonds, issued in the amount of $110,200,000, were to pay interest at a rate that was to be reset periodically by First Boston as the remarketing agent. Under the terms of the Series B Bonds, the investors had the right to liquidate their investment on seven days' notice. To exercise this right, the investors were to tender their bonds for repurchase to First Boston as the remarketing agent. If First

Boston could not resell the tendered bonds within seven days, the Pools were obligated to purchase the tendered securities in an amount up to the County's unrestricted funds in the Pools. Thus, the Pools acted as the standby liquidity provider.

4. Misleading Disclosure in the Official Statement

a. The Pools' Investment Strategy and the Risks of that Strategy

The Official Statement represented that the Pools' "investment policy focuses on retaining the safety of investment principal while earning satisfactory yields." The Official Statement further represented that it was the Pools' "practice to select quality investments . . . and not to take any risks which, in the judgment of the Treasurer's Office, would be unreasonable."

The Official Statement further represented that the Pools:

[I]nvested primarily in United States Government Securities, including, but not limited to, United States Treasury Notes, Treasury Bills, Treasury Bonds, and obligations of United States Government Agencies. When circumstances warrant, the [Pools'] investments may also include bankers acceptances, negotiable certificates of deposit of national or state-chartered banks and state or federal thrift, commercial paper, repurchase agreements, reverse repurchase agreements, medium term corporate notes and collateralized time deposits.

These statements were misleading because they omitted to disclose material information about the Pools' investment strategy. Specifically, the Official Statement omitted to disclose the material information that the Pools' investment strategy: (1) was premised on the assumption that interest rates would remain relatively low for at least three years; (2) involved an extremely high degree of leverage, which at the time of the Pension Bond offering was 258.55%; and (3) involved a substantial investment in inverse floaters, which comprised 33.6% of the Pool's holdings at the time of the Pension Bond offering.

The Official Statement also omitted to disclose material information regarding the risks of that strategy if interest rates were to rise, including: (1) the Pools' cost of borrowing on the substantial reverse repurchase position would increase; (2) the Pools' interest income on the substantial investment in inverse floaters would decrease; (3) the Pools' securities would decline in market value; (4) as the value of the securities fell, the Pools would suffer collateral calls and reductions in loan amounts on the reverse repurchase agreements; (5) the Pools' earnings would decrease; and (6) the Pools would suffer losses of principal at certain interest rate levels.

The Official Statement also represented that: "To maintain the liquidity of its investments, the [Pools] invest in securities that are actively traded in the securities markets." In fact, many of the Pools' securities, including certain derivatives, were not actively traded.

b. The Pools' Investment Results

Regarding the Pools' investment performance, the Official Statement stated that the County had earned a net yield of 7.67% on its investment in the Pools in the fiscal year ended June 30, 1994, that the Pools had earned an average yield of 7.74% during the fiscal year ended June 30, 1994, and the Pools had an annualized yield of 7.45% during July 1994. In addition, in a footnote to the County's financial statements, the chart listing the Pools' securities indicated that, as of June 30, 1993, the market value of the investments was above the purchase price, indicating that the Pools had a market profit.

The inclusion of this market profit without the additional disclosure of certain material information concerning the Pools' declining investment results in 1994 was misleading. The Pools had suffered substantial declines during 1994 in the overall market value of the portfolio. Contrary to the market profit indicated in the County's 1993 financial statements, the Treasurer's records indicated that a substantial

portion of the Pools' securities, when marked-to-market as of the end of August 1994, had declined in value by at least $565 million. These market declines were not disclosed in the Official Statement. The Pools had also experienced over $1 billion in collateral calls and reductions in loan amounts under reverse repurchase agreements. These collateral calls and reductions in loan amounts were also not disclosed in the Official Statement.

5. The Knowledge of First Boston, Nowlin, and Montague

At the time of the Pension Bond offering, First Boston, Nowlin, and Montague knew or should have known certain material information regarding the Pools from: (1) media reports concerning the Pools that were published in the first half of 1994; and/or (2) information at the County, including the Treasurer's 1992-93 Financial Statement received by First Boston.<(3)>. This information included:

The Pools' investment strategy was premised on the assumption that interest rates would remain low for a minimum of three years; The County used reverse repurchase agreements to leverage the Pools' $7.5 billion of Participant deposits into an investment portfolio of $19.5 billion;

The Pools invested in derivative securities, including inverse floaters;

The Pools had suffered market declines as a result of the rise in interest rates;

The Pools had suffered collateral calls in early 1994; and Critics of the Treasurer had charged that the Pools' investment strategy was too risky for public funds.

6. Review of the Disclosure for the Pension Bond Offering

The County provided the underwriting team with disclosure regarding the Pools for inclusion in the Official Statement. This disclosure came from an offering earlier in 1994 in which the Pools had acted as liquidity provider. Nowlin and Montague adopted the disclosure for incorporation in the Official Statement with revisions relating to the historical liquidity of the Pools. Despite the importance of the Pools in the offering and the media articles voicing concerns about the Pools investment strategy, Nowlin and Montague did not make any inquiry within First Boston for information related to the Pools. Given the information known or readily available to them, First Boston, Nowlin, and Montague made insufficient inquiry into the Pools' investment strategy and the risks of that strategy, use of reverse repurchase agreements, investment in derivatives, or decline in investment results caused by the rise in interest rates.

Nowlin and Montague knew at the time of the Pension Bond offering that Orange County had conducted other securities offerings relating to the Pools. Despite this knowledge, they did not review the official statements for these prior offerings (except for the disclosure provided by the County) to determine whether the disclosure in the Pension Bond Official Statement regarding the Pools was consistent with disclosure in the prior offerings. In fact, the disclosure in the Official Statement for the Pension Bonds was different from the disclosure in the prior Orange County offerings.

7. First Boston's Supervision of Its Investment Bankers

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<(3)>Neither Nowlin nor Montague received or requested this Financial Statement.

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First Boston failed reasonably to supervise Nowlin and Montague by not establishing adequate policies and procedures relating to disclosure in municipal securities transactions. In 1994, First Boston allowed its investment bankers, such as Nowlin and Montague, to approve official statements on behalf of the

firm. Despite this grant of authority, First Boston did not have adequate policies or procedures concerning the review of official statements to guide investment bankers in their review of disclosure.

8. Orange County's Bankruptcy and Default on the Pension Bonds

As a result of the risks of the Pools' investment strategy, by December 1994, the Pools had suffered market declines of about $1.5 billion. In response to these declines, Orange County and the Pools filed Chapter 9 bankruptcy on December 6, 1994. Between mid-December 1994 and January 20, 1995, Orange County liquidated the Pools' securities portfolio, suffering a loss of almost $1.7 billion on the Participants' deposits of $7.6 billion, a 22.3% loss. The Pools also defaulted on their obligation to repurchase the tendered Series B Bonds. Thus, the investors were unable to liquidate their bonds, and the Pension Bonds' credit rating was downgraded to default status.

C. LEGAL DISCUSSION

1. First Boston, Nowlin, and Montague Violated Sections 17(a)(2) and (3) of the Securities Act in the Offer and Sale of the Pension Bonds

Sections 17(a)(2) and (3) of the Securities Act make it unlawful for any person, through the means or instruments of interstate commerce or the mails, in the offer or sale of any security:

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Scienter is not required to prove violations of Sections 17(a)(2) or (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 697 (1980). Violations of these sections may be established by showing negligence. SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997); SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992). Accordingly, First Boston, Nowlin, and Montague, through their negligent conduct, violated Sections 17(a)(2) and (3) of the Securities Act in the offer and sale of the Series B Bonds.

a. The Misstatements and Omissions Were Material

The Pools' investment strategy, the risks of that strategy, and the Pools' declining investment results were material to the Series B Bond investors. Information is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information made available. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). As previously discussed, the Pools were the standby liquidity provider on the Series B Bonds. The Pools' investment strategy, the risks of that strategy, and the Pools' declining investment results affected the Pools' ability to fulfill their obligations to repurchase the Series B Bonds. The safety of the investment and the Pools' ability to repurchase the Series B Bonds was material to reasonable investors.

b. First Boston, Nowlin, and Montague Should Have Known that the Official Statement was Materially Misleading

At the time First Boston, Nowlin and Montague participated in drafting the Official Statement, they knew or should have known certain information about the Pools' investment strategy, the risks of that strategy, and the Pools' declining investment results, which matters affected the Pools' ability to provide liquidity for the Series B Bonds. From a reasonable review of the Official Statement, First Boston, Nowlin, and Montague should have known that the Official Statement was materially misleading because the disclosure misrepresented or omitted to disclose such material information about the Pools. For purposes

of First Boston's violations, the conduct of the First Boston bankers may be imputed to the firm. See SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972).

2. First Boston, Nowlin, and Montague Violated Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17

Under Section 15B(c)(1) of the Exchange Act, a broker, dealer, or municipal securities dealer is prohibited from using the mails or any instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in violation of any rule of the Municipal Securities Rulemaking Board ("MSRB").

As a broker-dealer conducting a municipal securities business, First Boston was subject to Section 15B(c)(1) of the Exchange Act and the MSRB rules, as were its associated persons, Nowlin and Montague. See MSRB Rule D-11.

MSRB Rule G-17 provides that: "In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." For the reasons set forth above in Section C.1. with respect to the violations of Sections 17(a)(2) and (3) of the Securities Act, First Boston, Nowlin, and Montague violated MSRB Rule G-17.

3. First Boston Failed Reasonably to Supervise Its Investment Bankers

Under Section 15(b)(4)(E) of the Exchange Act, the Commission may sanction broker-dealers for failing reasonably to supervise a person under its supervision. Supervision is an essential function of broker-dealers. The Commission has "made it clear that it is critical for investor protection that a broker-dealer establish and enforce procedures to supervise its employees." In re Sheldon, Exchange Act Release No. 31475, 52 SEC Docket 3826 (Nov. 18, 1992). See also In re Dean Witter Reynolds, Inc., Exchange Act Release No. 26144, 41 SEC Docket 1680, 1684 (Sept. 30, 1988). In large organizations in particular, it is "imperative that the system of internal control be adequate and effective." In re Prudential Sec., Inc., Exchange Act Release No. 33082 (Oct. 21, 1993). See also In re Shearson, Hammill & Co., Exchange Act Release No. 7743, 42 S.E.C. 811, 843 (Nov. 12, 1965). A firm's failure to establish such guidelines is symptomatic of a failure to supervise reasonably. See In re G.K. Scott & Co., Exchange Act Release No. 33485 (Jan. 14, 1994).

First Boston failed reasonably to supervise Nowlin and Montague with a view towards preventing their violations of the federal securities laws within the meaning of Section 15(b)(4)(E) of the Exchange Act. First Boston allowed Nowlin and Montague to approve the Official Statement on behalf of the firm. The firm, however, failed to have adequate policies and procedures to guide the investment bankers in the review of the disclosure and to detect and prevent violations in connection with municipal securities offerings.

4. Conclusion

Accordingly, based on the foregoing, the Commission finds that First Boston, Nowlin, and Montague willfully violated Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17.<(4)>. The Commission further finds that pursuant to Section 15(b)(4)(E) of the Exchange Act, First Boston failed reasonably to supervise Nowlin and Montague with a view towards preventing their

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<(4)>In applying the term "willful" in Commission administrative proceedings instituted pursuant to Sections 15(b), 15B, 15C, 17A, 19(h), and 21B of the Exchange Act, Section 9 of the Investment Company Act of 1940, and Section 203 of the Investment Advisers Act of 1940, the Commission

evaluates on a case-by-case basis whether the respondent knew or reasonably should have known under the particular facts and circumstances that his conduct was improper. In this case as in all Commission administrative proceedings charging a willful violation under these statutory provisions, the Commission applies this standard to persons -- specifically, securities industry professionals -- who are directly subject to Commission jurisdiction and who have a responsibility to understand their duties to the investing public and to comply with the applicable rules and regulations which govern their behavior.

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IV.

First Boston has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's entry of this Order, which: (1) makes findings, as set forth above; (2) orders First Boston to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17; and (3) orders First Boston to pay a civil penalty in the amount of $800,000. As set forth in its Offer of Settlement, First Boston undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transaction that is the subject of this Order. Furthermore, First Boston has agreed to certain specific undertakings in the event that it reenters the business of underwriting municipal securities.

V.

Nowlin has submitted an Offer of Settlement in which, without admitting or denying the findings herein, he consents to the Commission's entry of this Order, which: (1) makes findings, as set forth above; (2) orders Nowlin to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17; and (3) orders Nowlin to pay a civil penalty in the amount of $35,000. As set forth in his Offer of Settlement, Nowlin undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transaction that is the subject of this Order.

VI.

Montague has submitted an Offer of Settlement in which, without admitting or denying the findings herein, he consents to the Commission's entry of this Order, which: (1) makes findings, as set forth above; (2) orders Montague to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act and Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17; and (3) orders Montague to pay a civil penalty in the amount of $35,000. As set forth in his Offer of Settlement, Montague undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings concerning the transaction that is the subject of this Order.

VII.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offers of Settlement submitted by First Boston, Nowlin, and Montague.

Accordingly, IT IS HEREBY ORDERED that, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act:

1. First Boston shall, effective immediately, cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17.

2. First Boston shall, within thirty (30) days of the date of this Order, pay a civil money penalty in the amount of $800,000 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the United States Securities and Exchange Commission; (3) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (4) submitted under cover letter that identifies First Boston as a Respondent in these proceedings, and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to William E. White, Senior Trial Counsel, Pacific Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

3. First Boston shall comply with the undertakings specified in its Offer as follows:

a. Should First Boston reenter the business of underwriting municipal securities, First Boston undertakes to implement policies and procedures relating to its review of preliminary official statements and supervisory procedures concerning such underwritings prior to reentering such business.

b. Within thirty (30) days of First Boston's reentry into the business of underwriting municipal securities, First Boston shall engage an Independent Consultant who is not unacceptable to the Commission staff. Such Independent Consultant shall have his or her compensation and expenses borne exclusively by First Boston. The Independent Consultant may retain such consultants as he or she shall deem reasonably necessary and appropriate for the task.

c. The Independent Consultant shall review First Boston's policies and procedures to determine the adequacy of such policies and procedures to reasonably detect and prevent the violations of the federal securities laws that gave rise to this proceeding, and with respect to such policies and procedures, the Independent Consultant shall: (1) recommend the adoption and implementation of any new and/or revised procedures deemed necessary or appropriate; and (2) recommend the adoption and implementation of new and/or revised training program deemed necessary or appropriate.

d. The Independent Consultant's recommendation shall be made in the form of an Initial Report submitted to the Chief Executive Officer and Board of Directors of First Boston and the Commission's staff within sixty (60) days of the appointment of the Independent Consultant.

e. Within thirty (30) days of receipt of the draft report submitted by the Independent Consultant, the Chief Executive Officer and Board of Directors of First Boston shall, in writing, advise the Independent Consultant of those recommendations that First Boston has determined not to accept because they are unduly burdensome. Regarding any recommendation First Boston believes is unduly burdensome, First Boston shall undertake to propose an alternative policy or procedure designed to achieve the same result. First Boston and the Independent Consultant shall then attempt in good faith to reach agreement on any policy and procedure as to which there is a dispute.

f. If there is a dispute over a policy or procedure recommended by the Independent Consultant then the Independent Consultant shall evaluate First Boston's alternative policy or procedure. First Boston will, however, abide by the determination of the Independent Consultant with regard thereto and adopt those recommendations deemed appropriate by the Independent Consultant.

g. The Independent Consultant shall complete the aforementioned review and submit a written Final Report thereon to First Boston and the Commission's staff within sixty (60) days following the date of the Initial Report.

h. First Boston shall cooperate fully with the Independent Consultant and shall provide such person with access to its files, books, records, and personnel as reasonably requested for the review by the Independent Consultant.

i. First Boston shall take all necessary and appropriate steps to adopt and implement the recommendations contained in the report.

j. Within sixty (60) days of receipt of the Final Report, First Boston shall file an affidavit with the Commission's staff stating that it has put in place a system of policies and procedures reasonably designed to prevent and/or detect the violations of the securities laws which gave rise to this proceeding or is in the process of so doing, providing a reasonable estimate not to exceed sixty (60) additional days without the approval of the Commission's staff, as to when implementation shall be completed.

k. For the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with First Boston, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any firm with which the Independent Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the staff of the Commission's Pacific Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with First Boston, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

4. Nowlin shall, effective immediately, cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17.

5. Nowlin shall, within thirty (30) days of the date of this Order, pay a civil money penalty in the amount of $35,000 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the United States Securities and Exchange Commission; (3) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (4) submitted under cover letter that identifies Nowlin as a Respondent in these proceedings, and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to William E. White, Senior Trial Counsel, Pacific Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

6. Nowlin shall comply with his undertakings described in Section V above.

7. Montague shall cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act, Section 15B(c)(1) of the Exchange Act, and MSRB Rule G-17.

8. Montague shall, within thirty (30) days of the date of this Order, pay a civil money penalty in the amount of $35,000 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the United States Securities and Exchange Commission; (3) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (4) submitted under cover letter that identifies Montague as a Respondent in these proceedings, and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to William E. White, Senior Trial Counsel, Pacific Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, California 90036.

9. Montague shall comply with his undertakings described in Section VI above.

<u>In re Lazard Freres & Co. LLC</u>, Securities Act Release No. 7480, Exchange Act Release No. 39388, A.P. File No. 3-9495 (December 3, 1997).

I.

The Commission deems it appropriate and in the public interest to institute public administrative proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77h-1] and Sections 15B(c)(2) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78o-4(c)(2) and 78u-3] against Lazard Freres & Co. LLC ("Lazard Freres" or "Respondent").

In anticipation of the institution of these proceedings, Lazard Freres has submitted an Offer of Settlement ("Offer") to the Commission. Solely for the purpose of these proceedings, and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and prior to a hearing pursuant to the Commission's Rules of Practice, Lazard Freres, without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of these proceedings, which is admitted, by its Offer, consents to the issuance of this Order Instituting Public Administrative Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15B(c)(2) and 21C of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions (the "Order") and to the entry of the findings and the imposition of the remedial sanctions set forth below.

The Commission has determined that it is appropriate and in the public interest to accept the Offer and is issuing this Order.

II.

FACTS

The Commission finds <(1)> that:

A. Respondent

Lazard Freres & Co. LLC. Lazard Freres is a New York limited liability company with its principal place of business in New York, New York. It is the successor to Lazard Freres & Co., a New York limited partnership with its principal place of business in New York, New York. At all relevant times, both Lazard Freres and its predecessor were a broker-dealer and municipal securities dealer, and were registered with the Commission pursuant to Sections 15(b) and 15B(a)(2) of the Exchange Act.

B. Relevant Entities

1. Fulton County, Georgia. The most populous county in the State of Georgia, Fulton County's largest city and county seat is Atlanta. Fulton County's governing body is the Board of Commissioners, which, at all times relevant, consisted of seven members, elected to four-year terms. Four members were elected from territorial districts and three, including the Chairman, were elected from the County at-large. At all times relevant, the Fulton County Commission was empowered to issue bonds and to select underwriters in connection with such bond issuances.

2. Fulton-DeKalb Hospital Authority. The Fulton-DeKalb Hospital Authority ("FDHA") was at all times relevant a public body created pursuant to Georgia law and resolutions adopted by Fulton and DeKalb Counties, Georgia. The FDHA was responsible for providing public health facilities, including the Grady Memorial Hospital in Atlanta. At all times relevant, the FDHA was also authorized to issue revenue anticipation certificates for the purpose of carrying out its duties, to issue such certificates to refund or refinance indebtedness, and to select underwriters for the foregoing. At all times relevant, the FDHA was managed by its Board of Trustees, which was composed of ten members: Seven were residents of Fulton

County and were appointed by the Fulton County Board of Commissioners, and three were residents of DeKalb County and were appointed by the DeKalb County Board of Commissioners.

3. Duval County, Florida, School Board. A public body existing under the laws of the State of Florida, the Duval County School Board ("DCSB") was at all times relevant the governing body of the Duval

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<(1)> The findings herein are made pursuant to Respondent's Offer solely for these proceedings and are not binding on any other person or entity in these or any other proceedings.

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County School District, which included the public schools of the City of Jacksonville. A participant in the "consolidated government" structure in place between the City of Jacksonville and Duval County, the DCSB was empowered to issue bonds, and to select underwriters and other professionals in connection with such bond issuances. The DCSB was composed of seven elected members.

C. Summary

This matter involves an undisclosed payment to a financial advisor and other improper practices to obtain municipal securities underwriting business. A former partner of Lazard Freres who was an investment banker in its Municipal Finance Department (the "Former Partner") and a former Vice-President resident in Florida who was also an investment banker in Respondent's Municipal Finance Department (the "Former Vice-President"), arranged for an outside consultant used by the Former Partner and Former Vice-President in connection with their efforts to obtain municipal securities business for Lazard Freres (the "Outside
Consultant"), to make a $41,936 payment to a former Vice-President of a co-financial advisor to Fulton County and the FDHA (the "Financial Advisor"). In addition, the Former Partner and Former Vice-President used and compensated the Outside Consultant on an undisclosed basis to assist in their efforts to secure a role for Lazard Freres in a 1992 municipal securities offering by the DCSB, in violation of certain representations contained in a contract with the DCSB. As a result of this misconduct of the Former Partner and Former Vice-President, Lazard Freres is responsible for defrauding the issuers in three offerings of municipal securities. Furthermore, the Former Partner also used third parties to act as conduits for political contributions in certain jurisdictions, under cover of false and misleading invoices for consulting and other services which were submitted to Lazard Freres in order to obtain funds from Lazard Freres to reimburse such third parties, thereby causing Lazard Freres to violate books and records provisions and the Municipal Securities Rulemaking Board's ("MSRB") fair dealing rule.<(2)>

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<(2)> The misconduct described herein for which Lazard Freres is responsible was limited to the Former Partner and Former Vice-President who worked in Lazard Freres' Municipal Finance Department. Moreover, the Former Partner and Former Vice-President caused numerous false and misleading invoices requesting payment for municipal legal, consulting and other services to be submitted to Lazard Freres for payment, in order to facilitate their activities as described in this Order. Notwithstanding the above, Lazard Freres is responsible for the improper conduct of the Former Partner and Former Vice-President by virtue of their prior positions with Respondent. At the end of 1995, Lazard Freres closed its Municipal Finance and Municipal Bond Departments and is no longer engaged in the municipal underwriting business.

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D. Payment to Financial Advisor

On June 3, 1992, the Fulton County Commission voted to select a two-firm team to provide financial advisory services in connection with, among other things, future municipal underwritings by Fulton County. The Financial Advisor was the senior investment banker for one of the firms selected and was

resident in Atlanta for his firm. The Financial Advisor was the person at his firm responsible for the Fulton County financial advisory assignment. Among the responsibilities of Fulton County's financial advisors was assistance with underwriter selection for future Fulton County bond issues.

By July 16, 1992, the Former Partner, the Former Vice President, the Outside Consultant and the Financial Advisor agreed that, in exchange for the promise of compensation, the Financial Advisor would assist the Former Partner and Former Vice-President in their efforts to obtain for Lazard Freres the senior managing underwriter position on a large upcoming bond issue of Fulton County, i.e., the $163,375,000 Fulton County, Georgia, Water and Sewage Revenue Bonds, Refunding Series 1992 (dated October 1992) ("Fulton Water & Sewer Refunding"). Thereafter, the Financial Advisor assisted the Former Partner and Former Vice-President in their ultimately successful effort to obtain that position for Lazard Freres by, among other things, manipulating the results of the financial advisors' ranking of the 32 underwriting proposals received to ensure that Lazard Freres received the top score, and joining in the recommendation submitted to the Fulton County Commission that Lazard Freres be named senior managing underwriter.

In December 1992, following closing of the Fulton Water & Sewer Refunding, the Former Partner arranged for the Outside Consultant to submit a false and misleading invoice to Lazard Freres requesting payment of $83,872 for "Governmental Consulting-Business Development/Marketing Services" and caused Lazard Freres to issue an $83,872 check to the Outside Consultant in payment of the invoice. The Outside Consultant then paid the Financial Advisor $41,936, exactly half of this amount. The $41,936 payment to the Financial Advisor was not disclosed to the issuer or to investors in the Fulton Water & Sewer Refunding.

In conduct that began shortly before he received the $41,936 from the Outside Consultant and that continued thereafter, the Financial Advisor also assisted the Former Partner and Former Vice-President in their efforts to obtain municipal underwriting business from a neighboring issuer, the FDHA, for which the Financial Advisor also came to serve as co-financial advisor by virtue of his position as financial advisor to Fulton County. The bond issue was the $336 million Fulton-DeKalb Hospital Authority (Georgia) Revenue Refunding Certificates, Series 1993 (dated May 1993) ("Grady Hospital Refunding"). The Financial Advisor assisted the Former Partner and Former Vice-President in their efforts to obtain a role for Lazard Freres in the Grady Hospital Refunding by, among other things, providing the Former Partner and Former Vice-President with a copy of a competitor's unsolicited refunding proposal, and joining in the recommendation to the FDHA that Lazard Freres be named as one of three co-senior managing underwriters. The Financial Advisor took these actions, again, without disclosing to the issuer or to investors in the Grady Hospital Refunding the financial arrangement he reached with the Former Partner and Former Vice-President or the $41,936 payment he received from the Outside Consultant. Nor was any such disclosure made by the Former Partner and Former Vice-President.

E. Undisclosed Use of Consultant and Improper Contacts

In connection with the underwriter selection process for the $184,500,000 School District of Duval County, Florida, General Obligation Refunding Bonds, Series 1992 (dated April 1992) ("Duval School Refunding") the terms of the DCSB's Request for Proposals ("RFP") for underwriting services prohibited prospective underwriters from using and paying non-full-time employees as consultants to assist in obtaining business for any such underwriter on the Duval School Refunding. The terms of the Investment Banking Services Agreement ultimately entered into by DCSB and the underwriters expressly empowered the DCSB to recover the amount of any such consultant payments from the underwriters, either as part of the purchase price for the bonds or otherwise.<(3)> In addition, the RFP limited contacts by prospective underwriters and their agents to two individuals: the financial advisor for the transaction and a DCSB staff member.

Notwithstanding these prohibitions, the Former Partner and Former Vice-President arranged to use the Outside Consultant, who was not a Lazard Freres employee, on an undisclosed basis to assist in their efforts to obtain the senior managing underwriter position on the Duval School Refunding for Lazard

Freres and promised the Outside Consultant compensation for doing so. Pursuant to such arrangement, the Outside Consultant assisted the Former Partner's and Former Vice-President's efforts to obtain the senior managing underwriter position on the Duval School Refunding for Lazard Freres by, among other things, making prohibited pre-selection contacts with an elected member of the DCSB. Following Lazard Freres' selection as senior managing underwriter for the Duval School Refunding, the Former Partner was responsible for the making of a materially false and misleading representation in the Investment Banking Services Agreement he caused to be executed with the issuer on behalf of Lazard Freres by (1) warranting that Lazard Freres "has not employed or retained any company or person, other than a bona fide employee working solely for Lazard Freres, to solicit or secure this Agreement, and that it has not paid or agreed to pay any person, company, corporation, individual or firm, other than a bona fide employee working solely for Lazard Freres any fee, commission, percentage, gift or other consideration, contingent upon or resulting from the award or making of this Agreement," and (2) failing to disclose the involvement of or compensation to be paid to the Outside Consultant.

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<(3)> Both the RFP and later, the "Investment Banking Services Agreement" for the Duval School Refunding provided that, in the event any underwriter paid any compensation to a non-full-time employee engaged to assist an underwriter in obtaining underwriting business in connection with the Duval School Refunding, the DCSB "shall have the right to terminate this agreement without liability and, at its discretion, to deduct from the contract price, or otherwise recover, the full amount" of any such compensation.

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F. Use of Consultant and Other Payments for Campaign Contributions

In September and October 1992 and February 1993, the Former Partner arranged for the reimbursement of at least $62,500 in political contributions to gubernatorial campaigns in two jurisdictions. In particular, the Former Partner arranged for third parties -- including certain Florida lawyers and consulting firms -- to make the political contributions. The Former Partner then had the third parties submit false and misleading invoices to Lazard Freres requesting payment for purportedly legitimate municipal-related legal, consulting or other services rendered to Lazard Freres in order to obtain funds from Lazard Freres to reimburse the third parties for the political contributions. The Former Partner then saw to it that these invoices were paid by Lazard Freres. All of the foregoing contributions were made in furtherance of the Former Partner's municipal securities underwriting business development efforts.

III.

OPINION

A. Violations of the Antifraud Provisions

By virtue of the above-described conduct of the Former Partner and the Former Vice-President, Lazard Freres is responsible for violations of (1) Section 10(b) of the Exchange Act and Rule 10b-5 thereunder with respect to the sales of bonds from the issuers to Lazard Freres on the three refunding issues, and (2) Sections 17(a)(2) and 17(a)(3) of the Securities Act with respect to the sales of bonds to investors in the three refunding issues.

1. Fraud on the Issuers

The failure to disclose the arrangement with and payment to the Financial Advisor constituted and operated as a scheme to defraud the issuers on the Fulton Water & Sewer and Grady Hospital Refundings. See First Fidelity Securities Group, Exchange Act Rel. No. 36694, 61 S.E.C. Docket 68 (Jan. 9, 1996) (underwriter defrauded issuers by paying undisclosed kickbacks to financial advisor for underwriting

business). Similarly, the failure to disclose the use of and the payment of a success fee to the Outside Consultant constituted and operated as a scheme to defraud the DCSB on the Duval School Refunding.

Moreover, as an underwriter of Fulton County, FDHA and DCSB securities, Lazard Freres was a purchaser of securities from those issuers. The Former Partner and Former Vice-President knew and understood that Lazard Freres, as a broker-dealer, had an obligation to deal fairly with the issuers. See MSRB rule G-17;<(4)> see also Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943), cert. denied, 321 U.S. 786 (1944). The undisclosed arrangement with and payment to the Financial Advisor breached that duty. See, e.g., SEC v. Feminella, 947 F. Supp. 722, 732 (S.D.N.Y 1996) (kickback paid to agent of broker-dealer's customer should have been received by the customer, and not the agent). Fulton County and the FDHA were entitled to impartial advice from the Financial Advisor and in evaluating that advice were entitled "to judge for themselves what significance to attribute" to the payment received by the Financial Advisor. See Wilson v. Great American Industries, Inc., 855 F.2d 987, 994 (2d Cir. 1988). This is "not because such [arrangements] are always corrupt but because they are always corrupting." Mosser v. Darrow, 341 U.S. 267, 271 (1951).<(5)> With respect to the DCSB and the Duval School Refunding, the Former Partner caused a false and misleading representation to be made to the issuer concerning the use and compensation of the Outside Consultant. That misrepresentation went to the terms of the sale of the bonds, and was therefore material to the issuer.

2. Nondisclosure to Investors

As underwriter on the three transactions, Lazard Freres delivered the Official Statements for the offerings to investors, and had a duty to review the key representations in those Official Statements.<(6)> The Official Statements for the Fulton Water and Sewer Refunding and the Grady Hospital Refunding failed to disclose the payment to the Financial Advisor. The Official Statement for the Duval School Refunding failed to disclose the success fee paid to the Outside Consultant. Because the existence of these payments cast doubt on the integrity of the offering process for the respective bond issues, they were material to investors. As the Commission has said, "information concerning financial and business relationships and arrangements among the parties involved in the issuance of municipal securities may be critical to an evaluation of an offering." Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Exchange Act Release No. 33741, 56 S.E.C. Docket 596, 599 (Mar. 9, 1994).

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<(4)> MSRB rule G-17 provides:

In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

<(5)> Cf. United States v. Waymer, 55 F.3d 564, 572 (11th Cir. 1995), cert. denied, 116 S. Ct. 1350 (1996) (nondisclosure of kickback prevented renegotiation of contracts at better price); United States v. Rudi, 902 F. Supp. 452, 456-57 (S.D.N.Y. 1995); and First Fidelity Securities Group, supra, 61 S.E.C. Docket at 78.

<(6)> See Exchange Act Rule 15c2-12. As the Commission stated in proposing the Rule: By participating in an offering, an underwriter makes an implied recommendation about the securities . . . [T]his recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings. Exchange Act Release No. 26100, 41 S.E.C. Docket 1402, 1411 (Sept. 22, 1988).

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3. Scienter

Both the Former Partner and the Former Vice-President acted with the requisite scienter, see Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885, 889 (5th Cir. 1987) (defining scienter as a mental state embracing "intent to deceive, manipulate, or defraud . . . or severe recklessness" (citations omitted)). This is evidenced by their efforts to keep hidden the arrangement with and payment to the Financial Advisor and their use and compensation of the Outside Consultant, including by making the payment to the Financial Advisor through an indirect channel, and also using false and misleading documentation submitted to Lazard Freres in connection with the payment to the Financial Advisor and the payment of the Duval success fee to the Outside Consultant. By virtue of their positions with Lazard Freres, the mental states of the Former Partner and Former Vice-President may be imputed to Lazard Freres.<(7)>

4. Jurisdiction

In order for there to be a violation of the antifraud provisions it would be necessary to find that the nondisclosures of the arrangement with and payment to the Financial Advisor and the use and compensation of the Outside Consultant were in connection with the purchase or sale of securities.<(8)> The nondisclosures satisfied this requirement, because they "touch[ed]" on DCSB's, Fulton County's and the FDHA's sale of the securities. Superintendent of Insurance of New York v. Bankers Life & Cas. Co., 404 U.S. 6, 12-13 (1971). The information withheld was material to the issuers' decision to select Lazard Freres as underwriter, and selection of underwriters had a direct nexus with the issuers' sale, and in turn, the public's purchase of the issuers' securities.

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<(7)> See Sharp v. Coopers & Lybrand, 649 F.2d 175 (3d Cir. 1981), cert. denied, 455 U.S. 938 (1982); Rochez Bros., Inc. v. Rhoades, 527 F.2d 880, 884 (3d Cir. 1975). See also American Soc'y of Mech. Eng'rs, Inc. v. Hydrolevel Corp., 456 U.S. 556, 565-566 (1982). The Commission need not show scienter to establish a violation of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

<(8)> The Commission need not show any financial loss in order to satisfy this element. SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985).

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B. Violations of Section 15B(c)(1) of the Exchange Act and MSRB rules G-17 and G-20 Section

15B(b) of the Exchange Act established the Municipal Securities Rulemaking Board ("MSRB") and empowered it to propose and adopt rules with respect to transactions in municipal securities by brokers, dealers and municipal securities dealers. As associated persons of broker-dealers, the Financial Advisor, the Former Partner and the Former Vice-President were bound by the MSRB rules. Pursuant to Section 15B(c)(1), a broker-dealer or municipal securities dealer is prohibited from using the mails or any instrumentality in interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in violation of any rule of the MSRB. As a municipal securities dealer, Lazard Freres is subject to Section 15B(c)(1) of the Exchange Act and the MSRB rules. By virtue of the above-described conduct of the Former Partner and the Former Vice-President in connection with the Fulton Water and Sewer, Grady Hospital and Duval School Refundings, Lazard Freres is responsible for violating Section 15B(c)(1) of the Exchange Act and MSRB rules G-17 and G-20.

1. MSRB rule G-17

MSRB rule G-17 is a fair dealing rule. The failure to disclose financial and other relationships between a fiduciary of an issuer and an underwriter that create potential or actual conflicts of interest violates MSRB rule G-17. See Lazard Freres & Co. LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Exchange Act Rel. No. 36419 (Oct. 26, 1995); SEC v. Ferber, Lit. Rel. No. 15193 (December 19, 1996); First Fidelity Securities Group, supra; SEC v. Busbee, Lit. Rel. Nos. 14387 (January 23, 1995) and 14508 (May 24, 1995)); SEC v. Rudi, Lit. Rel. Nos. 14421 (February 23, 1996) and 15202 (December 30, 1996).

2. MSRB rule G-20

This rule, "Gifts and Gratuities," prohibits municipal securities dealers from (1) giving any thing or service of value worth more than $100 per year; (2) directly or indirectly; (3) to a person other than an employee or partner of such dealer; (4) if such payment or service is in relation to the municipal securities activities of the employer of the recipient of the payment or service. MSRB Rule G-20(a). The rule specifically provides that "employer" includes the principal for whom the recipient of the payment or service is acting as agent or representative. The rule is intended to prohibit commercial bribery and covers payments to issuer officials and fiduciaries.

By using the Outside Consultant as a conduit for the $41,936 payment to the Financial Advisor, knowing that the Outside Consultant would pass on money to the Financial Advisor at a time when the Former Partner and the Former Vice-President were soliciting underwriting business for Lazard Freres from the Financial Advisor's principal, Fulton County, the Former Partner and the Former Vice-President "indirectly" gave the Financial Advisor "a thing or service of value . . . in excess of $100."

C. Books and Records Violations

Section 17(a)(1) of the Exchange Act requires brokerage firms to create and maintain books and records reflecting their operations and dealings as required by rules promulgated by the Commission. Rule 17a-3 specifies the books and records that brokerage firms must create pursuant to Section 17(a). The MSRB's books and records provisions parallel the Commission's. MSRB rule G-8 is the provision requiring municipal securities dealers to make certain books and records concerning their municipal securities business. The rule requires that the information be recorded "clearly and accurately." MSRB rule G-8(b). The Commission has described the records maintained by broker-dealers as "the basic source documents and transaction records of a broker-dealer," and the "keystone of the surveillance of brokers and dealers by our staff and by the securities industry's self-regulatory bodies." Edward J. Mawod & Co., 46 S.E.C. 865, 873 n. 39 (1977) aff'd sub nom. Edward J. Mawod & Co. v. SEC, 591 F.2d 588, 594 (10th Cir. 1979).

The conduct of the Former Partner and the Former Vice-President caused the books and records of Lazard Freres to be inaccurate with respect to the payment to the Outside Consultant on the Duval School Refunding, the payment to the Financial Advisor (via the Outside Consultant) on the Fulton Water & Sewer Refunding, and the reimbursement of political contributions. With respect to each of these transactions, Lazard Freres' books and records failed to accurately record the true nature of the payments, and characterized them in a misleading manner.

IV.

FINDINGS

On the basis of this Order and the Offer, the Commission finds that Lazard Freres willfully violated Sections 10(b), 15B(c)(1) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-3 thereunder, Sections 17(a)(2) and 17(a)(3) of the Securities Act and MSRB rules G-8, G-17 and G-20.

V.

OFFER OF SETTLEMENT

Lazard Freres has submitted an Offer of Settlement that the Commission has determined to accept.<(9)> In determining to accept the Offer, the Commission considered the remedial efforts promptly undertaken by Lazard Freres and the cooperation Lazard Freres afforded the Commission staff. In its Offer, Lazard Freres consents, without admitting or denying, to the entry of this Order making findings as set forth above, and ordering Lazard Freres to cease and desist from committing or causing any violation of and

committing or causing any future violation of Sections 10(b), 15B(c)(1) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-3 thereunder, Sections 17(a)(2) and 17(a)(3) of the Securities Act and MSRB rules G-8, G-17 and G-20.

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<(9)>In conjunction with the resolution of this matter, Lazard Freres has entered into a separate civil settlement with the Department of Justice. As part of that settlement, Lazard Freres has agreed to make restitutionary payments to Fulton County and the FDHA, and to make a civil settlement payment in the amount of $10 million.

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VI.

ORDER

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Sections 15B(c)(2) and 21C of the Exchange Act:

A. That Lazard Freres cease and desist from committing or causing any violation of and committing or causing any future violation of Sections 10(b), 15B(c)(1) and 17(a) of the Exchange Act and Rules 10b-5 and 17a-3 thereunder, Sections 17(a)(2) and 17(a)(3) of the Securities Act and MSRB rules G-8, G-17 and G-20;

B. That Lazard Freres pay a civil penalty in the amount of $1 million pursuant to Section 21B of the Exchange Act. Payment shall be made within ten (10) days of the date of this order. Payment shall be made by wire transfer, to the United States Treasury. Documentation confirming the wire transfer shall be hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6342 General Green Way, Stop 0-3, Alexandria, VA 22312, under cover of letter identifying the name and number of this administrative proceeding and the Respondent. A copy of the cover letter and wire transfer documentation shall be simultaneously transmitted to J. Lee Buck, II, Senior Counsel, Division of Enforcement, Securities and Exchange Commission, Stop 7-5, Washington, DC 20549.

In re Michael Lissack, Exchange Act Release No. 39119, A.P. File No. 3-9427 (September 23, 1997).

On September 23, 1997, the Commission instituted administrative and cease-and-desist proceedings against Michael Lissack ("Lissack"), pursuant to Sections 15(b), 15B(c)(4), 19(h) and 21C of the Securities Exchange Act of 1934 (Exchange Act). The Order Instituting Proceedings ("Order") alleges that beginning in 1990, Lissack worked within the derivative group of a nationally known broker-dealer ("the National Firm") in its public finance department and that through its public finance department, the National Firm, among other things, underwrote offerings by municipalities for a variety of bonds.

The Order further alleges that in June 1993, Dade County, Florida (the "County") issued a request for proposals ("RFP") in connection with a proposed bond offering to finance the refunding of existing water and sewer bonds and, in addition, to finance certain construction projects for its water and sewer system. The County initially planned to raise approximately $800 million through such an offering. After issuance of the RFP, the County determined to proceed with separate offerings: a new money offering of approximately $431 million (the "WASA transaction") and a refunding offering. The National Firm, along with a Miami-based underwriter ("Local Firm"), submitted a joint proposal in response to the RFP, whereby each would serve as co-senior managing underwriter. The response to the RFP discussed the National Firm's background, experience and capabilities, including its experience in structuring interest rate swaps. The RFP also included a discussion of alternative plans of finance that the County could consider should market conditions change prior to marketing the bonds. In September 1993, the County

selected the National Firm and the Local Firm to serve as co-senior managing underwriters for the WASA transaction.

According to the Order, the County originally had planned for the WASA transaction to consist of traditional, fixed-rate bonds, whereby the County would be obliged to pay a fixed interest rate to bondholders over the life of the bonds. However, over the next several months, the National Firm raised with the County a different financing structure as an alternative to fixed-rate bonds (the "Alternative Financing Structure"). The Alternative Financing Structure provided for the County to issue variable-rate bonds, and thereafter enter into a contract with a third-party (the "Swap Provider"), whereby the County would exchange its obligation to make variable-rate payments for an obligation to make fixed-rate payments. The National Firm assigned substantial responsibility for structuring the Alternative Financing Structure and calculating its benefits to Lissack, a senior professional within the National Firm's municipal derivative products group who, at the time of the WASA transaction, was a managing director of the firm. Also, according to the Order, the County informed the National Firm that it required a certain minimum threshold in present value savings in order to proceed with the Alternative Financing Structure. Lissack knew about the County's minimum savings requirement.

The Order alleges that Lissack, the banker assigned to the WASA transaction for purposes of structuring and assessing the economic benefits of the Alternative Financing Structure occupied a unique role within the National Firm's public finance department. Lissack was involved in many deals and was permitted latitude in creating and structuring concepts for the various clients of the National Firm. Lissack was also responsible for assessing the relative costs associated with the two possible financing scenarios in the WASA transaction, fixed-rate versus the Alternative Financing Structure. The National Firm's financing team made numerous presentations to the County concerning the proposed financing. Lissack was responsible for that portion of the presentations relating to the benefits of the Alternative Financing Structure as opposed to a fixed rate structure. The savings evaluations performed by Lissack were the centerpiece of such presentations.

The Order alleges that from late October 1993 through January 25, 1994, the presentations to the County showed present value savings that the County would realize if it selected the Alternative Financing Structure over a fixed-rate structure. Those presentations were based substantially on assumptions made and calculations performed by Lissack. In addition, the Order alleges that certain savings presentations to the County in 1993 showed that the County would indeed realize savings in excess of its minimum savings threshold if it implemented the Alternative Financing Structure. However, in late December 1993 or early January 1994, because of a change in interest rates, calculations of the potential savings associated with the Alternative Financing Structure revealed such savings fell below the County's minimum savings threshold, as compared to a traditional fixed-rate model. Thereafter, the staff alleges Lissack manipulated certain of the variables used in the traditional fixed rate and Alternative Financing Structure models in order to create the false impression that the selection of the Alternative Financing Structure would still result in savings to the County in excess of its stated threshold. Those presentations ultimately persuaded the County to implement the Alternative Financing Structure.

The Order alleges that the presentations to the County showing present value savings were based on intentional manipulations by Lissack and that the use of these faulty and inaccurate assumptions resulted, under conservative estimates, in an overstatement of the hypothetical savings associated with the Alternative Financing Structure by at least $5 million. Moreover, the Order alleges that on January 25, 1994, the County decided to implement the Alternative Financing Structure based upon the representation, as calculated by Lissack, that the County would realize present value savings of more than $8 million if it selected the Alternative Financing Structure. On January 25, 1994, the County entered into a thirty-year variable-to-fixed rate forward swap. On February 2, 1994, the County issued $431,700,000 in variable-rate bonds. The Order alleges that Lissack committed or caused violations of the antifraud provisions of the federal securities laws and MSRB Rule G-17 by intentionally manipulating the assumptions included within presentations to the County.

A hearing will be held to determine whether the staff's allegations are true and, if so, what remedial action, if any, is appropriate.

I.

As a result of an investigation, the Division of Enforcement alleges that:

A. At all relevant times, Michael Lissack ("Lissack" or "Respondent") was employed by a nationally known broker-dealer (the "National Firm"). Lissack was promoted to the position of Managing Director in the National Firm's public finance department in April 1, 1987. Beginning in 1990, Lissack worked within the derivative group of the National Firm's public finance department. Lissack was terminated by the National Firm in February 1995.

B. The National Firm that employed Lissack is a member of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers, Inc. ("NASD"). At all times relevant, the National Firm maintained a public finance department that was engaged in the business of structuring and implementing transactions with municipal issuers. Through its public finance department, the National Firm, among other things, underwrote offerings by municipalities for a variety of bonds.

C. In the course of conducting this business, it was the general practice of the National Firm to assemble a team of bankers, each of whom had specific responsibilities relating to a purported offering. This team would typically respond to an issuer's request for proposals ("RFP") and, if selected, generally would continue to deal with the issuer throughout the offering process.

D. At all times relevant, the public finance department of the National Firm maintained a municipal derivatives product group that specialized in offering municipalities certain derivative products and in structuring interest rate swaps. In those instances in which the National Firm intended to propose an interest rate swap to a municipality or where a municipality inquired about the potential use of an interest rate swap, a member of the municipal derivatives product group generally was assigned responsibility for addressing those issues and was assigned to the banking team.

E. In June 1993, Dade County, Florida (the "County") issued an RFP in connection with a proposed bond offering to finance the refunding of existing water and sewer bonds and, in addition, to finance certain construction projects for its water and sewer system. The County initially planned to raise approximately $800 million through such an offering. After issuance of the RFP, the County determined to proceed with separate offerings: a new money offering of approximately $431 million (the "WASA transaction") and a refunding offering.

F. The National Firm, along with a Miami-based underwriter ("Local Firm"), submitted a joint proposal in response to the RFP, whereby each would serve as co-senior managing underwriter. The response to the RFP discussed the National Firm's background, experience and capabilities, including its experience in structuring interest rate swaps. The RFP also included a discussion of alternative plans of finance that the County could consider should market conditions change prior to marketing the bonds. In September 1993, the County selected the National Firm and the Local Firm to serve as co-senior managing underwriters for the WASA transaction.

G. The County originally had planned for the WASA transaction to consist of traditional, fixed-rate bonds, whereby the County would be obliged to pay a fixed interest rate to bondholders over the life of the bonds. However, over the next several months, the National Firm raised with the County a different financing structure as an alternative to fixed-rate bonds (the "Alternative Financing Structure"). The Alternative Financing Structure provided for the County to issue variable-rate bonds, and thereafter enter into a contract with a third-party (the "Swap Provider"), whereby the County would exchange its obligation to make variable-rate payments for an obligation to make fixed-rate payments. n1

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n1 Mechanically, the proposed Alternative Financing Structure involved three steps. First, the County was to issue $431,700,000 in variable rate bonds, whereby the County would be obliged to make interest payments at a rate that would fluctuate over the life of the offering. Second, the proceeds from such an offering allocated for the Construction Fund and for the Debt Service Reserve Fund ("DSR") were to be placed in guaranteed investment contracts ("GIC"). The GIC provider for the construction fund guaranteed interest payments to the County at a rate higher than the amount the County was obliged to pay variable-rate bondholders. Third, the County was to enter into a forward, variable-to-fixed interest rate swap with the Swap Provider, pursuant to which the County would "swap" its variable-rate interest payments for the certainty of a fixed rate payment with the Swap Provider. The Swap Provider paid a fee to The National Firm in connection with this transaction.

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H. The National Firm assigned substantial responsibility for structuring the Alternative Financing Structure and calculating its benefits to Lissack, a senior professional within the National Firm's municipal derivative products group who, at the time of the WASA transaction, was a managing director of the firm.

I. The County understood that there were certain additional costs and risks associated with the Alternative Financing Structure that were not present in a fixed-rate financing. Accordingly, to offset these additional costs and risks, the County required a certain economic benefit in the form of present value savings before it would select the Alternative Financing Structure. The County informed the National Firm that it required a certain minimum threshold in present value savings in order to proceed with the Alternative Financing Structure. Lissack knew about the County's minimum savings requirement.

ROLE OF LISSACK

J. At all times relevant, Lissack, the banker assigned to the WASA transaction for purposes of structuring and assessing the economic benefits of the Alternative Financing Structure occupied a unique role within the National Firm's public finance department. Lissack was involved in many deals and was permitted latitude in creating and structuring concepts for the various clients of the National Firm. Lissack was also responsible for assessing the relative costs associated with the two possible financing scenarios in the WASA transaction, fixed-rate versus the Alternative Financing Structure. The National Firm's financing team made numerous presentations to the County concerning the proposed financing. Lissack was responsible for that portion of the presentations relating to the benefits of the Alternative Financing Structure as opposed to a fixed rate structure. The savings evaluations performed by Lissack were the centerpiece of such presentations.

K. From late October 1993 through January 25, 1994, the presentations to the County showed present value savings that the County would realize if it selected the Alternative Financing Structure over a fixed-rate structure. Those presentations were based substantially on assumptions made and calculations performed by Lissack.

L. Certain savings presentations to the County in 1993 showed that the County would indeed realize savings in excess of its minimum savings threshold if it implemented the Alternative Financing Structure. However, in late December 1993 or early January 1994, because of a change in interest rates, calculations of the potential savings associated with the Alternative Financing Structure revealed such savings fell below the County's minimum savings threshold, as compared to a traditional fixed-rate model.

M. Thereafter, Lissack manipulated certain of the variables used in the traditional fixed rate and Alternative Financing Structure models in order to create the false impression that the selection of the

Alternative Financing Structure would still result in savings to the County in excess of its stated threshold. Those presentations ultimately persuaded the County to implement the Alternative Financing Structure.

TREATMENT OF THE DEBT SERVICE RESERVE FUND

N. The County Bond Ordinance, which authorized the issuance of the bonds, required that a certain amount of the bond proceeds be placed in a Debt Service Reserve Fund ("DSR"). In comparisons run prior to late December 1993, the National Firm's calculation of the costs associated with the Alternative Financing Structure and the fixed-rate Structure accrued no interest on the DSR. In late December 1993 or early January 1994, Lissack changed the savings calculations to include accrued interest on the bond proceeds earmarked for the DSR in the Alternative Financing Structure. Lissack did not include accrued interest on the DSR for the fixed-rate financing model.

O. This treatment of the DSR resulted in an overstatement of the purported present value savings of the Alternative Financing Structure by at least $4 million. This analysis was incorporated into the savings presentations made to the County.

TREATMENT OF THE CONSTRUCTION FUND

P. Lissack also skewed the anticipated interest earnings on monies in the Construction Fund in favor of the Alternative Financing Structure. Lissack used an unreasonably low interest rate for calculating interest earnings on the Construction Fund in the traditional fixed-rate analysis. This resulted in an overstatement of the Alternative Financing Structure by at least $1 million. This disparity was also included in the presentations to the County which further inflated the purported savings associated with the Alternative Financing Structure.

Q. Accordingly, the presentations to the County showing present value savings were based on intentional manipulations by Lissack of the underlying calculations and assumptions as to the fixed-rate model and the Alternative Financing Structure, undertaken to fraudulently present the Alternative Financing Structure in an artificially favorable light. The use of these faulty and inaccurate assumptions resulted, under conservative estimates, in an overstatement of the hypothetical savings associated with the Alternative Financing Structure by at least $5 million.

R. On January 25, 1994, the County decided to implement the Alternative Financing Structure based upon the representation, as calculated by Lissack, that the County would realize present value savings of more than $8 million if it selected the Alternative Financing Structure. On January 25, 1994, the County entered into a thirty-year variable-to-fixed rate forward swap. On February 2, 1994, the County issued $431,700,000 in variable-rate bonds.

PRIMARY VIOLATIONS OF THE FEDERAL SECURITIES LAWS

As a result of the conduct described above, Lissack willfully committed or caused violations of Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5, thereunder, and MSRB Rule G-17.

II.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest and for the protection of investors that public proceedings be instituted to determine:

A. whether the allegations set forth in Section I hereof are true and, in connection therewith, to afford Lissack an opportunity to establish any defense to such allegations;

B. whether, pursuant to Section 21C of the Exchange Act, Lissack should be ordered to cease and desist from committing or causing a violation or any future violation of any or all of the Sections or Rules specified in Section I above;

C. what, if any, remedial sanctions are appropriate in the public interest against Lissack;

D. whether, Lissack should be required make an accounting and pay disgorgement plus prejudgement interest; and

E. whether, pursuant to Section 21B of the Exchange Act, a civil money penalty should be imposed against Lissack.

III.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section II hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed and before an Administrative Law Judge to be designated by further order as provided by Rule 200 of the Commission's Rules of Practice, 17 C.F.R. § 201.200.

IT IS FURTHER ORDERED that Lissack file an answer to the allegations contained in this Order Instituting Administrative and Cease-And-Desist Proceedings Pursuant to Sections 15(b), 15B(c)(4), 19(h) and 21C of the Exchange Act ("Order") within twenty (20) days after service upon him of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Lissack fails to file an answer, or fails to appear at a hearing after being duly notified, he may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 310 and 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.310 and § 201.220.

This Order shall be served upon Lissack personally or by certified mail, forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceedings will be permitted to participate or advise in the decision upon this matter, except as witnesses or counsel in proceedings held pursuant to notice.

Because this proceeding is not "rule-making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the provisions of that Section delaying the effective date of any final Commission action.

In re Michael Lissack, Exchange Act Release No. 39687 (February 20, 1998).

I.

The Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b), 15B(c)(4), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Michael Lissack ("Lissack") on September 23, 1997.

II.

Respondent Lissack has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting

or denying the findings contained herein, except as to the jurisdiction of the Commission over the Respondent and over the subject matter of this proceeding, which is admitted, Respondent Lissack by its Offer consents to the entry of findings and remedial sanctions set forth below.

III.

On the basis of the Order Making Findings And Imposing Sanctions And A Cease-And-Desist Order ("Order") and the Offer submitted by Respondent Lissack, the Commission finds that. n1

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n1 The findings contained herein are not binding on anyone other than Lissack.

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BACKGROUND

At all relevant times, Lissack was employed by a nationally known broker-dealer (the "National Firm"). Lissack was promoted to the position of Managing Director in the National Firm's public finance department on April 1, 1987. From 1990 to February 1995, Lissack worked within the derivative group of the National Firm's public finance department. The National Firm employing Lissack is a member of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers, Inc. ("NASD"). At all times relevant, the National Firm maintained a public finance department that was engaged in the business of structuring and implementing transactions with municipal issuers. Through its public finance department, the National Firm, among other things, underwrote offerings by municipalities for a variety of bonds. In the course of conducting this business, it was the general practice of the National Firm to assemble a team of bankers, each of whom had specific responsibilities relating to a purported offering. This team would typically respond to an issuer's request for proposals ("RFP") and, if selected, generally would continue to deal with the issuer throughout the offering process.

At all times relevant, the public finance department of the National Firm maintained a municipal derivatives product group that specialized in offering municipalities certain derivative products and in structuring interest rate swaps. In those instances in which the National Firm intended to propose an interest rate swap to a municipality or where a municipality inquired about the potential use of an interest rate swap, a member of the municipal derivatives product group was generally assigned to the banking team.

In June 1993, Dade County, Florida (the "County") issued an RFP in connection with a proposed bond offering to finance the refunding of existing water and sewer bonds and, in addition, to finance certain construction projects for its water and sewer system. The County initially planned to raise approximately $800 million through such an offering. After issuance of the RFP, the County determined to proceed with separate offerings: a new money offering of approximately $431 million (the "WASA transaction") and a refunding offering.

The National Firm submitted a joint proposal in response to the RFP, whereby it would serve as co-senior managing underwriter. The response to the RFP discussed the National Firm's background, experience and capabilities, including its experience in structuring interest rate swaps. The RFP also included a discussion of alternative plans of finance that the County could consider should market conditions change prior to marketing the bonds. In September 1993, the County selected the National Firm to serve as a co-senior managing underwriter for the WASA transaction.

The County originally had planned for the WASA transaction to consist of traditional, fixed-rate bonds, whereby the County would be obliged to pay a fixed interest rate to bondholders over the life of the bonds. However, over the next several months, the National Firm raised with the County a different financing

structure as an alternative to fixed-rate bonds (the "Alternative Financing Structure"). The Alternative Financing Structure provided for the County to issue variable-rate bonds, and thereafter enter into a contract with a third-party (the "Swap Provider"), whereby the County would exchange its obligation to make variable-rate payments for an obligation to make fixed-rate payments. n2

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n2 Mechanically, the proposed Alternative Financing Structure involved three steps. First, the County was to issue $431,700,000 in variable rate bonds, whereby the County would be obliged to make interest payments at a rate that would fluctuate over the life of the offering. Second, the proceeds from such an offering allocated for the Construction Fund and for the Debt Service Reserve Fund ("DSR") were to be placed in guaranteed investment contracts ("GIC"). The GIC provider for the construction fund guaranteed interest payments to the County at a rate higher than the amount the County was obliged to pay variable-rate bondholders. Third, the County was to enter into a forward, variable-to-fixed interest rate swap with the Swap Provider, pursuant to which the County would "swap" its variable-rate interest payments for the certainty of a fixed rate payment with the Swap Provider. The Swap Provider paid a fee to The National Firm in connection with this transaction.

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The National Firm assigned substantial responsibility for structuring the Alternative Financing Structure and calculating its benefits to Lissack, a senior professional within the National Firm's municipal derivative products group who, at the time of the WASA transaction, was a managing director of the firm. The National Firm's team assigned to the WASA transaction included bankers from the National Firm's Tampa, West Palm Beach, and Miami offices, as well as other bankers from its New York City Office.

The County understood that there were certain additional costs and risks associated with the Alternative Financing Structure that were not present in a fixed-rate financing. Accordingly, to offset these additional costs and risks, the County required a certain economic benefit in the form of present value savings before it would select the Alternative Financing Structure. The County informed the National Firm that it required a certain minimum threshold in present value savings in order to proceed with the Alternative Financing Structure. Lissack knew about the County's minimum savings requirement.

ROLE OF LISSACK

At all times relevant, Lissack was responsible for the National Firm's assessment of the relative costs associated with the two possible financing scenarios in the WASA transaction, fixed-rate versus the Alternative Financing Structure. The National Firm's financing team made numerous presentations to the County concerning the proposed financing. Lissack was responsible for that portion of the presentations relating to the benefits of the Alternative Financing Structure as opposed to a fixed rate structure. The savings evaluations were the centerpiece of such presentations.

From late October 1993 through January 25, 1994, the presentations to the County showed present value savings that the County would realize if it selected the Alternative Financing Structure over a fixed-rate structure. Those presentations were based substantially on assumptions provided by Lissack and calculations carried out pursuant thereto.

Certain savings presentations to the County in 1993 showed that the County would indeed realize savings in excess of its minimum savings threshold if it implemented the Alternative Financing Structure. However, in late December 1993 or early January 1994, because of a change in interest rates, calculations of the potential savings associated with the Alternative Financing Structure revealed such savings fell below the County's minimum savings threshold, as compared to a traditional fixed-rate model.

Thereafter, Lissack manipulated the use of certain variables in the traditional fixed rate and Alternative Financing Structure models in the presentations made to the County in order to create the false impression that the selection of the Alternative Financing Structure would still result in savings to the County in excess of its stated threshold. Those presentations ultimately persuaded the County to implement the Alternative Financing Structure.

TREATMENT OF THE DEBT SERVICE RESERVE FUND

The County Bond Ordinance, which authorized the issuance of the bonds, required that a certain amount of the bond proceeds be placed in a DSR. In comparisons run prior to late December 1993, the National Firm calculation of the costs associated with the Alternative Financing Structure and the fixed-rate Structure accrued no interest on the DSR. In late December 1993 or early January 1994, Lissack's savings calculations were changed to include accrued interest on the bond proceeds earmarked for the DSR in the Alternative Financing Structure. Lissack's changes did not include accrued interest on the DSR for the fixed-rate financing model.

This treatment of the DSR resulted in an overstatement of the purported present value savings of the Alternative Financing Structure by at least $4 million. This analysis was incorporated into the savings presentations made to the County.

TREATMENT OF THE CONSTRUCTION FUND

Lissack also skewed the anticipated interest earnings on monies in the Construction Fund in favor of the Alternative Financing Structure. Lissack decided to use an unreasonably low interest rate for calculating interest earnings on the Construction Fund in the traditional fixed-rate analysis. This resulted in an overstatement of the Alternative Financing Structure by at least $1 million. This disparity was also included in the presentations to the County which further inflated the purported savings associated with the Alternative Financing Structure.

Accordingly, the presentations to the County showing present value savings were based on intentional manipulations by Lissack of the underlying calculations and assumptions as to the fixed-rate model and the Alternative Financing Structure, undertaken to fraudulently present the Alternative Financing Structure in an artificially favorable light. The use of these faulty and inaccurate assumptions resulted, under conservative estimates, in an overstatement of the hypothetical savings associated with the Alternative Financing Structure by at least $5 million.

SUBSEQUENT EVENTS

On January 25, 1994, the County decided to implement the Alternative Financing Structure based upon the representation that the County would realize present value savings of more than $8 million if it selected the Alternative Financing Structure. That representation was based on Lissack's faulty methodology, as described above. On January 25, 1994, the County entered into a thirty-year variable-to-fixed rate forward swap. On February 2, 1994, the County issued $431,700,000 in variable-rate bonds.

PRIMARY VIOLATIONS OF THE FEDERAL SECURITIES LAWS

Based on his role in the false presentations to the County, Lissack willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The amount of present value savings associated with the Alternative Financing Structure was material to the County's decision as to which structure to utilize in issuing securities. See *Basic, Inc. v. Levinson, 485 U.S. 224 (1988).* Lissack's intentional manipulation of the assumptions included within the savings presentations, as described more fully above, demonstrates that he undertook such conduct with an intent to deceive. See *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).* Municipal securities brokers, dealers and municipal finance professionals, such as Lissack, also must comply with the Municipal Securities Rulemaking Board ("MSRB") rules. Section 15B(c)(4) of

the Exchange Act makes it unlawful to use the mails or other means or instrumentalities of interstate commerce to effect transactions in or induce the purchase or sale of any municipal security in contravention of the MSRB Rules. MSRB Rule G-17 requires that each broker, dealer, and municipal securities dealer deal fairly with all persons and refrain from engaging in any deceptive, dishonest, or unfair practice. Based on his previously described conduct, Lissack also willfully violated Section 15B(c)(4) of the Exchange Act and MSRB Rule G-17.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Lissack and impose the sanctions specified therein.

Accordingly, IT IS ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Lissack is ordered to cease-and-desist from committing or causing any violation or any future violation of Sections 10(b), and 15B(c)(4) of the Exchange Act, and Rule 10b-5, thereunder, and MSRB Rule G-17.

B. IT IS FURTHER ORDERED that Lissack be, and hereby is, barred from association with any broker, dealer, municipal securities dealer, investment advisor or investment company with the right to reapply for association after five years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. IT IS FURTHER ORDERED that Lissack shall, within thirty (30) business days after the entry of the Order, pay a civil money penalty in the amount of $30,000 to the United States Treasury. Such payment shall be: (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) mailed to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, Mail Stop O-3; and (d) submitted under cover letter which identifies Lissack as a respondent in these proceedings, the file number of this proceeding, a copy of which cover letter and money order or check shall be sent to David Nelson, Southeast Regional Office, Securities and Exchange Commission, 1401 Brickell Avenue, Suite 200, Miami, FL 33131.

In re Smith Barney, Inc., Exchange Act Release No. 39118, A.P. File No. 3-9426 (September 23, 1997).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to institute public administrative proceedings pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Smith Barney, Inc. ("Smith Barney" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent Smith Barney has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over the Respondent and over the subject matter of this proceeding, which is admitted, Respondent Smith Barney by its Offer consents to the entry of findings and remedial sanctions set forth below.

Accordingly, IT IS ORDERED that proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act be, and, they hereby are, instituted.

III.

On the basis of this Order and the Offer submitted by Respondent Smith Barney, the Commission finds n1 that:

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n1 The findings contained herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

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Background

Smith Barney is a member of the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers, Inc. ("NASD"). At all times relevant, Smith Barney maintained a public finance department that was engaged in the business of structuring and implementing transactions with municipal issuers. Through its public finance department, Smith Barney, among other things, underwrote offerings by municipalities for a variety of bonds. In the course of conducting this business, it was the general practice of Smith Barney to assemble a team of bankers, each of whom had specific responsibilities relating to a purported offering. This team would typically respond to an issuer's request for proposals ("RFP") and, if selected, generally would continue to deal with the issuer throughout the offering process.

At all times relevant, the public finance department of Smith Barney maintained a municipal derivatives product group that specialized in offering municipalities certain derivative products and in structuring interest rate swaps. In those instances in which Smith Barney intended to propose an interest rate swap to a municipality or where a municipality inquired about the potential use of an interest rate swap, a member of the municipal derivatives product group generally was assigned responsibility for addressing those issues and was assigned to the banking team.

In June 1993, Dade County, Florida (the "County") issued an RFP in connection with a proposed bond offering to finance the refunding of existing water and sewer bonds and, in addition, to finance certain construction projects for its water and sewer system. The County initially planned to raise approximately $800 million through such an offering. After issuance of the RFP, the County determined to proceed with separate offerings: a new money offering of approximately $431 million (the "WASA transaction") and a refunding offering.

Smith Barney, along with a Miami-based underwriter (hereinafter, the "Local Firm"), submitted a joint proposal in response to the RFP, whereby each would serve as co-senior managing underwriter. The response to the RFP discussed Smith Barney's background, experience and capabilities, including its experience in structuring interest rate swaps. The RFP also included a discussion of alternative plans of finance that the County could consider should market conditions change prior to marketing the bonds. In September 1993, the County selected Smith Barney and the Local Firm to serve as co-senior managing underwriters for the WASA transaction.

The County originally had planned for the WASA transaction to consist of traditional, fixed-rate bonds, whereby the County would be obliged to pay a fixed interest rate to bondholders over the life of the bonds. However, over the next several months, Smith Barney raised with the County a different financing structure as an alternative to fixed-rate bonds (the "Alternative Financing Structure"). The Alternative

Financing Structure provided for the County to issue variable-rate bonds, and thereafter enter into a contract with a third-party (the "Swap Provider"), whereby the County would exchange its obligation to make variable-rate payments for an obligation to make fixed-rate payments. n2.

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n2 Mechanically, the proposed Alternative Financing Structure involved three steps. First, the County was to issue $431,700,000 in variable rate bonds, whereby the County would be obliged to make interest payments at a rate that would fluctuate over the life of the offering. Second, the proceeds from such an offering allocated for the Construction Fund and for the Debt Service Reserve Fund ("DSR") were to be placed in guaranteed investment contracts ("GIC"). The GIC provider for the construction fund guaranteed interest payments to the County at a rate higher than the amount the County was obliged to pay variable-rate bondholders. Third, the County was to enter into a forward, variable-to-fixed interest rate swap with the Swap Provider, pursuant to which the County would "swap" its variable-rate interest payments for the certainty of a fixed rate payment with the Swap Provider. The Swap Provider paid a fee to Smith Barney in connection with this transaction.

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Smith Barney assigned substantial responsibility for structuring the Alternative Financing Structure and calculating its benefits to a senior professional within Smith Barney's municipal derivative products group, who left Smith Barney in early 1995 but who, at the time of the WASA transaction, was a managing director of the firm (hereinafter, the "SB Municipal Derivatives Banker").

The County understood that there were certain additional costs and risks associated with the Alternative Financing Structure that were not present in a fixed-rate financing. Accordingly, to offset these additional costs and risks, the County required a certain economic benefit in the form of present value savings before it would select the Alternative Financing Structure. The County informed Smith Barney that it required a certain minimum threshold in present value savings in order to proceed with the Alternative Financing Structure. The SB Municipal Derivatives Banker knew about the County's minimum savings requirement.

ROLE OF THE SB MUNICIPAL DERIVATIVES BANKER

At all times relevant, the SB Municipal Derivatives Banker assigned to the WASA transaction for purposes of structuring and assessing the economic benefits of the Alternative Financing Structure occupied a unique role within Smith Barney's public finance department. The SB Municipal Derivatives Banker was involved in many deals and was permitted latitude in creating and structuring concepts for the various clients of Smith Barney. The SB Municipal Derivatives Banker was also responsible for assessing the relative costs associated with the two possible financing scenarios in the WASA transaction, fixed-rate versus the Alternative Financing Structure. Smith Barney's financing team made numerous presentations to the County concerning the proposed financing. The SB Municipal Derivatives Banker was responsible for that portion of the presentations relating to the benefits of the Alternative Financing Structure as opposed to a fixed rate structure. The savings evaluations performed by the SB Municipal Derivatives Banker were the centerpiece of such presentations.

From late October 1993 through January 25, 1994, the presentations to the County showed present value savings that the County would realize if it selected the Alternative Financing Structure over a fixed-rate structure. Those presentations were based substantially on assumptions made and calculations performed by the SB Municipal Derivatives Banker.

Certain savings presentations to the County in 1993 showed that the County would indeed realize savings in excess of its minimum savings threshold if it implemented the Alternative Financing Structure. However, in late December 1993 or early January 1994, because of a change in interest rates, calculations

of the potential savings associated with the Alternative Financing Structure revealed such savings fell below the County's minimum savings threshold, as compared to a traditional fixed-rate model.

Thereafter, the SB Municipal Derivatives Banker, without informing his supervisors, manipulated certain of the variables used in the traditional fixed rate and Alternative Financing Structure models in order to create the false impression that the selection of the Alternative Financing Structure would still result in savings to the County in excess of its stated threshold. Those presentations ultimately persuaded the County to implement the Alternative Financing Structure.

TREATMENT OF THE DEBT SERVICE RESERVE FUND

The County Bond Ordinance, which authorized the issuance of the bonds, required that a certain amount of the bond proceeds be placed in a Debt Service Reserve Fund ("DSR"). In comparisons run prior to late December 1993, the Smith Barney calculation of the costs associated with the Alternative Financing Structure and the fixed-rate Structure accrued no interest on the DSR. In late December 1993 or early January 1994, the SB Municipal Derivatives Banker changed the savings calculations to include accrued interest on the bond proceeds earmarked for the DSR in the Alternative Financing Structure. The SB Municipal Derivatives Banker did not include accrued interest on the DSR for the fixed-rate financing model.

This treatment of the DSR resulted in an overstatement of the purported present value savings of the Alternative Financing Structure by at least $4 million. This analysis was incorporated into the savings presentations made to the County.

TREATMENT OF THE CONSTRUCTION FUND

The SB Municipal Derivatives Banker also skewed the anticipated interest earnings on monies in the Construction Fund in favor of the Alternative Financing Structure. The SB Municipal Derivatives Banker used an unreasonably low interest rate for calculating interest earnings on the Construction Fund in the traditional fixed-rate analysis. This resulted in an overstatement of the Alternative Financing Structure by approximately $1 million. This disparity was also included in the presentations to the County which further inflated the purported savings associated with the Alternative Financing Structure.

Accordingly, the presentations to the County showing present value savings were based on intentional manipulations by the SB Municipal Derivatives Banker of the underlying calculations and assumptions as to the fixed-rate model and the Alternative Financing Structure, undertaken to fraudulently present the Alternative Financing Structure in an artificially favorable light. The use of these faulty and inaccurate assumptions resulted, under conservative estimates, in an overstatement of the hypothetical savings associated with the Alternative Financing Structure by at least $5 million.

RELIANCE BY THE COUNTY

On January 25, 1994, the County decided to implement the Alternative Financing Structure based upon the representation, as calculated by the SB Municipal Derivatives Banker, that the County would realize present value savings of more than $8 million if it selected the Alternative Financing Structure. On January 25, 1994, the County entered into a thirty-year variable-to-fixed rate forward swap. On February 2, 1994, the County issued $431,700,000 in variable-rate bonds.

BENEFITS TO SMITH BARNEY

Smith Barney's up-front fees from the WASA transaction were derived primarily from its share, after splitting with the Local Firm, of the swap fee, management and underwriting fees, and a fee paid in connection with the GIC. Smith Barney's up-front compensation amounted to approximately $2.2 million before expenses.

Smith Barney has also earned and stands to earn additional fees pursuant to a remarketing agreement with the County dated February 4, 1994 (the "Remarketing Agreement"), whereby Smith Barney is obliged to perform certain duties in connection with bonds presented for sale over the 30-year life of the deal. Pursuant to the Remarketing Agreement, Smith Barney is entitled to earn a potential total of approximately $5 million over the life of the variable-rate debt. As of the date of this Order, Smith Barney has received approximately $709,668 pursuant to the Remarketing Agreement. Smith Barney's potential outstanding share of future fees due from the County for remarketing services is approximately $3,125,634, after expenses.

Had the County undertaken a traditional, fixed-rate financing, Smith Barney would have earned only approximately $700,000 before expenses and would not have entered into or received fees from a remarketing agreement. Smith Barney earned significantly more money on the WASA transaction as a result of the County's decision to implement the Alternative Financing Structure. After a credit for certain otherwise unreimbursed expenses, the economic benefit to Smith Barney for implementing the Alternative Financing Structure as opposed to a fixed rate financing, exclusive of remarketing fees, was over $1.5 million.

PRIMARY VIOLATIONS OF THE FEDERAL SECURITIES LAWS

In preparing the false presentations to the County, the SB Municipal Derivatives Banker violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The amount of present value savings associated with the Alternative Financing Structure was material to the County's decision as to which structure to utilize in issuing securities. See *Basic. Inc. v. Levinson, 485 U.S. 224 (1988).* The SB Municipal Derivatives Banker's intentional manipulation of the assumptions included within the savings presentations as described more fully above, demonstrates that he undertook such conduct with an intent to deceive. See *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).* Municipal securities brokers, dealers and municipal finance professionals, such as the SB Municipal Derivatives Banker, also must comply with the Municipal Securities Rulemaking Board ("MSRB") rules. Section 15B(c)(1) of the Exchange Act makes it unlawful to use the mails or other means or instrumentalities of interstate commerce to effect transactions in or induce the purchase or sale of any municipal security in contravention of the MSRB Rules. MSRB Rule G-17 requires that each broker, dealer, and municipal securities dealer deal fairly with all persons and refrain from engaging in any deceptive, dishonest, or unfair practice. Based on his previously described conduct, the SB Municipal Derivatives Banker also violated MSRB Rule G-17.

SMITH BARNEY'S FAILURE TO SUPERVISE

"The responsibility of broker dealers to supervise their employees by means of effective, established procedures is a critical component in the federal investor protection scheme regulating the securities market." In the Matter of Lehman Brothers. Inc., Exchange Act Release No. 37673 (Sept. 12, 1996) (citing In re Smith Barney, Harris Upham & Co., Exchange Act Release No. 21813 (Mar. 5, 1985)).

At all relevant times, Smith Barney had no express written supervisory procedures providing for any meaningful review of the calculations performed by the SB Municipal Derivatives Banker, or the assumptions and methodology underlying such calculations, or disclosures made to the County. As a result of the absence of any such written procedures or other institutionally-recognized practice, the SB Municipal Derivatives Banker's disparate treatment in the two models went undetected, and the savings associated with a financing transaction proposed by Smith Barney to Dade County were overstated by at least $5 million.

Accordingly, in light of the conduct described above, Smith Barney failed reasonably to supervise an individual subject to its supervision within the meaning of Section 15(b)(4)(E) of the Exchange Act with a

view to preventing violations of Sections 10(b) and 15B(c)(1) of the Exchange Act, Rule 10b-5 thereunder, and MSRB Rule G-17.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Smith Barney and impose the sanctions specified therein.

Accordingly, IT IS ORDERED that:

A. Smith Barney shall be, and hereby is, censured;

B. Smith Barney shall comply with the undertakings described below:

1. Smith Barney represents that, since the conduct described above, it has modified its compliance and supervisory policies in the following respects: (i) it has implemented a Quality Control Checklist procedure for all negotiated transactions senior managed by Smith Barney, and (ii) it has established a Transaction Review Committee that reviews, among other things, interest rate swaps over $25 million executed in conjunction with senior managed new issues. Smith Barney undertakes that, within twenty (20) days of the entry of the Order, it will further supplement, if it deems appropriate, its compliance and supervisory policies and procedures to address those deficiencies raised in this order. Smith Barney undertakes to maintain any modified supervisory and compliance policies and procedures, as well as existing supervisory and compliance policies and procedures, except as they may be inconsistent with, or superseded by, any new policies or procedures adopted in accordance with Paragraphs B.2. through B.7. below.

2. Smith Barney undertakes to retain within twenty (20) days of the date of the Order, at Smith Barney's expense, an Independent Consultant ("Consultant"), not unacceptable to the Commission's staff, to conduct a review of, and to report and make recommendations as to Smith Barney's supervisory and compliance policies and procedures applicable to the public finance department, related to the types of conduct which gave rise to this proceeding and which are described in this Order.

3. The Consultant shall conduct a review of Smith Barney's supervisory and compliance policies and procedures applicable to the public finance department, related to the types of conduct which gave rise to this proceeding and which are described in this Order.

4. Smith Barney shall cooperate fully with the Consultant in this review, including making such non-privileged information and documents available, as the Consultant may reasonably request, and by permitting and requiring Smith Barney's employees and agents to supply such non-privileged information and documents as the Consultant may reasonably request.

5. The Consultant shall provide a written report to Smith Barney and the Staff of the Commission within three (3) months of the date of this Order setting forth the Consultant's recommendations. The Consultant shall have the option to seek an extension of time by making a written request to the Commission staff.

6. Smith Barney shall adopt all recommendations contained in the written report of the Consultant; provided, however, that as to any recommendation that Smith Barney believes is unduly burdensome or impractical, Smith Barney may suggest an alternative policy or procedure designed to achieve the same objective, submitted in writing to the Consultant and the Commissions staff. Smith Barney and the Consultant shall then attempt in good faith to reach agreement as to any policy or procedure as to which there is any dispute and the Consultant shall reasonably evaluate any alternative policy or procedure proposed by Smith Barney. Smith Barney will abide by the Consultant's determinations with regard thereto and adopt those recommendations deemed appropriate by the Consultant.

7. Within thirty (30) days of the receipt of the Consultant's written report, Smith Barney shall submit an affidavit to the Commission's staff stating that it has implemented the recommendations of the Consultant.

8. To ensure the independence of the Consultant, Smith Barney: (i) shall not have the authority to terminate the Consultant without the prior written approval of the staff of the Southeast Regional Office of the Commission ("SERO"); and (ii) shall compensate the Consultant, and persons engaged to assist the Consultant, for services rendered pursuant to this Order at their reasonable and customary rates.

9. For the period of the engagement and for a period of two years from the completion of the engagement, the Consultant shall not enter into any employment, consulting, attorney-client or auditing relationship with Smith Barney, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. Any firm with which the Consultant is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in performance of his/her duties under this Order shall not, without prior written consent of the SERO, enter into any employment, consulting or other professional relationship with Smith Barney, or any of its present or former directors, officers, employees, or agents in their capacity as such for the period of the engagement and for a period of two years after the engagement.

10. Smith Barney shall agree to forego, in connection with the Remarketing Agreement, 46.6% of its prospective quarterly billings to the County under the remarketing agreement, to a maximum of $3,125,634 for the full term of the agreement, representing the outstanding amount of its share of such fee that exceeds certain anticipated expenses. Smith Barney's obligations under this Remarketing Agreement shall otherwise remain unchanged by this Order.

C. IT IS FURTHER ORDERED that Smith Barney shall, within thirty (30) business days after the entry of the Order, pay disgorgement in the amount of $1,584,671 and prejudgment interest in the amount of $452,365 to Dade County, Florida.

D. IT IS FURTHER ORDERED that Smith Barney shall also, within thirty (30) business days after the entry of the Order, pay a civil money penalty in the amount of $250,000 to the United States Treasury. Such payment shall be: (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, Mail Stop 0-3; and (d) submitted under cover letter which identifies Smith Barney as a respondent in these proceedings, the file number of this proceeding, a copy of which cover letter and money order or check shall be sent to David Nelson, Southeast Regional Office, Securities and Exchange Commission, 1401 Brickell Avenue, Suite 200, Miami, FL 33131.

In re Derek Washington, Securities Act Release No. 7442, Exchange Act Release No. 38978 (August 27, 1997).

On August 27, 1997, the Commission instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b), 15B(c)(4), 19(h) and 21C of the Securities Exchange Act of 1934 (Exchange Act), against Derek Washington(Washington) of Brooklyn, New York. The Order Instituting Proceedings (Order) alleges that Washington was a registered vice-president of a certain broker-dealer (the broker-dealer") from August 1991 to August 1993. Although not registered with the broker-dealer since August 1993, Washington, at all relevant times, maintained his office within the New York headquarters of the broker-dealer and was responsible for the broker-dealer's trading and back office operations. The Order further alleges that from May 10, 1995 through April 18, 1996, while unregistered, the broker-dealer purchased and sold over $13 million in municipal bonds and received over $200,000 in proceeds as a result of

participating in municipal underwritings. According to the Order, Washington was aware of his role in the broker-dealer s scheme to conduct unregistered underwriting business and rendered substantial assistance by, among other things, executing underwriting agreements, submitting solicitations for underwritings, executing transactions and placing orders. In addition, the Order alleges that Washington made material misrepresentations regarding the broker-dealer to various municipal issuers and other underwriting firms.

The Order alleges that as a result of the foregoing conduct, Washington committed and/or caused violations of Section 17(a) of the Securities Act and Sections 15(a)(1), 15B(a)(1), 15(c)(1) and 15B(c)(1) and 10(b) of the Exchange Act, and Rules 10b-5 and 15c1-2, thereunder, and Rule G-17 of the Municipal Securities Rulemaking Board (MSRB). The Order further alleges Washington willfully aided and abetted violations of Sections 15(a)(1), 15B(a)(1), 15(c)(1) and 15B(c)(1) of the Exchange Act, and Rule 15c1-2 thereunder, and MSRB Rule G-17. A hearing will be conducted to determine, among other things, whether
remedial sanctions and a cease-and-desist order should be entered against Washington.

In re Derek Washington , Securities Act Release No. 7504, Exchange Act Release No. 39650 (February 12, 1998).

I.

The Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 15B(c)(4), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Derek Washington ("Washington") on August 27, 1997.

II.

Respondent Washington has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over the Respondent and over the subject matter of this proceeding and as to Sections III.A. and B. below, which are admitted, Respondent Washington by his Offer consents to the entry of findings, remedial sanctions and cease-and-desist order set forth below.

III.

On the basis of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") and the Offer submitted by Respondent Washington, the Commission finds that. n1

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n1 The findings contained herein are not binding on anyone other than Washington.

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A. Derek Washington was a registered vice-president of a certain municipal securities broker-dealer (the "broker-dealer") from August 1991 to August 1993. Although not registered with the broker-dealer since August 1993, Washington, at all relevant times, maintained his office within the New York headquarters of the broker-dealer and was responsible for the broker-dealer's trading and back office operations. n2

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n2 From March 1995 to October 1996, Washington was associated with at least one, and at times as many as three, other broker-dealers.

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B. The broker-dealer, at all relevant times, operated as a municipal securities broker-dealer within the meaning of Sections 3(a)(30) and 3(a)(31) of the Exchange Act. Until March 1995, the broker-dealer was headquartered in New York City and maintained eight offices throughout the United States. The broker-dealer was founded and registered with the Commission in 1984.

C. In 1984, the broker-dealer was founded and registered with the Commission by a principal officer of the broker-dealer. Since its inception, the broker-dealer's primary source of business had been underwriting state and local municipal debt.

D. In 1994, the broker-dealer was financially distressed. In approximately February 1995, the broker-dealer's principal officer decided to close the firm. The principal officer, on behalf of the broker-dealer, filed the withdrawal of registration as a broker-dealer on March 31, 1995. The broker-dealer's withdrawal became effective with the National Association of Securities Dealers, Inc. ("NASD") and the Commission on April 27, 1995 and on June 9, 1995, respectively. At the time, Washington, who was no longer an employee of the broker-dealer but who worked out of the broker-dealer's New York office, was also informed of the pending closure by the firm's principal officer. The principal officer proceeded to wind down the broker-dealer's affairs, including the liquidation of the firm's equipment and furniture. Washington assumed the broker-dealer's lease after its closure.

E. By May 1995, the broker-dealer had effectively withdrawn its NASD registration as a broker-dealer. The principal officer failed to inform the various municipalities with which the broker-dealer had been registered in underwriting pools that it no longer could do business as a broker-dealer. As a result, the broker-dealer continued to be selected as an underwriter for municipal underwritings from various municipal underwriting pools.

F. After being advised of the broker-dealer's selection to these underwritings, the broker-dealer, the principal officer and Washington executed underwriting agreements with senior underwriters. These agreements contained material misrepresentations to the effect that the broker-dealer was then currently registered with the NASD and the Commission and that it was in regulatory compliance with the entity or agency.

G. The broker-dealer, through the principal officer and Washington, also prepared and submitted solicitations for additional business to various other municipalities after the broker-dealer had withdrawn its registration as a broker-dealer. The broker-dealer solicited underwriting business from at least five municipal bond issuers. These solicitations, prepared by Washington, contained misrepresentations and material omissions concerning the broker-dealer and its employees. For example, in the broker-dealer's September 6, 1995 response to an issuer's request for proposals for underwriters, the broker-dealer omitted to inform the issuer that it was not currently registered as a broker-dealer and misrepresented, among other things, the number of salespeople capable of distributing the upcoming transaction and the amount of secondary trading in which the firm was engaged.

H. During the period of May 10, 1995 through April 18, 1996, while unregistered, the broker-dealer, through Washington, purchased and sold $14,800,000 worth of bonds in at least fifteen different underwritings. The broker-dealer received over $200,000 in compensation as a result of its participation in these transactions.

I. Washington was aware of his role in the broker-dealer's scheme to conduct underwriting business and rendered substantial assistance to that scheme by, among other things, executing underwriting agreements and by submitting solicitations for underwritings.

J. Washington has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest or a civil money penalty. The Commission has reviewed the sworn financial statement and other evidence provided by Washington and has determined that Washington does not have the financial ability to pay disgorgement of $10,000 plus prejudgment interest or a civil money penalty.

Violations

K. As a result of the conduct described above, Washington willfully aided and abetted violations of Sections 15(a)(1), 15(c)(1), 15B(a)(1) and 15B(c)(1) of the Exchange Act and Rule 15c1-2, thereunder, and Municipal Securities Rulemaking Board ("MSRB") Rule G-17, by effecting, inducing and attempting to induce the purchase and sale of municipal securities while the broker-dealer was not registered with the Commission as a broker-dealer or municipal securities dealer, and by misrepresenting the registration status and qualifications of the broker-dealer.

L. As a result of the conduct described above, Washington committed or caused violations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act. Sections 10(b), 15(a)(1), 15(c)(1), 15B(a)(1), and 15B(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2, thereunder, and MSRB Rule G-17 by effecting, inducing and attempting to induce the purchase and sale of municipal securities while the broker-dealer was not registered with the commission as a broker-dealer or municipal securities dealer, and by misrepresenting the registration status and qualifications of the broker-dealer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Washington and impose the remedial sanctions and cease-and-desist order specified therein.

Accordingly, IT IS ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Washington is ordered to cease and desist from committing or causing any violation or any future violation of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act, Sections 10(b), 15(a)(1), 15(c)(1), 15B(a)(1) and 15(B)(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder, and MSRB Rule G-17.

B. Washington be, and hereby is, suspended from association with any broker, dealer, municipal securities dealer, investment adviser or investment company, for a period of one year, effective on the second Monday following the entry of this order.

C. Washington shall be liable for, and pay disgorgement of $10,000.00 plus prejudgment interest, but that the payment of such amount shall be waived and a civil money penalty will not be imposed based upon Washington's demonstrated financial inability to pay.

D. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Washington provided accurate and incomplete financial information at the time such representations were made; (2) order disgorgement of $10,000, plus prejudgement interest; (3) determine the amount of civil penalty to be imposed; and (4) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by the Respondent was

fraudulent, misleading, inaccurate or incomplete in any material respect, the amount of civil penalty to be imposed and whether any additional remedies should be imposed. Respondent may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding.

By the Commission.

In re Willie Daniels, Securities Act Release No. 7441, Exchange Act Release No. 38977, A.P. File No. 3-9375 (August 27, 1997).

I.

The Securities and Exchange Commission (Commission) deems it appropriate and in the public interest to institute public administrative and cease- and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b), 15B(c)(4), 19(h) and 21C of the Securities Exchange Act of 1934 (Exchange Act) against Respondent Willie Daniels (Daniels).

II.

In anticipation of the institution of these proceedings, Respondent Daniels has submitted an Offer of Settlement (Offer) to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over the Respondent and over the subject matter of this proceeding and as to Sections III.A. and B. below, which are admitted, Respondent Daniel by his Offer consents to the entry of findings, remedial sanctions and cease-and-desist order set forth below.

Accordingly, IT IS ORDERED that proceedings pursuant to Section 8A of the Securities Act and Sections 15(b), 15B(c)(4), 19(h) and 21C of the Exchange Act be, and, they hereby are, instituted.

III.

On the basis of this Order and the Offer submitted by Respondent Daniels, the Commission finds <(1)> that:

A. Daniels, at all relevant times, operated as a non-registered principal of a municipal securities broker-dealer (the broker-dealer). Daniels was the founder of the broker-dealer, and remains its president and sole owner. Daniels was registered with the National Association of Securities Dealers, Inc. (NASD) as a municipal securities principal of the broker-dealer until April 1995.

B. The broker-dealer, at all relevant times, operated as a municipal securities broker-dealer within the meaning of Sections 3(a)(30) and 3(a)(31) of the Exchange Act. Until March 1995, the broker-dealer was headquartered in New York City and maintained eight offices throughout the United States. The broker-dealer was founded and registered by Daniels with the Commission in 1984.

C. Since its inception, the broker-dealer s primary source of business had been underwriting state and local municipal debt.

D. In 1994, Daniels and the broker-dealer were financially distressed. In approximately February 1995, Daniels decided to close the firm. Daniels, on behalf of the broker-dealer, filed the withdrawal of its registration as a broker-dealer on March 31, 1995. The broker-dealer's withdrawal became effective with the NASD and the Commission on April 27, 1995 and on June 9, 1995, respectively. As a result of this action, Daniels also surrendered his Municipal Securities Principal registration. Thereafter, Daniels

proceeded to wind down the broker-dealer s affairs, including the liquidation of the firm s equipment and furniture.

E. By May 1995, the broker-dealer had effectively withdrawn its NASD registration as a broker-dealer. Daniels failed to inform the various municipalities with which the broker-dealer had been registered in underwriting pools that it no longer could do business as a broker-dealer. As a result, the broker-dealer continued to be selected as an underwriter for municipal underwritings from various municipal underwriting pools.

F. After being advised of the broker-dealer's selection to these underwritings, the broker-dealer, through Daniels and another individual acting on behalf of the broker-dealer, executed underwriting agreements with senior underwriters. Certain of these agreements contained affirmative material misrepresentations to the effect that the broker-dealer was then currently registered with the NASD and the

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<(1)> The findings contained herein are not binding on anyone other than Daniels.

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Commission and that it was in regulatory compliance with those entities.

G. The broker-dealer, through Daniels and another individual acting at his direction, also prepared and submitted solicitations for additional business to various other municipalities after the broker-dealer had withdrawn its registration. The broker-dealer solicited underwriting business from at least five municipal bond issuers. These solicitations also contained misrepresentations and material omissions concerning the broker-dealer and its employees. For example, in a September 6, 1995 response by the broker-dealer to a request for proposals for underwriters from an issuer, the broker-dealer omitted to inform the issuer that the broker-dealer was not currently registered as a broker-dealer and misrepresented, among other things, the number of salespeople capable of distributing the upcoming transaction and the amount of secondary trading in which the firm was engaged.

H. During the period of May 10, 1995 through April 18, 1996, while unregistered, the broker-dealer purchased and sold $14,800,000 bonds in at least fifteen different underwritings. The broker-dealer received over $200,000 in compensation as a result of its participation in these transactions.

I. Daniels was aware of his role in the broker-dealer's scheme to conduct unregistered underwriting business and rendered substantial assistance to that scheme by arranging for the offices of the broker-dealer to be maintained, by executing underwriting agreements, by submitting solicitations for underwritings, and by paying employees and otherwise meeting the costs of conducting the illicit business.

J. Respondent Daniels has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgement interest or a civil money penalty. The Commission has reviewed the sworn financial statement and other evidence provided by Daniels and has determined that Daniels does not have the financial ability to pay disgorgement of $218,419.54 plus prejudgement interest or a civil money penalty.

Violations

K. As a result of the conduct described above, Daniels willfully aided and abetted the broker-dealer s violations of Sections 15(a)(1), 15(c)(1), 15B(a)(1) and 15B(c)(1) of the Exchange Act, and Rule 15c1-2 thereunder, and Municipal Securities Rulemaking Board (MSRB) Rule G-17, by effecting and inducing and attempting to induce the purchase and sale of municipal securities while the broker-dealer was not registered with the Commission as a broker-dealer or municipal securities dealer, and by misrepresenting the registration status and qualifications of the broker-dealer.

L. As a result of the conduct described above, Daniels committed or caused violations of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act, Sections 10(b), 15(a)(1), 15(c)(1), 15B(a)(1) and 15B(c)(1) of the Exchange Act, and Rules 10b-5 and 15c1-2 thereunder, and MSRB Rule G-17 by effecting and inducing and attempting to induce the purchase and sale of municipal securities while the broker-dealer was not registered with the Commission as a broker dealer or municipal securities dealer, and by misrepresenting the registration status and qualifications of the broker-dealer. Daniels, acting through the broker-dealer, also willfully violated MSRB Rule G-2 by engaging in municipal securities business while not registered as a municipal securities principal and failing to requalify in accordance with MSRB Rule G-3.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Daniels and impose the remedial sanctions and cease-and-desist order specified therein.

Accordingly, IT IS ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Daniels is ordered to cease-and-desist from committing or causing any violation or any future violation of Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act, Sections 10(b), 15(a)(1), 15(c)(1), 15B(a)(1) and 15(B)(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder, and MSRB Rules G-2 and G-17.

B. Daniels be, and hereby is, barred from association with any broker, dealer, municipal securities dealer, investment advisor or investment company.

C. Daniels shall be liable for, and pay disgorgement of $218,419.54 plus prejudgement interest, but the payment of such amount shall be waived and a civil money penalty will not be imposed based upon Daniels demonstrated financial inability to pay.

D. The Division of Enforcement (Division) may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent Daniels provided accurate and incomplete financial information at the time such representations were made; (2) determine the amount disgorgement and prejudgement interest to order; (3) determine the amount of civil penalty to be imposed; and (4) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent s offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by the Respondent was fraudulent, misleading, inaccurate or incomplete in any material respect, the amount of disgorgement and prejudgement interest to order, the amount of civil penalty to be imposed and whether any additional remedies should be imposed. Respondent may not, by way of defense to any such petition, contest the findings in this Order or the Commission s authority to impose any additional remedies that were available in the original proceeding.

In re Robert D. Gersh, Exchange Act Release No. 38459, Advisers Act Release No. 1626, A.P. File No. 3-9284 (April 1, 1997).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that an administrative proceeding be instituted pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Robert D. Gersh ("Gersh").

II.

In anticipation of the institution of this administrative proceeding, Gersh has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Solely for the purpose of this proceeding, and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, Gersh, by his Offer, and without admitting or denying the findings contained herein except that he admits the jurisdiction of the Commission over him and over the subject matter of this proceeding and the entry of the injunction set forth in paragraph 7 in Section III hereunder, consents to the entry of the findings and the imposition of the remedial sanctions set forth below.

Accordingly, IT IS ORDERED that proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act and Section 203(f) of the Advisers Act be, and hereby are, instituted.

III.

On the basis of this Order Instituting Proceedings Pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions, and the Offer submitted by Gersh, the Commission finds that:

Background

1. From April 19, 1990 to November 20, 1991, Gersh, a resident of Burlington, Massachusetts, was an associated person of Boston Municipal Securities, Inc. ("BMS"), an investment adviser registered with the Commission during that time period.

2. From June 1990 to July 1995, Gersh was an associated person of Burlington Securities Corp. ("Burlington"), a broker-dealer registered with the Commission.

3. Gersh and two corporations that he controlled, BMS and Devonshire Escrow and Transfer Corp. ("Devonshire"), packaged, offered, sold and administered securities in the form of Certificates of Participation ("COPs") that were issued in 1990. Since early 1990, Devonshire has served as the trustee for several COPs offerings.

Injunction for Securities Law Violations

4. On November 29, 1995, the Commission filed a Complaint for Injunctive and Other Relief (the "Complaint") against Gersh, BMS and Devonshire, and against several relief defendants, in the United States District Court for the District of Massachusetts. -[1]- The Complaint alleged that Gersh violated Section 10(b) of the Exchange Act, Rule 10b-5 promulgated thereunder and Section 17(a) of the Securities Act of 1933 ("Securities Act").

5. The Complaint alleged, among other things, that, from early 1990 to the date of the Complaint, Gersh, BMS and Devonshire engaged in continuing fraudulent acts in connection with the offer and sale of $14 million in securities in the form of COPs. According to the Complaint, Gersh misappropriated at least $7,000,000 in investor funds. The Complaint alleged that, as a result of this misappropriation, two COPs issues, with an aggregate principal amount of $3,400,000, defaulted and six additional COPs issues, with an aggregate principal amount of $3,840,000, would also default.

---------FOOTNOTES----------

-[1]-SECURITIES AND EXCHANGE COMMISSION v. ROBERT D. GERSH, BOSTON MUNICIPAL SECURITIES, INC. AND DEVONSHIRE ESCROW AND TRANSFER CORP., Defendants, and MA'AYAN BOOK COMPANY, INC., CHARLES RIVER LANDING, LTD., CRL GROUP, INC., CULINARY CLASSICS OF CHESTNUT HILL, INC., CULINARY CLASSICS OF BURLINGTON, INC., THE KITCHEN SHELF, INC., AND THE COMPU-BILL CO., INC., Relief Defendants, Civil Action No. 95-12580 (RCL) (D. Massachusetts, filed November 29, 1995). See Litigation Release No. 14742 (November 30, 1995), 60 SEC Docket 2345, 2543.

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6. The Complaint alleged that, to induce public investors to invest in these COPs, Gersh, BMS and Devonshire marketed the offerings as tax-exempt municipal securities, collateralized by equipment leases entered into by state and local governments. Gersh, BMS and Devonshire allegedly made multiple false statements and omissions of material fact. These included falsely promising that investments were fully-secured by state and municipal obligations, that the defendants would merely pass-through the collateral payments to investors and that a trustee would protect the interests of investors. The Complaint also alleged that the defendants failed to disclose that Gersh exercised control over the trustee, and that they falsely represented that the COPs were issued pursuant to the authority of state or local government agencies. According to the Complaint, Gersh commingled the proceeds of the investments and misappropriated the monies to invest in a variety of personal business ventures. The complaint further alleged that Gersh's failure to use the investor proceeds as represented deprived investors of information material to an assessment of the tax-exempt status of the COPs.

7. On November 18, 1996, without admitting or denying any of the allegations contained in the Complaint, except as to jurisdiction which he admitted, Gersh consented to the entry of a final judgment of permanent injunction and other relief. The Final Judgment was entered by the United States District Court for the District of Massachusetts on March 20, 1997. Pursuant thereto, Gersh is permanently enjoined from violating Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and Section 17(a) of the Securities Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Gersh and impose the sanction specified in the Offer.

Accordingly, IT IS HEREBY ORDERED that Robert D. Gersh be, and hereby is, barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company.

<u>In re FAIC Securities</u>, Exchange Act Release No. 36937, A.P. File No. 3-8970 (March 7, 1996).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to institute public administrative proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against FAIC Securities, Inc. ("FAIC").

II.

In anticipation of the institution of these proceedings, the Respondent has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice [17 C.F.R. _ 201.1 et seq.],

without admitting or denying the findings contained herein, except that Respondent admits the jurisdiction of the Commission over it and over the subject matter of these proceedings and the findings contained in paragraph III.A. (below), Respondent consents to the entry of this Order Instituting Public Administrative Proceedings, Making Findings and Imposing Remedial Sanctions ("Order") as set forth below.-[1]-

Accordingly, IT IS ORDERED that administrative proceedings pursuant to Sections 15(b) and 21C of the Exchange Act, be, and hereby are, instituted.

---------FOOTNOTES----------

-[1]-The findings herein are made pursuant to FAIC's Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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III.

On the basis of this Order and Respondent's Offer of Settlement, the Commission finds that:

Background

A. At all times relevant to this proceeding, FAIC Securities, Inc. ("FAIC") was a broker-dealer registered with the Commission pursuant to Section 15 of the Securities Exchange Act of 1934 ("Exchange Act") and was a municipal securities dealer within the meaning of Section 3(a)(30) of the Exchange Act. Between August 21, 1995, and January 8, 1996, FAIC twice filed with the Commission a Form BDW, whereby it sought to withdraw its registration as a broker-dealer. In each instance, after discussions with the staff, FAIC withdrew the pending Form BDW before it went effective. The most recent Form BDW was withdrawn pending resolution of this matter.

B. At all times relevant to this proceeding, the Chairman of FAIC's Executive Committee and the Chairman of FAIC's Board of Directors were "municipal finance professionals" (hereinafter "FAIC's municipal finance professionals") subject to rules and regulations promulgated by the Municipal Securities Rulemaking Board ("MSRB"), as further described in paragraph H, below.

C. At all times relevant to this proceeding, FAIC's municipal finance professionals had financial stakes and controlling interests in a variety of corporate entities (hereinafter, collectively, the "FAIC-Affiliated Companies").

D. Prior to 1993, FAIC's business consisted of, primarily, brokering Certificates of Deposit (CDs) and acting as a finder for customers wanting to purchase CDs with the highest rate of return. During 1993, the market for brokered CDs declined. At about that time, FAIC entered the municipal securities underwriting business.

Applicability of MSRB Rules

E. In April of 1994, MSRB rule G-37 became effective, and FAIC became subject to its provisions.

F. Rule G-37, and several companion recordkeeping provisions, including amendments to rules G-8 and G-9, were enacted to ensure that the high standards and integrity of the municipal securities industry are maintained, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to perfect a free and open market and to protect investors and the public interest. The rules were also designed to remove any possibility of an appearance that decisions by municipalities in awarding negotiated underwriting business might have been influenced by political contributions. Rule

G-37 was therefore drafted and is applied as a broad prophylactic measure, and a violation does not require a particularized showing of an actual "quid pro quo."

G. Subsection (b) of rule G-37 provides that no broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by (i) the broker, dealer or municipal securities dealer; (ii) any municipal finance professional associated with such broker, dealer or municipal securities dealer; or (iii) any political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional, unless the contribution is exempted by the rule. For purposes of rule G-37, a contribution triggers the two-year prohibition if it is made to any person (or election committee for that person) who was at the time of the contribution, an incumbent, candidate, or successful candidate for elective office of the issuer if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for the issuer's municipal securities business or for any elective office of a state or political subdivision which office has authority to appoint an official to an office of an issuer if the office is directly or indirectly responsible for, or can influence the outcome of, hiring a broker, dealer or municipal securities dealer for the issuer's municipal securities business.

H. Rule G-37 defines a municipal finance professional to include, among other things, any associated person who is a member of the broker, dealer, municipal securities dealer, executive or management committee or similarly situated officials, if any. Thus, under rule G-37, political contributions by either FAIC, as a municipal securities dealer, or by FAIC's municipal finance professionals, would trigger the two-year prohibition on FAIC engaging in, or seeking to engage in, certain municipal securities business.

I. At all times relevant, FAIC was subject to rule G-37(c), which provides that no broker, dealer or municipal securities dealer, or any municipal finance professional, shall solicit or coordinate contributions to an official of an issuer with which the broker, dealer, or municipal securities dealer is engaging or is seeking to engage in municipal securities business.

J. Rule G-37(d) states that no broker, dealer, or municipal securities dealer or any municipal finance professional shall, directly or indirectly, through or by any other person or means, do any act which would otherwise result in a violation of rule G-37. Thus, pursuant to operation of subsection (d) of rule G-37, "indirect" contributions by FAIC or any of FAIC's municipal finance professionals would also invoke the two-year prohibition on FAIC engaging in, or seeking to engage in, certain municipal securities business.

K. FAIC also became subject to MSRB rules requiring periodic reports to the MSRB of political contributions (MSRB rule G-37(e)), and to certain MSRB rules requiring the maintenance of internal recordkeeping of such contributions, as well as an identification of the municipalities with which the municipal securities dealer was engaged in, or sought to engage in, business (MSRB rules G-8 and G-9). The requirements of rules G-8 and G-9 were, among other purposes, designed to keep certain relevant information readily available in order to facilitate compliance examinations of municipal securities dealers by the staff of the Commission, with the goal of promoting investor confidence in the integrity of the municipal securities market.

Violative Conduct

L. At all times relevant to this proceeding, FAIC's municipal finance professionals controlled, directed, and were ultimately responsible for, political contributions of the FAIC-Affiliated Companies to candidates for office who could influence the awarding of municipal securities business by the State of Florida and by Dade County, Florida. Indeed, the FAIC-Affiliated Companies were not authorized to make any political contributions without the approval of FAIC's municipal finance professionals.

M. After the effective date of MSRB rule G-37, until in or about November 1994, FAIC's municipal finance professionals continued, through the FAIC-Affiliated Companies, to make political contributions to various candidates for elected office in Dade County and the State of Florida who could influence the

awarding of municipal securities business. All told, FAIC's municipal finance professionals coordinated and directed the payment of thousands of dollars of contributions to candidates for elected office in those jurisdictions.

N. Nonetheless, well within the two-year prohibited period following political contributions to persons who could influence the awarding of municipal securities business by the State of Florida and by Dade County, Florida, FAIC sought, and was selected to participate in, three negotiated underwritings of certain municipal securities by both Dade County, Florida, and a state agency, the Florida Housing Finance Authority ("FHFA") (hereinafter, collectively, the "underwritings").

O. The underwritings included (i) a $240 million offering of Metropolitan Dade County Aviation Revenue Bonds, Series 1995 B and C, which went effective in or about March 1995; (ii) an $84.2 million offering of FHFA Single Family Mortgage Revenue Refunding Bonds, Series 1995 A, which went effective in or about February 1995; and (iii) a $54.9 million offering of FHFA Multi-Family Revenue Bonds, which went effective in or about January 1995.

P. In total, the underwritings represented sales to the public of approximately $379 million in securities issued by Dade County, Florida and the FHFA. For its roles in the underwritings, FAIC received $224,205.00 in fees.

Q. FAIC willfully violated MSRB rule G-37(b) in that FAIC, as a municipal securities dealer, engaged in municipal securities business with issuers within two years after FAIC's municipal finance professionals directed political contributions to an elected official (or candidate for office) who could influence the awarding of municipal securities business by such issuers.

R. FAIC willfully violated MSRB rule G-37(c), in that FAIC, as a municipal securities dealer directly, or indirectly through the FAIC-Affiliated Companies, solicited and coordinated political contributions for elected officials (or candidates for such offices) of issuers, who could influence the awarding of municipal securities business, while FAIC was engaging or seeking to engage in municipal securities business.

S. FAIC willfully violated MSRB rule G-37(e), in that FAIC, as a municipal securities dealer, failed to file, on a quarterly basis, a Form G-37, setting out for the reporting period (i) all political contributions, whether direct or indirect, to elected officials (or candidates for such offices) of issuers by FAIC, and its municipal finance professionals, and (ii) an identification of all issuers with which FAIC engaged in municipal securities business.

T. FAIC willfully violated MSRB rule G-8 in that FAIC, as a municipal securities dealer, failed to keep current and accurate records which show, among other things: (i) the states in which it was engaging, or was seeking to engage, in underwriting business, and (ii) for the current and two prior years, all political contributions, whether direct or indirect, to elected officials or candidates for office by FAIC, and its associated municipal finance professionals.

U. FAIC willfully violated MSRB rule G-9, in that FAIC, as a municipal securities dealer, failed to preserve, records described in paragraph T, above, for a period of not less than six years.

V. FAIC willfully violated MSRB rule G-17 in that FAIC, as a municipal securities dealer, failed to deal fairly with all persons and failed to refrain from engaging in any deceptive, dishonest, or unfair practice, in that in certain of its conduct with respect to political contributions and subsequent attempts to engage in municipal securities business, FAIC misled municipalities, the investing public, and possibly others, by failing to disclose its non-compliance with, and by affirmatively misrepresenting its compliance with, certain state regulations.

W. FAIC willfully violated Section 15B(c)(1) of the Exchange Act, in that it made use of the mails or other means or instrumentalities of interstate commerce to effect transactions in, or to induce or attempt to

induce the purchase or sale of, any municipal security in contravention of MSRB rules G-37, G-8, G-9, and/or G-17.

Summary of Violations

X. As a result of the foregoing described conduct, FAIC willfully violated Section 15B(c)(1) of the Exchange Act and MSRB rules G-37, G-8, G-9, and G-17.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in FAIC's Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, FAIC is ordered to cease and desist from committing any violation or future violation of Section 15B(c)(1) of the Exchange Act and MSRB rules G-37, G-8, G-9, and/or G-17.

B. FAIC's registration under Section 15 of the Exchange Act as a broker-dealer is hereby revoked.

C. FAIC shall pay disgorgement in the amount of $224,205.00, plus $15,754.74 in prejudgment interest, to the United States Treasury within sixty days from the date of this Order. Such payment shall be: (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) transmitted to the Comptroller, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549; and (iv) submitted under cover of a letter which identifies FAIC as the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Charles V. Senatore, Esq., Regional Director, Securities and Exchange Commission, Southeast Regional Office, 1401 Brickell Avenue, Suite 200, Miami, Florida 33131.

D. Pursuant to Section 21B of the Exchange Act, FAIC shall pay a civil money penalty in the amount of $200,000 to the United States Treasury within sixty days from the date of this Order. Such payment shall be: (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) transmitted to the Comptroller, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549; and (iv) submitted under cover of a letter which identifies FAIC as the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Charles V. Senatore, Esq., Regional Director, Securities and Exchange Commission, Southeast Regional Office, 1401 Brickell Avenue, Suite 200, Miami, Florida 33131.

In re Lazard Freres & Co., LLC, and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Exchange Act Release No. 36419, A.P. File No. 3-8872 (October 26, 1995).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public cease-and-desist proceedings and administrative proceedings be and hereby are instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Lazard Freres & Co. LLC ("Lazard") and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch").

II.

In anticipation of the institution of these proceedings, Lazard and Merrill Lynch have each submitted an Offer of Settlement, each of which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Lazard and Merrill Lynch each admits the jurisdiction of the Commission over each of them and over the subject matter of these proceedings, Lazard and Merrill Lynch, by their Offers, consent to the issuance of this Order Instituting Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions ("Order") and to the imposition of the remedial sanctions set forth in Section VII below.

Accordingly, IT IS ORDERED that proceedings pursuant to Sections 15(b) and 21C of the Exchange Act be, and hereby are, instituted.

III.

On the basis of this Order and the Offers submitted by Lazard and Merrill Lynch, the Commission finds that:-[1]-

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-[1]-The findings herein are made pursuant to Lazard's and Merrill Lynch's Offers of Settlement and are not (continued...)
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A. RESPONDENTS

Lazard is a New York Limited Liability Company with its principal place of business at Thirty Rockefeller Plaza, New York, New York. Lazard is registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act (File No. 8-2595). At all times relevant to these proceedings, Lazard was a New York Limited Partnership.

Merrill Lynch is a Delaware corporation with its principal place of business at 250 Vesey Street, New York, New York. Merrill Lynch is registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act (File No. 8-2592).

B. FACTS

1. Background

Among other things, Lazard conducts a municipal securities business through its Municipal Department, which principally (I) serves as financial advisor to certain municipal issuers with respect to the development of financial plans and strategies, and (ii) acts as underwriter with respect to the issuance of municipal securities by various state and local governments and their agencies and instrumentalities. Beginning in April 1988, Lazard maintained a Municipal Department branch office in Boston, Massachusetts, which was established and managed by a former partner of Lazard (the "Former Partner"). When the Former Partner resigned from Lazard at the end of January 1993, Lazard closed its Boston office.

At times relevant to these proceedings, Lazard was a financial advisor to the Massachusetts Water Resources Authority ("MWRA") and the District of Columbia ("D.C."). Lazard's financial advisory services to those municipal issuers were provided primarily by the Former Partner and others under his supervision.

Merrill Lynch, in addition to acting as a broker-dealer, is an underwriter of tax-exempt securities by state and local governments and their agencies. In the mid-1980s, Merrill Lynch began to develop and market interest rate swaps for municipalities and other tax-exempt issuers. By 1989, Merrill Lynch had become the largest provider of interest rate swaps to municipalities and other tax-exempt issuers.-[2]- Interest rate swaps are transactions by which an entity may exchange (i.e., swap) its obligation to make periodic payments based on a particular interest rate or index for the right to receive periodic payments based on a different rate or index (e.g., one may swap its obligation to make variable rate payments for the right to receive fixed rate payments). In the late 1980's, Merrill Lynch, whose swap business had in the past been done primarily with its own clients, sought to expand its swap business.

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-[1]-(...continued) binding on any other person or entity named as a respondent in this or any other proceeding.

-[2]-Unlike Merrill Lynch, Lazard did not serve as a counterparty in municipal interest rate swap transactions during the relevant time period.

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2. Events Leading Up To The June 1990 Contract

In the late 1980's, the MWRA, which had been given responsibility for cleaning up the Boston Harbor and for providing water and sewerage services to over 40 Boston area cities and towns, determined to issue several billion dollars in revenue bonds in the coming years. To assist it in executing its bond transactions, in January 1989, the MWRA issued a request for proposals for the purpose of selecting an underwriting team. In his position as financial advisor to the MWRA, during early 1989, the Former Partner advised the MWRA throughout the selection process concerning, among other things, the strengths and weaknesses of the potential underwriters.

Beginning in 1988 and continuing through 1989, Merrill Lynch representatives met and discussed with the Former Partner MWRA business and potential business involving non-financial advisory clients of Lazard. During the course of such discussions, the Former Partner solicited business from Merrill Lynch. The Former Partner did not advise anyone at Lazard's New York headquarters of these discussions.

In March of 1989, the Board of Directors of the MWRA, which was being advised by the Former Partner, chose Merrill Lynch as one of three senior managing underwriters. The MWRA decided to rotate the senior managing underwriters. Merrill Lynch was chosen from this group of three to act as the senior managing underwriter for the MWRA's first bond offering, which ultimately was executed in January 1990.

Beginning in the fall of 1989, Merrill Lynch attempted to market to the MWRA an interest rate swap in conjunction with the early 1990 underwriting. During this process, in late September 1989, Merrill Lynch initially raised the swap idea with the Former Partner as financial advisor to the MWRA. After being introduced to the swap concept by Merrill Lynch, the Former Partner expressed an immediate interest in the business potential of swaps. Merrill Lynch and the Former Partner discussed the prospect of Merrill Lynch and Lazard engaging in a joint swap marketing agreement.

In the fall of 1989, while working on an interest rate swap with the Indian Trace Community Development District in Broward County, Florida (the "Florida Transaction"), Merrill Lynch invited the Former Partner to learn about the mechanics of structuring and documenting interest rate swaps. Ultimately, although neither the Former Partner nor any other Lazard personnel worked on the Florida Transaction, Merrill Lynch paid Lazard $90,000 in connection with this transaction, which represented approximately 10% of Merrill Lynch's overall compensation on the swap. The Former Partner did not advise his partners that Lazard personnel did not work on the swap.

Following further discussions between representatives of Merrill Lynch and the Former Partner, Merrill Lynch and Lazard entered into a written contract dated December 5, 1989 (the "December 1989 Contract"). The December 1989 Contract, which was prepared by a national law firm at the request of the then head of Merrill Lynch's municipal swaps department, provided that Merrill Lynch and Lazard would split fees generated from any successful jointly marketed swaps.

In January 1990, Merrill Lynch attempted to persuade the MWRA and the Former Partner that the MWRA should enter into an interest rate swap in conjunction with the 1990 MWRA underwriting. In connection with the MWRA's consideration of a possible swap transaction, the Former Partner told a representative of the MWRA that Lazard had been involved with Merrill Lynch in an out-of-state interest rate swap transaction in late 1989. The Former Partner did not fully disclose, and Merrill Lynch did not ensure full and complete disclosure of, the facts and circumstances of the Florida Transaction, including Merrill Lynch's payment of $90,000 to Lazard. The Former Partner advised his partners that the December 1989 Contract applied only to the Florida Transaction. The Former Partner did not advise his partners at Lazard's New York headquarters that Merrill Lynch was attempting to market to the MWRA an interest rate swap in connection with the MWRA's early 1990 underwriting.

3. The June 1990 Contract

On June 26, 1990, Merrill Lynch entered into a successor contract with Lazard (the "June 1990 Contract"). The Contract, which was negotiated principally by the Former Partner and the then head of Merrill Lynch's municipal swaps department, provided that Merrill Lynch and Lazard would participate together in originating, negotiating and arranging interest rate swaps to be entered into between Merrill Lynch and municipal issuers. Like the December 1989 Contract, the June 1990 Contract was drafted by the same national law firm at the request of the then head of Merrill Lynch's municipal swaps department, and provided for fee-splitting between Merrill Lynch and Lazard on successful jointly marketed interest rate swaps. Unlike the December 1989 Contract, however, the June 1990 Contract further provided that: (1) Lazard would consult generally with Merrill Lynch with respect to the presentation, marketing and sales of municipal interest rate swaps; and (2) Merrill Lynch would pay Lazard an annual fee in the amount of $800,000 for the period June 26, 1990 through December 31, 1990.

The June 1990 Contract initially covered only calendar year 1990. But in December 1990, prior to its expiration, the June 1990 Contract was renewed in writing to cover calendar year 1991.

Later, Merrill Lynch and Lazard, acting through the Former Partner, orally extended the June 1990 Contract to cover the year 1992. During 1991 and 1992, the annual fee that Merrill Lynch paid Lazard was increased from $800,000 to $1,000,000. The June 1990 Contract effectively remained in place until it was terminated in January 1993.-[3]-

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-[3]-The Former Partner advised his partners at Lazard's New York headquarters that Lazard would be helping Merrill Lynch to obtain swap business only with Lazard's municipal underwriting clients. Payments under the fee-splitting provision of the June 1990 Contract were received only for swaps with entities that were underwriting clients, not financial advisory clients, of Lazard.

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The Former Partner and others under his direct supervision primarily provided Lazard's services to Merrill Lynch under the June 1990 Contract. Pursuant to the June 1990 Contract, Merrill Lynch paid Lazard a total of $5,766,878 between September 1990 and November 1992, which consisted of $2,550,000 in annual fees and $3,216,878 in payments under the fee-splitting provision. Since the Former Partner was compensated based on the overall production of the Boston branch office, the Former Partner received a substantial financial benefit from the June 1990 Contract.

The June 1990 Contract established an ongoing, continuing relationship between Lazard and Merrill Lynch that resulted in a substantial financial benefit to the Former Partner who was providing financial advisory services to certain clients that were considering the selection of Merrill Lynch. Consequently, the June 1990 Contract created at least a potential conflict of interest for Lazard that should have been disclosed to its financial advisory clients that were serviced by the Former Partner and were considering the selection of Merrill Lynch to provide certain financial services in the conduct of Lazard's and Merrill Lynch's municipal securities business.

4. Inadequate Disclosure of the June 1990 Contract and the Florida Transaction

The MWRA and D.C. were not fully informed of the facts relating to the relationship between Lazard and Merrill Lynch at the time they evaluated the advice of the Former Partner concerning the selection of Merrill Lynch to provide certain financial services. Specifically, the June 1990 Contract and the facts and circumstances of the Florida Transaction, including Merrill Lynch's payment of $90,000 to Lazard, were not adequately disclosed to the MWRA and D.C. when the Former Partner provided financial advisory services relating to the following actions taken by those municipal issuers. The MWRA, with advice from the Former Partner as its financial advisor, (1) selected Merrill Lynch to execute interest rate swaps in May 1990 (notional amount: $90 million) and June 1990 (notional amount: $78 million)-[4]- and to serve as Book-Running Manager on a $717 million bond issue in March 1992, and (2) negotiated with Merrill Lynch with respect to bond prices, underwriting fees and swap fees for those transactions. D.C., with advice from the Former Partner as its financial advisor and in connection with related municipal securities offerings, (1) selected Merrill Lynch to execute an interest rate swap in September 1991 (notional amount: $230 million) and March 1992 (notional amount: $299.8 million), and (2) negotiated with Merrill Lynch with respect to swap fees for those transactions.-[5]-

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-[4]-The MWRA decided to execute swaps with Merrill Lynch, as opposed to any other entity, without issuing a request for proposals. The MWRA's decisions were based, at least in part, upon the initial recommendation of the Former Partner in January 1990, and subsequent input and advice from the Former Partner throughout the spring of 1990.

-[5]-The related municipal offerings were a $331 million General Fund Recovery Bond issue in September 1991 and (continued...)

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Senior personnel in Lazard's New York office instructed the Former Partner to make disclosure and later asked the Former Partner whether he had made disclosure to the MWRA and D.C. In response, the Former Partner informed them that he had disclosed Lazard's relationship with Merrill Lynch to the MWRA and D.C. In addition, the Former Partner informed Merrill Lynch that he had disclosed Lazard's relationship with Merrill Lynch to the MWRA and D.C. In fact, however, the Former Partner had not fully disclosed the relationship; specifically, that Lazard and Merrill Lynch had entered into a contract, and that pursuant to the contract, Lazard and Merrill Lynch had an ongoing, continuing relationship pursuant to which Merrill Lynch was paying Lazard an annual fee of between $800,000 and $1 million for consulting generally concerning the marketing of interest rate swaps, as well as a share of Merrill Lynch's income earned on successful joint swap proposals. Moreover, not only did the Former Partner fail to fully disclose the June 1990 Contract, but he expressly represented to the MWRA that no conflicts of interest existed with respect to Lazard's services to that municipal issuer.

Lazard did not take adequate steps to ensure that the Former Partner had fully disclosed the June 1990 Contract to Lazard's financial advisory clients serviced by the Former Partner that were considering the selection of Merrill Lynch to provide certain financial services. Lazard did not have adequate procedures in place to ensure that the Former Partner made full disclosure of the June 1990 Contract to those

municipal financial advisory clients. Lazard did not have a procedure to require the Former Partner to make disclosures to Lazard's municipal financial advisory clients in writing. Moreover, when informed by the Former Partner that he had made disclosure, senior personnel in Lazard's New York office did not ask the Former Partner whether he had specifically disclosed the consulting relationship and the annual fee.

In addition, Merrill Lynch did not take adequate steps to ensure that the June 1990 Contract and the facts and circumstances of the Florida Transaction, including Merrill Lynch's payment of $90,000 to Lazard, were fully disclosed to Lazard's financial advisory clients serviced by the Former Partner. These clients were considering the selection of Merrill Lynch to provide certain financial services. Although the Former Partner advised Merrill Lynch that he had disclosed the relationship, Merrill Lynch did not ask the Former Partner whether he had specifically disclosed the Florida Transaction, the consulting relationship and the annual fee.

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-[5]-(...continued)
a $229.8 million General Obligation Bond refunding in March 1992. The swap transactions were executed contemporaneously with the two bond offerings for the purpose of converting variable-rate interest rate obligations arising from the bond offerings into fixed-rate obligations.
_ _ _ _ _ _ _ _ _ _

C. LEGAL DISCUSSION

1. Rule G-17

Rule G-17 of the Municipal Securities Rulemaking Board ("MSRB") provides that:

In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. As broker-dealers conducting municipal securities businesses, Lazard and Merrill Lynch are subject to the MSRB Rules.

2. Violations of Rule G-17

a. Lazard

The Former Partner did not fully disclose the June 1990 Contract to the MWRA and D.C., and Lazard did not have adequate procedures in place to ensure that the Former Partner made full disclosure of the June 1990 Contract to those financial advisory clients. Senior personnel in Lazard's New York office asked the Former Partner whether he had disclosed Lazard's relationship with Merrill Lynch to the MWRA and D.C. When told by the Former Partner that he had disclosed the relationship with Merrill Lynch to those municipal financial advisory clients, Lazard took no further steps to determine what was disclosed. For example, Lazard did not have a procedure to determine whether the Former Partner had specifically disclosed the consulting relationship and the annual fee. In addition, Lazard did not have a procedure to ensure that the Former Partner made disclosures to Lazard's municipal financial advisory clients in writing.

Lazard, as the financial advisor to the MWRA and D.C., was required to disclose the potential conflict of interest created by the June 1990 Contract. As a result of the Former Partner's failure to fully disclose the June 1990 Contract to the MWRA and D.C., Lazard's failure to take adequate steps to ensure that the Former Partner made full disclosure of the June 1990 Contract, and the Former Partner's representations to the MWRA that no conflicts of interest existed, Lazard engaged in a willful violation of MSRB Rule G-17.-[6]-

b. Merrill Lynch

While providing certain financial services for the MWRA and D.C., Merrill Lynch failed to take adequate steps to ensure that the June 1990 Contract and the facts and circumstances of the Florida Transaction, including Merrill Lynch's payment of $90,000 to Lazard, were fully disclosed to the MWRA and D.C. As a result, Merrill Lynch engaged in a willful violation of MSRB Rule G-17.

IV.

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-[6]-As used in this Order, "willful" means the intentional commission of an act which constitutes the violation. There is no requirement that the actor also be aware that he is violating the federal securities laws. See Tager v. SEC, 344 F.2d 5 (2d Cir. 1965).

_ _ _ _ _ _ _ _ _ _

Lazard has submitted an Offer of Settlement in which, without admitting or denying the findings herein, it consents to the Commission's issuance of this Order, which makes findings, as set forth above, and orders Lazard to cease and desist from committing or causing any violation or future violation of MSRB Rule G-17; to pay, as also required by Settlement Agreements among each of the Respondents, the United States Attorney's Office for the District of Massachusetts and the Attorney General's Office for the Commonwealth of Massachusetts, a civil money penalty of $2.5 million and restitution to the MWRA and D.C. in the amounts of $2.12 million and $1.8 million, respectively; to maintain the undertakings described in Section VI below, implemented prior to the date of this Order; and to a censure of Lazard pursuant to Section 15(b) of the Exchange Act. As set forth in Lazard's Offer of Settlement, Lazard undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceeding concerning the transactions that are the subject of this Order.

V.

Merrill Lynch has submitted an Offer in which, without admitting or denying the findings herein, it consents to the Commission's issuance of this Order, which makes findings, as set forth above, and orders Merrill Lynch to cease and desist from committing or causing any violation or future violation of MSRB Rule G-17; to pay, as also required by Settlement Agreements among each of the Respondents, the United States Attorney's Office for the District of Massachusetts and the Attorney General's Office for the Commonwealth of Massachusetts, a civil money penalty of $2.5 million and restitution to the MWRA and D.C. in the amounts of $2.0 million and $1.8 million, respectively; to maintain the undertakings described in Section VI below, implemented prior to the date of this Order; and to a censure of Merrill Lynch pursuant to Section 15(b) of the Exchange Act. As set forth in Merrill Lynch's Offer, Merrill Lynch undertakes to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceeding concerning the transactions that are the subject of this Order.

VI.

Prior to the date of this Order, Lazard and Merrill Lynch revised their policies and procedures. Lazard and Merrill Lynch undertake to maintain such policies and procedures.

The policies and procedures adopted and implemented by Lazard are as follows:

(a) In October 1993, Lazard adopted comprehensive compliance policies and procedures for its Municipal Department that address, among other things, the proper documentation and disclosure of joint business relationships, has distributed those policies to all Municipal Department personnel, and has continued to revise and update them;

(b) Lazard's Municipal Department compliance policies and procedures include a requirement that personnel working on financial advisory assignments make written disclosure to its municipal financial advisory clients of the existence and terms of all agreements and arrangements with actual or potential underwriters, financial advisors, consultants and/or swap counterparties that might create a potential conflict with the interests of Lazard's municipal financial advisory clients;

(c) Lazard has held periodic compliance training sessions that are mandatory for all Municipal Department personnel; and

(d) Lazard established a Municipal Task Force, of which a number of senior partners including the General Counsel are members, to ensure that the Municipal Department and its personnel are guided by all appropriate legal and ethical standards. This Task Force modified Lazard's training and compliance systems, its hiring procedures, its use of outside consultants and joint marketing efforts with other firms, its documentation and disclosure practices and its accounting policies.

The policies and procedures adopted and implemented by Merrill Lynch are as follows:

(a) On August 16, 1993, Merrill Lynch issued a new, comprehensive and detailed set of procedures governing interaction between Merrill Lynch's Municipal Markets employees and third parties such as consultants and broker-dealers. On June 6, 1994, Merrill Lynch supplemented those procedures.-[7]- The Procedures provide that Merrill Lynch will use the assistance of consultants to obtain or retain public finance business only in limited circumstances and only under specific guidelines, including the following:

(b) Whenever Merrill Lynch decides to use a consultant to assist in obtaining or retaining public finance business, it will now as a matter of course disclose in writing its retention of the consultant to the governing body of all existing or prospective potentially affected public finance clients. The basic terms of the consulting agreement, including the compensation to be paid to the consultant, either must be included in the written disclosure or made available to the public finance clients upon request;

(c) Whenever a Municipal Markets employee wishes to retain a consultant, the employee must prepare a memorandum for internal supervisory review and approval explaining the services sought from the consultant and indicating the compensation to be paid. When supervisory approval is granted, Merrill Lynch in-house counsel must review and approve all public finance consulting agreements before they are executed. As to specific payments under a consulting agreement, the Municipal Markets employee responsible for the agreement now must prepare a billing memorandum indicating the services performed and the amount of compensation to be paid. Management level review and written approval of the payments are required before payment will be made;

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-[7]-The August 16, 1993 procedures and the June 6, 1994 supplement thereto are hereinafter referred to as "the Procedures."

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(d) In cases in which the consultant also may act as a financial advisor to other issuers of municipal securities, Merrill Lynch is to obtain a list of the consultant's municipal financial advisory clients, which, by contract, the consultant is required to update quarterly. The Merrill Lynch Municipal Markets Consultant Relationship Manager responsible for the consultant's retention is required to promptly notify, in writing, the governing body of each of the consultant's financial advisory clients of the consultant arrangement. The written notification must include a general description of the arrangement, including the compensation;

(e) Merrill Lynch Municipal Markets will not pay, directly or indirectly, or split a fee with any consultant in connection with an assignment for which the consultant is the financial advisor to the municipal issuer;

(f) All agreements with Merrill Lynch public finance consultants are to be in writing. Consultants who may act as financial advisors to public entities during the pendency of the consulting agreement must acknowledge in the written agreement that they are not at the time of the agreement, and will not during the term of the agreement, be retained as financial advisors or financial consultants to any municipal issuers for whom Merrill Lynch is seeking to be retained as a result of the consultants' activities under the consulting agreement. Consultants who act as financial advisors to public entities must further acknowledge in the written agreement that no payment under the agreement will be made in connection with an assignment for which the consultants are the financial advisor to the public entity; and

(g) During 1993, 1994 and 1995, Merrill Lynch has conducted in-house compliance meetings for its Municipal Markets employees throughout the United States during which the employees have been instructed as to various compliance issues including Merrill Lynch's procedures governing interaction with third parties such as consultants.

VII.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offers submitted by Lazard and Merrill Lynch and impose the sanctions specified in the Offers. In determining to accept these Offers, the Commission considered the policies and procedures adopted and implemented by Lazard and Merrill Lynch and cooperation afforded the Commission staff.

Accordingly, IT IS HEREBY ORDERED that:

1. Lazard shall cease and desist from committing or causing any violation or future violation of MSRB Rule G-17;

2. Lazard shall be, and hereby is, censured;

3. Lazard shall, within ten business days of the issuance of this Order, pay a civil money penalty in the amount of $2.5 million to the United States Treasury and shall make restitution to the MWRA and D.C. in the amounts of $2.12 million and $1.8 million, respectively;

4. Lazard shall comply with its undertaking to maintain the policies and procedures described in Section VI above, implemented prior to the date of this Order; provided, however, that Lazard may modify such policies and procedures with alternative policies and procedures designed to achieve the same purposes;

5. Merrill Lynch shall cease and desist from committing or causing any violation or future violation of MSRB Rule G-17;

6. Merrill Lynch shall be, and hereby is, censured;

7. Merrill Lynch shall, within ten business days of the issuance of this Order, pay a civil money penalty in the amount of $2.5 million to the United States Treasury and shall make restitution to the MWRA and D.C. in the amounts of $2.0 million and $1.8 million, respectively;

8. Merrill Lynch shall comply with its undertaking to maintain the policies and procedures described in Section VI above, implemented prior to the date of this Order; provided, however, that Merrill Lynch may modify such policies and procedures with alternative policies and procedures designed to achieve the same purposes;

9. The Respondents have each entered into Settlement Agreements with the United States Attorney's Office for the District of Massachusetts and the Attorney General's Office for the Commonwealth of Massachusetts. The Respondents' respective obligations to pay penalties and restitution under the terms of this Order will be satisfied by the payment of penalties and restitution under the terms of such Settlement Agreements; and

10. Lazard and Merrill Lynch shall within 30 days of entry of this Order, send to Juan Marcel Marcelino, District Administrator, Securities and Exchange Commission, Boston District Office, 73 Tremont Street, Boston, Massachusetts, 02108, via certified mail, evidence, including copies of checks, of the payments of the civil penalties and restitution, as ordered herein. Such evidence shall be submitted under cover letter which identifies the respondent as the respondent in these proceedings, the file number, and the Commission case number.

In re Michael S. Goodman, Exchange Act Release No. 36279, A.P. File No. 3-8829 (September 26, 1995).

I.

The Commission deems it appropriate and in the public interest to institute administrative proceedings against Michael S. Goodman (Goodman), pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act). In anticipation of these proceedings, Goodman has submitted an Offer of Settlement (Offer) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by, or on behalf of, the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except those matters contained in subparagraph III. (z) below, which are admitted, Goodman, by his Offer, consents to the entry of this Order, its findings and the imposition of sanctions set forth below.

II.

ACCORDINGLY, IT IS ORDERED that proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act be, and hereby are, instituted.

III.

On the basis of this Order and Goodman's Offer, the Commission finds n1 that:

_ _ _ _ _ _ _ _ _ _

n1 The findings herein are made pursuant to Michael S. Goodman's Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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ENTITIES INVOLVED

a. First Humanics Corp. ("First Humanics"), a not-for-profit corporation, was in the business of acquiring, renovating and operating nursing homes. From 1984 through 1989, First Humanics renovated and operated 21 nursing homes acquired through 21 separate offerings totalling approximately $82 million in publicly sold municipal and corporate bonds. On October 15, 1987, the Economic Development Corporation of the City of Detroit, Michigan, for the benefit of First Humanics, acquired the Medicos Recovery Care Center (Medicos) through the issuance of $6,955,000 in tax-exempt bonds. This was First Humanics' last offering.

b. International Elderly Care, Inc. ("IEC"), also a not-for-profit corporation, performed the same function as First Humanics after First Humanics defaulted on numerous bonds in 1988. During 1988 and 1989, IEC renovated and operated five nursing homes acquired through 5 separately financed offerings totalling

approximately $25 million in publicly sold municipal and corporate bonds. On May 26, 1988, the Industrial Development Authority of the City of Boonville, Missouri, for the benefit of IEC, acquired the Colonial Gardens Convalescent Center (Colonial Gardens) through the issuance of $3,795,000 in tax-exempt bonds. This was IEC's first offering.

c. Grey, Randolph & Abbott ("GRA"), a broker-dealer registered with the Commission, was the principal underwriter for thirteen offerings in which First Humanics was involved from 1985 through 1987, including the Medicos offering, and all five offerings in which IEC was involved from 1988 through 1989, including the Colonial Gardens offering. GRA filed a Form BDW with the Commission, and is no longer doing business.

RESPONDENT

d. Goodman was a principal and controlling person of GRA from August 1984 through March 1991. Goodman was GRA's representative for the First Humanics and IEC offerings, and participated in drafting the Medicos and Colonial Gardens offering circulars. Goodman, through GRA, distributed those offering circulars to the investing public.

BACKGROUND

e. In connection with each offering, First Humanics and, thereafter IEC, typically contracted to purchase a particular nursing home (in paragraphs III.e. through j. only, unless otherwise stated, First Humanics and IEC are jointly referred to as "the Company" since the offering process for each entity was nearly identical). To finance the purchase, the Company arranged for a municipality to issue tax-free municipal bonds. However, the Company remained liable for all payments to bondholders. To finance the issuance costs on certain of the above offerings, the Company, in some instances, also issued a modest amount of corporate bonds in conjunction with the tax-exempt bonds. Again, the Company was liable for all payments to bondholders.

f. Each prospective nursing home was initially located by Lee F. Sutliffe ("Sutliffe"), the undisclosed control person of both First Humanics and IEC and the undisclosed promoter of First Humanics' and IEC's offerings. If Sutliffe decided a nursing home was acceptable for acquisition, the Board of Directors then typically voted to acquire the facility. Sutliffe generally received an acquisition fee of between $100,000 and $300,000 in connection with each nursing home purchased by the Company. Subsequent to the Board's approval, Sutliffe initiated the offering process, through which the Company obtained the funds necessary to purchase the nursing home. In connection therewith, Sutliffe assembled a "working group" which coordinated the offering process and was responsible for preparing the offering circulars. The working group included Sutliffe; the Company's officers; Company counsel; underwriters' representatives, including Goodman; and underwriters' counsel. The activities of the working group were largely directed by Sutliffe. In this manner, Sutliffe acted as the promoter of the offerings.

g. In connection with each offering, an offering circular was also prepared. The offering circular typically contained sections describing the Company, the nursing home to be acquired, the bonds, sources and uses of bond proceeds, risk factors and, as appendices, a financial feasibility study and the Company's audited financial statements. The primary purpose of the offering circular was to provide the investing public with all material facts pertaining to the relevant offering. Goodman reviewed and commented on offering circular drafts and analyzed investment risks. Thus, he was involved in the process of preparing offering circulars. Furthermore, as a principal and controlling person of the lead underwriter for the Company's offerings, Goodman, through GRA, distributed the offering circulars to the investing public.

h. Upon completion of the offering process, Sutliffe coordinated the bond closings. At each bond closing, the municipal issuer sold the bonds to underwriters who, in turn, re-sold them to the investing public through various retail broker-dealers. Upon receiving the bond proceeds from the underwriters, the municipal issuer either lent such proceeds to the Company so that the Company could purchase the

nursing home, or purchased the nursing home and leased it back to the Company. At all times, however, effective control of the nursing homes remained with the Company. A certain amount of bond proceeds were also set aside as working capital for the benefit of the Company. The Company then assumed the municipal issuer's repayment obligation to the bondholders. Thereafter, the Company was required to make monthly bond payments to the indenture trustee sufficient for the trustee to meet semi-annual interest payments to the bondholders. In addition, pursuant to various bond and trust indentures, the Company was required to allocate a certain amount of each offering's proceeds to a debt service reserve fund. The debt service reserve fund was used to offset any insufficiencies in funds available for the semi-annual interest payments to bondholders. However, the Company was required to pay back any monies withdrawn from this account.

i. Prior to promoting the First Humanics and IEC offerings, Sutliffe was involved in the promotion of numerous other bond issues. Most of these earlier offerings, however, had experienced financial problems and some eventually defaulted prior to the Medicos offering. Furthermore, in March 1985, the State of Missouri found that Sutliffe had participated in the making of false filings, and issued a cease and desist order against him.

j. In addition to Sutliffe's promoting activities, he also controlled the Company. The Company's officers and Board of Directors allowed Sutliffe to dictate virtually all significant decisions. Sutliffe even served on various First Humanics' Board sub-committees, including a management sub-committee. Sutliffe determined which nursing homes First Humanics and IEC would acquire and was involved in the day-to-day operations of the nursing homes. Sutliffe's control was openly displayed at Company Board of Directors meetings and reflected in the pertinent minutes, internal memoranda and correspondence.

FIRST HUMANICS/OPERATIVE FACTS

k. Revenues from First Humanics' nursing homes were generally paid directly to the company and, from 1984 on, First Humanics freely and openly commingled all such revenues in a central bank account located in Dixon, Illinois (Dixon account). First Humanics then used the revenues from any one nursing home to pay the expenses of other homes, as the need arose. When a nursing home's revenues were insufficient to meet a bond payment, money was simply taken from available funds in the Dixon account, whatever the source. Thus, each nursing home's expenses were paid according to the urgency of the bill and not limited by the amount of revenue generated by the particular nursing home. From 1986 on, however, most of the nursing homes failed to generate an amount of revenues sufficient to meet their own expenses. As a result, commingling became essential to the operation and survival of First Humanics. The success or failure of any one nursing home was thereby dependent upon the success or failure of all the other nursing homes. Therefore, each municipal offering was, in fact, a de facto investment into First Humanics and its existing nursing homes.

l. In addition, the vast majority of First Humanics' nursing homes were located in Illinois and heavily dependent on Illinois' Medicaid reimbursements, which were often insufficient and continually late. Given the nursing homes' interdependence, as the result of the commingling discussed above, such late and insufficient payments affected all nursing homes, even those located outside of Illinois. Thus, largely because of the Medicaid problems, in late 1985 First Humanics became late in its required monthly bond payments to the indenture trustees for certain bond issues. Therefore, First Humanics began using the funds from some of these delinquent nursing homes' debt service reserve accounts to offset the insufficiencies. Although First Humanics was required to pay back monies withdrawn from such accounts, these payments were often late and insufficient.

m. As a result of First Humanics' cash flow shortages, First Humanics also became reliant on the working capital generated from new bond offerings as a source of funds for current operations. Additionally, a procedure was developed, of which Goodman was aware, whereby Sutliffe "kicked-back" a portion of his acquisition fee to First Humanics at, or shortly after, each bond closing. Thus, the success of existing

nursing homes and the payments to existing bondholders became largely dependent on First Humanics' ability to obtain funds from future offerings. In this manner, First Humanics operated a Ponzi scheme.

n. Nonetheless, First Humanics continued to be late in its monthly bond payments to the trustees. As a result, First Humanics also continued to deplete certain bond issues' debt service reserve funds. In August 1986, one of the trustees, in fact, informed First Humanics that based on its continued failure to repay these funds it was in violation of four of its bond indentures and, therefore, in technical default. First Humanics experienced a $1.5 million loss for its fiscal year ended November 30, 1986. Furthermore, none of the nursing homes had met their cash flow projections as originally stated in their offering circulars. In December 1986, one of the trustees again informed First Humanics that it was in technical default on two of its municipal bonds. However, Sutliffe caused six new bond issues to close on December 18, 1986. As a result, and in connection with First Humanics' Ponzi scheme, additional working capital was generated and, undisclosed to investors, $500,000 of Sutliffe's acquisition fee was kicked-back to First Humanics. These funds were immediately applied to cure First Humanics' monthly bond payment deficits and to pay its past due bills. Nonetheless, First Humanics' cash flow problems continued.

MEDICOS OFFERING

o. Despite First Humanics' financial problems, in early 1987 Sutliffe directed First Humanics to acquire Medicos. In connection therewith, Sutliffe arranged to have the City of Detroit issue $6,955,000 in tax-exempt bonds. Sutliffe also directed First Humanics board members to issue $530,000 in taxable bonds to cover the issuance expenses. Both series of bonds were issued pursuant to one offering circular. Sutliffe, acting as the promoter, then began the offering process by assembling the working group which prepared the Medicos offering circular. Again, Sutliffe largely directed the working group's activities as the undisclosed promoter for Medicos.

p. Upon completion of the offering process, Sutliffe then coordinated the Medicos bond closing. The Medicos offering closed on October 15, 1987 and the municipal and corporate bonds were sold to the public through underwriters and various broker-dealers. Upon receiving the proceeds from the underwriters, the municipal issuer purchased Medicos and thereafter leased the facility back to First Humanics. Finally, Sutliffe kicked-back approximately $200,000 of his Medicos acquisition fee to First Humanics as part of First Humanics' ongoing Ponzi scheme.

q. However, not all of the taxable bonds had sold by the time the Medicos offering closed. Since this could have postponed the closing, Sutliffe, undisclosed to investors, agreed to buy the remaining taxable bonds until they could be resold. To finance that purchase, Sutliffe arranged for a loan of $250,000 from the sellers of Medicos to himself. Goodman was aware of this transaction.

r. The primary purpose of the Medicos offering circular was to provide the investing public with all material facts related to the Medicos offering. As the representative and principal of the underwriter, Goodman was one of those responsible for the preparation and contents of the final offering circular distributed to the investing public. Despite Goodman's knowledge of the above facts, however, the Medicos offering circular omitted to disclose numerous material facts. For instance, the Medicos offering circular failed to adequately disclose Sutliffe's promotion of the Medicos offering, his control over First Humanics, his prior bond failures and his past securities law sanction. Additionally, the Medicos offering circular portrayed Medicos as a "stand alone" nursing home. Thus, the Medicos offering was simply presented as an investment into Medicos. Nothing adequately describing the commingling of nursing home revenues or the resulting financial interdependence among First Humanics' nursing homes was disclosed. Thus, Medicos bondholders were not informed that Medicos revenues would be used to pay First Humanics' existing nursing homes' expenses. Consequently, bondholders were not informed that, in fact, their investments constituted de facto investments into First Humanics and its existing nursing homes and not merely Medicos. Similarly, the serious Illinois Medicaid problem which at the time was adversely affecting all First Humanics nursing homes was not disclosed. Thus, Medicos bondholders were not informed that, given the nursing homes' financial interdependence, their future bond payments were

largely dependent on First Humanics' ability to secure the late Medicaid payments from the State of Illinois. The offering circular also failed to disclose both the August and December 1986 defaults which related directly to First Humanics' ability to pay bondholders. Furthermore, neither Sutliffe's $200,000 kick-back nor First Humanics' dependence on the capital generated from future offerings to finance its existing nursing homes, as part of its ongoing Ponzi scheme, were disclosed. Thus, Medicos bondholders were not informed that their ability to receive payments was also dependent on First Humanics' ability to secure funds from future offerings. Finally, there was no disclosure that First Humanics was unable to sell all of the taxable bonds by closing and that, as a result, Sutliffe had arranged for a loan from the sellers to purchase the bonds.

s. Goodman, as the underwriter's representative, participated in working group meetings, reviewed the Medicos offering circular and the related offering documents and analyzed investment risks. As a member of the working group, through his due diligence review, and through conversations and correspondence with other working group members, Goodman knew, or was reckless in not knowing, of the above material misrepresentations and omissions. Despite his knowledge and his role in the offering as underwriter's representative, however, Goodman, through GRA, distributed the offering circular to the investing public and caused the bonds to be sold.

IEC/COLONIAL GARDENS OFFERING

t. In late 1987, First Humanics contracted to acquire Colonial Gardens. In connection with the proposed offering, an offering circular was prepared by the First Humanics working group, which included Goodman. However, prior to closing, First Humanics defaulted on numerous municipal bonds. In light of this and First Humanics' deteriorating financial condition, there were no additional First Humanics offerings. As a result, Sutliffe utilized IEC to acquire Colonial Gardens through an offering of tax-exempt municipal bonds. However, IEC was simply a successor corporation to First Humanics and performed the same function. In fact, former First Humanics directors served as directors for IEC. Furthermore, the company responsible for managing First Humanics' nursing homes performed a similar role for IEC and managed both entities' nursing homes at the same time. In some instances, assets were even intermingled between the two companies. In addition, the IEC-Colonial Gardens working group was virtually identical to the one for Medicos as each member had nearly the same role. Likewise, the terms of First Humanics' and IEC's offerings were almost identical.

u. Although Sutliffe was not a named officer or director of IEC, he controlled the company. IEC's officers and directors were generally Sutliffe's friends or business associates and acted under his direction. As with First Humanics, Sutliffe determined which nursing homes IEC would acquire. Sutliffe also dominated and controlled the Colonial Gardens offering process. In connection therewith, Sutliffe arranged to have the City of Boonville issue $3,795,000 in tax-exempt bonds to be used to purchase Colonial Gardens. Sutliffe also directed IEC to issue $380,000 in taxable bonds to finance the issuance costs. Although there were two separate offering circulars, one for the tax-exempt bonds and another for the taxable bonds, the substantive disclosures contained in the two offering circulars were virtually identical. Sutliffe also assembled the working group and acted as the offering coordinator. As such, Sutliffe determined working group members, time schedules, and the sources and uses of bond proceeds. Although each working group member had specific duties, their activities were primarily directed by Sutliffe. In this manner, Sutliffe acted as the promoter for the Colonial Gardens offering.

v. The primary purpose of the Colonial Gardens offering circulars was to provide the investing public with all material facts related to the Colonial Gardens offering. As the representative and principal of the lead underwriter, Goodman was one of those responsible for the preparation and contents of the final offering circulars distributed to the investing public. Despite Goodman's knowledge of the above facts, however, the Colonial Gardens offering circulars omitted to disclose numerous material facts. Despite Sutliffe's active role in both IEC's operations and in the Colonial Gardens offering, there was no mention of him in the offering circulars. As a result, neither his role in the offering nor his control over IEC was disclosed. Similarly, there was also no disclosure concerning Sutliffe's prior bond failures or his securities

law sanction. In addition, the Colonial Gardens offering circulars contained virtually no disclosures concerning the nexus between First Humanics and IEC. Thus, no pertinent information concerning First Humanics' poor financial performance or its defaults on municipal bonds similar to those of Colonial Gardens was disclosed. Instead, the Colonial Gardens offering circulars highlighted First Humanics' high nursing homes occupancies. These high occupancies made it appear that First Humanics' nursing homes were financially viable when, in fact, such nursing homes were unable to pay their debt service. As a result, investors were unaware that the same persons, namely management, Sutliffe and company counsel, among others, responsible for the financial problems of a predecessor not-for-profit corporation, were now involved in IEC and the Colonial Gardens offering.

w. Goodman, as underwriter's representative, participated in working group meetings, reviewed the Colonial Gardens offering circulars and related offering documents, and analyzed investment risks. Through Goodman's role as principal and controlling person of GRA and through his participation in the First Humanics and Colonial Gardens offering process, Goodman was aware of the above material facts. In light of his participation in the preparation of the Colonial Gardens offering circulars, Goodman knew or was reckless in not knowing that the offering circulars omitted and misrepresented these facts. However, despite this knowledge, Goodman, through GRA, distributed the Colonial Gardens offering circulars to the investing public and caused the bonds to be sold.

x. Respondent Goodman willfully violated Section 17(a) of the Securities Act in that he, in the offer or sale of certain securities, namely Medicos and Colonial Gardens municipal bonds and First Humanics and IEC corporate bonds described in paragraphs III. (a), (b), (o) and (u) above, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, employed devices, schemes or artifices to defraud; obtained money or property by means of untrue statements of material facts or omissions 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; or engaged in transactions, practices or courses of business which operated as a fraud or deceit upon purchasers or prospective purchasers. As part of the aforesaid conduct, Respondent made misrepresentations and omissions of material facts to purchasers and prospective purchasers concerning, among other things, Sutliffe's role in promoting the offerings, Sutliffe's control over First Humanics and IEC as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; First Humanics' on-going Ponzi scheme; and the nexus between First Humanics and IEC.

y. Respondent Goodman willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder in that he, in connection with the purchase or sale of certain securities, namely Medicos and Colonial Gardens municipal bonds and First Humanics and IEC corporate bonds described in paragraphs III. (a), (b), (o) and (u) above, by use of the means or instrumentalities of interstate commerce or by the use of the mails, directly or indirectly, employed devices, schemes or artifices to defraud; made untrue statements of material facts or 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; or engaged in acts, practices or courses of business which operated as a fraud or deceit. As part of the aforesaid conduct, Respondent made misrepresentations and omissions of material facts to purchasers and sellers concerning, among other things, Sutliffe's role in promoting the offerings, his control over First Humanics and IEC as well as his regulatory history and numerous prior bond and business failures; First Humanics' prevalent commingling of revenues from past nursing home projects and the resulting financial interdependence of all First Humanics nursing homes; the Illinois Medicaid problem; First Humanics' on-going Ponzi scheme; and the nexus between First Humanics and IEC.

z. On April 28, 1995, the United States District Court for the Eastern District of Michigan, in Securities and Exchange Commission v. Michael S. Goodman and Harold A. Tzinberg, (Civil Action No. 95-CV-71563), entered a Final Judgment of Permanent Injunction and Other Equitable Relief by consent against

Goodman. The order enjoins Goodman from future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

In view of the foregoing, it is in the public interest to impose the sanctions agreed to in the Offer.

ACCORDINGLY, IT IS HEREBY ORDERED THAT Michael S. Goodman be barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company.

In re Preston C. Bynum, Exchange Act Release No. 35870, A.P. File No. 3-8729 (June 20, 1995).

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings pursuant to Sections 15(b)(6) and 15B(c)(4) of the Securities Exchange Act of 1934 ("Exchange Act") be, and they hereby are, instituted against Preston C. Bynum ("Respondent" or "Bynum") to determine what action, if any, is necessary in light of the permanent injunction entered against Preston C. Bynum by the United States District Court for the Northern District of Florida on June 6, 1995.

II.

In anticipation of the institution of these proceedings, Bynum has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except for those contained in Section III.A, III.B, and III.C below, which are admitted, Bynum consents to the issuance of this Order, the entry of the findings contained herein and the imposition of the sanctions set forth below.

III.

The Commission makes the following findings: n1

A. From February 1983 through February 1995, Bynum was associated with Stephens Inc. ("Stephens"), a broker-dealer and municipal securities dealer registered with the Commission pursuant to Sections 15 and 15B(a) of the Exchange Act;

B. Bynum is permanently enjoined by judgment of the United States District Court for the Northern District of Florida, in the action styled Securities and Exchange Commission v. Terry D. Busbee and Preston C. Bynum ("SEC v. Busbee"), Civil Action No. 95-30024 RV (N.D. Fla., judgment entered June 6, 1995), from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-20 of the Municipal Securities Rulemaking Board.

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n1 The findings herein are solely for the purpose of these proceedings. These findings are not binding on any other person named or not named as a defendant or respondent in any other proceeding.

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C. On March 3, 1993, Bynum pleaded guilty to one count of theft or bribery concerning programs receiving federal funds in violation of *18 U.S.C. § 666,* in United States District Court for the Northern District of Florida in the action styled United States v. Preston C. Bynum, 95-03001/RV.

D. The Commission's complaint in SEC v. Busbee alleges that, from at least 1990 through at least 1993, Bynum defrauded the Escambia County Utilities Authority ("ECUA") and investors in three offerings of municipal securities issued by the ECUA. According to the complaint, Bynum, then an employee of Stephens, a municipal securities underwriter, provided certain benefits to an elected public official of the ECUA during a time when the official had an important role in selecting the underwriter for municipal securities issued by the ECUA and, in fact, voted on three separate occasions to select Bynum's employer as the underwriter or senior managing underwriter for ECUA municipal securities issues. The Complaint further alleges that, although under a duty to do so, Bynum failed to disclose to the ECUA and investors in the three offerings the benefits Bynum provided to the official and the conflicts of interest created by those financial arrangements.

IV.

Based on the foregoing, the Commission deems it appropriate and in the public interest to impose the following sanctions specified in Bynum's Offer.

Accordingly, it is ORDERED that, effective immediately, Bynum be, and he hereby is, barred from association with any broker, dealer, investment adviser, investment company, or municipal securities dealer.

In re George L. Tuttle, Jr. and Alexander S. Williams, Exchange Act Release No. 35605, A.P. File No. 3-8668 (April 14, 1995).

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings be instituted pursuant to Section 15B(c) of the Securities Exchange Act of 1934 ("Exchange Act") against George L. Tuttle, Jr. ("Tuttle") and Alexander S. Williams ("Williams").

II.

In anticipation of the institution of this administrative proceeding, Tuttle and Williams have each submitted an Offer of Settlement ("Offer"), which the Commission, after due consideration, has determined is in the public interest to accept. Solely for the purpose of this proceeding, and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained in this Order Instituting Public Administrative Proceedings Pursuant to Section 15B(c) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions ("Order"), except as to the entry of the injunction set forth in Section IV.E. below, which Tuttle and Williams each admits, Tuttle and Williams each consents to the issuance of this Order and to the entry of the findings and the imposition of the remedial sanctions set forth below.

Accordingly, IT IS ORDERED that a public administrative proceeding pursuant to Section 15B(c) of the Exchange Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offers, the Commission finds that nl:

A. Since in or about December l975, First Fidelity Securities Group ("FFSG") has been a municipal securities dealer registered with the Commission pursuant to Section l5B(a) (2) of the Exchange Act. It is also a separately identifiable department of the treasury division of First Fidelity Bank, N.A. ("FFB"), which in turn is a wholly-owned subsidiary of First Fidelity Bancorporation, a bank holding company.

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nl The findings herein are not binding on anyone other than the Respondents.

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B. From in or about January 1983 to in or about November 1994, Tuttle was associated with FFSG and was a senior vice president of FFB.

C. From in or about September 1970 to in or about December 1994, Williams was associated with FFSG. Williams was the head of FFSG and an executive vice president of FFB.

D. Tuttle and Williams each willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), sections 10(b) and 15B(c) (1) of the Exchange Act and Rule 10b-5, and Rules G-17 and G-20 of the Municipal Securities Rulemaking Board (“MSRB”). Tuttle agreed to make undisclosed payments to Consolidated Financial Management, Inc. ("CFM"), the financial advisor of the Camden County Municipal Utilities Authority ("CCMUA"), to assure FFSG's continued participation as book-running senior manager for the CCMUA's February 1990 offering of approximately $ 237,000,000 of debt securities. Pursuant to this agreement, and with Williams' knowledge and approval, Tuttle caused FFSG to pay over $ 200,000 to CFM between February and April 1990. Tuttle and Williams also willfully violated Section 15B(c) (1) of the Exchange Act and MSRB Rule G-8 by failing to record these payments on FFSG's municipal securities dealer books and records.

E. On February 23, 1995, the Commission filed a complaint in SEC v. Nicholas A Rudi, et al., 95 Civ. 1282 (LAK) (S.D.N.Y.), alleging that Tuttle and Williams, among others, engaged in the conduct described in Section IV.D., above. In that civil action, on March 21, 1995, Tuttle and Williams were permanently enjoined on consent by the United States District Court for the Southern District of New York from future violations of Section 17 (a) of the Securities Act, Sections 10(b) and 15B(c) (1) of the Exchange Act, Rule 10b-5, and MSRB Rules G-8, G-17 and G-20. Tuttle and Williams neither admit nor deny the allegations in the complaint.

IV.

In view of the foregoing, the Commission finds it is in the public interest to impose the sanctions specified in the Offer.

Accordingly, it is ORDERED that, effective immediately, Tuttle and Williams be, and hereby are, barred from association with any broker, dealer, investment adviser, investment company or municipal securities dealer.

In re Matthews & Wright Group, Inc., Exchange Act Release No. 34-26841, A.P. File No. 3-7191 (May 19, 1989).

I. INTRODUCTION

The Commission deems it appropriate and in the public interest that proceedings pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934 (‘Exchange Act’) be, and they hereby are, instituted with respect to Matthews & Wright, Inc. (‘M&W Inc.’ or the ‘Company’) to determine what action, if any, is necessary in light of the permanent injunction entered against M&W Inc. by the United States District Court for the Southern District of New York on May 4, 1989.

Simultaneously with the institution of this proceeding, M&W Inc. has submitted an Offer of Settlement (‘Offer’) for the purpose of settling the issues raised by this proceeding. Under the terms of this Offer, M&W Inc. consents to the issuance of the Order Instituting Proceedings Pursuant to 15(b)(4) of the Securities Exchange Act of 1934 and Findings and Order of the Commission (‘Order’) set forth herein.

The Commission has determined that is appropriate and in the public interest to accept M&W Inc.'s Offer of Settlement and accordingly is issuing this Order.

II. FINDINGS

The Commission finds as follows:

(I) That the Commission filed a Complaint for Permanent Injunction against M&W Inc. on April 27, 1989 in the United States District Court for the Southern District of New York in the action styled Securities and Exchange Commission v. Matthews & Wright Group, Inc., et al., 89 CIV.2877;

(ii) That Respondent, without admitting or denying any allegations of the Complaint, except as to jurisdiction admitted, consented to the entry of a Final Judgment of Permanent Injunction as to M&W Inc.; and

(iii) That on May 4, 1989 pursuant to the filing of the Complaint and Consent, the United States District Court for the Southern District of New York entered a Final Judgment of Permanent Injunction enjoining Respondent from violations of Section 17(a) of the Securities Act of 1933 ('Securities Act'), Sections 10(b), 15(c)(1), 15B(c)(1) and 17(a) of the Exchange Act, Rules 10b-5, 15cl-2 and 17a-5 promulgated thereunder, and Rules G-8, G-9, G-14 and G-17 of the Municipal Securities Rulemaking Board.

III. OFFER OF SETTLEMENT

M&W Inc. has submitted an Offer of Settlement in which it consents, without admitting or denying any of the allegations of the Complaint for Permanent Injunction served upon it, except as to jurisdiction, to the issuance of this Order revoking its registration with the Commission as a broker-dealer on the bases, as provided in Section 15(b)(4)(C) of the Exchange Act, that the Company is permanently enjoined by order of a court of competent jurisdiction from engaging in any conduct or practice in violation of Section 17(a) of the Securities Act, Sections 10(b), 15(c)(1), 15B(c)(1) and 17(a) of the Exchange Act, Rules 10b-5, 15cl-2 and 17a-5 promulgated thereunder, and Rules G-8, G-9, G-14, and G-17 of the Municipal Securities Rulemaking Board. The Commission deems it appropriate and in the public interest to accept this Offer of Settlement.

IV. ORDER

IT IS HEREBY ORDERED that the registration of M&W Inc. with the Commission as a broker-dealer be, and it hereby is, revoked.

In re Bullington-Schas & Co., Inc., Exchange Act Release No. 17832, A.P. File No. 3-6028 (June 1, 1981).

I.

The Commission deems it appropriate that public administrative proceedings be instituted with regard to Bullington-Schas & Co., Inc. ("Bullington-Schas"), a registered broker-dealer, a member of the National Association of Securities Dealers, Inc., and a member of the Philadelphia Stock Exchange and the Cincinnati Stock Exchange; A. Dulaney Tipton ("Tipton"), the president, a director and owner of more than 50% of Bullington-Schas' common stock; and Terry Allen Frost ("Frost"), a securities salesman associated with Bullington-Schas (collectively, the "Respondents"), alleging that Respondents willfully violated Section 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act") in connection with the offer and sale of revenue bonds of the Calhoun County Medical Facility, Inc. (hereinafter "Calhoun County") of Bruce, Mississippi, n1 and that Tipton failed reasonably to supervise Frost and others in connection with the offering.

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n1 See Securities Exchange Act of 1934 Release No. 17831 containing a report issued by the Commission pursuant to Section 21(a) of the Securities Exchange Act of 1934 concerning William M. Gotten, underwriter's counsel; and Litigation Release No. 9366, discussing the institution of a Commission injunctive action and the issuance of permanent injunctions against the Respondents herein and others, which action arises directly from the factual basis for the instant matter.

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II.

In connection with the administrative proceedings, each of the Respondents has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings, without admitting or denying the allegations or findings herein, Respondents Bullington-Schas, Tipton and Frost consent to the entry of the findings and sanctions set forth below.

III.

Accordingly, it is ORDERED that administrative proceedings pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 be, and they hereby are, instituted.

On the basis of the Order for Proceedings and the Offers of Settlement, it is found that:

1. In or about October 1977, Respondent Bullington-Schas acted as underwriter in connection with a $1.8 million public bond offering by Calhoun County for the purchase of an existing hospital;

2. In connection with the underwriting, Respondents Bullington-Schas, Tipton and Frost, among others, were responsible for the preparation and dissemination of an Offering Circular containing certain information with respect to Calhoun County and the bond offering;

3. The foregoing Offering Circular contained certain pro forma financial statements and projections relating to future revenues and income of Calhoun County, which statements and projections were prepared by an independent firm with experience in such matters;

4. In connection with its operations during the period 1971-76, the hospital prepared or caused to be prepared certain unaudited financial statements which reflected lower revenues and higher bad debt losses than the pro forma statements and projections referred to hereinabove, and which financial statements reflected operating losses or nominal profits during said period;

5. Respondents Bullington-Schas, Tipton and Frost, among others, determined not to include in the offering circular the prior unaudited financial statements described herein;

6. In failing to include the prior unaudited financial statements in the Offering Circular, Respondents Bullington-Schas, Tipton and Frost willfully violated and aided and abetted violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act in that, among other things, they failed to disclose material facts to purchasers of the Calhoun County bonds concerning, but not limited to, those matters set forth in item 4 hereinabove.

7. Respondent Tipton failed reasonably to supervise securities salesmen associated with Bullington-Schas; and

8. It is in the public interest to impose the sanctions contained in the Officers of Settlement.

In imposing the sanctions herein, the Commission recognizes the existence of certain mitigating factors, including the Respondents' cooperation in the staff's investigation and their prior inexperience as a principal underwriter of municipal securities.

IV.

Accordingly, it is ORDERED that:

1. Respondent Bullington-Schas be, and hereby is, censured;

2. Respondent Tipton be, and hereby is, suspended from association with any broker or dealer for a period of five (5) business days, said period of suspension to commence on the second Monday following the date on which the Order instituting these proceedings is entered by the Secretary of the Commission.

3. Respondent Frost be, and hereby is, suspended from association with any broker or dealer for a period of fifteen (15) business days, said period of suspension to commence on the second Monday following the date on which the Order instituting these proceedings is entered by the Secretary of the Commission.

4. Respondent Bullington-Schas comply with its undertaking that within thirty (30) days following the date of entry of this Order by the Secretary of the Commission, it shall retain the services of a person or persons knowledgeable in the matter of broker-dealer compliance with the federal securities laws.

a) to conduct a review of Respondent Bullington-Schas' due diligence and compliance procedures with respect to its activities as a principal underwriter of municipal securities, and

b) to prepare a manual of due diligence and compliance procedures which shall be adopted, implemented and adhered to by Respondent and its employees in all of its future principal underwritings of municipal securities.

5. Respondents Tipton and Frost comply with their undertaking to enroll in and complete a course of study for municipal bond principals which course is not objectionable to the staff of the Commission and which will be conducted by a recognized firm that administers such courses.

In re First Citizens Municipal Corp., Exchange Act Release No. 16725, A.P. File No. 3-5900 (April 8, 1980).

I.

The Commission deems it appropriate that public administrative proceedings be instituted with regard to First Citizens Municipal Corporation ("First Citizens"), a registered broker-dealer and a member of the National Association of Securities Dealers, Inc.; Michael A. C. Siemer ("Siemer"), the president and a director of First Citizens; Paul A. Goldberg ("Goldberg"), the secretary-treasurer and a director of First Citizens; Thomas F. Ventresca ("Ventresca"), a vice-president of First Citizens; Ronald C. Fontane, an employee of First Citizens and Robert J. Seifert ("Seifert"), Jon W. Montesinos ("Montesinos"), Gary J. Pollack ("Pollack"), Alan Richard Holman ("Holman"), Richard T. Tanaka ("Tanaka"), Charles P. Bernstein ("Bernstein"), John A. Adamek ("Adamek"), Paul S. Whitaker ("P. Whitaker"), Frederick Whitaker, III ("F. Whitaker"), Richard C. Ellis ("Ellis"), Robert J. Lubin ("Lubin"), Nicholas H. Keegstra ("Keegstra") and Richard A. Williamson ("Williamson"), who are all securities salesmen associated with First Citizens [First Citizens and all of the above-listed individuals are hereinafter collectively referred to as the "Respondents"], alleging that Respondents willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder in connection with the offer and sale of revenue bonds of the Park Nursing Center, Inc. (hereinafter "PNC"), Taylor, Michigan.

II.

In connection with the administrative proceedings, each of the Respondents has submitted Offers of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings, without admitting or denying the allegations or finding herein, Respondents First Citizens, Siemer, Ventresca, Goldberg, Montesinos, Seifert, Pollack, Holman, Tanaka, Bernstein, Adamek, P. Whitaker, F. Whitaker, Ellis, Lubin, Keegstra and Williamson consent to the entry of findings and sanctions set forth below.

Accordingly, it is ORDERED that administrative proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act be and they hereby are instituted.

On the basis of the Order for Proceedings and the Offers of Settlement, it is found that:

1. Respondents First Citizens, Montesinos, Seifert, Pollack, Holman, Tanaka, Bernstein, Adamek, P. Whitaker, F. Whitaker, Ellis, Lubin, Keegstra and Williamson willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that, among other things, they each made certain of the following misrepresentations and they each failed to disclose certain of the following material facts to purchasers of PNC bonds:

(a) The insolvency of the issuer;

(b) Regulatory enforcement proceedings by the States of Arizona and Michigan;

(c) Liabilities involving real estate taxes and income tax liabilities;

(d) The significance of the ratio of Medicare/Medicaid patients to private paying patients and its potential adverse impact on PNC's financial condition;

(e) That this was a "safe investment;"

(f) That "there was no risk in the bonds;"

(g) That "there was no risk in the bonds because the nursing home was 80% occupied and making money;"

(h) That "the purpose for the issuance of the bonds was to refund some 10% bonds that had been issued two years earlier in order to save money on the difference in interest rates;"

(i) That "one of the trustees purchased $125,000 so it must be a good issue;"

2. Respondents Siemer, Ventresca and Goldberg have failed reasonably to supervise the other individual respondents herein who were subject to their supervision with a view toward preventing certain of the violations in paragraph 1 above which were committed by such persons.

3. Respondents Siemer, Ventresca and Goldberg willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that, among other things, they participated in certain of the violations set forth in paragraph one (1) above.

4. Respondents Fontaine willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that, among other things, he participated in certain of the violations set forth in paragraph one (1) above.

5. It is in the public interest to impose the sanctions contained in the Offers of Settlement.

Accordingly, IT IS ORDERED that:

1. Respondent First Citizens be, and hereby is, censured;

2. Respondent First Citizens shall comply with its undertakings, including the provision by independent sources, of further training for each of its registered representatives in the duties and responsibilities imposed upon them by the federal securities laws.

3. Respondent First Citizens shall comply with its undertaking to have each of its registered representatives take the Series 7 Examination of the National Association of Securities Dealers, Inc.

4. Respondent Siemer be, and hereby is, suspended from association with any broker or dealer or investment adviser for a period of twenty-two (22) business days; said period of suspension to commence on the second Monday following the date of the Order instituting these proceedings.

5. Respondent Ventresca be, and hereby is, suspended from association with any broker or dealer or investment adviser for a period of fifteen (15) business days; said period of suspension to commence on the first business day following termination of the suspension of Respondent Siemer.

6. Respondent Goldberg be, and hereby is, suspended from association with any broker or dealer or investment adviser for a period of fifteen (15) business days; said period of suspension to commence on the first business day following termination of the suspension of Respondent Ventresca.

7. Respondents Montesinos, Williamson and Keegstra be, and hereby are, suspended from association with any broker or dealer or investment adviser for a period of twelve (12) business days; said periods of suspension to commence on the second Monday following the date of the Order instituting these proceedings.

8. Respondents Adamek, Holman, F. Whitaker, Seifert, and P. Whitaker be, and hereby are, suspended from association with any broker or dealer or investment adviser for a period of ten (10) business days; and periods of suspension to commence on the second Monday following the date of the Order instituting these proceedings.

9. Respondents Tanaka and Bernstein be, and hereby are, suspended from association with any broker or dealer or investment adviser for a period of eight (8) business days; said periods of suspension to commence on the second Monday following the date of the Order instituting these proceedings.

10. Respondents Pollack, Lubin, Fontaine, and Ellis be, and hereby are, suspended from association with any broker or dealer or investment adviser for a period of five (5) business days; said periods of suspension to commence on the second Monday following the date of the Order instituting these proceedings.

11. Respondents Montesinos, Seifert, Pollack, Holman, Tanaka, Bernstein, Adamek, P. Whitaker, F. Whitaker, Ellis, Lubin, Keegstra, and Williamson shall comply with their undertaking to acquire further education and training in their duties and responsibilities imposed upon them by the federal securities laws with a view toward taking the Series 7 Examination of the National Association of Securities Dealers, Inc.

In re Rovinsky & Co., Inc., Exchange Act Release No. 15451, A.P. File No. 3-5609 (January 2, 1979).

The Securities and Exchange Commission has ordered the institution of public administrative proceedings pursuant to Sections 15(b), 15B(c), and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") against Rovinsky & Co., Inc., a registered broker-dealer and municipal securities dealer, and Elliot Ben Rovinsky of Scottsdale, Arizona.

The Commission's Order for Proceedings alleges that the respondents willfully violated Sections 5 and 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Order for Proceedings charges that the respondents made false and misleading statements to purchasers of bonds issued by Park Nursing Center, Inc. of Taylor, Michigan. More specifically, the respondents are charged with making false and misleading statements with regard to the risks of an investment in said bonds, the financial condition of the issuer, various potential conflicts of interest and the amount of compensation paid to the respondents for their role in underwriting the sale of these bonds to the public. In addition, the Order alleges that the respondents sold unregistered securities, namely Park Professional Center 12% First Mortgage Series 1 bonds.

A hearing will be scheduled by further Order to determine whether the allegations are true, to afford the respondents an opportunity to offer any defense and to determine whether any remedial action is necessary or appropriate in the public interest.

In re Rovinsky & Co., Inc., Exchange Act Release No. 15756, A.P. File No. 3-5609 (April 23, 1979).

In these broker-dealer and municipal securities dealer proceedings under the Securities Exchange Act of 1934 ("Exchange Act"), n1 Respondents Rovinsky & Co., Inc. ("Registrant") and Elliot Ben Rovinsky ("Rovinsky"), Registrant's president and controlling shareholder, without admitting or denying the substantive allegations of the Order for Proceedings, have submitted an offer of settlement which the Commission has determined to accept.

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n1 In the Matter of Rovinsky & Co., Inc., et al., instituted on December 12, 1978. See Securities Exchange Act of 1934 Release No. 15451, *16 SEC Docket 589* (January 2, 1979).

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On the basis of the Order for Proceedings and the offer of settlement, the Commission finds that Registrant and Rovinsky willfully violated, and willfully aided and abetted violations of, Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as alleged in the Order for Proceedings.

It is, therefore, in the public interest to impose the sanctions specified in the offer of settlement.

Accordingly, IT IS ORDERED that, effective at the opening of business on the second Monday after the date of this Order:

(1) Rovinsky be, and hereby is, suspended for a period of twelve months from being associated with any broker, dealer, municipal securities dealer, investment company, or investment adviser;

(2) For a period of three years after the suspension described in paragraph (1) hereof, the activities and functions of Rovinsky be, and they hereby are, limited in that Rovinsky is prohibited from being associated with any broker, dealer, municipal securities dealer, investment company, or investment adviser in any supervisory or proprietary capacity, and further, if Rovinsky thereafter becomes associated in any such capacity, he shall file with the Commission, prior to assuming any such position, an affidavit describing his experience and the affirmative steps he has taken to qualify himself for such a position;

(3) For a period of three years after the suspension described in paragraph (1) hereof, the activities and functions of Rovinsky be, and they hereby are, also limited in that he is prohibited from being associated with any broker, dealer, municipal securities dealer, investment company, or investment adviser unless he has filed an affidavit with the Commission: (a) affirming that he has complied with the aforesaid suspension; (b) affirming that he is not assuming any supervisory or proprietary position with such firm; and (c) demonstrating that the broker, dealer, municipal securities dealer, or other firm or entity which employs him, or with which he becomes associated, has instituted adequate supervisory procedures, and shall adequately implement such procedures with respect to Rovinsky; and

(4) The broker-dealer registration and municipal securities dealer registration of Registrant are hereby ordered withdrawn.

In re Midwest Securities Co., Exchange Act Release No. 14544 (March 8, 1978).

The Securities and Exchange Commission has ordered public administrative proceedings under the Securities Act of 1934, as amended ("Exchange Act"), against Midwest Securities Co., ("Midwest") and Arthur Bruce Weichelt of Chicago, Illinois and Howard Herndon Percy of St. Louis, Missouri.

The proceedings are based upon allegations of the Commission's staff that the respondents violated the antifraud provisions of the Securities Act of 1933 and the Exchange Act in the offer and sale of municipal bonds while acting as underwriter to various municipalities in certain revenue refunding bond issues. The order for proceedings alleges that Weichelt and Percy aided and abetted Midwest in violating the antifraud provisions of the Securities Act and Exchange Act by utilizing an interim financing and immediate refunding scheme to circumvent the effect of an Illinois Statute that limited the net cost that could be paid by a municipality in the sale of its bond issues. The Order alleges that pursuant to the scheme Midwest purchased an interim revenue bond at a discount such that the net interest cost to the issuing municipality did not exceed the statutory interest rate and then immediately either exchanged the aforesaid revenue bonds at par for refunding bonds issued at the statutory interest rate, or caused the municipality to issue refunding bonds at par at the statutory interest rate with the proceeds from such sale deposited in an escrow account subsequent to which Midwest sold the refunding issue and presented the aforesaid revenue bond to the escrow agent for redemption at par.

The Order also alleges that Midwest, Weichelt and Percy distributed offering circulars that failed to disclose the aforementioned scheme.

A hearing will be scheduled by further order to take evidence on the staff allegations and to afford the respondents an opportunity to offer any defense thereto, for the purpose of determining whether the allegations are true and if so, whether any action of a remedial nature should be ordered by the Commission.

In re Midwest Securities Co., Exchange Act Release No. 14919, A.P. File No. 3-5391 (July 3, 1978).

In these broker-dealer proceedings under the Securities Exchange Act, Midwest Securities Co. (Registrant), a registered municipal securities dealer; Howard Herndon Percy ("Percy"), and Arthur Bruce Weichelt ("Weichelt"), partners, have submitted an offer of settlement, without admitting or denying the allegations in the order for proceedings, which the Commission has determined to accept.

On the basis of the order for proceedings and the offer of settlement, it is found that Modwest, Percy and Weichelt willfully n1 violated and willfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 (Securities Act), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as allege in Paragraphs II B1(a) and (b), II B2(a)-(d), that portion of II B2(e) which states that "the bonds were issued in deliberate circumvention of an Illinois statute which establishes a maximum rate of interest on municipal bonds" and II C of the Order.

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n1 "For the purposes of this Offer, the term "willfully", as defined by the Second Circuit in *Tager v. Securities and Exchange Commission, 344 F.2d 5 (2d Cir. 1965),* shall mean that the actions alleged in the order were knowingly done by the respondents but without knowledge of any violation of, or intent to violate the federal securities laws."

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ACCORDINGLY, IT IS ORDERED THAT:

(1) (a) Respondent Midwest's registration with the Commission as a broker-dealer be suspended for twenty-one (21) calendar days, and

(b) Respondents Percy and Weichelt be suspended from being associated with Midwest, or any other registered broker-dealer, for twenty-one (21) calendar days, said suspensions to commence the second Monday following the week in which this Order is entered.

(2) Midwest retain experienced securities counsel to review their future securities underwritings.

(3) In connection with any future underwriting of a municipal bond refunding issue used to refund or redeem an earlier municipal bond issue Midwest shall obtain an opinion from experienced municipal bond counsel that such bonds were issued in conformity with the requirements of Illinois law, including the statutory interest rate limitations.

For the Commission, by its Secretary, pursuant to delegated authority.

In re Carl Hanauer & Co., Exchange Act Release No. 9099, A.P. File No. 3-723 (March 12, 1971).

These were private proceedings pursuant to Section 15(b) of the Securities Exchange Act 0f 1934 (“Exchange Act”) in which Carl Hanauer & Company (“Hanauer Co.”) , a California corporation which held itself out to the public as a specialist in municipal bonds, issued by the State of California and its political subdivisions, and Carl Hanauer, who was president and the principal stockholder of Hanauer Co., have submitted an offer of settlement.

Under the terms of the offer, respondents waived a hearing and post-hearing procedures and, solely for the purpose of settlement of these proceedings, and without admitting the violations alleged in the order for proceedings, consented to findings of willful violations of certain provisions of the Exchange Act alleged in such order, and to the entry of an order imposing certain sanctions.

After due consideration of the offer of settlement and upon the recommendation of its staff, the Commission determined to accept such offer.

On the basis of the order for proceedings and the offer of settlement, is found that from about July 1, 1962 to about September 1963 respondents, singly and in concert, willfully violated and willfully aided and abetted violations of Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15cl-2 thereunder in the offer and sale of “5-1/2% Act Improvement Bonds of Rio Ramaza Community Services District, Sutter County, California”, which were speculative and unseasoned securities.

Respondents represented that such securities were “good tax-exempt bonds”, “high-grade municipal bonds” and “good secure bonds”, although they were aware or upon reasonable inquiry would have become aware of information casting doubt upon the ability of the issuer to meet the payments thereon as they become due, including the fact that the land included within the Rio Ramaza Community Service District (“District”) was owned by one individual who would be unable to meet the assessments necessary

to service such bonds. In addition, respondents made untrue and misleading statements concerning the District's financial condition, ability to meet its financial obligations, and prospective income, the purpose of the bond issue and the use of proceeds to be derived therefrom, the amount of the underwriting discount to be derived by Hanauer Co. and others, the ownership of the land within the District and the background and financial condition of its sole owner, the nature and method of financing a marina or boat harbor to be operated by such owner as part of the development of the land comprising the District, the identity and interrelationship of the persons instrumental in forming the District, the assessed value of the land included within the District as compared to the valuation placed thereon for purposes of selling the bonds, and unfavorable factors relating to the land which might inhibit its sale and the consequent effect on the District's ability to meet its obligations.

The settlement offer submitted by respondents provided that an order may be entered suspending them from association with any broker or dealer for a period of six months. It further provided that thereafter Hanauer shall not be barred by virtue of such order from any future association in the securities industry but that he would not enter into such association without first submitting to the Commission a full statement of all the facts, circumstances and conditions thereof, with specific regard to control and review of transactions in which he may or will engage. In support of the settlement offer respondents state that Hanauer Co. is defunct and that for about seven years Hanauer has not engaged in or been connected with the securities industry.

It is concluded that it is appropriate in the public interest to impose the sanctions specified in the offer of settlement.

Accordingly, IT IS ORDERED that Carl Hanauer & Company and Carl Hanauer be, and they hereby are, suspended from being associated with any broker or dealer for a period of six months from the date of this order, subject to the terms, conditions, and undertaking specified above.

For the Commission, by the Office of Opinions and Review, pursuant to delegated authority.

In re Walston & Co. Inc., and Harrington, Exchange Act Release No. 8165 (September 22, 1967).

These proceedings were instituted pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act") to determine what remedial action, if any, should be taken in the public interest with respect to Walston & Co., Inc. ("registrant"), a registered broker-dealer and Gregory I. Harrington, who had been a vice president of registrant and manager of the Municipal Bond Department of the Western Division of registrant at its office in San Francisco, California. The order for proceedings among other things alleged violations of the anti-fraud provisions of the Exchange Act and of the Securities Act of 1933 ("Securities Act"), in connection with the offer and sale of securities of the Rio Ramaza Community Services District, Sutter County, California ("Rio Ramaza District"), during the period from about May to September 1963.

Registrant and Harrington submitted offers of settlement, accompanied by a stipulation of facts, in which they waived hearings and post-hearing procedures and without admitting any of the allegations of the order for proceedings or any violation of law, consented to findings that they had willfully violated the anti-fraud provisions as alleged in the order for proceedings. They further consented to the entry of an order censuring respondents; directing registrant, subject to certain conditions, to suspend for a period of 30 days all operations of its National Municipal Bond Department; and suspending Harrington from being associated with any broker or dealer for a period not to exceed six months, provided that such order shall not constitute a bar to his employment or association in the securities business after the expiration of the suspension period. Our Division of Trading and Markets recommended that the offers be accepted, and for the reasons hereinafter set forth, we have determined to accept such offers.

On the basis of the allegations in the order for proceedings, and the stipulations, consents and offers of the respondents, we make the following findings.

Registrant is a Delaware corporation formed in 1955 as a successor to a partnership which had been in existence since 1932. It is a member of the New York Stock Exchange and other principal securities and commodities exchanges, as well as of the National Association of Securities Dealers, Inc., and had principal offices in New York, Chicago and San Francisco. In January 1963, registrant acquired the assets and business of a firm which had been engaged in the municipal bond filed. Harrington had been manager of the municipal bond department of the other firm, and he then became a vice president and manager of the municipal bond department of registrant's Western division headquartered in San Francisco, California.

In May 1963, Harrington, who had authority to commit registrant to participation in municipal bond offerings up to $1,500,000 at any one time, entered into an agreement on behalf of registrant with another dealer which represented itself as a specialist in California municipal bonds. Pursuant to this agreement registrant purchased $250,000 principal amount of a $555,000 issue of 5 1/2% bonds issued by the Rio Ramaza District for which the other dealer acted as principal underwriter. In June and July 1963, registrant as dealer sold the $250,000 of bonds to 34 of its customers then residing in California, Washington, Oregon, Nebraska and Hawaii.

Although Harrington's commitments on behalf of registrant were to be subsequently reviewed by registrant's vice president in charge of its National Bond Department, registrant's records contain no evidence that the Rio Ramaza commitment was ever submitted to that Department for review beyond the routine review of the position of the municipal bond portfolio. The only information given to registrant's salesmen about the bonds was that contained in an offering circular which Harrington adapted from an offering circular of the principal underwriter and which Harrington distributed to various of registrant's offices for use by salesmen in the sale of the bonds. The offering circular bore a prominent legend "TAX FREE MUNICIPAL BONDS", recited the amount, maturity, yield and approximate price of the bonds, and identified them as bonds issued pursuant to the provisions of the California Improvement Bond Act of 1915, n1 under which they were secured by special assessments against the property in the District. It also stated that the District comprised approximately 171 acres adjacent to the Sacramento River 14 miles north of the City of Sacramento; that the bonds were being issued to pay the cost of certain improvements within the District such as streets, sidewalks, sewers and water lines; that approximately $150,000 would be spent immediately on construction of a marina; and that development of a new subdivision within the District of 123 residential lots would also begin immediately.

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n1 California Streets and Highways Code, Sections 8500 et seq.

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Registrant's salesmen recommended the purchase of the bonds, in some instances as "good" or "high grade" or "secure" tax-free municipal bonds. Various customers purchased the bonds in reliance on these specific recommendations, as well as on the general impression that the bonds were safe and conservative investments, and that registrant, as a reputable firm, would not recommend them unless they were of that quality. Various customers also obtained the impression that the bonds were issued by a district in a rapidly growing part of the country, or for the expansion of an established community, or by an established district already developed.

The recommendations and representations made to the purchasers of the bonds were highly misleading in view of the failure to disclose material facts concerning the nature of the District and its ability to meet its obligations and service the bonds. Contrary to the express and implied representations made to customers, the bonds were highly speculative and of the most dubious investment quality.

Respondents did not make known to customers that the entire tract included in the District was owned by one individual, who was a farmer and a candy vendor at county fairs who had no previous experience in selling real estate subdivisions or the financial ability to service the bonds himself; that the District had been formed by the vote of the six eligible voters on the tract, including the owner and two members of his family, who elected the owner of the land, his son and one other, as the three directors of the District. Nor were purchasers told that the District consisted entirely of undeveloped farm lands, situated 12 miles from a shopping center and with no public transportation available; that existing schools were 13 miles away; that the tract was in the general vicinity of and under the pattern of approach to a metropolitan airport and within a zone of intense noise; and that the entire tract of land in the District had a current assessed value of only $15,560. n2

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n2 This valuation was prior to the construction of improvements financed by the bonds. The assessed value was supposed to represent 25% of the fair market value.

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The fact that bond issues under the California Improvement Bond Act of 1915 and other similar acts had been widely used by cities, counties and special districts in California made it all the more necessary to inform purchasers of the Rio Ramaza bonds that in this case the assessment district was merely the newly-formed instrument of an inexperienced developer and consisted of one tract of undeveloped land not a part of any established community, and that service of the bonds depended entirely on the sale of lots in the district. At the time registrant bought the Rio Ramaza bonds and sold them to its customers, Harrington had not inspected the land and he did not know or inquire as to the financial condition of the owner and developer, although he did know that all the land in the District was owned by one individual and the facts as to the election of the directors of the District.

It is incumbent on firms participating in an offering and on dealers recommending municipal bonds to their customers as "good municipal bonds" to make diligent inquiry, investigation and disclosure as to material facts relating to the issuer of the securities and bearing upon the ability of the issuer to service such bonds. It is, moreover, essential that dealers offering such bonds to the public make certain that the offering circulars and other selling literature are based upon an adequate investigation so that they accurately reflect all material facts which a prudent investor should know in order to evaluate the offering before reaching an investment decision. The offering circular used by registrant in this situation fell far short of that standard of disclosure.

We conclude and find that registrant and Harrington willfully violated and willfully aided and abetted in violations of the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240.10b-5 and 15c1-2 thereunder in connection with their offer and sale of the Rio Ramaza bonds.

In connection with the offers of settlement, respondents cite the facts that a firm specializing in California municipal bond issues was the principal underwriter of the Rio Ramaza bonds, that the District was organized and the bonds were issued in accordance and compliance with the applicable State statutes and procedures, and that the District was advised by experienced engineers and bond counsel. It is also noted that registrant's municipal bond department in San Francisco had only recently been established following Harrington's employment. Since that time registrant has taken various actions and instituted procedures intended to correct the shortcomings in registrant's review and control of underwritings of tax-exempt issues and to prevent reoccurrence of any situation resembling the transactions in Rio Ramaza bonds. n3

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n3 Among other things, registrant will not underwrite any special assessment bonds of the California 1915 Act type which constitute new or promotional developments. While it may underwrite or sell special assessment type municipal securities relating to developments which are already existing, customers will be furnished an offering circular fully descriptive of the securities, and agreements by local managers to

underwrite or purchase substantial amounts of municipal securities will be reviewed and approved by the vice president in charge of registrant's National Municipal Bond Department. Registrant's Executive Committee will review the activities of the Municipal Bond Department periodically and no less than six times a year, and maintain a constant supervision over the activities of that Department. Harrington's employment with registrant has been terminated and he ceased to be associated with registrant effective May 31, 1967.

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Registrant has also been active in efforts to protect the interests of bondholders. The bonds came into default when the developer was unsuccessful in selling lots and could not meet the assessments necessary to service the bonds. Through the organization of a bondholders' committee and otherwise, and in large part as a result of registrant's efforts the District was reorganized, possession of the property has been obtained, and some progress has been made in selling lots for the District.

Registrant has offered to repurchase all the bonds it sold at the prices paid by the customers plus interest and also to return to each customer any contribution he made to the bondholders' committee. As of July 1967, registrant had repurchased 234 of the 250 bonds it had sold. n4

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n4 The remaining 16 bonds had been purchased by three customers. One, who purchased five bonds, did not accept registrant's repurchase offer. The other two had sold their bonds and registrant has paid them the amounts of their realized losses plus interest.

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Under the circumstances, it is concluded that it is appropriate in the public interest to accept the offers of settlement, and to censure respondents, direct that registrant suspend its municipal bond activities for a period of 30 days in accordance with its agreement, and suspend Harrington from association with a broker or dealer for a period of six months.

Accordingly, IT IS ORDERED that:

(1) Walston & Co., Inc. and Gregory I. Harrington be, and they hereby are, censured.

(2) Walston & Co., Inc. shall, for a period of 30 days beginning on October 9, 1967, suspend trading and dealing in municipal securities and the operations of its National Municipal Bond Department, provided, however, that such suspension shall not apply to (1) execution of unsolicited orders of customers, which executions shall be accomplished without commission or other remuneration to Walston, and (2) performance of Walston's obligations under Fiscal Agency Contracts or Municipal Underwriting Contracts entered into prior to October 9, 1967. Walston may apply to the Division of Trading and Markets for modification of the suspension in the event some extraordinary development in the municipal bond market makes it necessary for it to liquidate or adjust its inventory of municipal securities.

(3) Gregory I. Harrington be, and he hereby is, suspended from association with a broker or dealer for a period of six months, effective October 2, 1967, provided, however, that at the expiration of the period of such suspension these findings and order shall not constitute a bar to any future employment or association of Harrington in the securities industry.

By the Commission (Chairman COHEN and Commissioners OWENS, BUDGE, WHEAT, and SMITH).

THE FINANCIAL ADVISOR

Report under Section 21(a) of the Exchange Act

SEC, Staff Report on Transactions in the Marine Protein Corporation Industrial Development Revenue Bonds, Exchange Act Release No. 15719 (April 11, 1979).

See "OBLIGATED PERSONS" section.

Injunctive Proceedings

Securities and Exchange Commission v. John Gardner Black, Devon Capital Management, Inc., and Financial Management Sciences, Inc., Civ. Action No. 97-2257 (W.D. Pa.) Litigation Release No. 15511 (September 26, 1997) (complaint).

The Securities and Exchange Commission ("Commission") announced that, on September 26, 1997, the Honorable William L. Standish of the U.S. District Court for the Western District of Pennsylvania issued a temporary restraining order against John Gardner Black ("Black"), Devon Capital Management, Inc. ("Devon"), and Financial Management Sciences, Inc. ("FMS"). Among other things, the Order freezes the defendants' assets and appoints as Trustee over those assets Dick Thornburgh, formerly Attorney General of the United States, United States Attorney for the Western District of Pennsylvania and Governor of Pennsylvania.

The complaint alleges an on-going fraudulent scheme perpetrated by Black through Devon, a Pennsylvania-based registered investment adviser, and FMS, an affiliate of Devon's. Both Devon and FMS are wholly owned and controlled by Black. The complaint alleges that the scheme has resulted in the loss of millions of dollars of municipal bond proceeds invested by school districts throughout western and central Pennsylvania.

Devon manages approximately $345 million in assets for approximately 100 investment advisory clients, the vast majority of which are local school districts seeking to invest the proceeds of municipal bond offerings. Devon has invested approximately $233 million of these funds, on behalf of 75 local school districts, in a form of investment called a Collateralized Investment Agreement ("CIA"). In promotional materials, Devon represented to these school districts that the CIA is an investment which pays a specified rate of return over a fixed period and which is fully protected by a pool of securities equaling the amount of the school districts' total principal investment. The complaint alleges that, in fact, the school districts that have invested in the CIA program have suffered a combined loss of their principal investment of approximately $71 million.

The complaint alleges that, in an effort to conceal this loss of principal from the school districts that have invested in the CIA program, Devon and Black have misrepresented to them the value of the assets held as collateral, overstating the actual value of those assets by approximately $71 million. The complaint further alleges that Black has continued to accept new clients for investment into the CIA program without disclosing to these new clients that, as a result of the shortfall in the funds already under management, any funds that new clients invest into the CIA program are immediately diluted. The complaint alleges that Devon must continue to attract new funds for investment in the program in order to fulfill its entire obligations to current advisory clients in the CIA program.

Finally, the complaint alleges that Black, Devon and FMS have benefited financially from this fraudulent scheme. Specifically, from January 1996 through August 1997, at least $2 million of school district funds were used to pay for the defendants' personal and business expenses.

The complaint alleges that Devon, FMS and Black violated the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The complaint further alleges that Devon, aided and abetted by Black, violated the antifraud and custody provisions in Sections 206(1), (2) and (4) of the Investment Advisers Act of 1940 and Rule 206(4)-2(a) thereunder.

Securities and Exchange Commission v. John Gardner Black, Devon Capital Management, Inc., and Financial Management Sciences, Inc., Litigation Release No. 15591 (December 15, 1997) (settled final orders).

The Securities and Exchange Commission ("Commission") announced that, on December 12, 1997, the Honorable Donetta Ambrose of the U.S. District Court for the Western District of Pennsylvania signed an order of permanent injunction ("Order") against defendants John Gardner Black ("Black"), Devon Capital Management, Inc. ("Devon"), and Financial Management Sciences, Inc. ("FMS"). The Order enjoins the defendants from future violations of the anti-fraud provisions of the federal securities laws while reserving the issues of the dollar amounts of disgorgement and civil penalties to be paid by them. The Order provides for a forty-five day period of discovery relating to the issues of disgorgement and civil penalties. At the conclusion of the discovery period, if the parties are unable to agree on the amounts of disgorgement and penalties to be paid, the parties will request that Judge Ambrose hold an evidentiary hearing and make rulings on these remaining issues.

Defendants Black, Devon and FMS consented to the Order without admitting or denying the allegations in the Commission's Complaint. The Commission filed this action as an emergency matter on September 26, 1997. On the same date, the Court granted the Commission's requested relief, including a temporary restraining order, freeze of assets and an order appointing the Honorable Richard Thornburgh, formerly Attorney General of the United States, United States Attorney for Western Pennsylvania and Governor of Pennsylvania, as Trustee.

The Order of permanent injunction maintains the freeze of the defendants' assets until such time as the issues of payment of disgorgement and civil penalties are resolved. Previously, on October 30, 1997, the Court denied defendant Black's request to release $625,000 of the frozen assets to pay legal fees, in part because he had failed to demonstrate that he did not have access to other funds. At the same time the Court denied in substantial part defendant Black's request to release approximately $127,000 of the frozen funds to pay living expenses, allowing him only $25,000 for this purpose.

The Commission's Complaint alleged that Black, acting through Devon, a Pennsylvania-based registered investment adviser, and FMS, an affiliate of Devon's engaged in a fraudulent scheme in connection with the solicitation and management of Devon's investment advisory clients' funds. The Complaint alleged that the scheme resulted in the loss of millions of dollars of municipal bond proceeds invested by school districts and other local government units throughout Western and Central Pennsylvania.

At the time the Complaint was filed, Devon managed approximately $345 million in assets for approximately 100 investment advisory clients, the vast majority of which were local school districts seeking to invest the proceeds of municipal bond offerings. The Complaint alleged that Devon had invested approximately $233 million of these funds, on behalf of 75 local school districts, in a form of investment called a Collateralized Investment Agreement ("CIA"). In promotional materials, Devon represented to these school districts that the CIA was an investment which paid a specified rate of return over a fixed period and which was fully protected by a pool of securities equaling the amount of the school districts' total principal investment. The Complaint alleged that, in fact, the school districts that had invested in the CIA program have suffered a combined loss of their principal investment of approximately

$71 million. Finally, the Complaint alleged that Black, Devon and FMS benefited financially from this fraudulent scheme.

The Complaint alleged that Devon, FMS and Black violated the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The Complaint further alleges that Devon, aided and abetted by Black, violated the antifraud and custody provisions in Section 206(1), (2) and (4) of the Investment Advisers Act of 1940 and Rule 206(4)-2(a) thereunder.

Securities and Exchange Commission v. Mark S. Ferber, Civ. Action No. 96-12653 (EFH) (D. Mass.), Litigation Release No. 15193 (December 19, 1996) (settled final order).

On December 19, 1996, the Securities and Exchange Commission filed a Complaint in the U.S. District Court for the District of Massachusetts against Mark S. Ferber ("Ferber"), a former partner of Lazard Freres & Co. ("Lazard"). In its Complaint, the Commission alleged that Ferber failed to adequately disclose a contract with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") to three of Lazard's financial advisory clients that were serviced by Ferber and that selected Merrill Lynch to provide underwriting, interest rate swap or other financial services. Simultaneously with the filing of the Complaint, Ferber consented, without admitting or denying the allegations in the Complaint, to a permanent injunction enjoining him from future violations of the antifraud provisions and rule G-17 of the Municipal Securities Rulemaking Board, which requires fair dealing in the municipal securities markets. Ferber also agreed to pay disgorgement of $553,000, which represents his portion of the financial advisory fees that he received, plus prejudgment interest of $97,000, for a total of $650,000.

The Complaint alleged that Ferber, on behalf of Lazard, negotiated a lucrative contract with Merrill Lynch, which provided that Lazard and Merrill Lynch would jointly market interest rate swaps and that Lazard would be a consultant to Merrill Lynch. Pursuant to the contract, between September 1990 and November 1992, Merrill Lynch paid Lazard nearly $5.8 million, which resulted in a substantial financial benefit to Ferber.

The Complaint further alleged that the contract with Merrill Lynch was a material fact that should have been disclosed to Lazard's financial advisory clients that were serviced by Ferber and were considering the selection of Merrill Lynch as a provider of financial services - the Massachusetts Water Resources Authority ("MWRA"), the District of Columbia ("the District") and the United States Postal Service ("USPS"). The contract created at least a potential conflict of interest for Ferber in that it gave rise to a significant risk that Ferber would not provide impartial advice to the financial advisory clients that were considering the selection of Merrill Lynch as a provider of financial services. Thus, the contract created the potential for Ferber to abuse his influence over the financial advisory clients.

The Complaint further alleged that Ferber knowingly or recklessly failed to adequately disclose the contract to the MWRA, the District and the USPS, all of which selected Merrill Lynch to provide underwriting, interest rate swap or other financial services in connection with municipal securities offerings and/or the purchase and sale of securities. As a result, Ferber defrauded these financial advisory clients and the purchasers of their municipal securities in violation of Sections 10(b) and 15B(c)(1) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder and rule G-17 of the Municipal Securities Rulemaking Board.

The Commission investigation that led to this action was conducted in close mutual cooperation with the Offices of the United States Attorney for the District of Massachusetts and the Attorney General of the Commonwealth of Massachusetts.

<u>Securities and Exchange Commission v. Nicholas A. Rudi, Joseph C. Salema, Public Capital Advisors, Inc., George L. Tuttle Jr. and Alexander S. Williams</u>, Civ. Action No. 95 Civ. 182 (S.D.N.Y.), Litigation Release No. 14421 (February 23, 1995) (settled final order against Salema).

The Commission announced today that defendants Nicholas A. Rudi ("Rudi") and his financial advisory firm, Public Capital Advisors, Inc. (formerly known as Consolidated Financial Management, Inc.) ("CFM") have agreed to settle this action without admitting or denying the Commission's allegations that Rudi and CFM committed securities fraud by soliciting and receiving more than $200,000 in kickbacks from First Fidelity Securities Group ("FFSG") in connection with a Camden County Municipal Utilities Authority's February 1990 offering of approximately $237,500,000 of debt securities ("Offering"). Under the terms of the settlement, which has been submitted to the Court for approval, Rudi and CFM would each be enjoined from committing securities fraud and Rudi would be ordered to pay $86,331.40, representing disgorgement of $49,131.63 and prejudgment interest of $37,199.77.

Also named in the Complaint were George L. Tuttle, Jr. ("Tuttle") and Alexander S. Williams ("Williams"), both formerly associated with FFSG, which was a registered municipal securities dealer and a division of First Fidelity Bank, N.A. at the time of the transactions and events alleged in the Complaint. The Complaint alleges that, between February and April 1990, Tuttle and Williams caused FFSG to pay CFM the kickbacks, which were shared by Rudi and his then partner Joseph C. Salema ("Salema"). Salema also allegedly solicited and received from Robert J. Jablonski ("Jablonski") an additional $90,000 as a kickback from the finder's fee that FFSG paid to Jablonski relating to the Offering. Tuttle and Williams caused FFSG to pay the kickbacks to CFM through Jablonski's firm and disguised these payments and other related payments on FFSG's municipal securities dealer books and records.

Each of the defendants is alleged to have violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5. In addition, Tuttle and Williams are alleged to have violated Section 15B(c)(1) of the Exchange Act, which prohibits effecting transactions in municipal securities in contravention of any rule of the Municipal Securities Rulemaking Board ("MSRB"), and MSRB rules G-8 (books and records), G-17 (fair dealing) and G-20 (gifts and gratuities).

Simultaneously with the filing of the Complaint, Salema consented, without admitting or denying the allegations, to the entry of a final judgment permanently enjoining him from violating Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5. Salema also paid $324,764.55, representing disgorgement of the money he received as a result of the conduct alleged in the Complaint and prejudgment interest. At the same time, Tuttle and Williams, without admitting or denying the allegations of the Complaint, each consented to the entry of a final judgment permanently enjoining them from violating Section 17(a) of the Securities Act, Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5, and MSRB rules G-8, G-17, and G-20. Tuttle and Williams have disgorged $18,171.48 and $4,684.14, respectively, representing the money each received as a result of the conduct alleged in the Complaint.

The disgorgement and prejudgment interest to be paid by Rudi will be held by the Court for the benefit of persons who submit valid claims arising under the federal securities laws by reason of the conduct alleged against defendants in the Complaint. Such claims must be filed within one year after the Court approves the settlement.

This past June, Rudi was acquitted in a criminal action of all charges based on the same conduct. For more information, see Litigation Release No. 14421 (Feb. 23, 1995).

Securities and Exchange Commission v. Nicholas A. Rudi, Joseph C. Salema, Public Capital Advisors, Inc., George L. Tuttle Jr. and Alexander S. Williams, Litigation Release No. 15218 (January 17, 1997) (settled final orders against Rudi and Public Capital Advisors).

The Commission announced today that, on January 15, 1997, the United States District Court for the Southern District of New York entered the Final Judgments on consent against defendants Nicholas A. Rudi ("Rudi") and his financial advisory firm, Public Capital Advisors, Inc. (formerly known as Consolidated Financial Management, Inc.). As previously announced, the disgorgement and prejudgment interest to be paid by Rudi will be held by the Court for the benefit of persons who submit valid claims arising under the federal securities laws by reason of the conduct alleged against Rudi in the Complaint. Such claims must be filed by January 16, 1998. For more information, see Litigation Release Nos. 15202 (Dec. 30, 1996) and 14421 (Feb. 23, 1995).

SEC v. The Senex Corporation, et al., Civ. Action No. 74-53 (E.D. Ky.), Litigation Release No. 6451 (July 24, 1974) (complaint); Litigation Release No. 6769 (March 5, 1975) (settled final order); Litigation Release No. 8651 (January 23, 1979) (settled final order); 399 F. Supp. 497 (E.D. Ky. 1975).

See "OBLIGATED PERSONS" section.

Commission Orders - Settled Administrative Proceedings

In re Lazard Freres & Co. LLC, Securities Act Release No. 7671, Exchange Act Release No. 41318, A.P. File No. 3-9880 (April 21, 1999).

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b)(4), 15B(c)(2) and 21C of the Securities Exchange Act of 1934 (Exchange Act) against Lazard Frères & Co. LLC (Lazard). In anticipation of the institution of these proceedings, Lazard has submitted an offer of settlement, which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, Lazard, without admitting or denying the findings contained herein, except that it admits to the jurisdiction of the Commission over it and over the subject matter of these proceedings, consents to the entry of the findings, the institution of the cease-and-desist order, and the imposition of the remedial sanctions set forth below.

II.

Based on the foregoing, the Commission finds as follows:

Respondent

Lazard Frères & Co. LLC is an investment banking firm with its principal place of business in New York City. It is the successor to Lazard Frères & Co., a New York limited partnership. At all relevant times, both Lazard and its predecessor were registered with the Commission as broker-dealers and municipal securities dealers pursuant to Sections 15(b) and 15B(a)(2) of the Exchange Act.

B. Summary

This is a municipal finance case involving the breach of Lazard's fiduciary duty to its financial advisory client, the Passaic Valley Sewerage Commissioners ("Passaic Valley"). The breach of duty involved Lazard's failure to make necessary disclosures in an advance refunding transaction in which it served as financial advisor and also sold Treasury securities to Passaic Valley as principal. This case also involves Lazard's sale of Treasury securities to Passaic Valley at excessive, undisclosed markups.

C. Background: Advance Refundings

When interest rates fall, state and local governments often seek to reduce their borrowing costs by paying off outstanding bonds through the issuance of new bonds paying lower interest rates. When the old bonds cannot be paid off until a future call date, the municipality can still obtain a benefit from lower interest rates through an advance refunding. An advance refunding can lock in current interest rates and ensure that the municipality will realize debt service savings over the life of the new bonds.

In an advance refunding, the municipality issues new "refunding" bonds and immediately invests the proceeds in a portfolio of U.S. Treasury or agency securities structured to pay the principal and interest obligations on the old bonds until the call date and then to pay off the outstanding principal and any call premium. The portfolio of government securities is normally placed in a defeasance escrow to guarantee repayment of the old bonds.

Defeasance escrow portfolios are subject to Internal Revenue Code provisions and Treasury regulations that prohibit the issuer of tax-exempt refunding bonds from earning tax arbitrage (that is, a profit from the rate differential between the taxable and tax-exempt markets).[1] I.R.C. § 148; Treas. Reg. §§1.148-0 et seq. The regulations provide that the issuer cannot receive a yield on the securities held in escrow that exceeds the yield it pays on the refunding bonds. In addition, to prevent an issuer from diverting tax arbitrage to the seller of the escrow securities by paying artificially high prices, the regulations provide, in effect, that the price paid by refunding bond issuers for escrow securities purchased in the secondary market (known as "open market securities") cannot exceed the fair market value or market price of the securities as defined in those regulations.[2]

When the yield on the investments in the escrow, if purchased at fair market value, would be below the yield on the refunding bonds, the transaction is said to be in "negative arbitrage." Overcharging by dealers for open market escrow securities in a negative arbitrage transaction takes money away from the municipality by reducing, dollar for dollar, the present value savings the municipality obtains through the advance refunding, but it does not involve any diversion of tax arbitrage.[3]

D. Lazard Failed to Make Required Disclosures to Passaic Valley

In mid-1992, Lazard proposed to Passaic Valley that it undertake an advance refunding to achieve debt service savings, with Lazard as its financial advisor. Passaic Valley accepted Lazard's proposal. Under the parties' written agreement, Lazard was to perform financial advisory services in connection with Passaic Valley's refunding. In exchange for those services Lazard was to receive a fee of one dollar for every one thousand dollars of principal amount of bonds issued by Passaic Valley. The agreement listed certain services that Lazard would perform "as requested by [Passaic Valley]," including the providing of government securities to fund the escrow for the refunded bonds.

As is often the case in municipal bond transactions, the sale date and closing date of Passaic Valley's $191,535,000 refunding bond offering were several weeks apart. Both the bonds and the escrow securities were priced on the sale date, November 19, 1992, but not delivered until the closing date nearly a month later. The refunding portion of the issue required Passaic Valley to purchase a portfolio of Treasury securities costing nearly $140 million. Lazard sold the Treasury securities to Passaic Valley as principal from Lazard's own account. Lazard priced the Treasury securities without any discussion with Passaic Valley.

Passaic Valley's personnel had no prior experience with refundings or purchasing Treasury notes or bonds. They relied on Lazard to provide financial expertise and to represent Passaic Valley's economic interests in the refunding. Lazard explained little about the escrow securities transaction to Passaic Valley personnel. There is no evidence that Passaic Valley was aware that Lazard would make a profit on the securities.[4] Nor is there evidence that anyone at Passaic Valley was aware until several weeks after the sale date that Lazard would sell the securities to Passaic Valley from Lazard's own account. On or about December 7, 1992, bond counsel sent Passaic Valley a copy of a draft escrow deposit agreement that noted, among other
things, that the escrow securities were being purchased from Lazard. Also, on December 10, 1992, Lazard provided Passaic Valley with a memorandum stating that the Treasury securities would be purchased from Lazard. On the refunding's closing date, December 17, 1992, Lazard provided a letter stating that it had
sold the escrow securities to Passaic Valley and that "the prices at which [Lazard] sold the Escrow securities were equal to the fair market value of such Escrow Securities obtained in an arm's length transaction." In turn, Passaic Valley certified that it had acquired the escrow securities "at arm's length, fair market value prices based on representations made by Lazard Frères & Co. as set forth in [Lazard's December 17 letter]." Lazard subsequently collected $191,535 in financial advisory fees from Passaic Valley under the financial advisory agreement.

E. Lazard Sold Treasury Securities to Passaic Valley at Excessive, Undisclosed Markups

Lazard received an additional $685,000 from the markups charged on, and carry received from, the sale of the escrow securities to Passaic Valley.[5] Lazard did not disclose this profit to Passaic Valley. Because the Passaic Valley refunding was a negative arbitrage transaction, all profit made by Lazard on the escrow securities reduced dollar-for-dollar Passaic Valley's debt service savings on the refunding. Under the Treasury regulations, Passaic Valley could have purchased escrow investments for approximately $727,000 less than the prices charged by Lazard and still complied with the yield restrictions. Therefore, Passaic Valley could have retained the benefit of purchasing the securities at lower prices.

Lazard's markup and carry on the transaction was approximately one half of one percent of the prevailing interdealer market prices of the Treasury securities sold to Passaic Valley. At the time, other dealers generally charged materially lower markups on escrow securities when the prices were determined through competition or bona fide arm's length negotiation. Under the facts and circumstances, Lazard's prices
were above fair market value as defined by federal tax laws.

III.

Section 17(a) of the Securities Act prohibits materially false or misleading statements, or material omissions when there is a duty to speak, in the offer or sale of any security. Section 17(a)(1) requires a showing of scienter; however, Sections 17(a)(2) and 17(a)(3) do not require such a showing. Aaron v. SEC, 446 U.S. 680, 697 (1980). Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit materially false or misleading statements, or material omissions when there is a duty to speak, made with scienter, in connection with the purchase or sale of any security. Both knowing and reckless conduct satisfy the scienter element. See, e.g., Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). A duty to speak arises, and material omissions become fraudulent, when a person or entity has information that another is entitled to know because of a fiduciary or similar relationship of trust and confidence. See Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-55 (1972); Chiarella v. United States, 445 U.S. 222, 228 (1980); In re Arleen W. Hughes, 27 S.E.C. 629 (1948), aff'd sub nom. Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949).

A. Material Omissions in Connection with the Sale of Securities to Passaic Valley

Generally, a municipality's financial advisor owes fiduciary obligations to it in connection with bond financings by the municipality.[6] In addition, under New Jersey state law, a fiduciary relationship arises when one person is under a duty to give advice for the benefit of another on matters within the scope of their relationship and the advisor occupies a dominant position over the other.[7] Passaic Valley had no expertise or experience in advance refundings or purchasing Treasury bonds and notes. Instead, Passaic Valley relied on Lazard, as its financial advisor, to serve its interests in all aspects of the refunding, including the purchase of escrow securities. Therefore, based on the facts and circumstances, Lazard had a
fiduciary or similar relationship of trust and confidence with Passaic Valley.

Courts have imposed on a fiduciary affirmative duties of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading its client. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963). A broker-dealer that seeks to sell securities from its own account, as principal, to a client to whom it owes fiduciary duties must follow well-established standards. Under both common law and federal securities law, the broker-dealer can only deal with its fiduciary client as a principal by making full disclosure(before entering into the transaction(of the nature and extent of any adverse interest that the broker-dealer may have with the client. See In re Arleen W. Hughes, 27 S.E.C. at 635-36; Restatement (Second) of Agency § 390 (1958). This standard requires disclosure of more than the fact that the broker-dealer will act as principal in the transaction. See, e.g., In re R.H. Johnson & Co., 36 S.E.C. 467 (1955), aff'd, 231 F.2d 523 (D.C. Cir. 1956); Norris & Hirshberg, Inc. v. SEC, 177 F.2d 228, 233 (D.C. Cir. 1949) (holding that a broker-dealer that sent a fiduciary client confirmations stating that it acted as principal in certain transactions nevertheless violated the anti-fraud provisions by failing to disclose its capacity as principal rather than agent at the time of the transaction). A broker-dealer subject to fiduciary obligations must disclose all material facts, including any current market price at which the customer could effect the transaction that is better than the price that the dealer intends to provide to the customer. See, e.g., Off Board Trading Restrictions, Exchange Act Rel. No. 13662, text accompanying notes 113-116 (June 23, 1977).

Lazard violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder when it failed to obtain Passaic Valley's fully informed consent before engaging in the escrow securities transaction as principal. Lazard failed to disclose "in a manner that its client would be sure to understand"(1) that it would sell the escrow securities to Passaic Valley from Lazard's own account, and (2) the nature and extent of its actual and apparent conflicts of interest. Under the circumstances, Lazard had, at a minimum, an obligation to investigate whether another seller would have provided the securities to Passaic Valley at better prices, and to disclose to Passaic Valley the results of that investigation.

B. Material Misrepresentations and Omissions in the Sale of Securities to Passaic Valley

As to the pricing of the escrow securities sold to Passaic Valley, Lazard violated Sections 17(a)(2) and 17(a)(3) of the Securities Act by effecting that transaction at prices not reasonably related to the current wholesale market prices for the securities under the particular facts and circumstances, including the pertinent tax regulations, and by representing to Passaic Valley that Lazard had sold the securities at fair market value. See, e.g., Grandon v. Merrill Lynch & Co., 147 F.3d 184, 192 (2d Cir. 1998) (under the shingle theory, a broker-dealer has a duty to disclose excessive markups); In re Lehman Bros. Inc., 62 SEC Dkt. at 2330-31; In re Duker & Duker, 6 S.E.C. 386, 389 (1939). Lazard's markup and carry on the transaction was approximately one half of one percent of the prevailing interdealer market prices of the Treasury securities sold to Passaic Valley. Based on all the relevant facts and circumstances, Lazard knew or should have known that the prices it charged were not reasonably related to the prevailing wholesale market prices of the securities. The excessive markups operated as a fraud or deceit because unbeknownst to Passaic Valley the excessive markups reduced the savings available to Passaic Valley from the refunding.

IV.

On the basis of this Order and Lazard's offer of settlement, the Commission finds that Lazard willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5.

V.

Accordingly, IT IS ORDERED, pursuant to Section 8A of the Securities Act and Sections 15(b)(4), 15B(c)(2), and 21C of the Exchange Act, that:

A. Lazard is censured;

B. Lazard shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

C. Within ten days of the entry of the Order, Lazard shall, by a postal or bank money order, certified check or bank cashier's check, pay disgorgement of $272,759 and prejudgment interest of $174,615 to the Passaic Valley Sewerage Commissioners in connection with a refunding that settled on December 17, 1992;

D. Within ten days of the entry of the Order, Lazard shall comply with its undertaking to make the following payments related to other sales of escrow securities: $305,421 to the City of Pittsburgh in connection with the advance refunding that settled on April 1, 1993; $1,355,719 to the Municipality of Seattle in connection with the advance refundings that settled on August 27, 1992, March 23, 1993, July 1, 1993, and September 8, 1993; $1,221,995 to the City of Indianapolis Public Improvement Bond Bank in connection with the advance refunding that settled on December 3, 1992; and $218,240 to the City of Indianapolis in connection with the advance refunding that settled on March 11, 1993;

E. Lazard shall comply with its undertaking to pay $7,451,251 to the United States Treasury under an agreement simultaneously entered into among Lazard, the Internal Revenue Service and the United States Attorney for the Southern District of New York; and

F. Copies of payments made to the municipalities and the United States Treasury as described in sub-paragraphs C, D and E above and any cover letters accompanying them shall be sent by Lazard to Lawrence A. West, Branch Chief, Division of Enforcement, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0806.

By the Commission.

FOOTNOTES

[1]: These provisions and regulations are designed to prevent abuse of the benefit the federal government affords municipalities by not taxing interest paid on municipal bonds. See Joint Comm. on Taxation, 91st Cong., 2d Sess., General Explanation of the Tax Reform Act of 1969, at 185-86 (Comm. Print 1970).

[2]: During the relevant period, Treasury regulations provided several definitions of fair market value and market price for purposes of valuing open market government securities for advance refundings. For example, a regulation generally applicable to advance refunding transactions that settled on or before June 30, 1993 defined market price as "the mean of the bid and offered prices on an established market" on the day of pricing; if, however, the price paid by the issuer was higher than the mean of the bid and offered prices, then the higher price could be treated as the market price of the security if the issuer acquired it in an "arm's length transaction without regard to any amount paid to reduce the yield . . . ." Treas. Reg. § 1.103-13(c)(1)(iii)(B) (1979). Generally, after June 30, 1993, fair market value was defined as "the price

at which a willing buyer would purchase the [security] from a willing seller in a bona fide, arm's length transaction." Treas. Reg. § 1.148-5(d)(6)(i) (1993).

[3]: In contrast, in a "positive arbitrage" situation "when the yield on open market securities purchased at fair market value would exceed the yield on the refunding bonds" overcharging by dealers for open market escrow securities diverts tax arbitrage to the dealers at the expense of the U.S. Treasury. This diversion, known colloquially as "yield burning," is illegal. If yield burning occurs, the IRS can declare interest paid on the refunding bonds taxable. See Harbor Bancorp & Subsidiaries v. Keith, 115 F.3d 722 (9th Cir. 1997), cert. denied, 118 S. Ct. 1035 (1998). There are several lawful methods to limit the yield of the defeasance escrow in a positive arbitrage situation. One method is to purchase from the Bureau of Public Debt at the Department of the Treasury below-market-interest Treasury securities "known as State and Local Government Series securities (SLGS)" customized to match the yield limitation. Alternatively, the municipality can purchase open market securities of shorter durations (and lower yields) than those required to satisfy the escrow requirements; when these securities mature, the cash proceeds are invested for the remaining period of the escrow in non-interest-bearing SLGS. When either of these methods is used, the Treasury obtains a benefit by issuing debt at interest rates lower than those prevailing in the taxable market.

[4]: Bond counsel to Passaic Valley for the refunding knew by the sale date that Lazard would act as principal and make a profit on the sale of the escrow securities. However, bond counsel had no expertise in
the pricing of escrow securities, and its representation of Passaic Valley did not extend to such financial matters as whether Passaic Valley was obtaining the best available prices. Bond counsel's services were limited to drafting documents and rendering certain opinions related to the validity and tax-exempt status of the refunding bonds.

[5]: Profit on open market escrow securities generally has two components: markup and carry. Markup is the difference between the price the dealer charges the issuer and the prevailing wholesale market price. In re Lehman Bros. Inc., Exchange Act Release No. 37673 (Sept. 12, 1996), 62 SEC Dkt. 2324, 2330. Carry is the difference between (a) the interest and accretion produced by the escrow securities between the sale date and closing date and (b) the cost of financing those securities during that period. See Board of Governors of the Federal Reserve System, Trading Activities Manual, Part 2 at 2-8 (March 1994).

[6]: See, e.g., Order Approving Proposed Rule Change of MSRB Relating to Activities of Financial Advisors, Exchange Act Release No. 30258 (Jan. 16, 1992) ("The MSRB . . . believes that the existence of the conflict of interest [faced by a dealer acting as both financial advisor and placement agent on the same issue] is contrary to the fiduciary obligations of municipal securities professionals acting as financial advisors to issuers . . . ."); Notice by MSRB of Proposed Rule G-23, 42 Fed. Reg. 49856, 49859 (Sept. 28, 1977) ("As a financial advisor, the municipal securities professional acts in a fiduciary capacity as agent for the governmental unit . . . ."); cf. In re O'Brien Partners, Inc., Securities Act Release No. 7594 (October 27,
1998) (violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act for failure to make full disclosure in breach of fiduciary duty owed as municipal financial advisor). The term financial advisor is not defined in the federal securities laws. However, Rule G-23(b) of the Rules of the Municipal Securities Rulemaking Board provides that "a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or
issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services."

[7]: F.G. v. MacDonell, 150 N.J. 550, 696 A.2d 697 (1997) (citing In re Stroming's Will, 12 N.J. Super. 217, 224, 79 A.2d 492, 495 (App. Div.), certif. denied, 8 N.J. 319 (1951) (stating essentials of confidential
relationship "are a reposed confidence and the dominant and controlling position of the beneficiary of the transaction"), and Blake v. Brennan, 1 N.J. Super. 446, 453, 61 A.2d 916 (Ch. Div. 1948) (describing "the test [as] whether the relations between the parties were of such a character of trust and confidence as to render it reasonably certain that the one party occupied a dominant position over the other and that consequently they did not deal on terms and conditions of equality")).

In re Leifer Capital, Inc., Jeffrey Leifer, and David Leifer, Securities Act Release No. 7630, A.P. File No. 3-9810 (January 14, 1999).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that a public cease-and-desist proceeding be and hereby is instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Leifer Capital, Inc. ("Leifer Capital"), Jeffrey Leifer, and David Leifer (collectively, the Leifers").

II.

In anticipation of the institution of this proceeding, the Leifers have submitted Offers of Settlement, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except that the Leifers admit the jurisdiction of the Commission over them and over the subject matter of this proceeding, the Leifers, by their Offers of Settlement, consent to the entry of this Order Instituting a Public Cease-And-Desist Proceeding Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing Cease-and-Desist Order ("Order") and to the entry of the findings and the cease-and-desist order set forth below.

Accordingly, IT IS HEREBY ORDERED that a proceeding pursuant to Section 8A of the Securities Act be, and hereby is, instituted.

III.

On the basis of this Order and the Offers of Settlement submitted by the Leifers, the Commission finds that:[1]

A. RESPONDENTS

1. Leifer Capital, Inc. ("Leifer Capital") is a California corporation and was the issuers' Financial and Marketing Specialist ("marketing specialist") for seven note offerings (the "Note Offerings") related to the County of Orange ("Orange County" or the "County") Investment Pools (the "Pools") that raised a total of $1.125 billion. Leifer Capital, among other things, participated in preparing the official statements (the "Official Statements") for the Note Offerings.

2. Jeffrey Leifer, since 1989, has been the sole owner and President of Leifer Capital. Jeffrey Leifer, with his brother David Leifer, represented Leifer Capital in the Note Offerings.

3. David Leifer is Jeffrey Leifer's brother and, since 1993, has been employed by Leifer Capital as a Vice-President. David Leifer also represented Leifer Capital in the Note Offerings.

B. FACTS

1. Introduction

Leifer Capital was the issuers' marketing specialist for the Note Offerings. The Official Statements for the Note Offerings, which the Leifers participated in drafting, omitted material facts about the Pools' investment strategy, the risks of that strategy, and the Pools' investment losses. Accurate and complete disclosure about the Pools was material to investors because these matters affected the issuers' ability to repay the Notes, as the funds pledged to repay the Notes were invested in the Pools and three of the offerings were conducted for the purpose of reinvesting the offering proceeds for profit. In addition, in two other Note Offerings, the Pools guaranteed repayment of the Notes.

FOOTNOTES

[1]:/ The findings herein are made pursuant to the Leifers' Offers of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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2. The Orange County Investment Pools

The Pools operated as an investment fund managed by the Orange County Treasurer-Tax Collector (the "Treasurer"), in which the County and various local governments or districts (the "Participants") deposited public funds. As of December 6, 1994, the Pools held approximately $7.6 billion in Participant deposits, which the County had leveraged to an investment portfolio with a book value of over $20.6 billion.

a. The Pools' Investment Strategy

From at least April 1992 until December 1994, the Treasurer's investment strategy for the Pools involved: (1) using a high degree of leverage by obtaining funds through reverse repurchase agreements on a short-term basis (less than 180 days); and (2) investing the Participants' deposits and funds obtained through reverse repurchase agreements in debt securities (issued by the United States Treasury, United States government sponsored enterprises, and highly-rated banks and corporations) with a maturity of two to five years, many of which were derivative securities. The Pools' investment return was to result principally from the interest received on the securities in the Pools. Leverage enabled the Pools to purchase more securities with the anticipation of increasing interest income. This strategy was profitable as long as the Pools were able to maintain a positive spread between the long-term interest rate received on the securities and the short-term interest rate paid on the funds obtained through reverse repurchase agreements.

b. The Pools' Portfolio

During 1993 and 1994, the Treasurer, using reverse repurchase agreements, leveraged the Participants' deposits to amounts ranging from 158% to over 292%. As of the end of June 1994, the Pools held $19.8 billion in securities, with approximately $7.2 billion in Participant deposits and about $12.6 billion in reverse repurchase agreements, resulting in leverage of about 274%.

During 1993 and 1994, the amount of derivatives in the Pools' portfolio ranged from 27.6% to 42.2% of the portfolio. As of the end of June 1994, 38.2% of the Pools' securities were derivatives. Most of the Pools' derivative securities were inverse floaters, which paid interest rates inversely related to the prevailing interest rate. From January 1993 through November 1994, 24.89% to 39.84% of the Pools' portfolio consisted of inverse floaters. As of the end of June 1994, 35% of the Pools' portfolio was invested in inverse floaters. From January 1993 through November 1994, only 1.84% to 5.59% of the Pools' portfolio consisted of securities that paid interest rates directly related to the prevailing interest rate (variable rate securities) or securities that paid interest rates that rose at certain stated intervals to certain

stated rates (step-up securities). As of the end of June 1994, about 3.17% of the Pools' portfolio was invested in variable and step-up securities.

c. The Pools' Sensitivity To Interest Rate Changes And The Rise In Interest Rates During 1994

The composition of the Pools' portfolio made it sensitive to interest rate changes. As interest rates rose, the market value of the Pools' securities fell, and the interest received on the Pools' inverse floaters also declined. Thus, the Treasurer's investment strategy was profitable so long as interest rates, including the cost of obtaining funds through reverse repurchase agreements, remained low, the market value of the Pools' securities did not decline, and the Pools had the ability to hold securities to maturity.

From April 1992 through 1993, U.S. interest rates remained low and relatively stable. Due to the low interest rates and the Pools' investment strategy, the Pools earned a relatively high yield of approximately 8%. Beginning in February 1994, interest rates began to rise. This rise in interest rates resulted in: (1) an increase in the cost of obtaining funds under reverse repurchase agreements; (2) a decrease in the interest income on inverse floaters; (3) a decrease in the market value of the Pools' debt securities; (4) collateral calls and reductions in amounts obtained under reverse repurchase agreements; and (5) a decrease in the Pools' yield.

d. Orange County's Bankruptcy

By early December 1994, the Pools had an unrealized decline in market value of about $1.5 billion. Shortly thereafter, on December 6, 1994, Orange County filed Chapter 9 bankruptcy petitions on behalf of itself and the Pools (the petition filed on behalf of the Pools was later dismissed). Between early December 1994 and January 20, 1995, the Pools' securities portfolio was liquidated, incurring a loss of almost $1.7 billion on the Participants' deposits of $7.6 billion, a 22.3% loss.

3. The Note Offerings

In July and August 1994, Leifer Capital, through Jeffrey Leifer and David Leifer, was the marketing specialist to Orange County, the Orange County Flood Control District (the "Flood Control District"), and the Placentia-Yorba Linda Unified School District ("Placentia USD") in connection with and for purposes of their seven offerings of municipal securities that raised a total of $1.125 billion.[2]

FOOTNOTES

[2]:/ Orange County, the Flood Control District, and related parties previously settled enforcement proceedings relating to the Note Offerings. See SEC v. Citron, Civil Action No. SA CV 96-0074 (C.D. Cal. Jan. 24, 1996); In re County of Orange, California, Securities Act Rel. No. 7260 (Jan. 24, 1996).
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a. The Taxable Note Offerings

Orange County, the Flood Control District, and Placentia USD raised $750 million through three offerings of taxable notes (the "Taxable Note Offerings") in 1994. The issuers conducted these offerings for the purpose of generating an anticipated profit by reinvesting the proceeds (together with funds equal to the estimated interest on the notes) in the Pools to earn an investment return that would be higher than the rate of interest payable to the Taxable Note investors. The issuers pledged these invested funds to secure repayment of the Taxable Notes, and, if the pledged funds were insufficient to pay principal and interest, the issuers would satisfy any deficiency with other moneys lawfully available to repay the notes in the respective issuer's general fund attributable to the fiscal year in which the notes were issued.

The County issued $600 million in notes (the "$600 Million Taxable Notes") on July 8, 1994, described in an Official Statement dated July 1, 1994. These notes earned a variable interest rate reset monthly at the

one-month London Interbank Offered Rate ("LIBOR") not to exceed 12% per annum. The $600 Million Taxable Notes were originally due on July 10, 1995. On June 27, 1995, the County and the noteholders entered into Rollover Agreements under which the maturity of the notes was extended from July 10, 1995, to June 30, 1996, and the interest rate paid on the notes was increased. On June 12, 1996, as part of its emergence from bankruptcy, the County repaid the notes with a portion of the proceeds from another County municipal securities offering.

On August 2, 1994, the Flood Control District issued $100 million in notes (the "$100 Million Taxable Notes") described in an Official Statement dated July 27, 1994. These notes earned a variable interest rate reset monthly at the one-month LIBOR plus .03% not to exceed 12% per annum. The notes matured, and were repaid, on August 1, 1995.

On August 25, 1994, Placentia USD issued $50 million in notes (the "$50 Million Taxable Notes") described in an Official Statement dated August 19, 1994. The notes matured, and were repaid, on August 24, 1995.

b. The TRAN Offerings

In 1994, the County conducted two tax and revenue anticipation note ("TRAN") offerings (the "TRAN Offerings") to raise a total of $200 million to fund its expected cash flow deficits, as it received revenue infrequently throughout the fiscal year but had constant working capital expenses. The Official Statements for these offerings represented that: the County would pledge certain anticipated revenues to pay the notes' principal and interest; the revenue, when received, would be placed into a repayment account; the funds in the repayment account would be invested; and if the County lacked sufficient funds in the repayment account to repay the notes, the County would satisfy any deficiency from other moneys received or accrued during the fiscal year in which the notes were issued and lawfully available for repayment of the notes.

The County issued $169 million in TRANs (the "$169 Million TRANs") on July 5, 1994, described in an Official Statement dated June 27, 1994, and $31 million in tax-exempt TRANs (the "$31 Million TRANs") on August 11, 1994, described in an Official Statement dated August 5, 1994. The $169 Million TRANs and $31 Million TRANs were originally due on July 19, 1995 and August 10, 1995, respectively. On June 27, 1995, the County and the noteholders entered into Rollover Agreements under which the maturity of the TRANs was extended to June 30, 1996. On June 12, 1996, as part of its emergence from bankruptcy, the County repaid the TRANs with a portion of the proceeds from another County municipal securities offering.

c. The Teeter Note Offerings

In 1994, Orange County conducted two offerings of Teeter Notes (the "Teeter Note Offerings"). The purpose of these offerings was to fund the County's Teeter Plan, an alternate method of property tax distribution whereby the County pays local taxing entities (such as school districts) their share of property taxes upon levy rather than actual collection and the County retains all property taxes, and the penalties and interest thereon, upon collection.

The first Teeter Note Offering was conducted on July 20, 1994, for $111 million (the "$111 Million Teeter Notes"). These notes were described in an Official Statement dated July 13, 1994. These notes earned a variable interest rate reset monthly at one-month LIBOR not to exceed 12% per annum. The second Teeter Note Offering was conducted on August 18, 1994, for $64 million (the "$64 Million Teeter Notes"). These notes were described in an Official Statement dated August 12, 1994. These notes earned a variable interest rate reset monthly at 70% of one-month LIBOR not to exceed 12% per annum. The $111 Million and $64 Million Teeter Notes matured, and were repaid, in part with proceeds from a June 30, 1995 Teeter bond offering.

The Official Statements for the Teeter Note Offerings represented that the County planned to deposit certain delinquent tax payments, penalties, and interest collections in accounts pledged to repay the Teeter Notes and to then invest those funds in the Pools. The Official Statements for the Teeter Note Offerings represented that the County anticipated that the funds in the repayment account would not be sufficient to pay the principal and interest on the Teeter Notes at maturity and that the County estimated that, at maturity of the Teeter Notes, approximately $70 million would be available in the repayment account to pay the principal and interest on the $175 million in Teeter Notes. The Official Statements further represented that this anticipated deficiency in the repayment account would be satisfied from moneys received under Standby Note Purchase Agreements, which agreements obligated the Treasurer (as "fund manager" of the Pools) to purchase the Teeter Notes, and from other moneys lawfully available to the County for repayment from revenues received or attributable to the fiscal year in which the notes were issued.

4. The Leifers' Role In The Note Offerings

Leifer Capital was the issuers' marketing specialist for the Note Offerings. In this capacity, the Leifers assisted the issuers in negotiating the interest rate on the Notes and the underwriters' fees or discounts. Leifer Capital, through Jeffrey Leifer and David Leifer, also participated with other participants in the Note Offerings in the preparation of the Official Statements for all of the Note Offerings and communicated with the other participants to ensure that the transactions remained on schedule.[3]

5. The Omissions

a. The Pools' Investment Strategy

The disclosure in the Official Statements for the Note Offerings regarding the Pools' investment strategy was misleading because it failed to disclose material information, including: (1) the Pools' investment strategy was predicated upon the assumption that prevailing interest rates would remain at relatively low levels; (2) the Pools' use of leverage through reverse repurchase agreements was constant, high, and a major part of the Pools' investment strategy; and (3) the Pools had a substantial investment in derivative securities, particularly inverse floaters.

b. The Risks Of The Pools' Investment Strategy

The disclosure in the Official Statements regarding the risks of the Pools' investment strategy was misleading because it omitted material information about the Pools' sensitivity to rises in interest rates. Specifically, the Official Statements failed to disclose that because of the Pools' high degree of leverage and substantial investment in inverse floaters, rising interest rates would have a negative effect on the Pools, including: (1) the Pools' cost of obtaining funds under reverse repurchase agreements would increase; (2) the Pools' interest income on the inverse floaters would decrease; (3) the Pools' securities would decline in market value; (4) as the value of the securities fell, the Pools would be subject to collateral calls and reductions in amounts obtained under reverse repurchase agreements; (5) the Pools' earnings would decrease; (6) the Pools would suffer losses of principal at certain interest rate levels; and (7) if the Pools' began to suffer lower earnings or losses of principal, certain Participants could withdraw their invested funds, leaving the County and other Participants such as the Flood Control District who were required to deposit their funds with the Treasurer to absorb any losses.

c. The Pools' Investment Results

The disclosure in the Official Statements regarding the Pools' historic investment results was misleading because it omitted material information regarding the Pools' investment results during the first half of 1994 when interest rates were rising. Specifically, the Official Statements omitted to disclose that as a result of rising interest rates in 1994, the market value of the Pools' securities was declining, the Pools

were subject to collateral calls and reductions in amounts obtained under reverse repurchase agreements, and the Pools' costs of obtaining funds under reverse repurchase agreements were increasing.

6. The Leifers' Knowledge Of Or Access To Information About The Pools And Their Participation In The Drafting Of The Disclosure

While assisting in the preparation of the Official Statements, the Leifers received, had access to, or could have sought to discover information concerning the Pools' investment strategy, the risks of that strategy, and the Pools' recent investment results. The Leifers, however, did not adequately assure that this information about the Pools was disclosed in the Official Statements.

a. March 1994 Meetings

In late March 1994, Jeffrey Leifer, David Leifer and others participating in preparing the Official Statements for the Note Offerings met with the rating agencies and two potential institutional investors in New York City to discuss the upcoming Note Offerings. During the meetings, the rating agencies and the potential investors questioned a County official about the Pools and the effect the recent rise in interest rates had had on the Pools. The official responded that the Pools used leverage through reverse repurchase agreements and invested in derivative securities, including inverse floaters. The official also stated that the County would continue to pursue a "buy and hold" investment strategy and that the Pools had liquidity to meet its needs.

b. The Media Coverage Of the Pools

From January 31 through June 30, 1994, articles appeared in the media regarding the Pools. The articles reported that the Treasurer admitted that: he used reverse repurchase agreements to leverage the Pools' $7.5 billion in deposits to $19.5 billion in investments; 20% of the $19.5 billion portfolio was invested in derivative securities; his strategy was to borrow short-term and invest in medium-term securities; the value of the Pools' portfolio had "been hit by rising interest rates"; and as a result of rising interest rates and the declining market value of the Pools' securities, the County had recently experienced up to $300 million in collateral calls under reverse repurchase agreements. These articles also reported that the County's portfolio had suffered a decline in market value of "an estimated $1.2 billion" and that many believed that the investment strategy was too risky for public funds and exposed the Pools to very large losses. Press coverage also noted that the rating agencies that reviewed and rated the Note Offerings did not have any major concerns about the Pools' financial condition and investment strategy. Jeffrey Leifer and David Leifer read at least one of the articles discussed above, and Jeffrey Leifer was aware of other articles published about the Pools.

c. The Adoption Of, And Changes To, The Disclosure In A Prior Offering

As a result of the media coverage and the rating agency's questions regarding the Pools and in an effort to improve the issuers' disclosure regarding the Pools, David Leifer obtained and reviewed a copy of the Official Statement for a 1993 taxable note offering conducted by another local government located in Southern California (the "Prior Offering"). The Official Statement for the Prior Offering contained disclosure regarding the issuer's investment pool (the "Prior Pool"). The Leifers circulated the relevant portions of the Prior Offering to others participating in drafting and reviewing the Official Statements and recommended that it be used in the Note Offerings as a template for disclosure regarding the Pools.

On June 17, 1994, the County, after discussion with David Leifer and with other professionals participating in drafting the Official Statements, including disclosure counsel and bond counsel, determined to revise the disclosure about the Pools to be similar to the Prior Pool disclosure. Indeed, much of the disclosure in the Official Statements for the Note Offerings was copied directly from the Official Statement for the Prior Offering. The County, however, in consultation with David Leifer and with others who participated in drafting the Official Statements, including disclosure counsel and bond

counsel, made some critical changes to the disclosure in the Prior Offering for use in the Note Offerings. The changes to the disclosure principally related to the Pools' reverse repurchase position and derivative holdings. The Leifers were aware of these changes and did not object to them.

First, with respect to reverse repurchase agreements, both offerings stated that "[f]rom time to time" the pools engaged in reverse repurchase transactions. The Prior Offering, however, disclosed that the Prior Pool had engaged in no reverse repurchase agreements as of the end of the prior quarter and that the maximum amount of the Prior Pool's portfolio that could be pledged under reverse repurchase agreements was 25%. In contrast, the Note Offerings only disclosed that "a significant portion" of the Pools' securities were pledged under reverse repurchase agreements but did not disclose that the Pools were leveraged by about 274% and that the Pools' investment strategy was based on such leverage. Second, with respect to derivative investments, the Prior Offering specifically disclosed the dollar amount of derivative securities held by the pool and the structure of the derivatives. In contrast, the Note Offering only disclosed the Pools' investment in fixed and floating rate securities but did not specifically disclose the Pools' dollar investment in inverse floaters.

FOOTNOTES

[3]: Other participants in the Note Offerings were County officials, bond counsel (retained by the County), the underwriter, and disclosure counsel (retained by the Leifers). The Leifers were not financial advisers to the Treasurer or to the Pools in connection with the Pools' investment strategy or investments or with the County's decision to issue Taxable Notes.
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C. LEGAL DISCUSSION

1. The Leifers Violated Sections 17(a)(2) And (3) Of The Securities Act In The Offer And Sale Of The Notes

Sections 17(a)(2) and (3) of the Securities Act make it unlawful for any person, through the means or instruments of interstate commerce or the mails, in the offer or sale of any security:

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Scienter is not required to prove violations of Sections 17(a)(2) or (3) of the Securities Act. Aaron v. SEC, 446 U.S. 680, 697 (1980). Violations of these sections may be established by showing negligence. SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997); SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992). Accordingly, the Leifers, through negligent conduct, violated Sections 17(a)(2) and (3) of the Securities Act in the offer and sale of the Notes.

a. The Omissions Were Material

Information about the Pools' investment strategy, the risks of that strategy, and the Pools' declining investment results was material to the Note investors. Information is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information made available. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

Accurate and complete disclosure about the Pools was material to investors because it affected the sources of repayment for the Notes. In particular, in all of the Note Offerings, the funds pledged to repay the

securities were invested in the Pools, and, in the two of Teeter Note Offerings, the Pools guaranteed repayment of the securities.

b. The Leifers Should Have Known That The Official Statements Were Materially Misleading

The Leifers, as the marketing specialist to the issuers of the Note Offerings, participated in drafting the disclosure in the Official Statements that omitted material information about the Pools. The Leifers also knew, had access to information from which they could have known, or reasonably should have known material information about the Pools. From participating in drafting the Official Statements, the Leifers reasonably should have known that the Official Statements omitted to disclose material information that they knew or reasonably should have known about the Pools.

2. Conclusion

Accordingly, based on the foregoing, the Commission finds that the Leifers violated Sections 17(a)(2) and (3) of the Securities Act.

IV.

The Leifers have submitted Offers of Settlement in which, without admitting or denying the findings herein, they consent to the Commission's entry of this Order, which: (1) makes findings, as set forth above; and (2) orders the Leifers to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act. As set forth in the Offers of Settlement, the Leifers undertake to continue to cooperate with Commission staff in preparing for and presenting any civil litigation or administrative proceedings against others concerning the transaction that is the subject of this Order.

V.

In view of the foregoing, the Commission deems it appropriate to accept the Offers of Settlement submitted by the Leifers. Accordingly, IT IS HEREBY ORDERED that, pursuant to Section 8A of the Securities Act, Leifer Capital, Jeffrey Leifer, and David Leifer shall, effective immediately, cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act.

<u>In re O'Brien Partners, Inc</u>., Securities Act Release No. 7594, Investment Advisers Act Release No. 1772, A.P. File No. 3-9761 (October 27, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act), and Section 8A of the Securities Act of 1933 ("Securities Act") against O'Brien Partners, Inc. ("O'Brien Partners" or the "Respondent").

II.

In anticipation of the institution of these administrative proceedings, the Respondent has submitted an Offer of Settlement for the purpose of disposing of the issues raised in these proceedings. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, the Respondent, without admitting or denying the findings set forth herein, except that it admits to the jurisdiction of the Commission over it and over the subject matter of

these proceedings, consents to the entry of the findings and to the issuance of this Order Instituting Proceedings ("Order").

III.

On the basis of this Order and the Respondent's Offer of Settlement, the Commission finds the following:

A. RESPONDENT

O'Brien Partners, whose offices are located in New York and Los Angeles, was incorporated in November 1987, and was registered with the Commission as an investment adviser during all relevant periods. O'Brien Partners served as an investment adviser, as well as a financial advisor[1] to state and local government agencies on a variety of matters, including bond transactions and refundings, and the investment of bond proceeds. O'Brien Partners withdrew its registration with the Commission in March 1996.

B. OTHER RELEVANT ENTITIES AND PERSON

OBP Municipals Corporation ("OBPM"), an affiliate of and under common control with O'Brien Partners, was registered with the Commission as a broker-dealer during all relevant periods, and received nine of the ten third-party payments that are discussed below. OBPM withdrew its registration with the Commission on March 10, 1997, and the company was dissolved on July 15, 1997.

Pacific Matrix Financial Group, Inc. ("Pacific Matrix") acted as a finder of investments for bond proceeds, including guaranteed investment contracts ("GICs") and other complex investment vehicles during all relevant periods. A Pacific Matrix vice president, Christopher Winters ("Winters"), left Pacific Matrix in late 1992, along with a colleague, to form Feld Winters Financial Inc. ("Feld Winters"), which also acted as a finder of investments for bond proceeds. In instances in which it successfully brokered agreements that were used for the investment of bond proceeds, Pacific Matrix and Feld Winters generally received a commission equal to the maximum allowable commission calculated in accordance with the five basis point formula set forth in the applicable tax regulations. In 1991, Pacific Matrix, through Winters, began an arrangement that led to its sharing with O'Brien Partners approximately 50 percent of the commissions that Pacific Matrix received for brokering investment agreements used by O'Brien Partners' clients to invest bond proceeds. Winters and O'Brien Partners continued this practice when Winters left Pacific Matrix to form Feld Winters.

C. FACTS

1. Summary

This case concerns O'Brien Partners' failure adequately to disclose to its municipal advisory clients that it had arranged to obtain a portion of the commissions paid to the broker involved in the placement of interim investments of the proceeds of O'Brien Partners' clients' bond offerings. O'Brien Partners, directly or through OBPM, received approximately $450,000 in ten third-party payments in connection with investments by four municipal bond issuers from August 1991 through November 1993. Although there is no evidence that the payments directly affected the cost of those investments to O'Brien Partners' clients, the payments created at least a potential conflict of interest for O'Brien Partners in discharging its duty to provide impartial advice to its clients concerning the choice of the fee-sharing broker to handle investments for the issuers' bond proceeds. O'Brien Partners thus breached its fiduciary duty to its clients to disclose all actual or potential conflicts of interest by not adequately disclosing fees it shared in handling investments for the issuer's bond proceeds. After considering legal advice that it solicited in late 1991, O'Brien Partners decided that disclosure should be made, and took certain steps to implement that decision, but those steps were not effective. In addition, amendments and annual supplements to

O'Brien Partners' Form ADV filed with the Commission failed to disclose O'Brien Partners' receipt of such payments as additional compensation. Additionally, O'Brien Partners failed to provide either a copy of Part II of its Form ADV or a document containing the information required in Part II to its advisory clients, as required by the Advisers Act.

2. Background

In its role as financial advisor to municipalities, O'Brien Partners offers a range of services, the precise scope of which varies from engagement to engagement depending on the bond offering and client. O'Brien Partners typically assists in preparing the preliminary official statement, and may assist the issuer in selecting and/or negotiating with the underwriter. O'Brien Partners also, among other things, advises the issuer on the optimum time to issue bonds to minimize interest costs; attends the signing of the bond purchase agreement; and assists in the preparation of the Official Statement and the formal signing and delivery of the bonds.

During the period relevant to this Order, O'Brien Partners also advised clients in their investments of bond proceeds in securities, consistent with the limitations thereon as generally described in the bond issue indenture or bond resolution.[2] In such instances, O'Brien Partners identified appropriate investment vehicles, solicited potential investment providers, prepared and disseminated bid forms, and collected and evaluated the bids. At times, O'Brien Partners used Winters as a broker to assist in various aspects of the process.

3. O'Brien Partners Begins Receiving A Split Of Brokerage Commissions Without Notice to its Client

In August 1991, O'Brien Partners accepted its first payment from Pacific Matrix in connection with a reinvestment transaction. The payment occurred in a transaction involving the Wisconsin Public Power Inc. System ("Wisconsin"), for whom O'Brien Partners served as financial advisor for bond offerings in 1990 and 1991 and subsequent investments of bond proceeds used for reserve funds.[3] The 1990 bond issue of approximately $113 million was Wisconsin's first bond offering ever, and Wisconsin looked to O'Brien Partners for special guidance concerning the offering and investment of proceeds in securities, including repurchase agreements, consistent with the limitations in the bond offering documents or bond resolution. As part of the transaction, O'Brien Partners used Pacific Matrix to broker the investment agreement for the approximately $9.4 million held in the debt service reserve fund. Pacific Matrix and O'Brien Partners entered into an arrangement whereby Pacific Matrix would pay 50 percent of its resulting commission to O'Brien Partners. At O'Brien Partners' recommendation, Wisconsin entered into a repurchase agreement with the winning bidder, Mitsui Taiyo Kobe Global Capital Inc. ("MTK"). MTK paid a $68,000 commission to Pacific Matrix, which wrote a check dated August 22, 1991 made payable to O'Brien Partners in the amount of $34,000.[4]

The O'Brien Partners employee responsible for the Wisconsin offerings asked John O'Brien, the President of O'Brien Partners, whether he should notify Wisconsin of the Pacific Matrix payment. The O'Brien Partners employee stated that John O'Brien replied that he believed that notice wasn't necessary because the client was getting the best price available after receiving at least three bids and the fee was being paid not by the client but by the third-party provider. Accordingly, O'Brien Partners did not disclose that payment to Wisconsin. O'Brien Partners' invoice to Pacific Matrix incorrectly described the services for which payment was sought (i.e., a share of the commissions that Pacific Matrix was receiving from MTK) as "Professional Services" related to "Tax Exempt Market Information Pertaining to Municipal Issues Debt Service Reserve Fund Investments."

O'Brien Partners also advised Wisconsin with respect to its July 1991 bond offering of approximately $42 million and the subsequent investment of bond proceeds for the reserve fund. As with the previous transaction, Wisconsin relied on O'Brien Partners' expertise with respect to the investment of proceeds in securities, including repurchase agreements. At O'Brien Partners' request, Pacific Matrix brokered a repurchase agreement to invest moneys from the debt service reserve fund. Pacific Matrix and O'Brien

Partners again agreed to share the commission. The winning bidder paid a commission of $48,733.52 to Pacific Matrix, which, in turn, paid $24,366 to OBPM.[5] O'Brien Partners followed the same process as in the first Wisconsin transaction and, for the same reasons, did not notify the client of Pacific Matrix's payment to OBPM.

While OBPM's invoice to Pacific Matrix described the $24,366 due as a "referral fee for investments services," other than a handwritten entry by an O'Brien Partners bookkeeper it did not identify the issuer, bond offering, investment provider, or any other information.[6]

4. O'Brien Partners Reevaluates Its Notice Obligation But Fails to Adopt Procedures Adequate to Ensure Successful Notice to Clients

By late 1991, when it became apparent that additional opportunities to share brokerage commissions would become available, O'Brien Partners began to analyze further whether it needed to notify its clients of its receipt of third-party commissions. O'Brien Partners sought legal advice on the issue of client notification in late 1991. Counsel opined in an advice memorandum dated November 18, 1991 that while it did not believe that legal authority specifically mandated disclosure, "[n]onetheless, published disclosure guidelines, the spirit and intent of securities disclosure laws, and a related statutory provision suggest that such disclosure to the Issuer and the Seller should be made." [7]

Shortly thereafter, John O'Brien decided that O'Brien Partners would notify its clients of its opportunity to receive third-party payments and seek permission to do so, but did not implement an effective notification procedure. John O'Brien orally informed O'Brien Partners employees that such notice should be given, but O'Brien Partners did not provide written direction to its employees or instructions as to the precise form and substance of such disclosure. At relevant times, O'Brien Partners' policy also did not contemplate any written disclosure. Nor did it require that the notice be given to a particular decision-making body within each issuer, such as a board or committee. Rather, the procedures adopted by O'Brien Partners called for the employee who handled the transaction at issue to inform the official at the client handling the transaction that O'Brien Partners had the opportunity to receive a third-party payment stemming from the investment of bond proceeds. John O'Brien said that he would confirm with that employee that notice had been given; if not, John O'Brien would notify the client himself. The policy of O'Brien Partners was to inform clients that the total payment in which it would share would equal up to five basis points of the investment. They did not inform the clients of the dollar amount that it had received, unless asked.[8]

The disclosure procedures adopted by O'Brien Partners at that time were not adequate to inform its clients of the facts creating a potential conflict of interest. The disclosure failure is evident from the disparate statements of O'Brien Partners and its clients. Although John O'Brien and other O'Brien Partners' officers and employees stated that from the time its disclosure procedures began, in late 1991 or early 1992, each client was informed of each third-party payment to be made to O'Brien Partners or OBPM, no O'Brien Partners clients discussed herein recalled receiving any such notice, or knew of any third-party payment.[9]

a. Calleguas Municipal Water District

O'Brien Partners served as financial advisor to Calleguas Municipal Water District ("Calleguas") in its 1991 offering of approximately $62 million and investments of bond proceeds held in the construction and debt service reserve funds.[10] The offering was Calleguas' first since the 1970s, and the issuer relied on O'Brien Partners' advice concerning the offering and the investments of proceeds in securities, including repurchase agreements, consistent with the limitations in the bond offering documents or bond resolution. O'Brien Partners used Pacific Matrix to broker the two above-mentioned investments, and they again agreed to share the commissions. The two winning bidders paid commissions to Pacific Matrix in the amount of $50,000 and $33,000, and it, in turn, paid OBPM $25,000 and $16,500, respectively.

John O'Brien stated that, at the outset of the engagement, he had a general conversation with the Calleguas Board Chairman in which he discussed reinvestment of proceeds and that OBPM could receive a brokerage fee on reinvestments. Also, an O'Brien Partners' officer stated that she explained the process of investing proceeds to Calleguas' Controller, informing the Controller how the bidding worked, that the winning bidder generally paid a brokerage commission, and that O'Brien Partners might receive a split of that commission. The officer also stated that Calleguas' bond counsel participated in this conversation, and that, after its conclusion, the Controller stated that she had the authority to and did approve O'Brien Partners' request to receive brokerage fees of up to five basis points. While bond counsel recalled a general conversation about the investment process, including the payment of fees, bond counsel and the Controller stated that they could not recall any discussion that O'Brien Partners and OBPM would be sharing in such payments.

O'Brien Partners also advised Calleguas in its August 1993 bond offering of approximately $57 million and the investment of certain bond proceeds in GICs. At O'Brien Partners' request, Feld Winters brokered an investment agreement for approximately $3.2 million held in the reserve fund. The winning bidder paid a commission of $19,540 to Feld Winters, which, in turn, paid 60 percent of that total, or $11,724, to OBPM.[11] Although an O'Brien Partners employee who worked on the transaction recalled that this payment was disclosed during a Calleguas Board meeting, Calleguas' Controller, bond counsel, and outside counsel, who attended the meeting, said they did not recall such a discussion and were not aware of the payment.

b. Southern California Public Power Authority

Pursuant to a January 1989 contract, O'Brien Partners served as financial advisor to the Southern California Public Power Authority ("SCPPA") for various bond offerings, including two 1993 transactions discussed below. SCPPA relied on O'Brien Partners' advice with respect to, among other things, the timing and pricing of the offering, and the investment of bond proceeds in securities, including repurchase agreements and GICs.

O'Brien Partners advised SCPPA in connection with two bond offerings in March 1993 and July 1993 for a combined $520 million. At O'Brien Partners' request, Feld Winters brokered the repurchase agreement used to invest the reserve funds in each offering. The winning bidders paid commissions of $72,000 and $200,000 to Feld Winters, which, in turn, paid $36,000 and $125,000 to OBPM.

The O'Brien Partners point person on the transactions said that he spoke with a SCPPA representative several times about sharing brokerage fees, and received permission from that representative for O'Brien Partners to receive such fees. That representative stated that no such conversations occurred, and he and other high-level SCPPA officials who were involved in the offerings stated that they were not aware of, and did not consent to, these payments.

c. City of Anaheim, California

Pursuant to an April 1989 contract, O'Brien Partners served as financial advisor to the City of Anaheim, California ("Anaheim"), for four bond offerings in the summer of 1993.[12] In each transaction, Anaheim relied on O'Brien Partners' advice on various matters, including the investment of certain bond proceeds in repurchase agreements. At O'Brien Partners' request, Feld Winters conducted the bidding process and brokered three agreements used to invest certain proceeds resulting from the above-mentioned Anaheim offerings. OBPM received three payments from Feld Winters totaling approximately $180,000 in connection with these investments.[13]

John O'Brien and another O'Brien Partners employee asserted that they discussed the payments with an Anaheim official prior to the offerings, saying they disclosed that O'Brien Partners might be able to share in a brokerage commission of up to five basis points. Although O'Brien Partners representatives claim that the Anaheim official consented to O'Brien Partners' receipt of the third-party fees, the Anaheim

official said no such discussions occurred, that he was not aware of and did not consent to O'Brien Partners' receipt of any such payments.

Further, sometime in 1994 (several months after the Feld Winters payments), Anaheim's City Treasurer stated that she learned for the first time that investment providers occasionally pay commissions in connection with the investment of bond proceeds, and that payments that exceed the maximum allowable commission calculated in accordance with the five basis point formula set forth in the applicable tax regulations could affect the tax-exempt status of the bonds.[14] She then asked O'Brien Partners for a written record of any such payments. The point person on the transactions created a multi-page document entitled "Summary of Investments" ("Summary"), which referenced all bids submitted for each investment vehicle discussed above, who solicited each bid, and the total payments made by the winning bidder. A copy of the Summary was provided to Anaheim.

The Summary accurately identified the total dollar amounts paid by two of the winning bidders, (Transamerica Life ($39,922) and Societe Generale ($217,000)), but did not identify the payees, and did not disclose that O'Brien Partners or OBPM had received any part of the payments.[15] The Summary incorrectly stated that O'Brien Partners solicited all bids for the forward supply contract and that no payments were made by the winning bidder, but Feld Winters ultimately assisted in securing the winning bidder, Merrill Lynch, and Merrill Lynch paid a $61,000 commission to Feld Winters, which paid $25,250 to OBPM.

5. O'Brien Partners Fails to Report Its Third-Party Fees in Amended Forms ADV, and Fails to Provide Such Information to Its Clients

None of the amendments to O'Brien Partners' Form ADV filed from 1991-93 disclosed the third-party payments discussed herein. Furthermore, an amendment to O'Brien Partners' Form ADV filed with the Commission on February 18, 1992 incorrectly indicated, in a section entitled "Additional Compensation," that neither O'Brien Partners nor any related person had any written or oral arrangements under which it received cash or "some economic benefit," including "commissions," from a "non-client in connection with giving advice to clients." Moreover, O'Brien Partners failed to provide either a copy of Part II of its Form ADV or a document containing at least the information required in Part II to its municipal advisory clients, as required by Rule 204-3 under the Advisers Act.

D. LEGAL DISCUSSION

1. O'Brien Partners Provided Investment Advice to its Municipal Clients

O'Brien Partners acted as an investment adviser to Wisconsin, Calleguas, SCPPA, and Anaheim for purposes of the Advisers Act because it rendered advice to those clients concerning their investment of bond proceeds in securities, including repurchase agreements and GICs, and was compensated for that advice. See Section 202(a)(11) of the Advisers Act;[16] see also Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Release No. IA-1092, 39 SEC Docket 653 (October 8, 1987) (hereinafter "Advisers Act Release No. 1092"). O'Brien Partners' relationship with these issuers generally envisioned that O'Brien Partners would advise them as to how they should invest their bond proceeds, including whether to invest them in securities, whenever such advice might be requested. O'Brien Partners' contracts with Wisconsin and Calleguas specifically provided that O'Brien Partners would provide "expert advice" on a variety of matters, including the "reinvestment of the bond proceeds." SCPPA and Anaheim also entered into each bond transaction relying on O'Brien Partners' advice concerning how to invest their proceeds. Although municipal issuers have somewhat limited options with respect to how they can invest bond proceeds,[17] a sufficient number of alternatives existed in each transaction at issue so as to support the issuers' need for investment advice. O'Brien Partners selected the GIC broker used in each transaction and advised the issuers on the possible alternatives with respect to how to invest their proceeds. By overseeing the competitive bidding process for locating appropriate

investment vehicles for the bond proceeds, reviewing the bid forms, and assuring that the investments met the client's guidelines and were within the parameters of the bond offering, O'Brien Partners advised its clients regarding the investment of their bond proceeds in non-government securities and the type of securities in which to invest. Based on O'Brien Partners' advice, each municipality at issue invested the relevant bond proceeds in government securities or in separate investment agreements, including GICs, forward supply contracts, and repurchase agreements. All of the GICs, forward supply contracts and repurchase agreements discussed herein were securities for purposes of the federal securities laws. Other recent enforcement proceedings have been based on similar transactions. See e.g., SEC v. Stifel, Nicolaus and Company, Inc., Lit. Rel. No. 14587 (August 3, 1995) (complaint alleged undisclosed payments stemming from issuer's investment of bond proceeds in GICs and forward purchase agreements); In the Matter of Pacific Matrix Financial Group, Inc., Administrative Proceeding File No. 3-9539 (January 30, 1998).

Finally, O'Brien Partners was compensated for rendering advice concerning its clients' investments in securities. This compensation was received in a variety of ways. As discussed above, O'Brien Partners' contracts with its clients in some cases explicitly provided that investment advice was among the services to be provided in exchange for the contractual payments. In one instance, O'Brien Partners separately invoiced its client for its advice concerning the reinvestment of proceeds. In addition, O'Brien Partners was compensated for this advice through its receipt of third-party payments. Compensation for advisory services rendered can be demonstrated by showing the adviser received compensation "from some source for his services;" it is not necessary to show the compensation was paid directly by the person receiving the investment advisory services. See Advisers Act Release No. 1092, 39 SEC Docket at 662.

O'Brien Partners' arrangement with its clients is distinguishable from the arrangement described in The Knight Group, 1991 SEC No-Act. LEXIS 1303 (Nov. 13, 1991). In that no-action letter, the staff of the Division of Investment Management said that it would not recommend enforcement action against a financial advisor to issuers of municipal securities if, without registering as an investment adviser, the financial advisor assisted clients in structuring new bond issues and occasionally made recommendations of temporarily idle proceeds pending their project use. The staff's response noted in particular that The Knight Group would not be compensated for making such recommendations.

2. O'Brien Partners Violated Section 206(2) of the Advisers Act

Section 206(2) makes it unlawful for an investment adviser to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or potential client and codifies the fiduciary duty of investment advisers to act for the benefit of their clients, requiring advisers to exercise the "utmost good faith in dealing with clients, to disclose all material facts, and to employ reasonable care to avoid misleading clients." SEC v. Moran, 922 F. Supp. 867, 895-96 (S.D. N.Y. 1996); see also SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963). An investment adviser's failure to disclose an actual or potential conflict of interest violates Section 206(2). Capital Gains, 375 U.S. 180; In the Matter of Patrick Clements d/b/a/ Patrick Clements & Assoc., 42 S.E.C. 373 (1964). Proof of scienter is not required to establish a violation of Section 206(2). See Capital Gains, 375 U.S. at 195.

As an investment adviser, O'Brien Partners owed a fiduciary duty to its clients, Wisconsin, Calleguas, SCPPA and Anaheim, to disclose all material facts, including all instances in which "the adviser is in a situation involving a conflict, or potential conflict, of interest with a client. The type of disclosure required by an investment adviser who has a potential conflict of interest with a client will depend upon all the facts and circumstances. As a general matter, an adviser must disclose to clients all material facts regarding the potential conflict of interest so that the client can make an informed decision as to whether to enter into or continue an advisory relationship with the adviser or whether to take some action to protect himself against the specific conflict of interest involved." Advisers Act Release No. 1092, 39 SEC Docket at 667-68. See also Capital Gains, 375 U.S. at 191-92 (Congress's intent in enacting the

Advisers Act was "to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser -- consciously or unconsciously -- to render advice which was not disinterested").

O'Brien Partners breached its fiduciary duty to Wisconsin, Calleguas, SCPPA, and Anaheim by failing adequately to disclose that, while providing advisory services to these issuers, O'Brien Partners also was receiving payments from third parties that brokered agreements used by these issuers to invest their bond proceeds. These third-party payments were material because they gave rise to a risk that O'Brien Partners would not provide impartial advice to its financial advisory clients with respect to the use of Pacific Matrix and Feld Winters as investment brokers, and how the issuers should invest their bond proceeds.[18] "An investor seeking the advice of a registered investment adviser must . . . be permitted to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving two masters or only one, `especially . . . if one of the masters happens to be economic self-interest.' " Capital Gains, 375 U.S. at 196 (citations omitted). The payments also cast doubt on the integrity of the offering process. O'Brien Partners' clients lacked material information they needed to consider in deciding whether to proceed with the offerings, the manner in which to invest the bond proceeds, and whether to heed O'Brien Partners' advice. See Wilson v. Great American Industries, Inc., 855 F.2d 987, 993-94 (2d Cir. 1988) (where a person with a duty to investors makes a decision or recommendation on a matter important to investors, but fails to disclose that he has a potential conflict that might have influenced his decision, the existence of the conflict of interest is material and should be disclosed); Steadman v. SEC, 603 F.2d 1126, 1130 (5th Cir. 1979).[19]

In view of the materiality of these payments and the actual or potential conflict they created, O'Brien Partners was obligated, but failed, to adopt procedures that would insure effective notice was given to its clients. By failing adequately to advise its clients of its receipt of these payments, O'Brien Partners violated Section 206(2) of the Advisers Act.

3. O'Brien Partners Violated Sections 17(a)(2) and (3) of the Securities Act

Sections 17(a)(2) and (3) of the Securities Act prohibit misrepresentations or omissions of material facts in the offer or sale of any security. Scienter is not required to prove violations of Sections 17(a)(2) or (3). Aaron v. SEC, 446 U.S. 680, 697 (1980). Instead, violations of these sections may be established by showing negligent conduct. SEC v. Hughes Capital Corp., 124 F.3d 449, 453-54 (3d Cir. 1997). For purposes of the Securities Act, a duty to disclose material information may be premised upon a fiduciary relationship, or the existence of a similar relationship of trust and confidence, which results in the party charged with the disclosure obligation being aware that the other party is relying on the relationship in making his or her investment decisions. See Chiarella v. United States, 445 U.S. 222, 228 (1980); United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991), cert. denied, 112 S. Ct. 1759 (1992); Zweig v. Hearst Corp., 594 F.2d 1261, 1268 (9th Cir. 1979). A fiduciary relationship can exist between financial advisor and client when the relationship is marked by dependency and influence. Chestman, 947 F.2d at 568-69. Further, as mentioned earlier, an investment adviser also owes a fiduciary duty to its clients. Capital Gains, 375 U.S. at 194.

O'Brien Partners owed a fiduciary duty to its clients, both as a financial advisor and as an investment adviser.[20] As a result, it was obligated to disclose the material facts concerning its arrangement to share commissions paid to the brokers on its clients' transactions. See Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949) (petitioner acted in dual capacity of investment adviser and broker, owed a fiduciary duty to her clients, and violated Section 17(a) by failing to make full disclosure concerning certain securities transactions). O'Brien Partners' failure to make full disclosure of those facts violated Sections 17(a)(2) and (3) of the Securities Act.

4. O'Brien Partners Violated The Reporting, Disclosure and Recordkeeping Provisions of the Advisers Act

Section 207 of the Advisers Act makes it unlawful for any person "willfully to make any untrue statements of a material fact," or "willfully to omit to state ... or report any material fact," in any "report" filed with the Commission. The term "report" includes amendments to Form ADV and Forms ADV-S.[21] Rule 204-3 under the Advisers Act requires investment advisers to furnish to each advisory client either a copy of Part II of the adviser's Form ADV or a document containing at least the information required therein. Under Rule 204-2(a)(5) under the Advisers Act, investment advisers must maintain "true, accurate and current" records forming the basis of entries in any ledger and "all bills or statements . . . relating to the business of the investment adviser."

None of O'Brien Partners' amendments to Form ADV filed between 1991 and 1993 disclosed its receipt of the additional compensation generated by its fee-sharing arrangements with Pacific Matrix and Feld Winters. Furthermore, the amendment to Form ADV filed on February 19, 1992, incorrectly indicated that O'Brien Partners received no economic benefit (defined as including commissions) from a non-client in connection with giving advice to clients. In addition, O'Brien Partners' Forms ADV-S filed between 1991 and 1993 incorrectly certified that no amendment needed to be filed to correct any information contained in the Form ADV. Accordingly, O'Brien Partners violated Section 207 of the Advisers Act, which makes it unlawful for "any person willfully to make any untrue statements of a material fact," or "willfully to omit to . . . report any material fact" in an amended Form ADV or other report filed with the Commission.

In addition, O'Brien Partners failed to provide the information set forth in Part II of its Form ADV, and amendments thereto, to Wisconsin, Calleguas, SCPPA, or Anaheim or other municipal issuers, as required by the Advisers Act. Accordingly, O'Brien Partners violated Section 204 of the Advisers Act and Rule 204-3 thereunder.

Finally, O'Brien Partners generated and submitted to Pacific Matrix an incorrect invoice in 1991 concerning the $34,000 paid in connection with Wisconsin's investment of bond proceeds. Accordingly, O'Brien Partners failed to make and keep true and accurate books and records as required under Section 204 of the Advisers Act and Rule 204-2(a)(5) thereunder.

IV.

FINDINGS

On the basis of this Order and the Offer of Settlement submitted by the Respondent, the Commission finds that O'Brien Partners willfully violated Sections 17(a)(2) and (3) of the Securities Act, and Sections 204, 206(2) and Section 207 of the Advisers Act and Rules 204-2 and 204-3 thereunder.[22]

V.

In view of the foregoing, the Commission has determined it is in the public interest to accept the Respondent's Offer of Settlement. Accordingly, IT IS HEREBY ORDERED, effective immediately, that O'Brien Partners:

A. be, and hereby is, censured;

B. shall cease and desist from committing or causing any violation and any future violation of Sections 17(a)(2) and (3) of the Securities Act, and Sections 204, 206(2) and Section 207 of the Advisers Act and Rules 204-2 and 204-3 thereunder; and

C. shall pay a civil penalty in the amount of $250,000 to the United States Treasury, which shall be paid pursuant to the following schedule: $100,000 shall be paid within ten (10) days of the date of this Order; $75,000 shall be paid within three (3) months of the date of this order; and $75,000 shall be paid within six (6) months of the date of this Order. Such payments shall be: (1) made by United States postal money

order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) delivered to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 0-3, Washington D.C. 20549; and (4) submitted under cover letter which identifies O'Brien Partners as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Erich T. Schwartz, Assistant Director, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 7-6, Washington, D.C. 20549.

FOOTNOTES

[1]: The term financial advisor is not defined in the federal securities laws. Rule G-23(b) of the Rules of the Municipal Securities Rulemaking Board provides that "a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services."

[2]: A municipal bond offering ordinarily creates several investment requirements for the issuer. For example, if the bond issue is undertaken to advance refund all or part of the issuer's outstanding debt, the issuer will be required to purchase and place in escrow securities sufficient to "defease," or pay when due, the principal and interest on the refunded debt. Frequently, the security for a municipal bond issue includes a debt service reserve fund providing a cushion of one year's debt service against cash flow problems during the life of the issue. This fund, too, is invested. If the purpose of the offering is to finance a construction or other project, issuers may use instruments such as a GIC to invest the proceeds until needed. Generally, with respect to municipal securities offerings, a GIC is an agreement to deposit money with a financial institution. The terms of the GIC, including the interest rate, withdrawal limitations, termination and collateralization are specifically negotiated and tailored to address the specific needs of the issuer. A GIC allows the issuer to invest the bond proceeds at a specified rate or rates until needed and earn a return in excess of most short-term investments. Municipal issuers also often need to invest other moneys associated with a bond offering, including reserve funds, which are set aside as additional security for bondholders in the event of default.

Beginning in the mid-1980s, firms known as investment or GIC brokers arose to assist issuers in locating investment vehicles to meet these investment requirements. These brokers typically solicit providers of GICs, forward supply contracts, and other investments needed by municipal entities. Given their expertise and industry contacts, such brokers often can find investment alternatives for an issuer that the issuer's underwriter or financial advisor cannot secure. Such brokers generally are compensated by the entity selected to provide the investment vehicle to the issuer. Fee percentages typically were equal to the maximum allowable commission calculated in accordance with the five basis point formula set forth in the applicable tax regulations.

[3]: In April 1990, O'Brien Partners entered into a financial advisory contract with Wisconsin that provided that O'Brien Partners would advise the issuer about the upcoming 1990 bond issue and the reasonableness of future bond issuances, and provide "expert advice" with respect to various matters, including the "reinvestment of the bond proceeds." In exchange for such services, Wisconsin agreed to pay O'Brien Partners a quarterly retainer and an additional transaction fee, depending on the size and complexity of the bond offerings.

[4]: O'Brien Partners sent an invoice dated August 21, 1991 to Wisconsin in the amount of $34,125 for "professional services associated with the Repurchase Agreement with Mitsui Taiyo Kobe Global Capital Inc." Thus, O'Brien Partners was paid twice -- once by Wisconsin, and once by Pacific Matrix -- for the same services. O'Brien had previously been paid separately by Wisconsin for services provided in connection with the underlying bond offering.

[5]: This and all subsequent third-party payments discussed herein were made through OBPM, as opposed to directly to O'Brien Partners.

[6]: With respect to each subsequent payment discussed herein, the OBPM invoice submitted to Pacific Matrix or Feld Winters for payment similarly described the amount due as concerning simply a "Referral Fee for Investments Services." The invoices uniformly failed to include a single identifying aspect of the transaction, such as the issuer, bond offering, or investment vehicle. O'Brien Partners' copies of the invoices included a handwritten note by an O'Brien Partners clerk that identified the issuer. This absence of detail contrasts with invoices that O'Brien Partners routinely sends its clients, which generally identify the bond issue by name and dollar amount and, when relevant, the investment provider.

[7]: In the memorandum, O'Brien Partner's counsel stated that, notwithstanding that O'Brien Partners was registered as an investment adviser, counsel generally had taken the position that O'Brien Partners was not an investment adviser to municipal issuers because it was not providing advice with respect to investments in securities. The memorandum further stated, however, that if O'Brien Partners were deemed to be providing such advice, it would be required to comply with various provisions of the Advisers Act, including provisions requiring disclosure in O'Brien Partners' Form ADV of OBPM's receipt of third-party commissions.

[8]: Although it received counsel's opinion in November 1991 concerning the need to give notice to its clients, O'Brien Partners did not immediately implement its disclosure policy. For example, O'Brien Partners did not give notice to Wisconsin concerning the payment to OBPM in May 1992. (See supra at Section III.C.3.).

[9]: In certain transactions the procedures employed did place O'Brien Partners' municipal clients on notice that the firm proposed to receive such fees from third-party providers. Those transactions are not charged in this Order.

[10]: In December 1990, O'Brien Partners entered into a financial advisory contract with Calleguas that provided that it would provide "expert advice" concerning, among other things, the "reinvestment of the bond proceeds."

[11]: The 50-50 fee-sharing arrangement between Winters and O'Brien Partners was adjusted to 60-40 in O'Brien Partners' favor in certain transactions, and was adjusted to less than 50 percent in one other.

[12]: The transactions were: (1) a June 1993 offering of $71.3 million; (2) a June 1993 offering of $60.7 million; (3) a June 1993 offering of $13.545 million; and (4) a July 1993 offering of $62.810 million.

[13]: First, Feld Winters brokered repurchase agreements used to invest moneys held in the reserve funds from the $71.3 million and $62.810 million offerings. The winning bidder for both investments, Transamerica Life Insurance Co., paid a combined commission of $39,922 to Feld Winters which, in turn, paid $23,995.64 to OBPM. Second, Feld Winters brokered two repurchase agreements used to invest moneys held in the reserve funds from the $60.7 million and $13.545 million offerings. The winning bidder for both repurchase agreements, Societe Generale, paid Feld Winters a commission of $217,179 and Feld Winters, in turn, paid OBPM a total of $130,307.53. Finally, Feld Winters brokered a forward supply contract in connection with the $71.3 million, $60.7 million, and $13.545 million offerings. Merrill Lynch, the winning bidder, paid a combined commission of $61,000 to Feld Winters which, in turn, paid OBPM a total of $25,250.

[14]: It does not appear that any of the commissions discussed herein threatened the tax exempt status of the underlying municipal securities.

[15]: The amounts were listed under a heading entitled "Administrative Cost," which the Summary said "includes cost paid by the provider for the brokerage or selling commissions, legal and accounting fees, investment advisory fees, recording keeping, safekeeping, custody and similar cost." While identifying the payors, it did not identify the payees.

[16]: Section 202(a)(11) of the Advisers Act, in relevant part, defines an investment adviser as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . ."

[17]: State law and the governing documents in each bond offering set the parameters with respect to how proceeds can be reinvested, and often limit such investments to certificates of deposit, Treasury securities, government agency securities, and other similar investments.

[18]: Because the third-party payments were significant, they created great risk of influencing the advice O'Brien Partners gave to its clients. The third-party payments ranged from 15 percent to more than 100 percent of the financial advisory fee received by O'Brien Partners directly from its client in the particular transactions.

[19]: Moreover, since even potential conflicts of interest are material and must be disclosed, O'Brien Partners was required to disclose its receipt of third-party payments, even if it had concluded that the payments did not influence the manner in which it advised its clients.

[20]: In addition to its duties under the Advisers Act, relevant state law also imposed a fiduciary duty on O'Brien Partners. Under Wisconsin law, a fiduciary relationship exists when there is an inequality, dependence, weakness of business intelligence, "or other conditions giving to one an advantage over the other." Production Credit Ass'n of Lancaster v. Croft, 143 Wis. 2d 746, 754-55, 423 N.W. 2d 544, 547 (App. 1988). Similarly, under California law, a fiduciary relationship is created where a person " `reposes trust and confidence in another and the person in whom such confidence is reposed obtains control over the other person's affairs.' " Recorded Picture Co. v. Nelson Entertainment, Inc., 61 Cal. Rptr. 2d 742, 754 (Ct. App. 2 Dist. 1997) (citation omitted). O'Brien Partners' relationship with Wisconsin, Calleguas, SCPPA and Anaheim was characterized by the superiority of position and entrusting of power that Wisconsin and California courts have deemed sufficient to find a fiduciary relationship. The issuers relied on O'Brien Partners' expertise and advice concerning, among other things, the optimum investments in which to place certain bond proceeds. As a fiduciary, O'Brien Partners owed its clients a duty of loyalty and assumed an obligation to notify these entities of all information relevant to the affairs entrusted to it.

[21]: See Rule 204-1(d). Pursuant to Rule 204-1(c) under the Advisers Act, Forms ADV-S were required to be filed annually until December 27, 1996, and obligated advisers to certify that no amendment to Form ADV needed to be filed to correct any information contained therein. This requirement was in effect at all relevant times. Subsequent to the time period at issue in this case, the requirement to file Form ADV-S was stayed pending other rulemaking. See Advisers Act Release No. 1602 (Dec. 20, 1996).

[22]: In applying the term "willful" in Commission administrative proceedings instituted pursuant to Sections 15(b), 15B, 15C, 17A, 19(h) and 21B of the Securities Exchange Act, Section 9 of the Investment Company Act, and Section 203 of the Investment Advisers Act, the Commission evaluates on a case-by-case basis whether the respondent knew or reasonably should have known under the particular facts and circumstances that his conduct was improper. In this case, as in all Commission administrative proceedings charging a willful violation under these statutory provisions, the Commission applies this standard to persons -- specifically, securities industry professionals -- who are directly subject to

Commission jurisdiction and who have a responsibility to understand their duties to the investing public and to comply with the applicable rules and regulations which govern their behavior.

<u>In re John Gardner Black and Devon Capital Management, Inc.</u>, Investment Advisers Act Release No. 1720, A.P. File No. 3-9599 (May 4, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be instituted pursuant to Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Devon Capital Management, Inc. ("Devon") and John Gardner Black ("Black").

In anticipation of the institution of these proceedings, Devon and Black have submitted Offers of Settlement ("Offers") which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except for those set forth below in Section II, paragraphs A. and B., which are admitted, Devon and Black, by their respective Offers, consent to the entry of the findings and imposition of the sanctions contained in this Order Instituting Public Proceedings, Making Findings and Imposing Remedial Sanctions ("Order").

Accordingly, IT IS ORDERED that proceedings, pursuant to Sections 203(e) and 203(f) of the Advisers Act, against Devon and Black be, and hereby are, instituted.

II.

On the basis of this Order and the Offers submitted by Devon and Black, the Commission finds that:

A. Devon Capital Management, Inc. has been registered with the Commission as an investment adviser from December 15, 1989 until the present. As of September 1997, Devon managed approximately $345 million in assets for approximately 100 investment advisory clients, the vast majority of which were local school districts seeking to invest the proceeds of municipal bond offerings.

B. John Gardner Black was, at all times relevant to this proceeding, the president, portfolio manager, and sole shareholder of Devon.

C. On December 12, 1997, an Order of Permanent Injunction was entered against Black and Devon by the United States District Court for the Western District of Pennsylvania, in Securities and Exchange Commission v. John Gardner Black, et al., 97-CV-2257, pursuant to their consent. The Order of Permanent Injunction, inter alia, enjoined Black and Devon from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. In addition, Devon was enjoined from future violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and Black was enjoined from aiding and abetting violations of these same provisions.

D. The Commission's Complaint alleged that Black, acting through Devon and a corporate affiliate of Devon's, made misrepresentations and omissions of material fact in connection with the solicitation and management of Devon's investment advisory clients' funds, resulting in the loss of millions of dollars of municipal bond proceeds invested by school districts and other local government units throughout Western and Central Pennsylvania. The Complaint alleged that Black and Devon benefited financially from their actions.

III.

On the basis of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offers submitted by Devon and Black and to impose the sanctions specified therein.

Accordingly, IT IS HEREBY ORDERED THAT:

A. The registration of Devon Capital Management, Inc. with the Commission as an investment adviser is revoked.

B. John Gardner Black is barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company.

FOOTNOTES

-[1]- The findings herein are made pursuant to Devon's and Black's respective Offers and are not binding on any other person or entity in this or any other proceeding.

In re Freeman B. Irby III, Exchange Act Release No. 39362, A.P. File No. 3-9490 (November 26, 1997).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to institute this administrative proceeding pursuant to Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Freeman B. Irby III ("Irby" or "Respondent") to determine whether Respondent willfully aided and abetted and was a cause of violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept.<(1)> Solely for the purpose of these proceedings, and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, and without admitting or denying the findings contained herein, except as to the Commission's finding of jurisdiction over him and the subject matter, which are admitted, Respondent consents to the entry of this Order Instituting A Proceeding, Making Findings and Imposing Remedial Sanctions, a Cease and Desist Order and a Penalty (the "Order").

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<(1)> In determining to accept the Offer, the Commission considered the cooperation Respondent afforded the Commission staff.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds<(2)> that:

A. From March 1992 until July 24, 1996, Respondent was associated with Stephens Inc. ("Stephens"), a broker-dealer and municipal securities dealer registered with the Commission pursuant to Sections 15 and 15B(a) of the Exchange Act.

B. On June 3, 1992, the Board of Commissioners of Fulton County, Georgia, selected Stephens and another firm (the "Co-Financial Advisor") to serve as financial advisors to the county for a two-year term commencing July 1, 1992.<(3)>

C. As part of its work as one of the financial advisors to Fulton County, Stephens assisted with the selection of underwriters for an offering by Fulton County of $163.375 million in Water & Sewerage Revenue Bonds, Refunding Series 1992 ("Fulton Water & Sewer Refunding"), which closed on November 19, 1992. Respondent and his immediate supervisor (the "Supervisor") were principally responsible for drafting the request for underwriting proposals, and evaluating the responses to that request.

D. By late July 1992, the Supervisor had agreed, in exchange for a promise of remuneration, to help Lazard Freres obtain the position of senior managing underwriter (the most lucrative position) for the Fulton Water & Sewer Refunding. By mid-August 1992, the Supervisor had informed Respondent that he (the Supervisor) wanted Lazard Freres to be selected as lead underwriter on the Fulton Water & Sewer Refunding. The Supervisor did not tell Respondent or the Co-Financial Advisor that he (the Supervisor) expected to be paid by Lazard Freres.

E. During the period August 31 - September 2, 1992, at the Supervisor's instruction, Respondent took steps that affected the process of evaluating and ranking the responses to the request for underwriting proposals so that Lazard Freres was given the highest score and recommended

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<(2)> The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

<(3)> Rule G-23(b) of the MSRB provides, in relevant part, that: "a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services."

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to the Fulton County Commission to serve as senior managing underwriter. At a meeting of the Fulton County Commission on September 2, 1992, the County's financial advisors and its Finance Director submitted a joint recommendation to the Fulton County Commission that Lazard Freres be named lead underwriter for the Fulton Water & Sewer Refunding. The County Commission adopted that recommendation on September 16, 1992. On November 19, 1992, the Fulton Water & Sewer Refunding issue closed.

F. By agreeing to assist Lazard Freres with its effort to be named senior managing underwriter for the Fulton Water & Sewer Refunding in exchange for undisclosed remuneration, and by taking undisclosed steps, described above, to assist Lazard Freres with that effort, the Supervisor violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

G. As a result of the conduct described above, Respondent willfully aided and abetted and was a cause of the Supervisor's violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

Based on the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Respondent and impose the sanctions that are consented to in that Offer. Accordingly, IT IS HEREBY ORDERED that:

A. Pursuant to Section 15(b)(6) of the Exchange Act [15 U.S.C. § 7 o(b)(6)], Respondent be, and hereby is, censured;

B. Pursuant to Section 21C of the Exchange Act [15 U.S.C. § 7 8u-3], Respondent cease and desist from being a cause of any violation, and from being a cause of any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and C. Pursuant to Section 21B(a) of the Exchange Act [15 U.S.C. § 7 8u-2(a)], Respondent shall within 21 days of the entry of this Order, pay a civil penalty of $5,000 to the United States Treasury. Such payment shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered or delivered by certified mail (return receipt requested) to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C., 20549; and (d) submitted under cover letter that identifies the Respondent in these proceedings, and the file number of the proceedings. A copy of such cover letter and check shall be sent to J. Lee Buck, II, Senior Counsel, Division of Enforcement, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 7-5, Washington, D.C., 20549.

In re Ferber, Exchange Act Release No. 38102, A.P. File No. 3-9211 (December 31, 1996).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that a public administrative proceeding be instituted pursuant to Sections 15(b), 15B and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") against Mark S. Ferber ("Ferber").

II.

In anticipation of the institution of these proceedings, Ferber has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Solely for the purpose of this proceeding, and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. _201.100 et seq., and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over him and over the subject matter of this proceeding and the entry of the conviction and injunction as set forth in paragraphs III.B.1. and III.C.5., which are admitted, Ferber consents to the issuance of this Order Pursuant to Sections 15(b), 15B and 19(h) of the Exchange Act, Instituting Proceedings, Making Findings and Imposing Remedial Sanctions (the "Order") and to the imposition of the remedial sanctions set forth below.

III.

FINDINGS

On the basis of this Order and the Offer, the Commission finds that:

A. Respondent

Ferber, a resident of Concord, Massachusetts, was at all times relevant hereto an investment banker with Lazard Freres & Co., a broker-dealer and municipal securities dealer with a principal place of business in New York, New York ("Lazard"). Ferber joined Lazard in April 1988 as Senior Vice President, and was promoted to General Partner in January 1990. Ferber established and managed Lazard's Municipal Department branch office in Boston, Massachusetts until he resigned in January 1993.

B. Criminal Conviction

1. Following his conviction on mail and wire fraud charges, on December 19, 1996, Ferber was sentenced to a prison term of 33 months, and was ordered to pay a criminal fine of $1,000,000. United States of America v. Mark S. Ferber, Criminal No. 95-10338-WGY (D. Mass).

2. The indictment alleged that Ferber violated his fiduciary duties to his public financial advisory clients. The indictment further alleged that Ferber intentionally failed to adequately disclose to those clients material facts concerning a financial relationship that he entered into on behalf of Lazard with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), and thereby deprived his financial advisory clients of the ability to assess his advice concerning Merrill Lynch.

C. Injunction for Securities Laws Violations

1. On December 19, 1996 the Commission filed a Complaint against Ferber in the United States District Court for the District of Massachusetts, SEC v. Mark S. Ferber, Civil Action No. 96-12653 (EFH) (D. Mass). -[1]-

2. The Complaint alleged that Ferber was responsible for performing and/or overseeing all financial advisory services provided to the Massachusetts Water Resources Authority ("MWRA"), the District of Columbia ("the District") and the United States Postal Service ("USPS"). The Complaint alleged that Ferber, on

---------FOOTNOTES----------

-[1]- See Litigation Release No. 15193 (December 19, 1996).

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behalf of Lazard, negotiated a lucrative contract with Merrill Lynch, which provided that Lazard and Merrill Lynch would jointly market interest rate swaps and that Lazard would be a consultant to Merrill Lynch. The Complaint alleged that Ferber and others under his direct supervision primarily provided Lazard's services under the contract. Pursuant to the contract, between September 1990 and November 1992, Merrill Lynch paid Lazard nearly $5.8 million, which resulted in a substantial financial benefit to Ferber.

3. The Complaint further alleged that the contract with Merrill Lynch was a material fact that should have been disclosed to Lazard's financial advisory clients that were serviced by Ferber and were considering the selection of Merrill Lynch as a provider of financial services. The Complaint alleged that the contract created at least a potential conflict of interest for Ferber in that it gave rise to a significant risk that Ferber would not provide impartial advice to the financial advisory clients that were considering the selection of Merrill Lynch as a provider of financial services. Thus, the Complaint alleged that the contract created the potential for Ferber to abuse his influence over the financial advisory clients.

4. The Complaint further alleged that Ferber knowingly or recklessly failed to adequately disclose the contract to the MWRA, the District and the USPS, all of which selected Merrill Lynch to provide underwriting, interest rate swap or other financial services in connection with municipal securities offerings and/or the purchase and sale of securities. As a result, the Complaint alleged that Ferber defrauded these financial advisory clients and the purchasers of their municipal securities.

5. On December 19, 1996, without admitting or denying the Commission's allegations, Ferber consented to the entry of a final judgment of permanent injunction. On December 27, 1996, the District Court (i) permanently enjoined Ferber from future violations of Sections 10(b) and 15B(c)(1) of the Exchange Act, Rule 10b-5 thereunder and rule G-17 of the Municipal Securities Rulemaking Board, and (ii) ordered Ferber to pay disgorgement of $553,000, plus prejudgment interest of $97,000, for a total of $650,000.

IV.

Based on the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Ferber's Offer of Settlement.

Accordingly, IT IS HEREBY ORDERED that Ferber be, and hereby is, barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company.

In re Peacock, Hislop, Staley & Given, Inc. and Larry S. Given, Securities Act Release No. 7353, Exchange Act Release No. 37777, A.P. File No. 3-9139 (October 2, 1996).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to institute public cease-and-desist and administrative proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b)(4), 15(b)6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Peacock, Hislop, Staley & Given, Inc. ("PHS&G") and Larry S. Given ("Given") (collectively "the Respondents").

Accordingly, IT IS HEREBY ORDERED that said proceedings be, and hereby are, instituted.

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over them and over the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Cease-and-Desist and Public Administrative Proceedings Pursuant to Section 8A of the Securities Act and Sections 15(b)(4), 15(b)(6) and 21C of the Exchange Act, Making Findings, and Imposing a Cease-and-Desist Order and Remedial Sanctions ("Order"), and to the entry of the findings and the imposition of the cease-and-desist order and sanctions set forth below.

III.

On the basis of this Order and the Respondents' Offer, the Commission finds that:-[1]-

A. THE RESPONDENTS

1. PHS&G, headquartered in Phoenix, Arizona (File No. 8-38994), has been a registered broker-dealer since May 1989. During 1993, PHS&G served as financial adviser to Maricopa County, Arizona ("Maricopa County" or "the County") in connection with two general obligation bond offerings ("the 1993 G.O. Bond Offerings"). As financial adviser, PHS&G had access to the County's financial information including interim financial statements and budget projections.

2. Given, a registered representative, at all relevant times was and currently is a principal of PHS&G. During 1993, Given was President of PHS&G and was primarily responsible for providing financial advisory services to the County in connection with the 1993 G.O. Bond Offerings.

B. FACTS

1. Between July 26, 1993 and August 10, 1993, Maricopa County offered and sold $25.575 million worth of ten year general obligation project bonds ("Project Bonds") and $22.25 million worth of four year

general obligation refunding bonds ("Refunding Bonds") (collectively referred to as the "1993 G.O. Bond Offerings"). PHS&G and Given served as financial adviser to the County in connection with the 1993 G.O. Bond Offerings and, pursuant to an agreement, prepared offering statements which were to contain complete financial and other data. The Preliminary and Final Official Statements (hereinafter, the "Official Statements"), the primary disclosure documents for the 1993 G.O. Bond Offerings, were reviewed by the County, PHS&G, Given and others for accuracy and completeness.

---------FOOTNOTES----------

-[1]-The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity named as a respondent in this or any other proceeding.

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2. The Official Statements for each offering contained financial statements for the year ended June 30, 1992. However, the County's financial condition at the time of the 1993 G.O. Bond Offerings had materially worsened since June 30, 1992, in that the County's operating cash flow had materially declined. Specifically, during fiscal year 1992-93, the County developed a deficit in its General Fund and had nearly doubled the deficit in its Medical Center Enterprise Fund, from $16.9 million to $31.8 million. The Official Statements, which included 1992 financial statements, failed to disclose these changes. Given was aware of the County's cash flow problems and of Moody's Investor Service's downgrade of the County's preexisting G.O. Bond rating due to the cash flow situation. In addition, the Official Statements failed to disclose that the current liabilities of the Medical Center Enterprise Fund on June 30, 1993, exceeded its current assets by approximately 40% more than on June 30, 1992.

3. Furthermore, the Official Statements for the 1993 G.O. Bond Offerings failed to disclose that the County's cash flow position had materially declined since the close of the prior fiscal year. Such information, which was available to PHS&G and Given, was included in contemporaneous documents relating to a tax anticipation note offering by the County.

4. In addition, the Project Bonds' Official Statements represented that bond proceeds would be used to finance specific County projects. However, at a July 26, 1993, meeting of the County's Board of Supervisors, Given learned that proceeds from the sale of Project Bonds would be made available for other purposes, not disclosed to investors. In fact, Project Bond proceeds were used temporarily to finance the County's cash flow deficit through July 1994. Despite knowing of the County's plan to make Project Bond proceeds available for other purposes, PHS&G, through Given, did not revise or supplement or cause the County to revise or supplement the Final Official Statement for the Project Bond Offering to reflect this plan. Consequently, persons and entities who received the Official Statements for the Project Bond Offering, including investors in the offering, were unaware of the County's plan to make investor funds available for other purposes not disclosed in the Official Statements.

5. These facts were material since: 1) the County's changed financial condition, as reflected by the development of a General Fund deficit and the doubling of the Medical Center Enterprise Fund deficit would have been important for an investor to consider in deciding whether or not to purchase the County's G.O. Bonds; and 2) use of Project Bond proceeds to alleviate the County's cash flow deficit was an undisclosed use of investor funds, which an investor may have considered important in deciding whether or not to purchase the Bonds.

6. As the County's financial adviser, PHS&G and Given were reckless in that they, in, and in connection with, the offer, purchase and sale of the 1993 G.O. Bond Offerings, by use of the means and instruments of transportation and communication in interstate commerce and the means and instrumentalities of interstate commerce, and the mails, failed to cause the County to include in the Official Statements for the G.O. Bonds interim financial information indicating that the County's operating cash flow position had materially declined and information regarding the interim use of Project Bond proceeds. Therefore, Respondents caused and willfully aided and abetted the County's violation of Section 17(a) of the

Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the offer and sale of the 1993 G.O. Bonds.

IV.

Based on the foregoing, the Commission deems it appropriate to accept the Offer of the Respondents.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act that PHS&G and Given cease and desist from committing or causing any violation and any future violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IT IS FURTHER ORDERED, pursuant to Section 21B of the Exchange Act that PHS&G and Given shall, within 60 days of the entry of this Order, pay a civil money penalty in the respective amounts of $50,000 (PHS&G) and $25,000 (Given) to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549; and (D) submitted under cover letter that identifies PHS&G and Given as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Sandra J. Harris, Pacific Regional Office, Securities and Exchange Commission, 5670 Wilshire Boulevard, 11th Floor, Los Angeles, CA 90036.

<u>In re Lazard Freres & Co., LLC, and Merrill Lynch, Pierce, Fenner & Smith Incorporated</u>, Exchange Act Release No. 36419, A.P. File No. 3-8872 (October 26, 1995).

See “THE UNDERWRITER” section.

NAK

SALES PRACTICES

Injunctive Proceedings

<u>Securities and Exchange Commission v. First California Capital Markets Group, Inc., H. Michael Richardson and Derrick Dumont</u>, Civ. No. 97-2761-SI (N.D. Cal.), Litigation Release No. 15423 (July 28, 1997) (complaint); Litigation Release No. 16107 (April 7, 1999) (settled final orders).

See “THE UNDERWRITER” section.

<u>SEC v. J.B. Hanauer & Co.</u>,
Civ. Action No. 82-407 (D. N.J.), Litigation Release No. 9582 (February 11, 1982) (settled final order).

The Commission announced today that the United State District Court for the District of New Jersey permanently enjoined J. B. Hanauer & Co. ("Hanauer") from violating the antifraud, recordkeeping and certain other provisions of the Securities Exchange Act of 1934, the anti-fraud provisions of the Securities Act of 1933, Rules of the Municipal Securities Rulemaking Board concerning customer account information, delivery of confirmations, and supervision of employees and the filing and recordkeeping requirements of the Currency and Foreign Transactions Reporting Act and regulations thereunder. J.B.

Hanauer & Co. is a municipal bond dealer with headquarters in Livingston, New Jersey. Hanauer consented to the entry of the Final Judgment of Permanent Injunction without admitting or denying the allegations in the Commission's Complaint, which was also filed today. n1

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n1 The Commission today also issued an order instituting proceedings, making findings and imposing remedial sanctions in administrative proceedings against Hanauer and eighteen past and present associated persons. See Securities Exchange Act of 1934 Release No. / February 11, 1982.

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The Commission's Complaint alleges that Hanauer engaged in a course of conduct in which it encouraged its salesmen to solicit business of persons who, for income tax avoidance or other reasons, sought anonymity and paid for bond purchases with currency. As a part of this course of conduct and to accommodate these persons by concealing their identity, according to the Complaint, Hanauer opened and maintained accounts in fictitious names and addresses, made false entries in its books and records, failed to deliver customer confirmations of securities transactions and failed to file Currency Transaction Reports with the Internal Revenue Service which it was required to file upon the receipt of currency in excess of $10,000. The Complaint further alleges that Hanauer, through certain of its officers and employees, overcharged or permitted customers to be overcharged and made or caused false statements to be made to such customers concerning the prices charged for such purchases. In connection therewith, such persons overstated the offering prices for municipal securities and failed to deliver customer confirmations indicating the purchase price or delivered confirmations which they prepared indicating a higher purchase price, received the greater amount in currency from the customer and remitted the actual amount owed to the firm, diverting the excess to their own use. The Complaint also alleges that one Hanauer employee made or caused false statements to be made to a customer concerning the prices of certain municipal securities in order to conceal a market loss from this customer.

SEC v. Shelby Bond Service Corporation, et al. Civ. Action No. C-77-2236 (W.D. Tenn.), Litigation Release No. 7888 (April 27, 1977) (complaint); Litigation Release No. 7965 (June 9, 1977) (settled final orders); Litigation Release No. 8578 (October 27, 1978) (settled final order).

See “THE UNDERWRITER” section.

SEC v. Bertsil L. Smith and Robert W. Bradford and Jon R. Walls , Civ. Action No. C-76-497 (W.D. Tenn.), Litigation Release No. 7652 (November 16, 1976) (complaint).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, today announced that on November 5, 1976 the Honorable Bailey Brown, Chief Judge of the United States District Court for the Western District of Tennessee at Memphis, after a hearing on motions filed by the Commission, entered an Order of Preliminary Injunction and an Order Barring Disposal of Assets against Bertsil L. Smith ("Smith"), individually and d/b/a Smith-Walls, Inc. ("Smith-Walls") and Jon R. Walls ("Walls"), all of Memphis. The defendants were preliminarily enjoined from further violations of the antifraud provisions of the federal securities laws.

The complaint on which the Commission's motions were based alleged that Smith and Robert W. Bradford ("Bradford"), a co-defendant, aided and abetted by Walls, defrauded a Georgia investor by inducing him to sell municipal bonds and then converting the proceeds to their personal use. Smith induced the investor to sell his bonds on the misrepresentations that they were in imminent danger of default and that the investor would be paid within one week of delivery of the bonds. Bradford picked up the investor's bonds and returned to Memphis. Smith contracted Walls, who was then employed as a salesman with a Memphis municipal securities firm, and offered them to Walls at a price substantially less than Walls knew the bonds could be sold for. Walls told Smith that his employer had forbidden any

employees from effecting securities transactions with Smith. Walls then arranged for Smith to sell the bonds to one of Walls' customers and for Walls to purchase them from the customer, thereby hiding Smith's identity as the true seller of the bonds. In addition to receiving a commission on the transaction, Walls was paid additional monies by Smith.

The investor never received any proceeds from the sale of his bonds.

SEC v. Bertsil L. Smith and Robert W. Bradford and Jon R. Walls, Litigation Release No. 7764 (January 31, 1977) (defaults entered).

Jule B. Greene, Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced that on January 21, 1977, Honorable Bailey Brown, Chief Judge of the United States District Court for the Western District of Tennessee, at Memphis, entered default judgments permanently enjoining Bertsil L. Smith and Robert W. Bradford, both of Memphis, individually and doing business as Smith-Walls, Inc., from violations of the anti-fraud provisions of the Securities Exchange Act of 1934 in the purchase or sale of any security, including but not limited to municipal securities. Smith and Bradford were further ordered to disgorge proceeds from the sale of securities fraudulently obtained from customers to the registry of the Court.

(For further information see Litigation Release Nos. 7615 and 7652).

SEC v. C. Norman Driscoll, et al., Civ. Action No. 76-1520 (D. N.J.), Litigation Release No. 7515 (August 6, 1976) (settled final orders).

William D. Moran, Administrator of the New York Regional Office of the Securities and Exchange Commission, announced that on August 3, 1976, a Complaint was filed in the U.S. District Court for the District of New Jersey seeking to enjoin C. Norman Driscoll ("Driscoll'), Lyle Hatch ("Hatch"), Stephen Skubina ("Skubina"), and Richard L. Tecott ("Tecott") from engaging in further violations of the reporting and anti-fraud provisions of the federal securities laws.

The Commission's Complaint alleges that between August 1973 and September 1974, Driscoll, Hatch, and Skubina, while employed by Fidelity Union Trust Co. ("Fidelity Bank"), a wholly-owned subsidiary of Fidelity Union Bancorporation ("Holding Company"), along with Tecott, a partner in a now defunct municipal securities dealer, engaged in a series of pre-arranged purchases and sales of municipal securities, at prices unrelated to their fair market value, which were designed to cover up losses sustained in Fidelity Bank's municipal securities portfolio. Following the discovery of these prearranged transactions, an analysis was conducted to determine the impact of this wrongful conduct on the financial condition of Fidelity Bank. This analysis disclosed that Fidelity Bank had sustained a realized loss of $2,003,921.85 and an unrealized loss of $1,305,795.81.

The Complaint further alleges that Driscoll, Hatch, Skubina, and Tecott hid the true nature of their transactions, and the actual losses sustained as a result thereof, from the senior management of Fidelity Bank and the Holding Company. Accordingly, the books and records of Fidelity Bank failed to accurately state Fidelity Bank's financial condition, and accordingly, caused the Holding Company to file a false and misleading Form 10-Q for the six month period ending June 30, 1974.

Skubina and Tecott consented, without admitting or denying the allegations contained in the Commission's Complaint, to the entry of Final Judgments of Permanent Injunction, prohibiting further violations of Sections 10(b) and 13(a) of the Exchange Act and Rules 10b-5 and 13a-13 thereunder.

SEC v. C. Norman Driscoll, et al., Litigation Release No. 7588 (September 28, 1976) (settled final order).

William D. Moran, Administrator of the New York Regional Office, announced that on August 27, 1976, the Honorable Vincent P. Biunno, United States District Judge for the District of New Jersey, signed a Final Judgement of Permanent Injunction by Consent of Lyle Hatch enjoining Lyle Hatch ("Hatch") of Emerson, New Jersey, from engaging in further violations of the reporting and anti-fraud provisions of the federal securities laws.

The Commission, in its complaint filed on August 3, 1976, alleged that between August 1973 and September 1974, Hatch, while employed by Fidelity Union Trust Co. ("Fidelity Bank"), a wholly-owned subsidiary of Fidelity Union Bancorporation ("Holding Company"), along with two other employees of Fidelity Bank and a partner in a now defunct municipal securities dealer, who were also named in the complaint, engaged in a series of prearranged purchases and sales of municipal securities, at prices unrelated to their fair market value, which were designed to cover up losses sustained in Fidelity Bank's municipal securities portfolio. Following the discovery of these prearranged transactions, an analysis was conducted to determine the impact of this wrongful conduct on the financial condition of Fidelity Bank. This analysis disclosed that Fidelity Bank had sustained a realized loss of $2,003,921.85 and an unrealized loss of $1,305,795.81.

The Complaint further alleged that Hatch, and the other three defendants, concealed the true nature of their transactions, and the actual losses suffered as a result thereof, from the senior management of Fidelity Bank and the Holding Company. As a result, the books and records of Fidelity Bank failed to accurately state Fidelity Bank's financial condition, and, accordingly, caused the Holding Company to file a false and misleading Form 10-Q for the six month period ending June 30, 1974.

Hatch consented to the entry of the injunction without admitting or denying the allegations contained in the Commission's complaint.

For further information, see Litigation Release No. 7515.

<u>SEC v. C. Norman Driscoll, et al.</u>, Litigation Release No. 7612 (October 20, 1976) (settled final order).

William D. Moran, Administrator of the New York Regional Office, announced that on September 23, 1976, the Honorable Vincent P. Biunno, United States District Judge for the District of New Jersey, signed a Final Judgment of Permanent Injunction by Consent of C. Norman Driscoll enjoining C. Norman Driscoll ("Driscoll") of Chatham, New Jersey, from engaging in further violations of the reporting and antifraud provisions of the federal securities laws.

The Commission, in its complaint filed on August 3, 1976, alleged that between August 1973 and September 1974, Driscoll, while employed by Fidelity Union Trust Co. ("Fidelity Bank"), a wholly-owned subsidiary of Fidelity Union Bancorporation ("Holding Company"), along with two other employees of Fidelity Bank and a partner in a now defunct municipal securities dealer, who were also named in the complaint, engaged in a series of prearranged purchases and sales of municipal securities, at prices unrelated to their fair market value, which were designed to cover up losses sustained in Fidelity Bank's municipal securities portfolio. Following the discovery of these prearranged transactions, an analysis was conducted to determine the impact of this wrongful conduct on the financial condition of Fidelity Bank. This analysis disclosed that Fidelity Bank had sustained a realized loss of $2,003,921.85 and an unrealized loss of $1,305,795.81.

The complaint further alleged that Driscoll, and the other three defendants, concealed the true nature of their transactions, and the actual losses suffered as a result thereof, from the senior management of Fidelity Bank and the Holding Company. As a result, the books and records of Fidelity Bank failed to accurately state Fidelity Bank's financial condition, and, accordingly, caused the Holding Company to file a false and misleading Form 10-Q for the six month period ending June 30, 1974.

Driscoll consented to the entry of the injunction without admitting or denying the allegations contained in the Commission's complaint.

For further information, see Litigation Release No. 7515.

SEC v. Irvin D. Kaplan
Civ. Action No. ___ (S.D. Tex.), Litigation Release No. 7051 (August 22, 1975) (settled final order).

Richard M. Hewitt, Administrator of the Fort Worth Regional Office of the Securities and Exchange Commission, announced that on August 19, 1975 Federal District Judge Allen B. Hannay at Houston, Texas entered an order of permanent injunction enjoining Irvin. D. Kaplan, Houston, from further violations of the antifraud provisions of the Securities Exchange Act of 1934 in the purchase and sale of various bonds.

Kaplan consented to the entry of the order without admitting or denying the allegations in the Commission's complaint. The Commission's complaint was filed contemporaneously with the entry of the order of permanent injunction.

The Commission's complaint alleges that during the period from November 1974 to April 10, 1975 Kaplan engaged in a securities trading and check manipulation scheme wherein he sold corporate, government and municipal bonds valued at $93,000,000 and purchased bonds worth approximately $111,000,000, through ten brokerage firms and one bank bond department. The complaint further alleges Kaplan made payment for the purchases with checks drawn on accounts at five banks when the accounts had insufficient funds to cover the checks.

During the second week of April 1975 Kaplan, according to the complaint, issued checks in payment for the purchase of securities which were dishonored and returned by the banks. The losses from the sales of securities and from the returned checks given in payment for the securities were more than $2.7 million.

In connection with the securities purchases, the complaint charges that Kaplan made misrepresentation of material facts concerning his true financial condition and the sources and availability of funds used to purchase securities.

SEC v. R.J. Allen & Associates, Inc., et al., Civ. Action No. 74-1273-Civ-CF (S.D. Fla.), 386 F. Supp. 866 (S.D. Fla. 1974).

See Federal Reporter.

SEC v. R.J. Allen & Associates, Inc., et al., Litigation Release No. 6653 (December 7, 1974) (settled final orders).

Jule B. Greene, Administrator, and Michael J. Stewart, Associate Administrator of the Atlanta Regional Office of the Securities and Exchange Commission, announced today that on November 27, 1974, the Honorable Charles B. Fulton, Chief Judge for the Southern District of Florida, issued a Memorandum Opinion permanently enjoining R.J. Allen & Associates, Inc., Robert J. Allen, Howard W. Alexander, Charles J. Diaz, and Thomas A. Preston, all of Ft. Lauderdale, Florida, from further violations of the anti-fraud provisions of the Securities Act of 1933 [Section 17(a)] and the Securities Exchange Act of 1934 [Section 10(b) and Rule 10b-5 thereunder].

Chief Judge Fulton's Opinion, which was entered following an extensive hearing on the merits of the Commission's Complaint, was twenty-five pages in length. Labeling the defendants' operation "a horrible fraud," "vicious and brutal," and "a diabolical scheme," Chief Judge Fulton, equating the Commission's

request for disgorgement with restitution, ordered the defendants to disgorge to the Court-appointed Receiver the full amount received from all investors who purchased Industrial Development Revenue Bonds ("IDR's") from the firm of R.J. Allen & Associates, Inc. ("R. J. Allen"). The total to be disgorged, which is not definitely known at this time, is to be restored in the following fashion: R. J. Allen plus the individual defendants Robert J. Allen and Howard W. Alexander must jointly and severally restore to the Receiver "the full amount received from all of those investors who purchased IDR's," while Charles J. Diaz ("Diaz"), Executive Vice President of the firm, and Thomas A. Preston ("Preston"), a salesman, must return the aggregate sum received by each as a result of such sales.

In order to determine exactly how much money must be disgorged, the Court's Opinion continues the appointment of David Hughes as Receiver for the corporation and directs him to prepare an accounting showing the sums received by the defendants as a result of the bond sales; it also directs Diaz and Preston to account to the Receiver for all monies or property received by them directly or indirectly from such sales. The Court also directed Receiver Hughes to ascertain the names and addresses of all IDR purchasers from R. J. Allen and to then circularize those purchasers and allow them to file verified claims with him. Any correspondence in this matter should be directed to Mr. Hughes at P.O. Box 397, Airport Branch, Miami, Florida 33148.

Concluding that it would be appropriate and necessary to prevent waste and dissipation of any assets available for restitution and disgorgement, the Court responded affirmatively to the Commission's motion for a temporary trust over the assets of all the defendants. The Order prohibits each and every defendant from directly or indirectly "dissipating, concealing, or disposing of in any manner, any assets, choses in action, or other property . . ." until further Order of the Court.

On the same day that the Memorandum Opinion was entered, the Court issued an Order denying various motions by the defendants for modification and/or to vacate previous orders of the Court.

(For further information see Litigation Release 6575).

SEC v. Investors Associates of America, et al., Civ. Action No. (W.D. Tenn.), Litigation Release No. 6164 (December 4, 1973) (settled final orders).

The Securities and Exchange Commission today announced the entry of orders of permanent injunction in the United States District Court for the Western District of Tennessee against Investors Associates of America, Inc., (Investors), a Memphis, Tennessee municipal bond dealer (formerly known as Hamilton Securities, Inc., Liberty National Securities, Inc. and Harper Investment Company); Investors Associates of America, an Arizona partnership; Investors Associates of Mississippi, Inc.; Clarence H. Hamilton, Jerry R. Hamilton and Bill H. Harper, officers, directors and partners of Investors and its Affiliates; and Edward J. Blumenfeld, a former sales and branch office manager for Investors, from engaging in further violations of certain anti-fraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder, in connection with transactions in municipal bonds by, among other things, the employment of "boiler room" sales techniques, fraudulent interpositioning in securities transactions, and excessive mark-ups.

The defendant Blumenfeld, in his consent to a permanent injunction, agreed to disgorge the sum of $2,500 representing the gross profit realized by Investors' Arizona Office on specific transactions alleged in the Commission's complaint to be improper and illegal.

Investors Associates of America, Inc., an Arizona partnership, Investors Associates of Mississippi, Inc., Clarence H. Hamilton, Jerry R. Hamilton, and Bill H. Harper, in their consents to permanent injunctions, agreed to disgorge under certain conditions the sum of $196,715.58 representing the gross profit realized by these defendants on specific transactions alleged in the Commission's complaint to be improper and illegal, and further agreed (1) that the judgment of permanent injunction providing for disgorgment of

profits would survive any decree of bankruptcy against the defendants and (2) that the judgment of permanent injunction would not preclude any individual investors from filing or prosecuting any claim against the defendants.

SEC v. Jackson Municipals Inc., et al. Civ. Action No. ___ (W.D. Tenn.), Litigation Release No. 5763 (February 28, 1973) (settled final orders).

The Securities and Exchange Commission today announced the entry of an order of permanent injunction in the United States District Court for the Western District of Tennessee against Jackson Municipals, Inc. (Jackson) a municipal bond dealer located in Jackson, Mississippi, and Cecil Lamberson, an officer and director of Jackson from engaging in further violations of certain anti-fraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in connection with transactions in municipal bonds. Also announced was the entry of orders of preliminary injunction by the same court against Investors Associates of America, Inc. (Investors), a Memphis, Tennessee municipal bond dealer (formerly known as Hamilton Securities, Inc., Liberty National Securities, Inc. and Harper Investment Company); Investors Associates of America, an Arizona partnership; Investors Associates of Mississippi, Inc.; Clarence H. Hamilton, Jerry R. Hamilton and Bill H. Harper, officers, directors and partners of Investors and its affiliates; and Edward J. Blumenfeld, a former sales and branch office manager for Investors from engaging in further violations of certain anti-fraud provisions of the federal securities laws, Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in connection with transactions in municipal bonds.

By their consents to permanent (Jackson and Lamberson) and preliminary (all others) injunctions, each defendant, without admitting or denying the allegations of the Commission's complaint, agreed to injunctions against, among other things, the employment of "boiler room" sales techniques, fraudulent interpositioning of persons in securities transactions, and excessive mark-ups by:

(a) employing any device, scheme or artifice to defraud, or

(b) engaging in any transactions, practices or course of business which operates or would operate as fraud or deceit upon any person, by, among other things: paying and charging such persons prices not reasonably related to the current prevailing market price for such securities; sending confirmations of sale to customers who have not agreed to purchase securities; causing customers to "trade in," purchase, and sell securities without regard to the character of the security sold and the investment objectives of the customer; employing high pressure sales tactics which require hasty investment decisions by investors; interpositioning any other securities dealer or person between itself and the best market in the security, therefore increasing the price of the security as sold to the ultimate purchaser; receiving as a kickback from any person, monies previously paid to that person as part of an interpositioning arrangement employed to defraud others; maintaining and keeping inaccurate and incomplete books and records which, among other things, reflect transactions in securities involving fictitious prices and secret rebates in a manner aimed at concealing the true nature of such transactions; or other acts and practices of similar purport and object; or

(c) obtaining money or property by means of untrue statements of material facts or omitting 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, concerning among other things: the current market price of the securities offered; the purchase or sale price of the securities offered; the financial condition of the issuer of the securities offered; the available supply of the securities offered for sale at bargain prices; the source from which the securities were obtained which are being offered for sale at bargain prices; the investment rating and quality of the securities being offered; the amount of securities required to be purchased in order to obtain a bargain or discount price; the prospects of an increase of decrease in the market price or value of the securities offered; the speculative nature of the securities offered; the likelihood of default on

payment of interest or principal of bonds offered; the "call" features of the bonds being offered; the cost of acquisition by the dealer of such securities; the repurchase by a dealer of such securities from the customer and the price to the customer to which such repurchase would occur; prospective aid or assistance to be received by the issuer of the securities being offered; the potential income or gain realizable from such securities; the tax treatment to owners of such securities; the date of maturity of bonds; the rate of interest of bonds; the capacity in which the dealer is acting toward the investor; the current market price of securities being purchased from customers; the suitability of a security to the investor's needs in light of his financial condition and investment objectives; the interpositioning any other securities dealer or person between itself and the best market in the securities therefore increasing the price of the security as sold to the ultimate purchaser; the receiving as a kickback from any firm, monies previously paid to that firm as reflected by false confirmations which were employed as a device to defraud others; the maintaining and keeping inaccurate and incomplete books and records which, among other things, reflect transactions in securities involving fictitious prices and secret rebates in a manner aimed at concealing the true nature of such transactions; or other statements of similar object and purport. (Section 17(a) of the Securities Act, *15 U.S.C. 77a*(a); and Section 10(B) of the Exchange Act, *15 U.S.C. 78j*(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5.)

In addition, the defendant Jackson, in its consent to a permanent injunction, agreed to pay to the court the sum of $6,275 with interest thereon, representing the gross profit realized by the firm on the specific transactions alleged in the Commission's complaint to be improper and illegal.

SEC v. Charles A. Morris & Associates, Inc., et al. , Civ. Action No. ___ (W.D. Tenn.), Litigation Release No. 5584 (October 26, 1972) (complaint).

The Securities and Exchange Commission today announced the filing of a complaint in the United States District Court for the Western District of Tennessee seeking a preliminary and a permanent injunction against Charles A. Morris & Associates, Inc. formerly known as Morris-Darley and Associates, Inc. and Tax Free Bonds, Inc. ("Tax Free"), Charles A. Morris ("Charles Morris"), Michael Patrick McTighe ("McTighe"), Claude Dean Dillard ("Dillard"), Edward Disbrow Morris ("E. Morris"), Ray Thomas Bauman, Charles T. Chicorelli, Jim Walker Cunningham, Jr., Ted L. Cutshaw, Ronald Lee Epperson, John William Ferrell, Gary Crizer Hottum, Steven Adams Lancaster, Roy G. Lovelace, Robert J. Phillips, Malcolm E. Ratliff, Roger Charles Russell, Donald Bryan Smith, and Roy Langston White from engaging in further violations of certain of the anti-fraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with transactions in certain securities commonly referred to as municipal bonds.

In its complaint the Commission alleges that Tax Free is a securities dealer in Memphis, Tennessee, specializing in municipal bonds and is not registered with the Commission as a broker-dealer; that defendants Charles Morris, McTighe, E. Morris, and Dillard, were all officers of Tax Free; and the remaining fourteen defendants were all employed as securities salesmen for Tax Free.

It is further alleged that the defendants employed "boiler room" sales techniques and, among other things, conducted high pressure sales campaigns through the concentrated use of long distance telephone calls to individuals whose names were obtained from various sources such as telephone books; employed salesmen with little or no experience or training; mailed confirmations of sales to customers who had not agreed to purchase securities; and pressed potential customers to make quick investment decisions based on misrepresentations and omissions of material facts concerning, among other things: (a) the current market price of the securities offered, (b) the financial condition of the issuer of the securities offered, (c) the source and available supply of such securities, (d) the speculative nature of such securities, (e) the likelihood of default on payment of interest and principal of bonds offered, and (f) the availability of securities at "bargain" prices.

It is also alleged that Tax Free as part of the violative conduct failed to keep accurate and timely records of its transactions and transactions for its customers.

The complaint further alleges that the defendants have been buying from and selling to customers, bonds at prices not reasonably related to the current market price for such securities and in connection with transactions in three specific issues of securities, the mark-ups charged by Tax Free averaged approximately 35%, 45% and 75%, respectively, over the current prevailing market prices for such securities.

SEC v. Charles A. Morris & Associates, Inc., et al. , Litigation Release No. 5728 (February 7, 1973) (orders of preliminary injunction).

The Securities and Exchange Commission today announced the entry of an order of preliminary injunction in the United States District Court for the Western District of Tennessee against Charles A. Morris & Associates, Inc. formerly known as Morris-Darley and Associates, Inc. and Tax Free Bonds, Inc. ("Tax Free"), Charles A. Morris ("Charles Morris"), Michael Patrick McTighe ("McTighe"), Claude Dean Dillard ("Dillard"), Edward Disbrow Morris ("E. Morris"), Ray Thomas Bauman, Charles T. Chicorelli, Jim Walker Cunningham, Jr., Ronald Lee Epperson, John William Ferrell, Steven Adams Lancaster, Roy G. Lovelace, Malcolm E. Ratliff, Donald Bryan Smith, and Roy Langston White enjoining them from engaging in further violations of certain of the anti-fraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with transactions in certain securities commonly referred to as municipal bonds. Earlier, the defendants Ted L. Cutshaw, Roger Charles Russell and Gary Crizer Hottum had consented to similar injunctions.

After a five day hearing on the Commission's motion for preliminary injunction, the Court in its opinion found that Tax Free was a securities dealer in Memphis, Tennessee, specializing in municipal bonds; that defendants Charles Morris, McTighe, E. Morris, and Dillard, were all officers of Tax Free; and the remaining fourteen defendants were all employed as securities salesmen for Tax Free.

The Court further found that the defendants employed "boiler room" sales techniques and, among other things, conducted high pressure sales campaigns through the concentrated use of long distance telephone calls to individuals; employed salesmen with little or no experience or training; and pressed potential customers to make quick investment decisions based on misrepresentations and omissions of material facts concerning, among other things, the following: that certain bonds were being offered by persons needing to sell the bonds to establish a tax loss or raise money to pay taxes when, in fact, such was not the case; that there was available only a limited supply of bonds sought to be sold when, in fact, the supply was abundant; that certain bonds were general obligation bonds when, in fact, they were revenue bonds; that the payment of interest and principal of certain bonds was guaranteed by the state and federal governments when, in fact, payment was not so guaranteed, that certain securities were presently rated "BBB" by Standard and Poor's Corporation when, in fact, the rating had been withdrawn; that the financial condition of certain issuers was good when, in fact, the issuers were experiencing severe financial difficulties; that a purchase of bonds offered would be a safe investment when, in fact, the investment was highly speculative; that certain bonds were revenue bonds; that certain bonds had been given a very low "B" rating by Standard and Poor's; that a purchase of certain bonds was a speculative investment; that Tax Free was selling to the customer securities for its own account rather than acting as an agent for the customer; that the bonds matured at a date in the distant future; and that the issuers of certain bonds were experiencing severe financial difficulties adversely affecting the likelihood of their continued payment of interest and principal.

The Court found that Tax Free maintained few of the records traditionally maintained by securities broker-dealers and that certain of the records that it did maintain were grossly inaccurate. Finally, the Court found that the defendants have been selling to customers bonds at prices not reasonably related to the current market price for such securities and in connection with transactions in three specific issues of

securities, the majority of markups charged ranged between 25% and 100% over Tax Free's contemporaneous cost.

SEC v. Charles A. Morris & Associates, Inc., et al. , Litigation Release No. 6264 (February 28, 1974) (settled final orders and defaults entered).

The Securities and Exchange Commission announced the entry of orders of permanent injunction in the United States District Court for the Western District of Tennessee against Charles A. Morris & Associates, Inc., formerly known as Morris-Darley and Associates, Inc. and Tax Free Bonds, Inc., Charles A. Morris, Michael Patrick McTighe, Claude Dean Dillard, Edward Disbrow Morris, Ray Thomas Bauman, Charles T. Chicorelli, Jim Walker Cunningham, Jr., Ted L. Cutshaw, Ronald Lee Epperson, John William Ferrell, Steven Adams Lancaster, Roy G. Lovelace, Malcolm E. Ratliff, Donald Bryan Smith, and Roy Langston White from engaging in further violations of certain of the anti-fraud provisions of the federal securities laws (Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) in connection with transactions in certain securities commonly referred to as municipal bonds.

Each of the above defendants, with the exception of Smith and Ferrell, without admitting or denying the allegations of the Commission's complaint consented to the entry of an injunctive decree which enjoined them from, among other things, employing "boiler room" sales techniques and selling bonds at prices not reasonably related to the current market price for such securities.

The Court issued similar decrees with respect to defendants Smith and Ferrell by default.

In addition, pursuant to the Commission's prayer for disgorgement in its complaint, the Court ordered certain defendants to pay into the Court funds which they had received as a result of their alleged unlawful conduct. A trustee has been appointed to administer the disgorged funds.

Administrative Proceedings - Commission Decisions

In re Donald T. Sheldon, et al., Exchange Act Release No. 31475, A.P. File No. 3-6626 (November 18, 1992).

TEXT: OPINION OF THE COMMISSION

Initial Decision.

Donald T. Sheldon, Bruce W. Reid, and Gregory L. Pattison appeal from the decision of an administrative law judge. The law judge found that Sheldon aided and abetted violations of the Commission's net capital, hypothecation, and customer protection rules and violated, or aided and abetted violations of, the Municipal Securities Rulemaking Board's ("MSRB") advertising rule. The law judge further found that Sheldon and Reid violated, or aided and abetted violations of, the antifraud provisions of the securities laws and failed reasonably to supervise, as well as violated, or aided and abetted violations of, the MSRB fair dealing, markup, and supervisory rules and, in the case of Reid, the MSRB suitability rule. He further found that Pattison violated the antifraud provisions of the securities laws and the MSRB fair dealing rule. The law judge barred both Sheldon and Reid from association with any broker, dealer, or municipal securities dealer, although he permitted Reid to apply after two years to become associated in a non-supervisory and non-proprietary capacity upon a satisfactory showing of adequate supervision. Pattison was suspended from association with any broker, dealer, or municipal securities dealer for 45 days.

The Division of Enforcement appeals the sanction imposed on Reid, asking that an unqualified bar be imposed against him. Our findings are based on an independent review of the record, except to the extent that respondents do not challenge particular findings of fact on review. n1

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n1 Following issuance of the initial decision by the law judge, certain of the exhibits in this case were misplaced, and, despite an exhaustive search, have not been located. Consequently, we have, to the extent possible, reconstructed the missing exhibits, and hereby admit as additions to the record these reconstructed exhibits: Sheldon Exhibits D, F, I, L, M, N, P, R, S, T, U; Reid Exhibits A, D, F; and Pattison Exhibit A.

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Where such reconstruction was not possible, we have in certain instances assumed the fact or facts that the exhibits were intended to establish, as discussed more specifically below. In other instances, we have declined to rely on Division exhibits because corresponding respondents' exhibits are missing. For example, the Division introduced redacted versions of certain investigatory transcripts, including Exhibits 237, 239, 240, 242, and 248. In lieu of making cross-designations of these transcripts, Sheldon successfully moved that the transcripts be admitted in their entirety. These transcripts, including Sheldon Exhibits J, K, W, O, V and Q, were transmitted by the Division to the law judge (the letter, dated March 29, 1988, from the Division to the law judge transmitting these exhibits, is hereby admitted as an addition to the record), and the law judge retained them until he rendered his decision. They are now missing. Sheldon did not rely below, and does not rely on appeal, on particular portions of these transcripts. However, we have also excluded the Division's redacted transcripts from our consideration of this matter.

II.

Introduction.

Donald Sheldon was president of Donald Sheldon & Co., Inc. ("DSC"), formerly a registered broker-dealer engaged in the sale of municipal securities and a member of the Securities Investor Protection Corporation ("SIPC"), and Donald Sheldon Government Securities, Inc. ("GSI" and, collectively with DSC, the "Firms"), formerly an unregistered dealer in United States government-backed securities. Reid, a registered principal of DSC, was branch manager of the Firms' Houston office, and Pattison was a registered representative in that office. n2

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n2 The Commission brought proceedings against several other persons associated with the Firms. These proceedings were concluded on the basis of settlement offers accepted by the Commission and, in one case, by default. See *Donald T. Sheldon (Melvin Feldman), Securities Exchange Act Rel. No. 24129 (February 24, 1987), 37 SEC Docket 1294; Donald T. Sheldon (Gary Himber), Securities Exchange Act Rel. No. 24128 (February 24, 1987), 37 SEC Docket 1292; Jonathan Smith, Securities Exchange Act Rel. No. 23375 (June 26, 1986), 35 SEC Docket 1709; Joseph H. Stafford, Securities Exchange Act Rel. No. 23366 (June 23, 1986), 35 SEC Docket 1693; Douglas J. Ebbitt, Securities Exchange Act Rel. No. 23270 (May 23, 1986), 35 SEC Docket 1313; Paul A. Steets, Securities Exchange Act Rel. No. 23271 (May 23, 1986), 35 SEC Docket 1315; Mary A. Schad, Joseph A. Jennings, Securities Exchange Act Rel. No. 23057 (March 24, 1986), Securities Investor Protection Act Rel. No. 130 (March 24, 1986), 35 SEC Docket 551.*

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The Firms were wholly-owned subsidiaries of Donald Sheldon Group Inc. ("Group"), of which Sheldon was also president. In addition to DSC and GSI, Group owned other ventures, including an investment

adviser n3 and Data Station Systems, Inc. ("Systems"), which was organized in the early 1980s and developed and marketed computer applications.

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n3 See n. 27, infra.

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Increasingly during the last year of their existence, Sheldon ignored the operations of the Firms and the numerous indications that violations were occurring under his supervision. He was largely concerned with the pursuit of new business ventures (particularly with respect to Systems) which proved to be a significant drain on the financial and management resources of the Firms. Faced with a shortage of cash, the Firms misused customers' securities. Ultimately, the financial drain on Sheldon's enterprises produced a net capital deficiency at DSC. Sheldon aided and abetted these violations. n4

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n4 DSC and GSI ceased retail operations at the close of business on July 26, 1985. On July 30, 1985, the Commission brought an injunctive action against the Firms and, on that date, obtained a temporary restraining order and the appointment of a temporary receiver. Subsequently, the Firms were permanently enjoined from further violations of the securities laws and a trustee was appointed for each.

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The Firms maintained joint offices in Houston, New York, Los Angeles, and Pompano Beach and Miami Beach, Florida. n5 Sheldon staffed his far-flung operations with inexperienced salesmen, and, because the Firms did not pay well, the turnover among those salesmen was high. Sheldon designated branch managers to supervise his sales force who nonetheless did not play a strong supervisory role. n6 Many of these managers were unqualified, n7 and there were no internal controls to determine whether the branch managers were fulfilling their responsibilities.

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n5 DSC also maintained an office in Honolulu. Reid briefly operated a branch office of the Firms in Memphis, Tennessee.

n6 Following the departure in June 1983 of the Los Angeles branch manager, Sheldon failed to appoint a successor. Eventually, a group of three salesmen took charge of the day-to-day operation of the office, but all important decisions had to be made by Sheldon who was rarely present in that office.

n7 For example, Sheldon admitted that, at various times, the managers of the Firms' Pompano Beach, Los Angeles, and Hawaii offices were not registered principals.

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The Firms conducted little formal research with respect to the securities they offered and sold, but instead relied on their salesmen to ferret out and provide any material facts about the issuers and the securities. Sheldon and Reid failed to ensure that the salesmen were obtaining these facts or that such facts were being conveyed to customers. The Firms' salesmen, including Pattison, misrepresented and failed to disclose material information. Moreover, DSC undertook a series of misleading advertisements and engaged in excessive and fraudulent markups. Sheldon and Reid's failures to supervise resulted in widespread violations of the antifraud and markup provisions, as well as, in the case of Sheldon, misappropriation of customer securities.

III.

Financial Mismanagement.

The customers of GSI and DSC depended on the Firms' sound operation for the safety of their cash and securities. For a time preceding their demise, the Firms grossly abused this trust. In addition to operating DSC with inadequate net capital, the Firms' back office n8 repeatedly defrauded customers, especially those whose securities were pledged to secure financing for the Firms. n9 As is well recognized, once a customer makes full payment for a security, the security must be removed from pledge and treated as the customer's sole property. n10 The Firms, however, used customers' fully-paid securities as collateral to obtain financing without disclosing that fact and the further fact that DSC's business depended on that practice.

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n8 Although some personnel appear to have been specifically assigned to DSC or GSI, the back office of both Firms was essentially a joint operation headed by Mary Schad, the Firms' financial officer, who reported to Sheldon.

n9 The securities were pledged to collateralize both ordinary lines of credit and "repurchase agreements." Although a repurchase agreement or "repo" is structured as a sale and repurchase of securities, it is economically equivalent to a collateralized loan. A firm, in this case GSI, receives cash in exchange for securities, subject to an agreement to repurchase the securities, by repaying subsequently an amount that exceeds the original amount. In effect the lender uses these securities as collateral for its loan.

n10 According to a leading commentator:

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Trade custom requires a dealer to consummate transactions with customers promptly . . . [and a dealer may not] divert the proceeds of payments to his other business activities. . . Additionally, for the same basic reasons, it is a fraudulent and deceptive act, practice, and course of business, which operates as a fraud and deceit on a customer, for a broker-dealer to hypothecate or otherwise convert to his own use customers' funds or fully-paid for securities of customers held by the broker-dealer for safe-keeping.

E. Weiss Registration and Regulation of Brokers and Dealers 181 (1965) (citations omitted). See also *SEC v. Scott, Gorman Municipal, Inc., 407 F. Supp. 1383, 1387 (S.D.N.Y. 1975); Edward C. Jaegerman, 46 S.E.C. 706 (1976).*

The above practices violated the general antifraud provisions n11 as well as securities law requirements regarding customer protection n12 and net capital. n13 Sheldon was given early and repeated notice of the Firms' deteriorating condition and the need for decisive action. The pertinent facts are as follows.

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n11 The Firms violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as well as Section 15(c)(1) of the Exchange Act and Rule 15c1-2 thereunder, which prohibit broker-dealers from effecting transactions in, or inducing or attempting to induce the purchase or sale of, securities by fraudulent means. DSC further violated MSRB Rule G-17 which prohibits, in the conduct of a municipal securities business, unfair dealing with customers, and deceptive, dishonest or unfair practices.

n12 Under Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder, DSC was required promptly to obtain and thereafter maintain the physical possession or control of all fully-paid securities.

n13 Under Section 15(c)(3) of the Securities Exchange Act of 1934 and Rule 15c3-1 thereunder, DSC was required to maintain "net capital," i.e., assets less certain deductions or "haircuts," of the greater of 6 2/3 percent of the firm's aggregate indebtedness, or $25,000.

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As mentioned, Sheldon launched a new computer business, Systems, in the early 1980's. To provide cash for Systems, Sheldon had GSI lend Group about $2 million, which Group in turn transferred to Systems. Beyond its substantial demand on GSI's financial resources, n14 Systems drew Sheldon's attention away from the Firms. His lack of involvement with the Firms repeatedly evoked criticism from his bankers. By summer 1984, officials at Chase Manhattan Bank, which was then providing financing to DSC, warned Sheldon that he was "spread too thin"; that Chase had no confidence in the firm's backup management; and that the credit relationship would end in six months unless changes were made. These pleas went unheeded by Sheldon and, in early 1985, Chase terminated the relationship. n15

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n14 As of the end of its fiscal year, GSI had total assets of about five million dollars, including its roughly two million dollar receivable from Group. It also owed, at such time, approximately four million dollars in bank loans.

n15 Sheldon claims that Chase terminated its relationship with the Firms because of Chase's concerns about a pending Commission investigation, not the Firms' operations. While a memorandum prepared by a junior Chase employee lists the investigation as a factor to be considered by Chase in its determination whether to continue the relationship, a Chase vice president who was instrumental in making this determination did not allude to the investigation in his testimony and Sheldon did not cross-examine him on this point.

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Sheldon also received warnings from the National Association of Securities Dealers, Inc. (the "NASD"). The NASD, which in 1978 had disciplined Sheldon, DSC, and the Firms' financial officer, Mary Schad, for certain back office violations, conducted an examination of DSC in late 1983 and early 1984. Among the numerous back office problems discovered was a failure by DSC in four instances to reduce customer fully-paid securities to its possession or control. n16 In an October 31, 1984 letter to Sheldon, the NASD described these problems and directed Sheldon to set up a meeting to discuss them. Sheldon failed to respond either to this letter or a follow-up letter in February 1985. n17 Finally, in late July 1985, DSC's compliance officer responded to the NASD's October letter.

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n16 Other failures noted by the NASD included incorrect computation of the Customer Reserve Formula and a corresponding reserve account deficiency of over half a million dollars, routine late filings of financial reports, and failure to complete customer account cards.

n17 We do not credit Sheldon's statement that he could not recall receiving the October 1984 NASD letter. The letter was properly addressed to Sheldon, was received by DSC in New York and its contents were important. Moreover, Sheldon indicated in testimony that he was operating out of the New York office at about the time the letter was received. He further observed that, if mail were received by an office in which he was then located, "it would be delivered to me for sure." Moreover, Sheldon did not deny receiving the February 1985 follow-up letter.

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As the financial pressure increased, the Firms repeatedly failed to redeem the pledge of customers' securities. Increasingly, during the fall of 1984 and the spring of 1985, GSI, with a large debt outstanding to its clearing agent, Security Pacific Clearing & Services Corp. ("SEPAC"), kept securities under pledge even after customer payment had been made. n18 As of October 31, 1984, GSI was using roughly $1.7 million of fully-paid customer securities to collateralize its SEPAC loan. It also pledged customer securities to another brokerage firm after they had been fully paid. n19 By May 1985, DSC's financial position had deteriorated to the point that it, too, was unable to redeem customer securities that it had pledged to SEPAC. n20 The value of customer securities pledged by DSC during this period ranged as high as $2 million.

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n18 We would disagree with Sheldon to the extent he suggests that the reason for this failure was a difficulty in removing the lien on a portion of a government security that had been pledged when customer payment was received for that portion. This explanation is not supported by the record. According to the GSI trustee's accountant, GSI "did segregate [fully-paid] securities" and it was "only from time to time that they did not segregate the securities." The facts of this case strongly suggest that it was a lack of cash, and not technical difficulties related to the handling of certificates, that caused the securities to remain under lien. Moreover, in any case where redemption of government securities after customer payment would not be feasible, it then would be improper for a firm to sell the securities to customers -- at least where no disclosure to customers was made.

n19 This latter case, relating to the pledge of securities pursuant to repurchase agreements, did not involve the failure to remove securities from pledge once they had become fully-paid. Instead, it involved the active step of selecting fully-paid securities as collateral for a new round of financing for the firm.

n20 Sheldon states that DSC instructed SEPAC to segregate customer fully-paid securities, and suggests that the failure to do so may have been the result of SEPAC's error. The record indicates, however, that the failure to segregate DSC customer securities was not the result of SEPAC's failure to follow instructions, but rather the result of DSC's lack of funds.

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These practices came to the attention of James Neill, one of the Firms' auditors, while he was auditing the Firms. n21 In a May 9, 1985 letter, Neill told Sheldon of GSI's poor financial condition and improper practices. Neill noted that GSI's loss for the 1984 fiscal year would approximate $500,000 and that its $2 million receivable from Group was uncollectible. Moreover, Neill expressed concern over his discovery of GSI's pledging of customer securities:

Fully paid customer government securities, on deposit at Security Pacific Clearing, are not being delivered to the customers or placed in safekeeping on a timely basis. To the extent that this problem exists, the Company is borrowing money against customer fully paid securities. A review of the April 30, 1985 stock record indicates that this condition is worse than at October 31, 1984. We urge you to review this condition immediately.

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n21 Sheldon claims that the law judge gave excessive weight to the testimony of Neill who, according to Sheldon, had no experience with any government securities firm except GSI, and did not understand the mechanics of repurchase agreements. However, we find no support for the suggestion that Neill lacked the competence to assess adequately the situation.

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Sheldon's only response to the accountants' letter was to have a brief conversation with Schad, the Firms' financial officer. n22 On July 9, 1985, Neill and his colleagues resigned upon learning that GSI had not merely failed to redeem fully-paid customer securities, but had deliberately pledged customer securities, pursuant to repurchase agreements, after customer payment had been received by the firm. n23

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n22 Sheldon also testified that around this time his operations manager, Mort Wasserman, approached him to discuss concerns Neill had raised with Wasserman over GSI's failure to segregate customer securities that had been fully paid. Sheldon claims that Wasserman told him that such segregation was not possible. Testimony by other witnesses, however, indicates that Wasserman recognized that the failure to segregate was a problem that needed to be addressed. Moreover, the record establishes -- and we conclude Sheldon must have known -- that it was not technical impediments but a lack of cash that prevented segregation of fully paid securities.

n23 See n. 19, supra.

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Sheldon feared the repercussions of the accountants' resignation on a planned public offering of Systems stock and tried to dissuade them. At a meeting on July 10, the accountants confronted Sheldon with their discovery of GSI's collateralizing of repurchase agreements with fully-paid securities. Sheldon admitted that he had not responded to their earlier instruction to redeem fully paid securities on a timely basis. He assured them, however, that he would do so in the future. In addition, and notwithstanding the accountants' advice to Sheldon that, given GSI's financial condition, repayment was impossible, Sheldon announced to the accountants that all the repurchase agreements had been paid off or would be within the next day or so. n24

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n24 However, as Sheldon later indicated, he "never even gave it a thought" as to where the money would come from.

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At the time, the Firms' collapse was all but complete. n25 Sometime in June or July 1985, SEPAC notified Sheldon it was terminating its line of credit with GSI. n26 As a result, between July 9 and 12, 1985, DSC advanced $4.25 million to GSI's SEPAC account to pay GSI's debt. That measure placed DSC in a net capital deficiency which, by July 15, totaled $1 million. DSC remained in business for two additional weeks despite this deficiency.

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n25 Sheldon contends that unnamed "Washington Regulators" discouraged a prospective purchaser for the Firms by overstating the extent of the Firms' liabilities, thereby precipitating their collapse. Our review of the record, however, indicates that nothing improper occurred.

It appears that, immediately prior to the Firms' collapse, NASD staff members were on the premises, reviewing DSC's books and records. The prospective purchaser testified that he discussed his interest in the Firms with the NASD and, by phone, with the staff of this Commission. While these regulators may have overstated the Firms' liabilities, they also told the prospective purchaser that their estimate was qualified because, given the large volume of business involved, it was impossible to make an accurate assessment at that time. Indeed, it was the prospective purchaser's impression that no one, not even the Firms' personnel, "really had any confidence in any particular number" concerning the size of the liabilities. In any event, by the time that these conversations occurred, "a day or two before" the Firms closed, the violations at issue had already occurred.

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n26 According to testimony by a SEPAC official, SEPAC terminated its relationship because Group and GSI had failed to furnish timely 1984 financial statements. We find this testimony more plausible than Sheldon's claim that SEPAC was motivated by apprehension over financing government securities firms generally.

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On July 26, 1985, NASD examiners discovered the fund transfers from DSC to GSI and asked DSC for a net capital computation. On July 29, Sheldon reported DSC's net capital deficiency to the NASD and did not reopen the Firms for business. At that point, roughly $1 million in fully-paid customer securities were still collateralizing an outstanding repurchase agreement. Those securities ultimately were liquidated by the lender under the repurchase agreement. Shortly after they closed, the Firms were placed in liquidation. n27

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n27 Sheldon blames Group's financial problems on the Commission's denial of an exemption under Section 9(a) of the Investment Company Act of 1940 to Investors Portfolio Management, Inc. ("IPM"), another Sheldon affiliate. However, IPM's disqualification, which resulted from the injunctive action against the Firms, became effective over a month after the Firms had ceased doing business and been placed into a receivership. The disqualification therefore did not -- and, indeed, could not -- create or contribute to the Firms' financial troubles.

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Sheldon claims that a Division staff member working on this proceeding vindictively persuaded the Commission to deny IPM's exemption. As noted, however, the necessity for the exemption proceeding concerning IPM arose automatically pursuant to provisions of the Investment Company Act by virtue of the temporary restraining order. In any event, no member of the trial staff participated in consideration of IPM's exemption request. See n. 4, supra.

We agree with the law judge that Sheldon willfully aided and abetted an array of back office misconduct. The record establishes the three elements courts have associated with aiding and abetting: (1) violations by the Firms; (2) Sheldon's knowing and substantial assistance of those violations; and (3) Sheldon's general awareness that his actions were part of an overall course of conduct that was illegal or improper. n28

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n28 See *Investors Research Corp. v. SEC, 628 F.2d 168, 178* (D.C. Cir.), cert. denied, *449 U.S. 919 (1980); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 94-95 (5th Cir. 1975).* See also *Kirk A. Knapp, Securities Exchange Act Rel. No. 30391 (February 21, 1992), 50 SEC Docket 1840, 1842.*

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The Firms' violations are clear. The facts show not only DSC's violations of customer protection requirements n29 and our net capital rule, but also a scheme by both Firms to deceive customers as to the use the Firms were making of fully-paid securities. Customers were not told that the Firms were using customers' securities to secure the Firms' financing, and that DSC's cash was so scarce that it could not conduct business any other way. n30 Fraudulent intent with respect to the schemes by the Firms is demonstrated by the repeated and prolonged retention of customers' securities under pledge, and by GSI's willingness to pledge fully-paid securities. Sheldon's assertion that government securities firms were not subject to any requirements is simply wrong. n31 Nor is the result affected by Sheldon's assertion that repurchase agreements were widely used within the industry. n32

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n29 The law judge further found that DSC violated the Commission's hypothecation rule, Rule 15c2-1 under Section 15(c)(2) of the Exchange Act, which differs to some extent from the customer protection requirements. In light of DSC's numerous other violations in this area, we see no need to reach the question of whether the evidence satisfies the elements of a Rule 15c2-1 violation.

n30 Cf. *C.D. Beal & Co., Ltd., 46 S.E.C. 395, 398 (1976).* No similar charge was made with regard to non-disclosure of the financial position of GSI. Hence we do not address that issue.

n31 The violations occurred prior to the enactment of the Government Securities Act of 1986. That Act made government securities firms subject for the first time to net capital and other back office requirements, including rules specifically governing the segregation of fully-paid securities. Contrary to Sheldon's contention, however, government securities firms like GSI were at the time subject to antifraud provisions. See Loss, Securities Regulation 1428-1429 (1961); *Blyth & Company, Inc., 43 S.E.C. 1037, 1039-1040, n. 4 (1969).* The use of customer fully-paid securities to collateralize firm loans without customers' knowledge and consent clearly violates these provisions. Scott, Gorman Municipal, Inc., supra; Edward C. Jaegerman, supra.

n32 It is not the use of repurchase agreements that is violative, but the improper use of customer fully-paid securities. Moreover, even if Sheldon had established that other firms also misused customer fully-paid securities, that would not have exonerated him. See *C.A. Benson & Co., Inc., 42 S.E.C. 107, 111 (1964).*

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Sheldon notes that owners of securities that had been redeemed received no better settlement in bankruptcy than those whose securities had remained under pledge, and further claims that all repurchase agreements had been paid off by the time of the Firms' bankruptcy. However, in determining whether the Firms violated antifraud provisions the issue is not what ultimately happened to their customers, but rather whether their failure to disclose their hypothecation of customer fully-paid securities was material. It is clear that, at the time the Firms were dealing with customers, their pledge of fully-paid securities was a fact that would have assumed actual significance in the deliberations of the reasonable investor, and as such was material. *TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1979)* See also, *SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)* (en banc), cert. denied, *394 U.S. 976 (1969).*

It also is clear that Sheldon substantially assisted these violations and acted with the requisite knowledge. Sheldon's focus, as well as the Firms' financial resources, was diverted to other projects, setting the stage for the problems to follow. n33 Sheldon was, at a minimum, recklessly indifferent to serious problems in the Firms' back office. Not only did he thoroughly dominate the Firms and insist on knowing their most important affairs, but, at critical points, his bank and the NASD warned him of an ever worsening situation. Sheldon, however, did nothing. Even when, in May 1985, he was directly confronted with Neill's revelations of serious irregularities, Sheldon merely held a perfunctory consultation with his financial officer. At the hearing, Sheldon claimed he could not recall what the financial officer told him, except that she somehow allayed his concerns. n34 In our view, even allowing for the possibility that that official misled Sheldon, it is not credible that Sheldon saw no need to take strong independent action or even to confer with Neill.

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n33 See generally *IIT, an Intern. Inv. Trust v. Cornfeld, 619 F.2d 909, 927 (2d Cir. 1980)* (violation of an independent duty to act can establish element of substantial assistance). See also *Hochfelder v. Midwest Stock Exchange, 503 F.2d 364, 374* (7th Cir.), cert. denied, *419 U.S. 875 (1974).*

n34 The financial officer, invoking her privilege against self-incrimination, declined to testify.

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Only in July, to impress his auditors and to meet SEPAC's demands, did Sheldon attempt to respond. Juggling funds from one troubled firm to another, Sheldon plunged DSC into a severe net capital deficiency, and, thereafter, kept dealing with customers for two additional weeks. Moreover, during that time, despite the disclosure from Neill that back office misconduct included the pledge of already paid-for securities, Sheldon still did not eliminate the serious deficiencies in his back office operations.

The picture that emerges is that of an entrepreneur bent on staying in business regardless of the effect on public investors. We conclude that Sheldon was culpably aware with respect to the violations that were occurring. He either fully knew about, or, in bad faith, intentionally ignored indications of, the Firms' fraudulent and improper practices regarding customer securities and, later, DSC's deception regarding its financial condition, and that firm's net capital deficiency. Such conduct, which was at the very least reckless, amply supports a finding that Sheldon willfully aided and abetted those violations. n35

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n35 *IIT, 619 F.2d at 927.* See also *Woodward, 522 F.2d at 96.*

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IV.

Antifraud Violations and Related Misconduct.

All three respondents, in connection with transactions in municipal securities, willfully violated, or willfully aided and abetted violations of, Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder and MSRB Rule G-17. Sheldon and Reid also failed reasonably to supervise to prevent violations of the securities laws and violated MSRB Rules as set forth below.

A. Misconduct in the Offer and Sale of WPPSS 4 and 5 Bonds.

1. Events of 1982 through 1983. Between 1982 and 1983, a series of adverse events culminated in the default of certain bonds ("WPPSS 4 and 5 Bonds") issued by the Washington Public Power Supply System ("WPPSS"). In the face of these rapidly deteriorating conditions, Sheldon and DSC salesmen, including Pattison, offered and sold WPPSS 4 and 5 Bonds to the public without adequate disclosure.

In the early 1970s, WPPSS began construction of several nuclear power plants to generate electricity for the Pacific Northwest, and, over the next several years, issued bonds to fund their construction. WPPSS 4 and 5 Bonds were issued to fund construction of two of those plants, projects 4 and 5. However, those projects were delayed by labor problems, environmental requirements, and mismanagement which, coupled with rising inflation, resulted in a tripling of their projected costs.

In January 1982, construction on projects 4 and 5 was terminated because of cost overruns and a decline in the projected need for power in the region. However, 88 municipal and cooperative utilities (the "Participants") had executed agreements (the "Participants' Agreements") to pay the debt service on the WPPSS 4 and 5 Bonds even if projects 4 and 5 were never completed. Notwithstanding the requirements of the Participants' Agreements, Standard & Poor's ("S&P") lowered its rating on WPPSS 4 and 5 Bonds to its lowest investment grade, BBB+, following the projects' termination. n36 In early October 1982, an Oregon trial court gave a preliminary indication of concern regarding the enforceability of the Participants' Agreements against Oregon Participants. This action caused S&P to place the WPPSS 4 and 5 Bonds on its "Credit Watch" list (an indication of a potential rating change). Later in October, Pattison discussed generally WPPSS 4 and 5 Bonds with a customer, Joseph MacInerney, and sent him a prospectus. He then sold MacInerney WPPSS 4 and 5 Bonds without disclosing that construction on projects 4 and 5 had been terminated, that there was ongoing litigation regarding the bonds' backing, that Moody's had suspended its ratings on the bonds, or that S&P had just placed the bonds on Credit Watch.

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n36 Moody's Investors Service ("Moody's) had suspended its rating a few days prior to the construction termination.

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In November, S&P lowered its rating on the bonds from "BBB+" to "B" (a speculative grade) -- and retained them on Credit Watch. S&P noted that judicial decisions in both Oregon and Idaho raised "serious questions" concerning whether WPPSS could meet its debt payments. Moreover, Washington state Participants were unwilling to make their contributions to pay the debt service until an appeal was heard from a Washington state court decision holding that Washington state Participants were bound by the terms of the Participants' Agreements.

Nonetheless, beginning in November 1982, Sheldon authorized DSC radio advertisements in Houston and Los Angeles, and television advertisements in Florida. In those advertisements, Sheldon reassured an investor who was concerned about a possible WPPSS default, explaining that Sheldon owned WPPSS 4 and 5 Bonds, which, he stated, were his most recent purchase in the tax exempt market. The

advertisement minimized the possibility of default and omitted any adverse information which would suggest caution, including any reference to the adverse judicial decisions.

At the end of January 1983, 86 of the 88 Participants failed to make their contributions to the bond fund, based on litigation in all three states questioning the enforceability of the Participants' Agreements. Nonetheless, in February, DSC distributed to its customers an "Editorial by Donald Sheldon, President, Donald Sheldon & Co., Inc.," in which Sheldon claimed that unspecified news "this week" about WPPSS 4 and 5 Bonds continued "to remain encouraging." Sheldon also asserted his "strongly" felt view that "the cases currently before the court . . . will protect the investor and that the utility companies in Washington will pay their just debts." The editorial did not describe the status of the litigation, and, before the law judge, Sheldon was unable to recall which news he found encouraging.

At the end of February, S&P lowered its rating on WPPSS 4 and 5 Bonds to "CC," the lowest rating above default, because it found that there was a "significant likelihood of actual payment default by January 1984." S&P attributed this possible default to the legal challenges to the Participants' Agreements, as well as "the absence of cooperation required for any resolution of this problem. . . ."

When, in April 1983, a tentative agreement was reached between government and power industry leaders to avoid default, Sheldon issued an advertisement hailing this "substantial agreement in principle," and asserting that, "[t]he capacity of these utilities to repay the people that had loaned them this money was never in doubt." n37 The tentative agreement quickly collapsed.

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n37 The issue in the litigation, however, was the Participants' legal obligation to pay, not their ability to do so.

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Nonetheless, in late May, Sheldon authorized, on DSC's behalf, the issuance of an "Economic Commentary: By Dr. Lance Brofman," an economist affiliated with DSC. In it, Brofman opined that "even WPPSS bonds have a significant probability of full payment." The commentary concluded that "[t]he mathematics of the situation suggests that those who do not presently include WPPSS bonds in their portfolio should do so now, and those who hold them should add to those positions." A DSC press release was issued, stating:

Rejecting dire warnings of possible default and bankruptcy for . . . WPPSS, Dr. Lance Brofman . . . sees the current steep price declines and yield run-ups as a not-to-be-missed opportunity for even the most prudent investor. (Emphasis added.)

In May 1983, Pattison sold WPPSS 4 and 5 Bonds to Charles Reass. Pattison reassured Reass that, notwithstanding the pending litigation and termination of construction, WPPSS would not default on the bonds. Pattison further told Reass that the WPPSS 4 and 5 Bonds were backed by the Bonneville Power Administration, which was not true, and that the State of Washington would not permit them to default.

In June 1983, the Washington Supreme Court ruled that the Participants' Agreements were unenforceable. Later that summer, when WPPSS failed to meet an accelerated demand for payment of principal and accrued interest, S&P lowered the rating for the bonds to "D" -- default.

We find that Sheldon and Pattison willfully violated or willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. n38 We further find that Reid, as branch manager, failed reasonably to supervise the Houston office with respect to violations of the antifraud provisions in the sale of WPPSS 4 and 5 Bonds.

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n38 We also find that Sheldon violated, or willfully aided and abetted violations of, MSRB Rule G-21(c) (governing advertising) with respect to the WPPSS advertisements, and that Pattison violated, or willfully aided and abetted violations of, MSRB Rule G-17 (requiring fair dealing with customers) in connection with his sales of WPPSS 4 and 5 Bonds.

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2. Sheldon. Sheldon authorized and, in certain instances, prepared and participated in, DSC advertisements that presented the WPPSS situation in a wholly misleading manner and minimized the increasingly significant risks of WPPSS 4 and 5 Bonds. n39 He distributed these advertisements to the Firms' sales representatives for use in their solicitations. Sheldon knew of many of the adverse developments relating to WPPSS and was, at best, reckless, in causing DSC to use these advertisements. n40

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n39 See, e.g., *Basic, Inc. v. Levinson, 485 U.S. 224, 241 n. 18 (1988)* (Those who make affirmative representations have an "ever-present duty not to mislead."); *SEC v. Texas Gulf Sulphur Co., 401 F.2d at 862.*

n40 *Drexel Burnham Lambert v. Commodities Futures Trading Commission, 850 F.2d 742, 748 (D.C. Cir. 1988);* see also *Hollanger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990)* (en banc), cert. denied, *111 S.Ct. 1621 (1991); Nelson v. Serwold, 576 F.2d 1332, 1337-8 (9th Cir. 1978),* cert. denied, *439 U.S. 970 (1978).*

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Sheldon claims that it is improper to hold him liable for these violations, which he claims are based on his inability to predict the adverse decision of the Washington Supreme Court. In this he is mistaken. As is clear from the discussion above, his liability is predicated on his repeated misleading descriptions in DSC advertisements of material adverse facts related to WPPSS 4 and 5 Bonds. Sheldon's personal belief that the bonds would not default did not diminish his obligation to disclose to DSC customers contrary material facts, including the termination of the projects, adverse legal decisions, and declining ratings. n41

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n41 An "honest belief in an issuer's prospects does not in itself give [one] a reasonable basis for recommending the stock to others." *Gilbert F. Tuffli, 46 S.E.C. 401, 405 (1976).* See also *James E. Cavallo, Securities Exchange Act Rel. No. 26639 (March 17, 1989), 43 SEC Docket 749, 752.*

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3. Pattison. Pattison conceded before the law judge not only that he omitted to disclose information to MacInerney but that the information was material. n42 Pattison also made misrepresentations to Reass regarding the safety and creditworthiness of WPPSS 4 and 5 Bonds. n43 Pattison claims that DSC provided him and other salesmen "only the most positive" information on WPPSS, and he was pressured to sell WPPSS 4 and 5 Bonds because they comprised the bulk of DSC's inventory at the time. However, Pattison, as a registered representative, had a duty to his customers to have a reasonable basis for his recommendations and to avoid "recklessly stat[ing] facts about matters of which he is ignorant." n44

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n42 Pattison argues, however, that MacInerney's testimony was not credible. Because our findings of material omissions with respect to the MacInerney sale are based on Pattison's own admission and not on the testimony of MacInerney, the latter's credibility is not at issue. Pattison further claims that he advised MacInerney on a strategy to eliminate his loss on the bonds, which, Pattison asserts, establishes his lack of scienter. However, any effort by Pattison after the fact to minimize MacInerney's loss is without relevance to the question of whether he made misrepresentations in connection with the sale.

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Pattison asserts that the law judge gave insufficient weight to the fact that the bonds were rated BBB+ at the time of the sale to MacInerney, which indicated their safety. Pattison misunderstands the objective of the federal securities laws, which is not to ensure that investors make only "safe" investments but, rather, to ensure that they invest based upon full disclosure. Once Pattison began offering WPPSS 4 and 5 Bonds to MacInerney, he could not present a partial picture of the WPPSS situation and thereby mislead MacInerney as to the attendant risks.

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n43 Although Pattison challenges Reass' testimony, the law judge credited Reass.

n44 *Hanly v. SEC, 415 F.2d 589, 595-6, 597 (2d Cir. 1969).*

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Pattison also asserts that he must have made proper disclosure to Reass, whom he characterizes as "yield aggressive," because another of his customers testified that he, the customer, had received full disclosure. Pattison's disclosures to other customers and Reass' interest in speculation are irrelevant to the issue of whether Reass received appropriate disclosure. *William L. Kicklighter, Jr., Securities Exchange Act Rel. No. 30096, 50 SEC Docket 826 at 831, 833; James F. Novak, 47 S.E.C. at 895.*

4. Reid's Failure to Supervise. Several Houston office salesmen violated the antifraud provisions of the securities laws in connection with the sale of WPPSS 4 and 5 Bonds. n45 Reid concedes that this misconduct occurred. He contends, however, that DSC's staff in New York -- not Reid -- was responsible for supervising the Houston salesmen. n46

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n45 For example, Houston salesmen recommended WPPSS 4 and 5 Bonds to customers without informing them about the termination of the construction of projects 4 and 5, the litigation challenging the Participants' Agreements, the creditworthiness of the bonds, or the downgrading of their ratings. In addition, customers were told that the State of Washington, the Federal government and/or the Bonneville Power Authority would back the bonds.

Houston salesmen also violated MSRB suitability requirements by selling the bonds, after they had been downgraded in November 1982 to a speculative rating, to persons seeking secure investments.

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n46 Reid also argues that he cannot be held liable for failure to supervise because the Houston office was not an "office of supervisory jurisdiction" ("OSJ") under the NASD Rules of Fair Practice and only the responsible persons in an OSJ can be held responsible for a failure to supervise. However, Reid was in fact the branch manager charged under the Firms' procedures with responsibility for the Houston office. He therefore had an obligation to supervise the salesmen in his office. See Sections 15(b)(4)(E) and 15(b)(6) of the Exchange Act.

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However, the record, including both Sheldon's testimony and DSC's procedures manual, demonstrates that Reid, as Houston branch manager, was responsible for supervising the Houston office. n47 He hired and fired personnel and handled customer complaints. He also received a sales override commission for exercising that authority. Reid admits that he never instructed any DSC salesman to inform customers about WPPSS' adverse financial, litigation, credit, or business status. n48

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n47 Reid's complaint that he did not have time during the day to supervise salesmen because he had his own customers does not mitigate his obligations in this regard.

n48 Similarly, Reid could not recall ever reprimanding a salesman for an unsuitable trade. In particular, he failed to impress upon salesmen that, when WPPSS 4 and 5 Bonds fell below investment grade in November 1982, they were no longer suitable for persons seeking non-speculative investments.

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Reid's only efforts with respect to WPPSS disclosures involved his attempts, from time to time, to circulate written and oral information about WPPSS. He had no procedure to provide accurate information to Houston salesmen or to maintain that information for reference. n49 Thus, new salesmen were dependent on "more senior" salesmen to obtain the information. Reid essentially relied on Houston salesmen to inform themselves concerning the material facts about WPPSS 4 and 5 Bonds, a practice not commensurate with his supervisory obligations. n50

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n49 Reid Exhibit E (which is one of the exhibits missing from the record, see n. 1, supra) was introduced to demonstrate that customers could have obtained information about Brofman's analysis from national publications. While we concede this possibility, several customers testified regarding the representations made directly to them by Houston salesmen.

n50 In addition, some of the Houston salesmen testified that Reid discouraged them from taking time from their telephone solicitations to perform research.

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Reid had notice of these deficiencies. He received customer complaints that various Houston salesmen had failed to disclose material facts in connection with sales of WPPSS 4 and 5 Bonds, which should have alerted him that DSC's procedures were inappropriate. Notwithstanding these complaints, Reid took no effective steps to ensure that his salesmen had and conveyed adequate information concerning WPPSS and WPPSS 4 and 5 Bonds. Given the general inexperience of the salesmen n51 and the complicated, rapidly changing conditions surrounding WPPSS 4 and 5 Bonds, Reid was unreasonable in assuming that novice salesmen, with little or no assistance, could obtain and understand the material information about WPPSS 4 and 5 Bonds. Moreover, he was aware that material information was not being conveyed to DSC customers. n52 Thus, under Section 15(b)(6) of the Exchange Act and MSRB Rule G-27, we find that he failed reasonably to supervise Houston salesmen with respect to WPPSS 4 and 5 Bonds.

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n51 As noted, the Houston office generally hired inexperienced salesmen, and the office suffered from a high turnover rate.

n52 Reid's claim -- that the WPPSS situation was too complex for him to instruct Houston salesmen on what facts to disclose to customers and that, as a consequence, he relied on the optimistic assessments of Sheldon and Brofman -- makes his delegation of the obligation to obtain relevant information about the securities to novice salesmen all the more irresponsible.

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While the prevailing view at DSC regarding WPPSS may have been positive, we believe someone with Reid's experience should have recognized the significant negative factors present and the need for their disclosure. *Edward J. Blumenfeld 47 S.E.C. 189, 190-1 (1979); Willard G. Berge 46 S.E.C. 690, 694 (1976),* aff'd sub nom., *Feeney v. SEC, 564 F.2d 260 (8th Cir. 1977).*

B. Other Antifraud Violations by Reid with Respect to Municipal Securities.

At Reid's instigation, DSC -- particularly its Houston office -- offered and sold to the public Cheneyville revenue bonds and Vanceburg bond anticipation notes. Both were obscure, thinly-traded securities. As set forth below, we find that Reid willfully violated, or willfully aided and abetted violations of, Section

17(a) of the Securities Act and Section 10(b), 15(c)(1) and 17(a) of the Exchange Act and Rules 10b-5, 15c1-2 and 17a-3 thereunder and MSRB Rules G-8, G-17 and G-19 in connection with the sale of these securities.

1. Cheneyville Revenue Bonds.

In April 1982, the Westside Habilitation Center, located in Cheneyville, Louisiana, issued $13.55 million in revenue bonds, bearing interest rates ranging from 14 percent to 16-1/2 percent, to construct a facility for the mentally retarded. The project experienced immediate difficulties.

In October 1983, Cheneyville's developer sued the bond trustee to determine whether the next bond interest payment would be made from the debt reserve fund or the construction reserve fund. If the developer were successful in preventing the use of the construction reserve fund to pay interest on the bonds, over $1 million in reserves would no longer be available to service the bonds. Moreover, once the debt reserve fund was depleted (which would occur after two additional -- for a total of three -- interest payments) Cheneyville would be completely dependent on operating income to meet its interest obligations. However, the Cheneyville facility was not meeting its occupancy or revenue forecasts. n53 By the fall of 1984, Cheneyville could not service the bonds. Cheneyville defaulted on the October 1984 interest payment and filed for bankruptcy in 1985. n54

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n53 Actual occupancy fell far below the issuer's projected average occupancy rate of 90 percent for the first year of operation. Cheneyville's problems were compounded because the facility was almost wholly dependent on Medicaid reimbursement, and, in 1983, Louisiana reduced the Medicaid reimbursement for which Cheneyville could be eligible.

n54 As a result of the bankruptcy proceedings, the interest rate on the bonds ultimately was lowered to 10 percent.

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Reid claims that he was unaware of the problems surrounding Cheneyville and relied on information provided by other DSC salesmen that the facility was doing well and able to meet its financial obligations. n55 However, the law judge credited Larry Greenfield, one of Reid's customers, who began liquidating his Cheneyville holdings through Reid in August 1983. Greenfield testified that, in the summer and fall of 1983, he and Reid discussed rumors that Greenfield had heard about Cheneyville's problems, as well as an October 1983 written update from the co-manager of the initial Cheneyville underwriting, describing the litigation. Greenfield and Reid also discussed why the price of Cheneyville bonds, which bore an interest rate of 16 1/2 percent, was falling during a period of low inflation. n56 According to Greenfield, Reid blamed the price decline on the pending litigation. n57

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n55 We reject Reid's further contention that, because, consistent with DSC policy, DSC salesmen were responsible for informing themselves about a security, he cannot be held liable as an aider and abetter of fraudulent sales made by Houston salesmen. See Section IV, A, 4, supra.

n56 Greenfield experienced a 13 basis point drop in the price of the bonds he held, from 106 to 93.

n57 Although denying knowledge of the problems plaguing Cheneyville, Reid admitted in testimony that, given the prevailing economic climate, prices for high interest rate bonds should have been rising -- not dropping -- unless there was "something wrong." In addition, Swink & Company, Cheneyville's principal underwriter and one of the few dealers trading in the issue, stopped trading Cheneyville in the spring of 1984. Reid acknowledged that Swink was one of a small group of brokers trading the bonds and that he became aware of Swink's decision. Under all the circumstances, we think that Reid knew that Cheneyville was troubled.

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Knowing this information, in May 1984, Reid nonetheless bought the bonds for the account of Louis Loeser, over which he exercised de facto discretionary authority. Reid made the purchase without first discussing it with Loeser. In June 1984, Reid sold Cheneyville bonds to Jimmy Bird who purchased the bonds at par. Reid did not disclose Cheneyville's problems, and, when Bird expressed concern about the safety of the bonds in light of their high rate of interest, Reid told Bird falsely that the issuer had an "entire city block" of real estate that was "more than enough" to secure its obligations to the bondholders. When Cheneyville defaulted on its October 1984 interest payment, Reid continued to mislead Bird and, toward this end, caused DSC to pay Bird's interest coupon (which the issuer had returned unpaid), assuring Bird that the problem had been caused by a change of trustees. n58 In light of Cheneyville's precarious financial situation, these bonds were unsuitable for Loeser and Bird, both of whom had told Reid that they wanted safe investments. n59

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n58 Only after the next coupon was returned unpaid to Bird in April 1985 did Reid tell Bird about Cheneyville's financial difficulties.

n59 As we have held, the broker has a duty to satisfy himself that speculative investments are suitable for the customer and that the customer understands and is willing to undertake the risks. *Arthur Joseph Lewis, Securities Exchange Act Rel. No. 29794 (October 8, 1991), 49 SEC Docket 1803, 1806.* See also *Wedbush Securities, Inc., 48 S.E.C. 963, 970 (1988)* (Bond recommendation "unwarranted" under MSRB Rule G-19(c) where salesman lacked "reasonable grounds for believing them suitable in light of [customer's] investment objectives.").

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2. Vanceburg (Kentucky) Bond Anticipation Notes.

In 1979, the City of Vanceburg, Kentucky issued bonds to construct an electric power plant, to be repaid from the sale of electric power to the plant's customers. Because of cost overruns, the project could not be completed with the proceeds of the original bond issue. In June 1982, Vanceburg issued bond anticipation notes bearing 10-1/2 percent interest, due June 1, 1984, by which time Vanceburg anticipated issuing a second bond offering. The City of Hamilton, Ohio, which was the chief prospective customer for the plant's power, had agreed to be liable for 90 percent of the debt service on the anticipated 1984 offering (although it was not liable on the notes).

However, in January 1984, Hamilton sued Vanceburg, alleging fraud and mismanagement and seeking to void its contract with Vanceburg and $10 million in damages. As a result, Moody's, which had initially assigned the notes its second highest grade for securities of this type, suspended the ratings of both the notes and the bonds, pending clarification of the suit's impact on the credit quality of the issuer's debt. S&P, which had not rated the notes, lowered the bonds' rating to a speculative grade. Both actions were reported in municipal bond publications. The suit hampered Vanceburg's efforts to issue additional bonds to pay off the notes.

In March 1984, Reid purchased Vanceburg notes for a DSC customer at 97-3/4, which he admitted was a low price for notes due to mature in less than three months. Reid claims that the trader he purchased the notes from told him that there was nothing wrong with the notes and that the notes were rated investment grade by both S&P and Moody's. n60 A day or so after this purchase, several salesmen asked Reid to add the notes to DSC's inventory. Without further investigation of the financial condition of the notes, Reid added them to the inventory with a notation that the notes were rated investment grade by Moody's. When another DSC trader told Reid that he was unable to verify that rating, Reid removed the reference to the rating but made no effort to determine the then-current rating.

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n60 The trader was unable to remember whether he discussed the rating with Reid. He did state, however, that, had he known such fact, he would not necessarily have told Reid that the rating had been suspended. He further stated that he never indicated to Reid that there was anything wrong with the notes, but added that it is not the practice of traders to highlight the negatives of a security they are trying to sell.

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Separately, three Houston salesmen contacted the Vanceburg fiscal agent who told them that the notes were "fully funded." Without further inquiry, the salesmen assumed, incorrectly, that this statement meant that the money to pay off the notes had been raised and was on deposit in the bank. One of these salesmen, Joseph Stafford, then sold $450,000 worth of the notes to Charles Epps, conditioned on Epps' verifying that funds to pay off the notes were on deposit. Epps cancelled the purchase when he determined that the funds were not on deposit. Reid spoke directly to Epps who confirmed that the money had not yet been raised.

Following the cancellation, Sheldon ordered Reid to liquidate the notes. Instead, Reid gave Stafford "a few days" to resell the notes and offset the loss which DSC would otherwise require Stafford to bear. Reid also directed Stafford to determine the status of the Vanceburg bond offering. According to Reid, Stafford informed him that, although the money was not then on deposit, a new issue would be sold within two weeks (the time that the notes were due), to pay the principal and interest. n61 The efforts to refinance the notes, however, proved to be unsuccessful, and the notes went into default on June 1, 1984. n62

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n61 Stafford's actual assessment was not so favorable. In a memorandum written to Sheldon and reviewed by Reid after the default, Stafford stated that he had contacted Vanceburg's underwriters in early May who told him "that there was [sic] some possible problems in funding the notes at their due date on 6/01/84 . . . ."

n62 On the maturity date, June 1, 1984, Vanceburg defaulted on payment of the principal. Eventually, the notes were paid in full from the proceeds of a bond sale several months following the default.

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In May 1984, Reid sold to Loeser's account $50,000 worth of the notes returned by Epps, without consulting with Loeser before the transaction. Thus, Reid effectively recommended the notes to Loeser without informing him of the issuer's troubles. In mid-June after the default, Reid purchased an additional $25,000 in notes for Loeser's account. n63 Given Loeser's conservative investment goals, these purchases were unsuitable for his account. Moreover, Reid backdated the second purchase to make it appear that the purchase occurred in May, prior to the default. n64

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n63 Reid claims that he purchased these notes only after obtaining Loeser's express consent. However, the law judge credited Loeser's testimony that Loeser had not given prior consent to the transaction. As mentioned supra, Reid exercised de facto discretionary authority over Loeser's account.

n64 By falsifying DSC's records to hide the fact that he bought the notes for Loeser after the default, Reid willfully aided and abetted violations by DSC of Section 17(a) of the Exchange Act, Rule 17a-3 thereunder, and MSRB Rule G-8.

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Reid also encouraged other Houston salesmen to offer Vanceburg notes to customers, and the salesmen offered these notes to customers seeking safe investments. Houston salesman represented to customers that the money to repay the Vanceburg notes was on deposit and failed to disclose the pending litigation, the rating suspension, or any other negative information.

In the face of these facts, Reid claims that he acted properly. He contends that the Houston office was in "regular" contact with Vanceburg officials and others associated with the notes, and received from them encouraging, albeit misleading, information. The record does not support this version of events. Although Reid testified in another context that bond ratings "are the most important ingredient in the bond business," he did not ascertain the publicly available information about the status of Vanceburg's ratings. He claimed to rely instead on the information provided by the selling trader, information that had been questioned by another DSC trader. n65 Reid was clearly reckless in assigning Stafford, who was being made responsible for DSC's loss as a result of the broken Epps trade, the task of DSC's further investigation of Vanceburg. Not only was Stafford not sufficiently disinterested in the result of the research since he would be held responsible for DSC's loss, he was inexperienced. Significantly, even after Reid knew that Epps had cancelled his purchase because the money to pay the notes was not on deposit, Reid willfully encouraged DSC salesmen to continue to sell Vanceburg notes to any customer without full disclosure of both the problems with the issue and the difficulty in obtaining accurate information -- and regardless of suitability. n66

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n65 Moreover, while the fiscal agent's "fully funded" statement was ambiguous, it was clearly within Reid's powers to obtain accurate information, as did Stafford's customer Epps.

n66 See, e.g., *Willard G. Berge, 46 S.E.C. 690, 693 (1976),* aff'd. sub nom, *Feeney v. SEC, 564 F.2d 260 (8th Cir. 1977)* (noting that a professional who recommends the unknown securities of obscure issuers must investigate those securities and determine that the recommendation has a reasonable basis). See also *Edward J. Blumenfeld, 47 S.E.C. 189, 190-191 (1979).*

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C. Unfair Pricing of Municipal Securities.

As described below, Reid charged, and/or aided and abetted the charging of, excessive markups on the sale of WPPSS 4 and 5 Bonds and Cheneyville bonds.

1. WPPSS 4 and 5 Bonds.

Between October 1982 and June 1983, DSC charged undisclosed markups ranging from 6 percent to as high as 15 percent in 109 transactions in WPPSS 4 and 5 Bonds. These excessive markups violated Rules G-17 and G-30 of the MSRB. n67 The law judge also found that, to the extent these markups exceeded 8 percent, they violated Section 17(a) of the Securities Act, and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. n68 We affirm these findings. n69

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n67 *Staten Securities Corp., 47 S.E.C. 766, 768 (1982)* (finding markups on municipal bonds ranging from 5.1 to 6.7 percent excessive and violative of MSRB Rules G-17 and G-30).

n68 *Edward J. Blumenfeld, 47 S.E.C. 189, 191-192 (1979)* (finding markups ranging from 8 to 25.3 percent on municipal bonds fraudulent). We disagree with Reid's assertion that "the more usual standard cited [for findings of antifraud violations] is ten percent." As we noted in Blumenfeld:

We have consistently held that, at the least, markups of more than 10% are fraudulent in the sale of equity securities. And we have found markups in excess of 7% fraudulent in connection with such sales. Markups on municipal bonds are generally lower than those for equity securities (emphasis in original). *Id. at 192.*

n69 Our Division of Enforcement did not appeal the law judge's finding that only those markups exceeding eight percent were fraudulent. We note that markups below this level have been found fraudulent as well. See, e.g., *Century Securities Company, 43 S.E.C. 371, 379 (1967).*

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Reid argues that, because DSC was a market maker in WPPSS 4 and 5 Bonds, DSC's contemporaneous costs were not the appropriate bases to use in calculating its markups. However, the law judge found that DSC was not a market maker in WPPSS 4 and 5 Bonds, and this finding is supported by the record, including the testimony of DSC's head trader. Thus, calculations based on DSC's contemporaneous costs were appropriate.

Reid complains that the law judge improperly placed the burden of proof on him to demonstrate that DSC's markups in WPPSS 4 and 5 Bonds were not excessive. The Administrative Procedure Act (the "APA") expressly places the burden of proof -- that is the burden of presenting some evidence -- on the proponent of an issue, in this case the Division with respect to the excessiveness of markups. Once the Division presented evidence of these markups, the burden shifted to Reid to refute that evidence. n70 Reid did not introduce any countervailing evidence either that other factors should be considered in evaluating DSC's markups or that contemporaneous costs were not a valid basis for calculating DSC's markups. We are satisfied that the record establishes excessive markups by a preponderance of the evidence. n71

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n70 See *Environmental Defense Fund, Inc. v. E.P.A., 548 F.2d 998, 1004 (D.C.Cir. 1976).* We also reject Reid's claim that, in presenting such evidence, the Division failed to satisfy the requirement of the APA that it produce "reliable, probative and substantial evidence." *5 U.S.C. § 556*(d).

n71 See *DMR Securities, Inc., 47 S.E.C. 180, 182 (1979).* See also S. Doc. No. 248, 79th Cong., 2d Sess. 208, 270 (1946) ("[W]here a party having the burden of proceeding has come forward with a prima facie and substantial case, he will prevail unless his evidence is discredited or rebutted").

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Reid also contends that he cannot be held accountable for the resulting markups because the prices were set by traders in DSC's New York office. However, Reid purchased many of the WPPSS 4 and 5 Bonds for the Houston office, and most of these bonds were sold by Houston salesmen on the same or next day. Reid further admitted that, since he purchased the bonds, he knew what the markup on them was. Nevertheless, Reid admitted that he did not challenge any of the New York trading desk's prices. n72

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n72 Reid also asserts that the law judge failed to specify "the number of mark-ups, if any, attributable to Houston office sales." However, the law judge in fact found "that, with one or two exceptions, the sales. . . were all effected by Houston salesmen."

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Reid was an experienced principal, trader, and branch manager. DSC's procedures manual, which Reid admitted reviewing, notes:

It is the practice in the municipal bond industry to charge a retail customer a price which is no more than one quarter of one percent to five percent over the current market price for a bond. n73

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n73 Reid also admitted receiving a memorandum from Sheldon in the early 1980s describing the markup standard set forth by the Commission in Blumenfeld. In addition, Reid has previously been sanctioned for excessive markups. See n. 128 infra.

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Thus, Reid knowingly and substantially assisted conduct that he knew, or was reckless in not knowing, was violative of the markup restrictions.

2. Cheneyville. Between January and November 1984, DSC charged markups of between 5 and 9 percent on over 70 sales of Cheneyville bonds. The finding of the law judge that Reid traded Cheneyville bonds for DSC and set their markups "in concert with . . . the salesmen" is fully supported by the record. n74 These markups were clearly excessive in violation of MSRB markup restrictions and, in several instances, fraudulent. n75

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n74 At oral argument, Reid's counsel referred to Reid's challenge of a markup schedule submitted by the Division. However, in his proposed findings of fact, Reid challenged only entries concerning 1983 Cheneyville transactions which had already been excluded by the law judge.

n75 See *Staten Securities, supra.*

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In addition, Reid sold Cheneyville bonds to the accounts of favored customers at prices close to DSC's contemporaneous costs. He repurchased the bonds from the favored accounts at a profit to those accounts. He then sold these same bonds to non-favored customers at a still higher price. n76 Reid's interpositioning of favored accounts between the dealer market and non-favored accounts resulted in fraudulent, effective markups of as much as 10 percent. This interpositioning on Reid's part demonstrates clear scienter and, in our view, was particularly egregious. n77

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n76 On September 13, 1984, for example, Reid acquired 135 Cheneyville bonds for DSC at 89 1/8, which he immediately sold to three favored accounts at 91 1/8 and 93. On that same day and the next, Reid bought bonds from these accounts at 94 and 95. Two business days thereafter, DSC sold Cheneyville bonds to three non-favored customers at 100.

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In other instances he sold the bonds short to non-favored customers and covered the resulting short position by repurchasing the bonds from the favored account at a profit to that account but at a price below that charged the non-favored customers.

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n77 See *Edward Sinclair, 44 S.E.C. 523, 527 (1971).*

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V.

Sheldon's Failures of Supervision.

We have made clear that it is critical for investor protection that a broker establish and enforce effective procedures to supervise its employees. n78 Ultimately, it is the broker-dealer's president who is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient. n79

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n78 *Dean Witter Reynolds, Inc., Securities Exchange Act Release No. 26144 (September 30, 1988), 41 SEC Docket 1680, 1684* ("Dean Witter").

n79 *Universal Heritage Investments Corporation, 47 S.E.C. 839, 845 (1982)* ("Universal Heritage").
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As detailed below, we find that, under Section 15(b)(4)(E) and 15(b)(6) of the Exchange Act and MSRB Rule G-27, Sheldon failed repeatedly to discharge this obligation.

A. Sales of Cheneyville and Vanceburg Securities.

As described above, DSC sold Cheneyville and Vanceburg securities to persons for whom they were not suitable and on the basis of material misrepresentations and omissions. Sheldon admitted responsibility for supervising the branch offices, although he also asserts that he delegated the duty to supervise sales to the branch managers, including Reid. We have repeatedly warned that "supervisory procedures which rely solely on supervision by branch managers" are not sufficient. n80 Nonetheless, Sheldon neither monitored, nor established procedures to monitor, DSC branch managers to determine whether they were carrying out their supervisory responsibilities. n81
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n80 *Dean Witter, 41 SEC Docket at 1685.*

n81 For example, other than Sheldon's assisting in training salesmen when the Houston office first opened and a few brief visits to that office, Sheldon was unable to identify any efforts undertaken by either him or any other DSC employee at his direction to ensure that Reid was providing the requisite level of supervision.
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Sheldon also neither identified nor corrected weaknesses in DSC's sales procedures and suitability standards. As noted, DSC placed the entire burden of investigating and evaluating the appropriate disclosure for a security on DSC's registered representatives, but provided no guidance through its procedures manual, training, its supervisory staff, or otherwise to the salesmen as to the manner in which they should comply with these regulatory requirements. This policy was inappropriate. It raises particular concerns with respect to troubled securities, such as Cheneyville and Vanceburg, especially since many of DSC's salesmen were novices. At a minimum, Sheldon had an obligation to ensure that DSC provided its salesmen with the means to obtain adequate information about these securities and with effective direction for its appropriate disclosure. n82

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n82 *Universal Heritage, 47 S.E.C. at 845,* citing *Reynolds & Co., 39 SEC 902, 916 (1960).*
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Sheldon ignored repeated indications of irregular conduct which should have alerted him to the problems in the Houston office. He received several customer complaints that DSC salesmen had failed to inform customers of the most fundamental information about securities DSC recommended, including ratings and financial information about, and litigation involving, the issuer. He had specific knowledge that Epps had cancelled his Vanceburg transaction because the Houston office had provided Epps with erroneous information. Nonetheless, although he ordered Reid to liquidate the notes into the market, he did not even ascertain whether this order was followed or whether Houston salesmen, including Reid, were continuing to market Vanceburg notes without adequate disclosure.

B. Markups in Municipal Securities.

Sheldon admits responsibility for supervising DSC's traders and ensuring that markups were not unfair or fraudulent. Sheldon contends that DSC's markups were not unfair or fraudulent. n83 However, as discussed in Section IV, C, supra, we affirm the law judge's finding that these markups were excessive

and, in many instances, fraudulent. The DSC procedure manual stated that the appropriate markup for municipal bonds sold to retail customers was between 1/4 to five percent above the market price of the bond and warned DSC employees that excessive markups could be fraudulent. n84 Sheldon nonetheless failed to provide a mechanism to review DSC's pricing of municipal bonds to achieve compliance with even this internal guideline or to detect interpositioning. n85

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n83 Sheldon asserts these markups were not excessive, noting that the MSRB, unlike the NASD, has not adopted a five percent markup policy. The Division called, as an expert witness, a former chairman of the MSRB, who explained that the MSRB rejected the NASD's five percent policy:

Because we did not want to set any numerical standard which might . . . induce people to do transactions at higher spreads than they were doing them at the time. There was strong concern that whatever the figures we set - say 2 1/2 percent, the people who were doing bonds for 1 point or 2 points would then say its okay to do 2 1/2.

Although Reid and Sheldon now question this witness' views because he lacked "market experience" with the WPPSS and Cheneyville securities at issue, at the hearing both Sheldon and Reid expressly acknowledged the witness' expertise.

n84 See text accompanying n. 73.

n85 Sheldon also incorrectly claims that he has been subjected to "selective prosecution" because none of the traders directly pricing WPPSS 4 and 5 Bonds was "accused of any wrong-doing." As noted, Reid violated the antifraud and MSRB markup provisions with respect to his trades in WPPSS 4 and 5 Bonds and Cheneyville. Another trader, Ebbitt, was also charged but consented to sanctions by the Commission, without admitting or denying the allegations. See n. 2, supra.

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Sheldon further contends that penalizing DSC and him for charging markups above specific percentages amounts to price fixing and, as such, violates the federal antitrust laws. However, neither the MSRB rules governing markups nor this Commission's markup cases set prices for securities. Instead, they seek to ensure that these prices are fair by providing guidance as to what prices are unfair. n86 In any event, the Supreme Court has recognized that the antitrust laws are deemed repealed to the extent necessary to permit the securities laws to function in the manner envisioned by Congress, n87 and this Commission has held that this implicit repeal applies in the context of markups. n88

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n86 In reviewing the NASD's analogous markup policy, Congress has noted that this policy properly serves "to protect investors against 'gouging'" and promotes just and equitable principles of trade. S. Rep. No. 75, 94th Cong. 1st Sess. 28, n.45, reprinted in 1975 U.S. Code Cong. & Admin. News 179, 226.

n87 *Silver v. New York Stock Exchange, 373 U.S. 341 (1963); United States v. NASD, 422 U.S. 694 (1975); Gordon v. New York Stock Exchange, 422 U.S. 659, 688-691 (1975).*

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Sheldon asserts that the markup policy violates the prohibition against restraints on interstate commerce. The interstate commerce clause prohibits the several states, not the Federal government, from imposing restraints on interstate commerce. See generally, J. Nowak, Constitutional Law (2d ed.) 266-291 (1983).

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n88 *In re Meyer Blinder, et al., Securities Exchange Act Release No. 31095 (August 26, 1992), 52 SEC Docket 1437, 1455.*

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C. Misrepresentation of SIPC Coverage of GSI.

Customer accounts at DSC -- but not GSI -- were insured by SIPC. n89 However, the Firms shared office space and sales personnel, creating the potential for confusion among customers about whether particular securities transactions were covered by SIPC. Sheldon failed to take measures to prevent this confusion, resulting in violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

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n89 Government securities firms, like GSI, which are not registered under Section 15(b) of the Exchange Act, are not eligible for SIPC membership.

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Sloppy office procedures exacerbated this problem by further blurring the distinctions between the Firms. Salesmen sent SIPC brochures to government securities customers. The Firms also used DSC business cards and DSC stationery, both noting SIPC membership, when sending correspondence concerning GSI government securities transactions. In the Los Angeles office, a SIPC decal was affixed on the Firms' front door. n90 Customers testified that they understood that their investments through GSI were protected by SIPC. n91

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n90 A SIPC decal was also affixed to a window at the Firms' Pompano Beach office.

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In response to the Division's introduction of a photograph taken after the Firms had closed showing such a sign on the entrance to the Los Angeles office, Sheldon introduced a SIPC sticker, Sheldon Exhibit B (which is missing from the record, see n. 1, supra), to demonstrate that the sticker was capable of being moved. Sheldon did not, however, adduce any evidence indicating that the sticker had in fact been moved. Our conclusion that the sign was displayed prominently by the Firms' Los Angeles office is confirmed by the record.

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n91 SIPC ultimately contributed $500,000 to a settlement with GSI customers. See n. 122 infra.

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Reid introduced a check made payable to GSI, Reid Exhibit B (which is one of the exhibits missing from the record, see n. 1, supra), to refute a customer's testimony that he believed his purchase of a government security was covered by SIPC. While this check shows that the customer knew that there were two firms, it does not undermine his testimony that he was confused about the differences between GSI and DSC.

Reid also introduced a letter written to this customer by a Houston salesman shortly after the Firms closed, Reid Exhibit C (which is also missing from the record), to demonstrate that he had no control over the misrepresentations made to this customer. However, our findings as to Reid's violations concerning representations of GSI's SIPC membership are based on Reid's testimony.

Sheldon notes that the Firms' procedures manual stated that "[e]ach new customer is to be informed by his representative. . . of the difference between Donald Sheldon & Co., Inc. and its subsidiary Donald Sheldon Government Securities Inc." However, this statement does not explain to a salesperson what those differences are or their import. n92 And aside from a single meeting in the Los Angeles office, there appears to have been no effort made to inform salesmen of the importance of the distinction between the Firms. n93 Sheldon thus failed to exercise reasonable supervision. n94

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n92 Sheldon claims that the Los Angeles office's clerical staff, which mailed information to customers, "sought to send out only appropriate material." However, the Firms' salesmen were uncertain about the distinction. For the most part, it appears that the clerical staff sent the information requested by the salesmen. In any event, it was inappropriate for Sheldon to rely on unsupervised clerical personnel to make this distinction.

n93 Reid, among other salesmen, sent a form introduction letter to customers of both Firms, stating, "We are members of the . . . Securities Investor Protection Corporation," leaving the clear impression that both firms were SIPC insured. Reid testified that the form letter was produced by the Firms' New York office and that all salesmen were directed to use it.

n94 In addition to the letters described in n. 93, supra., Reid also admitted that he was not "very concerned" whether GSI or DSC stationery was used in GSI correspondence because "[i]t didn't seem that important." He did not instruct anyone under his supervision to make this distinction. Because we find that Reid's conduct was negligent, we hold him liable, in connection with customers being misled about SIPC coverage, for violating Sections 17(a)(2) and (3) of the Securities Act. See *Aaron v. SEC, 446 U.S. 680, 695-700 (1980).*

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D. Salesman's Misappropriation.

In 1982, a salesman in the Firms' New York office, Jonathan Smith, purchased large numbers of bonds for non-existent customers. Although the scheme cost the Firms approximately $60,000 and required DSC to reimburse a customer, the incident was not reported to the NASD, and Smith was permitted to retain his position.

Sheldon, who was aware of this scheme, was on notice that Smith could not be trusted and required the strictest scrutiny. Sheldon required Smith to sit next to the New York sales manager, who, in turn, was instructed to observe Smith and answer his questions. Sheldon delegated responsibility for overall supervision to Jack Manion, a principal of the firm. However, this oversight lapsed after Manion's death in the spring of 1983. And, beginning about December 1982 (almost immediately following the discovery of his first scheme), Smith began to steal customer funds and securities. Smith confessed his misappropriation in October 1984 and was terminated. n95

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n95 Smith subsequently pleaded guilty to grand larceny in the second degree in connection with this activity and was sentenced to one to three years in prison. See also n. 2.

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Sheldon claims that DSC had procedures in place to prevent access by salesmen, including Smith, to customer funds and securities, and that the operations supervisor failed to enforce these procedures, making Smith's theft possible. n96 Even if DSC's procedures were adequate for a typical salesman, however, Sheldon was on notice that Smith required extraordinary supervision and failed to provide sufficient measures. n97

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n96 However, the record reflects that DSC rules restricting its salesmen's access to customer funds and securities were not rigorously enforced.

n97 *Michael E. Tannenbaum, 47 S.E.C. 703, 712 (1982)* (A broker's system of internal control must be adequate and effective and those in authority must exercise the utmost vigilance where an indication of irregularity reaches their attention.)

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VI.

Markups of Government Securities.

The Commission has observed that "mark-ups on government securities, like mark-ups on corporate and municipal debt securities, usually are smaller than those on equity securities." n98 Similarly, the Division's expert witness noted that it was industry practice to charge markups of no more than four percent on government securities. n99 Sheldon admitted that it was GSI's policy to charge an undisclosed markup of five basis points over the market price on discount mortgage-backed government securities "across the board." As a result, customers were defrauded in that they purchased securities at prices that bore no reasonable relationship to the prevailing market price. n100

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n98 *Securities Exchange Act Release No. 24368 (April 21, 1987), 38 SEC Docket 234, 235.* Sheldon admitted that, while municipal securities "have a credit as well as market potential for fluctuation," government securities largely fluctuate in response to changes in interest rates.

n99 We note in this connection, however, that even a four percent -- or smaller -- markup on government securities may be excessive.

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Sheldon challenges the competence of the Division's expert, claiming that he had limited experience and was personally hostile to Sheldon, based on past personal disputes. However, the law judge concluded the expert's testimony was not tainted by bias. In any event, our findings are based on Sheldon's admitted markup policy.

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n100 *Duker & Duker, 6 S.E.C. 386, 388-9 (1939).*

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GSI's markup policy necessarily produced markups in excess of five percent -- and often of eight percent or above -- on discount mortgage-backed government securities. n101 Indeed, GSI's inalterable policy of a five point markup precluded pricing these securities based on the particular circumstances of the sale or the market for the securities. We therefore hold that Sheldon, through this markup policy, willfully violated or willfully aided and abetted violations of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. n102

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n101 We have observed that "markups calculated based upon the face amount at maturity may be excessive in relation to the discounted price of the security." *Securities Exchange Act Release No. 24368 (April 21, 1987), 38 SEC Docket 234, 235.* For example, if a security cost $60, charging five points would result in a markup in excess of eight percent.

n102 As we have noted Sheldon does not dispute the amount of the markups, but rather asserts his view that government securities were unregulated and therefore not subject to the antifraud provisions. However, since 1933, transactions in government securities have been subject to the antifraud provisions of the securities laws.

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VII.

Miscellaneous Procedural Issues.

Sheldon and Reid raise a variety of issues, which they contend rendered these proceedings defective. For the reasons set forth below, we conclude that none of these contentions is meritorious.

A. Sheldon asserts that the financial problems of the Firms were due not to his mismanagement but, rather, to the disruption of the Firms' operations caused by the Division's investigation. n103 Scrutiny from inspections and investigations is an aspect of doing business in a regulated industry. n104 Securities firms are not excused from compliance with regulatory requirements because they are being examined and/or inspected. n105

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n103 The law judge generally declined to permit Sheldon to explore matters arising during the investigation because, in his view, they were not encompassed by the order instituting the proceeding, and Sheldon could pursue these claims in another forum. Nevertheless, he did permit Sheldon limited latitude to develop testimony concerning whether the investigation inhibited the Firms' compliance with particular regulatory requirements.

n104 See Section 17(b) of the Exchange Act and Article IV of the Rules of Fair Practice, Section 5, NASD Manual P2205 (CCH).

n105 As we have noted, it is of "overriding importance" that firms cooperate with regulatory authorities during investigations. *Wedbush Securities, Inc., 48 S.E.C. 963, 971-2 (1988).* If a firm is ill-equipped to provide the full degree of cooperation necessitated by such an investigation and also comply with its routine regulatory requirements, it has the obligation to act to correct that situation by, for example, hiring additional employees. Id. Failure to do so is certainly no defense.

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B. Sheldon claims that the Division withheld exculpatory information, misled witnesses, and even encouraged their lying. He charges that the law judge improperly excluded testimony regarding this alleged intimidation and ignored its presence. Although the law judge gave him numerous opportunities to make and support his allegations, Sheldon cited, in the most general terms, only a few instances of alleged misconduct. n106

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n106 The record in this case is extensive. Our review of this record has been handicapped due to Sheldon's failure to include citations to the record to support his charges. Moreover, one instance was mentioned for the first time during oral argument. Despite these obstacles, we are satisfied that these charges are unfounded.

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For example, Sheldon claims that a GSI customer misrepresented the amount she expected to recover from the GSI bankruptcy. However, when the witness testified on redirect, she made clear that her estimate of her recovery had been based on information she had received from the bankruptcy trustee and the custodian of GSI's funds, not the Division. n107 Sheldon similarly complains that one witness testified that his plans to retire "fell through" since his funds were not available because of GSI's bankruptcy. Sheldon claims that this statement is untrue because ultimately the GSI customers recovered most of their funds in bankruptcy. We fail to see how this eventual recovery makes the witness' statement that his retirement was delayed a lie. n108

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n107 Sheldon also complains that he was denied the ability to "expose further slanderous remarks" by this witness. When the witness was recalled solely to state the basis of her estimate, the law judge properly limited Sheldon's cross-examination to the matters covered in her redirect. Sheldon had previously had an opportunity to cross-examine the witness when she had testified on direct.

n108 We note that this testimony is, in any event, irrelevant to the Division's case. There is no requirement in a Commission enforcement action to demonstrate that the complained of conduct caused injury or damage to the investors. *SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963); SEC v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985).*

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Sheldon also claims that certain of his witnesses were intimidated by the Division n109 and, as a result, slanted their testimony or declined to testify. n110 Sheldon called Donald Wheeler, owner and principal of a municipal securities firm. Wheeler, who is an attorney, testified that he had second thoughts about testifying on Sheldon's behalf after he was contacted by the Division. However, Wheeler did testify and stated unequivocally that his testimony was unaffected by this contact, and the law judge credited this testimony. n111 Sheldon's two other allegations of intimidation are also not supported by the record. n112

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n109 At oral argument, Sheldon requested the appointment of a special outside investigator to look into these allegations. For the reasons stated herein, our review of these allegations convinces us that they do not warrant such extraordinary action.

n110 We reject Sheldon's additional claim that, as a result of this intimidation -- and the law judge's attitude towards it -- he declined to call any customers as witnesses on his behalf. He neither identified these customers nor made any proffer of any sort to support this claim.

n111 Sheldon's further assertion -- that the Division penalized Wheeler for his testimony by initiating an investigation of Wheeler's firm after his appearance -- is without basis and would not, in any event, demonstrate that Wheeler was intimidated when he testified before the law judge. Sheldon cites no other evidence of impropriety regarding this investigation, and we are aware of no such impropriety.

n112 Sheldon complained that one of his potential witnesses had refused to appear absent a subpoena. While the witness initially testified that the Division had suggested he insist on a subpoena, the witness admitted upon further questioning that the Division staff member had stated he did not want to influence the witness' decision and that the witness' lawyer and co-workers had advised him to insist on a subpoena.

A second witness asked Sheldon not to call him as a witness because he wanted to avoid "an adversarial position with the SEC staff." A witness' independent desire not to testify is not evidence of improper staff conduct. In addition, Sheldon did not cross-examine this witness when he testified for the Division.

C. Sheldon and Reid claim that they are the victims of selective prosecution with respect to the sale of WPPSS securities. They rely on a 1988 statement accompanying the transmission to Congress of a staff report on the collapse of WPPSS, n113 that the Commission had determined to "close its investigation into transactions in WPPSS securities without initiating any enforcement actions." n114 Thus, Sheldon and Reid claim that charging them with securities violations for the WPPSS 4 and 5 bonds transactions demonstrates selective prosecution by the Commission.

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n113 Staff Report on the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities (the "Staff Report").

n114 Letter dated September 22, 1988, from then-Commission Chairman David S. Ruder to Congressman John Dingell, Chairman of the House Subcommittee on Oversight and Investigations, transmitting the Staff Report (the "Transmittal Letter").

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The Transmittal Letter, however, clearly related to the "participants in offerings of WPPSS securities," and not, as in this case, to any activity in the secondary market in those securities. n115 In any event, to demonstrate selective prosecution, Sheldon and Reid must establish both that they were singled out for enforcement action while others who were similarly situated were not, and that the action was motivated by arbitrary or unjust considerations, such as race, religion or the desire to prevent exercise of a constitutionally-protected right. n116 They have failed to do so. Given the scope of the violations we have found and the variety of securities in which those violations occurred, the Commission's prosecution of these respondents is amply justified.

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n115 The offers and sales of WPPSS 4 and 5 Bonds which are the subject of this proceeding occurred more than one to two years after the events described in the Staff Report. Moreover, the Staff Report was issued some two years after the complaint in this matter.

n116 *U.S. v. Huff, 959 F.2d 731 (8th Cir. 1992); C.E. Carlson, Inc. v. S.E.C., 859 F.2d 1429, 1437 (10th Cir. 1988); Baltimore Gas & Elec. Co. v. Heintz, 760 F.2d 1408, 1419 (4th Cir. 1985),* cert. denied, *474 U.S. 847 (1985)* ("So long as an agency is not determining whether to enforce its regulations on the basis of some impermissible constitutional criterion, it is not violating the dictates of due process.").

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D. Sheldon also charges that the attorneys he retained during the investigation phase of this matter were adversely influenced in assisting him because Rule 2(e) of our Rules of Practice authorizes this Commission to discipline professionals who appear or practice before it. He asserts that this in terrorem effect forced him to proceed pro se at the hearing stage of these proceedings and therefore deprived him of effective assistance of counsel. Nevertheless, none of Sheldon's three former attorneys, two of whom testified in these proceedings, even hinted that possible disciplinary action by this Commission influenced their representation. n117 There is nothing in the record to indicate that Sheldon's relationship with his lawyers was improperly affected by this Commission, our staff or by any authority conferred on it. n118

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n117 We note that the trial staff expressed displeasure when Sheldon's third attorney, who apparently disposed of all the exhibits the Division had provided the attorney on Sheldon's behalf, resigned immediately before the hearing. A member of the staff wondered, on the record, whether disciplinary action was appropriate for this type of conduct. However, this interchange occurred well after the attorney had resigned.

n118 Sheldon also argues that Rule 2(e) caused the Firms' accountant to act to protect himself, deserting the Firms and leaving their financial records in shambles. The record is clear, however, that the accountant attempted to obtain the cooperation of the Firms' management to correct substantial violations. Having no success and after consultation with counsel, he felt compelled to resign. See Section III, supra.

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VIII.

Public Interest.

Respondents contend that the sanctions assessed by the law judge are too severe. The Division of Enforcement maintains that the sanctions imposed by the law judge on Sheldon (a bar) and Pattison (a 45-day suspension) are appropriate, but that, in light of Reid's serious misconduct, those assessed against him

(a bar with the right to reapply in two years to become associated in a non-supervisory capacity) are too lenient. Reid, the Division argues, should receive an unqualified bar. n119

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n119 We note that the Division sought a bar only from association with a broker, dealer, or municipal securities dealer.

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We agree with the staff. Accordingly, we shall affirm the sanctions imposed on Sheldon and Pattison. We further conclude that the public interest requires that Reid be barred from association with any broker or dealer. In assessing sanctions, we are guided by the factors cited by the court in *Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979),* aff'd, *450 U.S. 91 (1981):* n120

[T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

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n120 See, e.g., In the *Matter of Blinder, Robinson & Co., et al., 48 SEC 624, 632 (1986),* rev'd on other grounds, *837 F.2d 1099 (D.C. Cir. 1988).*

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A. Sheldon. Given Sheldon's serious individual misconduct and his total abdication of the responsibility that his position at the Firms imposed, an unqualified bar of Sheldon from association with any broker, dealer or municipal securities dealer is amply justified. n121 Sheldon willfully aided and abetted violations of antifraud and customer protection provisions (in connection with the Firms' use of fully-paid securities), as well as of net capital requirements, exposing the Firms' customers to financial risk. He further propounded misleading and irresponsible advertising which failed to disclose or downplayed material adverse information.

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n121 We note that this is not the first time Sheldon has been disciplined. In 1978, the NASD, by consent, censured Sheldon, among others, and fined him $400, jointly and severally with the other individual respondents, for violating net capital and recordkeeping requirements.

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This case also graphically demonstrates the mischief that can be wrought on the investing public when there is a total failure to establish or abide by the supervisory requirements imposed on the securities industry. n122 It is difficult to envision a more pervasive supervisory vacuum -- failure to establish and enforce adequate supervisory procedures, hiring inexperienced sales representatives while failing to provide them with adequate information concerning the securities in which the Firms specialized and discouraging them from performing any independent investigation of the issuers. In addition, Sheldon purposefully determined not to establish any compliance procedures at GSI. This structure allowed and effectively encouraged the broad range of serious violations found in this case. n123

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n122 Sheldon argues that GSI customers were ultimately made whole. Because Sheldon has raised this issue, we hereby admit as an addition to the record a declaration by Jonathan Kibbe, an attorney who advised the GSI trustee, dated April 27, 1989, which is attached to the brief of the Division.

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While each customer ultimately received the full value of his "net equity claim" (as defined in *11 U.S.C. § 741* (6)), the customers had to wait almost a year to receive 92 percent of such claims and almost 4 years

to receive the balance, and received no interest during this period. Sheldon also refuses to concede that the trustee's ability to pay out these amounts was in part due to the fact that SIPC made a $500,000 contribution to settle claims by GSI customers against SIPC.

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n123 The law judge additionally found that Sheldon violated the antifraud provisions with respect to certain representations made in connection with the offer and sale of government securities. He further found that Sheldon had violated MSRB rules because some of his branch managers were not properly qualified. However, because we consider the bar imposed by the law judge fully warranted by the violations we have sustained, we see no need to reach these additional findings.

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Significantly, Sheldon does not acknowledge the gravity of what his Firms did in using customers fully-paid securities to finance his operations. n124 This attitude compounds our concerns about any possible future role he might have in the securities industry. We consider the sanction imposed on Sheldon by the law judge to be fully warranted as a means of protecting public investors from any repetition of his misconduct. n125

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n124 Indeed, throughout these proceedings, Sheldon has refused to recognize the importance of the various regulatory provisions he violated.

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Sheldon contends, in connection with a similar observation by the law judge, that this amounts to penalizing him for not confessing and suggests a lack of impartiality. We disagree. It is not Sheldon's refusal to concede misconduct during the course of these proceedings, but his fundamental lack of appreciation for the importance of the provisions at issue that, among other things, leads us to conclude that a bar is appropriate. *Arthur Lipper Corp., 46 S.E.C. 78, 101 (1975)* (failure of a respondent to recognize the magnitude of his misconduct can indicate likelihood of repeating it), rev'd on other grounds, *547 F.2d 171, 184 (2d Cir. 1976),* cert. denied, *434 U.S. 1009 (1978).*

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n125 Sheldon contends that the law judge erred in failing to credit the beneficial contribution of DSC to the "communities of the nation and to the investors that it served." Sheldon, in particular, stresses DSC's willingness to continue to make a market in New York municipal bonds during that city's crisis in the 1970's, and introduced four exhibits, including Sheldon exhibits D and G (which are missing from the record, see n. 1, supra), documenting his commendations from the city. Even if Sheldon's activities were valuable to the City of New York during this period, these activities do not mitigate the extensive, serious and protracted nature of Sheldon's misconduct which is the subject of this proceeding.

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B. Reid. Reid asserts that his sanction should be lessened in light of his record in the securities business and claims that sanctions for markups are generally less severe and that his supervisory violations were not extreme. n126 Reid's effort to portray his numerous instances of misconduct as relatively insignificant and an aberration from an otherwise unblemished career is unpersuasive. Reid engaged in serious fraud upon his own customers in connection with sales of Cheneyville and Vanceburg securities. He compounded this fraud by attempting to disguise his actions by, in at least one instance, backdating firm records. n127 He disguised the amount of Cheneyville markups by interpositioning the accounts of favored customers between the market and the accounts of less favored customers.

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n126 Reid notes that, over a 25-year career in the securities industry, during which he developed a "positive record with his customers," he was disciplined on just one other occasion. He asserts that the securities involved in this case represented a small fraction of the securities sold out of the Houston office,

and that no allegations of wrongdoing were made with regard to the vast majority of the securities sold. He further asserts that whatever misconduct he engaged in it was not "extreme." He also claims that any misconduct on his part was far less serious than that engaged in by Sheldon. As discussed, infra, we disagree.

n127 Reid's argument that customers Loeser and Bird could not have been defrauded because both continued to deal with Reid after their Cheneyville investment is without merit. The fact that a customer continues to trust a salesman even after he has been defrauded, while perhaps inexplicable, does not affect the question of whether fraud occurred.

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In addition, salesmen in the Houston office, which he was charged with supervising, repeatedly violated the antifraud and suitability provisions. As manager of that office, he encouraged salesmen on several occasions to sell securities without adequate information. He also admits that he never instructed his salesmen on their duties of disclosure.

Finally, he was responsible for the charging of excessive markups by DSC. This is not the first time Reid has engaged in such misconduct. In 1979, we sanctioned Reid for charging an institutional customer excessive prices in bond transactions. n128 Yet at DSC he continued to charge excessive markups in municipal securities. Given the gravity of Reid's offenses, and particularly the fact that many of his own customers were victims of this misconduct, we believe that the protection of public investors necessitates Reid's total bar from association with any broker, dealer or municipal securities dealer. n129

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n128 Reid was suspended from association with any broker or dealer or investment adviser for 30 days and from association with any broker or dealer in any supervisory capacity for 1 year. This case was settled with Reid neither admitting nor denying the allegations or findings. In the *Matter of UMIC, Inc., Securities Exchange Act Rel. 16110 (August 16, 1979), 18 SEC Docket 103.*

n129 Reid refers to various instances in which we have imposed lesser sanctions on persons whose misconduct, in Reid's view, was more serious. It is, however, well recognized that the question of whether disciplinary action is excessive depends on the particular facts and circumstances of each case, and cannot be determined by comparison with the action in other cases. See, e.g., *Michael David Sweeney, Securities Exchange Act Rel. No. 29884 (Oct. 30, 1991), 50 SEC Docket 59, 68; Donald William Collins, 46 S.E.C. 642, 647 (1976).*

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Our determination of the appropriateness of Reid's sanction is based on our review of the record before the law judge (except as noted in n. 1, 49 and 91). The Division's motion to adduce additional evidence under Rule 21(d) of our Rules of Practice in the form of investigative testimony given by Reid in an unrelated matter is hereby denied in all respects.

C. Pattison. Pattison violated antifraud provisions in connection with the sale of WPPSS 4 and 5 Bonds to two customers. He points to his lack of experience and inadequate supervision as reasons for reducing his sanction. n130 While his misconduct was far less significant than that of the other two respondents, it nevertheless warrants the 45-day suspension imposed by the law judge.

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n130 Although, as Pattison contends, there were serious deficiencies in the supervision he and other of the Firms' salesmen received, this does not exonerate him. As a registered securities professional, he had an obligation to inform himself of the material facts about any securities he recommended. *Hanly v. SEC, 415 F.2d at 589.* That obligation could not be abridged by a failure on the part of his supervisors. Such a fact properly can be, and in this case was, considered in assessing Pattison's sanction.

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An appropriate order will issue. n131

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n131 All of he contentions advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

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By the Commission (Commissioners SCHAPIRO, ROBERTS, and BEESE); Chairman BREEDEN not participating.

ORDER IMPOSING REMEDIAL SANCTIONS
On the basis of the Commission's opinion issued this day, it is

ORDERED that Donald T. Sheldon and Bruce W. Reid be, and they hereby are, barred from association with any broker, dealer or municipal securities dealer; and it is further

ORDERED that Gregory L. Pattison be, and he hereby is, suspended from being associated with a broker, dealer or municipal securities dealer for a period of 45 days. The suspension shall be effective as of the opening of business on November 30, 1992.

By the Commission.

In re Edward J. Blumenfeld, Exchange Act Release No. 16437, A.P. File No. 3-5282 (December 19, 1979).

OPINION OF THE COMMISSION

TEXT:

I.

Edward J. Blumenfeld, who was a salesman for Shelby Bond Service Corporation, formerly a municipal bond dealer, n1 appeals from the adverse decision of an administrative law judge. The law judge found that, during the period from about January to June 1975, Blumenfeld violated antifraud provisions in connection with the sale of various municipal bonds. In addition, the law judge found that Blumenfeld had been permanently enjoined from violations of those provisions. n2 He concluded that Blumenfeld should be barred from association with any broker or dealer. On the basis of an independent review of the record, we make the following findings. n3

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n1 Shelby went out of business in December 1975.

n2 Subsequent to the issuance of the initial decision herein, Blumenfeld consented to the entry of another permanent injunction in an action arising out of his activities at Shelby, without admitting or denying the allegations of this Commission's complaint. S.E.C. v. Shelby Bond Service Corporation, et al., Civil Action No. C-77-2236 (W.D. Tenn.). See *Litigation Release No. 8822 (July 17, 1979), 17 SEC Docket 1362.*

n3 Our findings are based on a clear and convincing standard of proof.

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II.

Blumenfeld made fraudulent representations in connection with his recommendation and sale to a customer of Washington County (Tennessee) Utility District ("WCUD") bonds in March 1975. He told the customer that the bonds were "a good buy" and a safe investment, and assured him that the bonds would eventually be paid in full since "people had to have utilities." Blumenfeld did not give the customer any current financial information.

There was no reasonable basis for Blumenfeld's representations. An audit report then on file with the State of Tennessee disclosed that WCUD was in serious financial difficulties. For the fiscal year ended June 30, 1974, it had incurred a net loss (before depreciation and amortization) of about $107,000, thereby increasing its total deficit to more then $337,000. The report also disclosed that WCUD had not always used the proceeds of its various bond issues for the purposes stated in its bond resolutions, and that, not only had it failed to comply with sinking fund requirements, it was unable to do so. n4

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n4 About a year after Blumenfeld's sale to the customer, WCUD defaulted in making interest payments.

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Blumenfeld testified that he talked with both WCUD's operations manager and its paying agent who assured him that "everything was fine" and that WCUD had no problems. However, despite Blumenfeld's repeated requests for current financial statements from the operations manager, Blumenfeld never received any such statements. Nevertheless, he continued to recommend and sell WCUD bonds.

Blumenfeld also recommended the purchase of certain Alabama industrial revenue bonds although he had no financial information concerning the issuer. He testified that Shelby's president had informed all of the salesmen, "If anybody can sell these bonds, I will give you a watch of your choice." The salesmen were told the amount of bonds available, the interest they paid, and their type, price and maturity date. Shelby's president also stated that he had called the paying agent who told him that the bonds had never been in default. Solely on the basis of this information, Blumenfeld recommended and sold the bonds in question.

Every salesman who recommends securities, particularly those of little known issuers, is under a duty to investigate in order to make sure that his recommendations have a reasonable basis. n5 As we have previously pointed out:

"[O]ral assurances . . . [can] not be used as a substitute for the concrete financial data called for in situations such as this . . . . Each salesman has an obligation to deal fairly with his customers. Hence no salesman can recommend an unknown or little known security unless he has himself seen reliable financial data that supply him with a reasonable basis for his recommendation. This is especially true of debt securities." n6 (Emphasis supplied.)

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n5 In *Hanly v. S.E.C., 415 F.2d 589* (C.A. 2, 1969), the Court of Appeals for the Second Circuit stated, at p. 597:

> "In summary, the standards . . . are strict. [A salesman] cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation."

n6 *Willard G. Berge, Securities Exchange Act Release No. 12846 (September 30, 1976), 10 SEC Docket 600, 602,* aff'd sub nom. *Feeney v. S.E.C., 564 F.2d 260* (C.A. 8, 1977). See also *Richard C. Spangler, Inc., Securities Exchange Act Release No. 12104 (February 12, 1976) 8 SEC Docket 1257, 1264;*

Cortlandt Investing Corporation, 44 S.E.C. 45, 52 (1969); Crow, Brourman & Chatkin, Inc., 42 S.E.C. 938, 947-948 (1966).

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Lacking current financial information, Blumenfeld had no reasonable basis for the recommendations and representations that he made. n7 We accordingly conclude, as did the administrative law judge, that Blumenfeld willfully violated the antifraud provisions of Section 17(a) of the Securities act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. n8

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n7 In *Charles Michael West, Securities Exchange Act Release No. 15454 (January 2, 1979), 16 SEC Docket 592,* we stated at p. 595: "[T]here [is] no reasonable basis for recommending speculative debt securities to customers [without] the requisite financial information."

n8 Assuming that the Supreme Court's decision in *Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976),* is applicable to proceedings of this sort, a position with which we disagree, we find that Blumenfeld had the requisite scienter. We note, however, that Hochfelder has no bearing on Sections 17(a)(2) and 17(a)(3) of the Securities Act, and all of our findings of fraud are made under both those sections. Our findings that Blumenfeld also violated Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder are merely cumulative, and the sanction we are imposing would be the same even if we had made no findings under those provisions and had made findings solely under either Section 17(a)(2) or Section 17(a)(3).

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Blumenfeld complains that the administrative law judge unfairly held him responsible for Shelby's high pressure sales operations, and improperly relied on the allegations in a 1973 Commission injunctive complaint, and on a court opinion issued in connection with a preliminary injunction entered against him in another action. However, we have not held Blumenfeld responsible for Shelby's operations. Nor have we based any of our findings on either the allegations or the opinion in question.

III.

The record establishes that, in eight sales of municipal bonds effected by Blumenfeld during the period January to June 1975, the undisclosed markups charged customers ranged from 8% to 25.3% above the contemporaneous prices that Shelby paid other dealers for the securities in question. n9 In one additional transaction, the markup was 50% over Shelby's same-day cost. We agree with the administrative law judge that Blumenfeld charged customers excessive markups in these transactions.

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n9 In seven instances, the markup is based on Shelby's same-day cost. In one instance, a markup of 17.6%, it is based on the price which Shelby paid within one day of the sale in question.

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Blumenfeld argues that there is no evidence that the bonds contemporaneously purchased by Shelby were the same bonds he sold, and that markups should not be computed solely on the basis of the seller's contemporaneous cost. n10

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n10 Blumenfeld also claims that a staff witness indicated that markups as high as 100% might be permissible in some circumstances. However, the record does not support that claim, and there are no circumstances that would justify markups of that amount.

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These contentions are without merit. It is irrelevant whether or not the bonds Blumenfeld sold were those which Shelby purchased at the same time. Even if Shelby had a prior position in the bonds, Blumenfeld was only entitled to charge a fair markup over current market prices. n11 And we have repeatedly pointed out that, in the absence of countervailing evidence, a dealer's contemporaneous cost is the best evidence of those prices, n12 a standard that has been accorded judicial approval. n13

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n11 See *Charles Michael West, supra, 16 SEC Docket at 594* and the authorities there cited.

n12 Id.

n13 *Barnett v. S.E.C., 319 F.2d 340, 344* (C.A. 8, 1963).

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Blumenfeld further argues that no expert testimony was offered as to what markup would be considered excessive in the industry. However, no such testimony was necessary. We have consistently held that, at the least, markups of more than 10% are fraudulent in the sale of equity securities. n14 And we have found markups in excess of 7% fraudulent in connection with such sales. n15 Markups on municipal bonds are generally lower than those for equity securities. n16 As one court has noted, "[I]t is the practice in the municipal bond industry to charge a retail customer a price which is no more than one quarter of one per cent to five per cent over the then current market price for a bond." n17

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n14 See, e.g., *J.A. Winston & Co., Inc., 42 S.E.C. 62, 69 (1964); Robert M. Garrard, Securities Exchange Act Release No. 12219 (March 17, 1976), 9 SEC Docket 210, 211 n. 5.*

n15 *Century Securities Company, 43 S.E.C. 371, 379 (1967).*

n16 See *Charles Michael West, supra, 16 SEC Docket at 594 n. 12.*

n17 *S.E.C. v. Charles A. Morris & Associates, Inc., 386 F. Supp. 1327, 1334 n. 5 (W.D. Tenn. 1973).*

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We conclude that the markups Blumenfeld charged in the above transactions were clearly excessive. We accordingly find that, in connection therewith, he willfully violated the above-cited antifraud provisions. n18

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n18 Our discussion in n. 8, supra, is also applicable to our findings of antifraud violations in connection with the unfair markups that Blumenfeld charged customers.

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IV

On September 13, 1973, in an action which was based on Blumenfeld's activities while employed by another dealer in municipal bonds, a permanent injunction was entered against him. With his consent, and without his admitting or denying the charges in this Commission's complaint, Blumenfeld was enjoined from violating the above antifraud provisions by, among other things, making material misstatements and charging unfair prices in connection with the purchase or sale of securities. n19

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n19 S.E.C. v. Investors Asociates of America, Inc., et al., Civil Action No. C-72-367 (W.D. Tenn.). Blumenfeld was also ordered, pursuant to his consent, to pay $2500 "for the purpose of disgorging the gross profit realized . . . on the transactions alleged by the plaintiff to be improper and illegal . . . ."

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We agree with the administrative law judge that Blumenfeld should be barred from association with any broker or dealer. Respondent's actions cannot be attributed to mere negligence, inexperience or innocent overreaching. Just a year and a half earlier, he had been permanently enjoined from engaging in the very same illegal practices.

Even a novice in the securities business should have realized that a salesman cannot recommend highly speculative debt securities without first obtaining the most basis and important information concerning the issuer -- its current financial situation. To have made such recommendations, and to have assured a customer of the safety of his investment without that information, were egregious violations.

In addition, Blumenfeld was fully cognizant of the excessive prices that he charged customers. He could hardly be oblivious to the fraudulent nature of markups ranging as high as 50% above the contemporaneous prices he paid for the securities in question on Shelby's behalf. Under the circumstances, respondent's actions manifested a blatant indifference to the obligation of fair dealing borne by those in the securities business.

We recognize the serious effect of the imposition of a bar. Yet we are convinced that a lesser remedy will not suffice. We do not seek to punish Blumenfeld, but to protect the public from further harm at his hands. Indeed, as one court has observed in a case involving unfair markups, "[t]he essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do." n20 On the basis of his callous disregard for the securities laws, there is little reason to expect that Blumenfeld will refrain from future misconduct.

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n20 *Charles Hughes & Co. v. S.E.C., 130 F.2d 434, 437* (C.A. 2, 1943), cert. denied, *321 U.S. 786 (1944).*

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Finally, when we deal with the public interest requirements in a particular case, we must also weigh the effect of our decision on the welfare of investors as a class and on standards of conduct in the securities business generally. If these proceedings are to be truly remedial, they must have a deterrent effect not only on the respondent before us but also on others who may be tempted to engage in similar violations. n21

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n21 See *Arthur Lipper Corporation v. S.E.C., 547 F.2d 171, 184* (C.A. 2, 1976): "The purpose of such severe sanctions must be to demonstrate not only to petitioners but to others that the Commission will deal harshly with egregious cases."

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Under all the circumstances, including the prior injunction issued against Blumenfeld which failed to have any deterrent effect, we are convinced that the public interest requires that Blumenfeld be barred from further association with any broker or dealer.

An appropriate order will issue. n22

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n22 Blumenfeld's exceptions are overruled or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

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By the Commission (Chairman WILLIAMS and Commissioners LOOMIS, EVANS, POLLACK and KARMEL).

ORDER IMPOSING REMEDIAL SANCTION

On the basis of the Commission's opinion issued this day, it is

ORDERED that Edward J. Blumenfeld be, and he hereby is, barred from association with any broker or dealer.

By the Commission.

<u>In re Charles Michael West</u> , Exchange Act Release No. 15454, A.P. File No. 3-5255 (January 2, 1979).

OPINION OF THE COMMISSION

TEXT:

I.

Charles Michael West, who was a salesman for Shelby Bond Service Corporation, formerly a municipal bond dealer, n1 appeals from certain conclusions of an administrative law judge. The law judge found that, in connection with the offer and sale of various municipal bonds, West willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder in that he made false and misleading statements to customers and charge excessive prices. n2 The law judge barred West from association with any broker or dealer with the proviso that, after six months, he could apply to become so associated in a non-supervisory capacity, upon a satisfactory showing of adequate supervision.

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n1 Shelby went out of business in December 1975.

n2 The law Judge also found that, on May 20, 1977, the United States District Court for the Western District of Tennessee permanently enjoined West, with his consent, from engaging in fraudulent activities in connection with securities transactions. Civil Action No. C-77-2236. West does not dispute this finding.

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II.

West does not challenge the law judge's findings that he made fraudulent representations to customers. Those findings may be summarized as follows.

During the period October 1974 through December 1975, West was an active participant in a "boiler-room" operation conducted by Shelby. He engaged in a high pressure sales campaign, involving the use of repeated phone calls, to induce persons previously unknown to him to buy highly speculative municipal bonds about whose underlying value "[h]e knew nothing and apparently cared little." n3 In the course of

these sales efforts, he made material misrepresentations about the value of the bonds and the financial stability of the issuers. Illustrative of West's "boiler-room" activities were his dealings with the following two customers.

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n3 West was "top man" of the 14 salesman employed by Shelby at various time during 1975.

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West persuaded Dr. B., an unsophisticated investor with whom West had not previously done business, to exchange a $5,000 industrial development revenue bond for a utility district bond of the same denomination and $504 in cash. In effecting the transaction, West represented the he had "a good utility bond" which was more secure than the bond held by Dr. B. Dr. B. was given no information about the utility district's financial condition. Nor did West inform him that the district had not filed certified financial statements as required by state law, that it was unable to comply with sinking fund requirements, and that, despite the promise given West by the utility district's operations manager, West had not obtained any financial information from the district. Shortly after Dr. B. acquired the bond, the issuer defaulted in making payments.

On November 26, 1974, after several telephone calls, West induced another customer, Mr. W., to purchase $20,000 worth of bonds issued by the Gallaway (Tenn.) Industrial Development Board. The bonds were issued to finance the construction of a plant to be lease to Precision Optical Laboratory, Inc., and principal and interest on the bonds were to be paid from rental income. In making the sale, West advised Mr. W. that the Gallaway bonds were "the best thing going in a bond issue," that they would sell at a premium, and that West would see to it that Mr. W. made money on them. A week later, Mr. W. bought another $5,000 Gallaway bond from West and, in September 1975, after several more telephone calls, Mr. W. purchased additional Gallaway bonds in the face amount of $15,000.

West did not tell Mr. W. that Shelby was the majority stockholder of Precision. Nor was there any reasonable basis for West's optimistic representations. Although he assertedly requested Precision's financial statements, he was never able to obtain them. In fact, Precision was losing money. It suffered losses of $77,364 for the seven months ending July 31, 1975, and Gallaway subsequently defaulted in making payments on the bonds.

In April 1975, West sold Mr. W. $11,250 worth of Anderson County, Tennessee industrial development revenue bonds. Payments of principal and interest on the bonds were to come from the rents paid by the lessee of a building. West assured Mr. W. that he could make money on his purchase, and that the bond issue was secured by the New York parent company of the building's lessee. However, the parent company was not obligated on the bonds. And, after the Tennessee subsidiary ceased doing business, the issuer of the bonds defaulted.

III.

West challenges the administrative law judge's finding that he charged customers excessive markups in the sale of municipal bonds. In 13 sales effected by West during 1975, the markups ranged from 11% to 28% over the contemporaneous prices that Shelby paid other dealers for the securities in question. In one additional transaction, the markup was 50% over Shelby's same-day cost. The law judge found the Shelby's contemporaneous costs were reflective of the prevailing wholesale market prices.

West argues that it is erroneous to compute markups simply by comparing Shelby's cost with its sales prices. He contends that "expert testimony" is necessary to establish prevailing market prices and excessive markups based thereon. He further asserts that "in many instances" the wholesale offering prices listed in The Blue List of Current Municipal Offerings ("Blue List") were close to the retail prices that he charged customers.

These contentions are without merit. Markups are generally computed on the basis of the prevailing inter-dealer price, that is, the price at which transactions take place among dealers. n4 We have repeatedly pointed out that, in the absence of countervailing evidence, a dealer's contemporaneous cost is the best evidence of the current market, n5 and that standard has been accorded judicial approval. n6 It reflects a recognition of the fact that the prices paid for a security by a dealer in actual transactions closely related in time to his sales are normally a highly reliable indication of the prevailing market price. The burden is on the dealer to establish the contrary. n7

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n4 *Naftalin & Co., Inc., 41 S.E.C. 823, 825 (1964); Kenneth B. Stucker Investment Securities, 42 S.E.C. 910, 911 (1966).*

n5 See, e.g., *William Harrison Keller, Jr., 38 S.E.C. 900, 905 (1959); Naftalin & Co., Inc., supra, 41 S.E.C. at 826-27; J.A. Winston & Co., Inc., 42 S.E.C. 62, 68-69 (1964); Costello, Russotto & Co., 42 S.E.C. 798, 801 (1965); Crow, Brourman & Chatkin, Inc., 42 S.E.C. 938, 949 n. 23 (1966).*

n6 *Barnett v. S.E.C., 319 F.2d 340, 344* (C.A. 8, 1963).

n7 See *Naftalin & Co., Inc., supra, 41 S.E.C. at 827.*

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West has failed to meet that burden here. We have generally refused to accept published quotations in lieu of contemporaneous cost as the best evidence of market price. n8 Quotations for securities with limited inter-dealer trading activity, such as those involved here, are likely to be subject to negotiation and may have little value as evidence of the current market. n9 In any event, the quotations in the Blue List do not aid West. In 13 instances, there were no published quotations contemporaneous with the retail sales at issue. And, in the remaining instance, the markup exceeded 10% even when computed on the basis of the quoted offer. n10

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n8 See, e.g., *J.A. Winston & Co., Inc., 42 S.E.C. 49, 55 (1964); Gateway Stock and Bond, Inc., 43 S.E.C. 191, 192-93 (1966); Waldron & Co., Inc., Securities Exchange Act Release No. 12872 (October 6, 1976), 10 SEC Docket 663, 664.*

n9 See *Naftalin & Co., Inc., supra, 41 S.E.C. at 828.*

n10 West cited one contemporaneous quotation for an issue with a maturity date different from that of the issue he sold. Hence the cited quotation has no bearing on the reasonableness of the price West charged.

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Finally, West asserts that Shelby had positions in the securities in question and was therefore entitled to more profit to compensate for the risk. The record does not show that Shelby had positions in all of the securities involved here. But even if it did, West was not entitled to charge customers excessive markups because Shelby was in a risk position. n11

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n11 See *Naftalin & Co., Inc., supra, 41 S.E.C. at 826-827; Waldron & Co., Inc., supra, 10 SEC Docket at 664; Financial Estate Planning, Securities Exchange Act Release No. 14984 (July 21, 1978), 15 SEC Docket 352, 354.*

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We find in 14 transactions West charged customers unfair markups ranging from 11% to 50%. n12 Accordingly, we conclude that West willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. n13

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n12 At the least, markups of more than 10% are fraudulent. See *J.A. Winston & Co., Inc., supra, 42 S.E.C. at 68-9; Century Securities Company, 43 S.E.C. 371 (1967).* Although prior makeup cases cited in this opinion dealt with equity, not municipal, securities, the applicable principles are the same. In fact, markups for municipal securities are generally lower than for equity securities. See S.E.C. v. Charles A. Morris & Associates, Inc., 386F. Supp. 1327, 1334 and n.5 (W.D. Tenn. 1973).

n13 We agree that the administrative law judge that the evidence with respect to West's violations is clear and convincing. And assuming that the Supreme Court's interpretation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in *Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976),* is applicable to proceedings of this sort, a position with which we disagree, we find that West had the requisite scienter. We note, however, that the references to Section 10(b) and Rule 10b-5 in our findings are merely cumulative. Hochfelder has no bearing on Section 17(a) of the Securities Act. And all of our findings of fraud are made not only under Section 10(b) and Rule 10b-5 but also under Section 17(a). The sanction we are imposing would be the same even if we made no findings under Section 10(b) and Rule 10b-5.

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West argues that the sanction imposed on him by the administrative law judge is unduly severe. He states that, during the period in question, he did not have much experience in the securities business and relied on his superiors at Shelby; that he is presently employed under close supervision by a registered broker-dealer; that he has not been named in any regulatory complaint except for these proceedings and the related injunctive action; and that he has "learned his lesson."

We see no basis for any reduction in the sanction imposed by the administrative law judge. West engaged in a high-pressure "boiler-room" sales campaign characterized by fraudulent representations.

Even though he may have been inexperienced, he should have realized that there was no reasonable basis for recommending speculative debt securities to customers when he lacked the requisite financial information. n14 Moreover, in a number of transactions he charged customers patently excessive markups.

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n14 See *Willard G. Berge, Securities Exchange Act Release No. 12846 (September 30, 1976), 10 SEC Docket 600, 602,* aff'd sub nom. *Feeney v. S.E.C., 564 F.2d 260* (C.A. 8, 1977).

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West's high pressure selling of obscure securities by false representations and excessive markups cannot be countenanced. Under the circumstances, we are not disposed to be lenient.

An appropriate order will issue. n15

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n15 West's exceptions to the initial decision are overruled or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

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By the Commission (Commissioners LOOMIS, EVANS and POLLACK); Chairman WILLIAMS and Commissioner KARMEL not participating.

ORDER IMPOSING REMEDIAL SANCTION

On the basis of the Commission's opinion issued this day, it is

ORDERED that Charles Michael West be, and he hereby is, barred from association with any broker or dealer with the proviso that, after six months, he may apply to the Commission for permission to become so associated in a non-supervisory capacity, upon a satisfactory showing of adequate supervision.

Commission Orders - Settled Administrative Proceedings

In re Howe, Solomon, Hall, Exchange Act Release No. 40038, A.P. File No. 3-9613 (May 28, 1998).

I.

The Securities and Exchange Commission deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be instituted against Howe, Solomon & Hall ("HSH") and Christopher J. Hall ("Hall") (collectively "Respondents"), pursuant to Sections 15(b), 19(h), and 21C of the Securities Exchange Act of 1934 ("Exchange Act").

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying any of the findings contained herein, except as to the jurisdiction of the Commission over them and over the subject matter of these proceedings, and as to the findings contained in Section II., paragraphs A. and B., which are admitted, Respondents consent to the entry by the Commission of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b), 19(h), and 21C of the Exchange Act, Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Order ("Order").

Accordingly, IT IS HEREBY ORDERED that proceedings against Respondents hereby are instituted.

II.

On the basis of this Order and the Offer, the Commission finds that:

A. HSH has been registered with the Commission as a broker-dealer since June 1983.

B. At all relevant times, Hall was the Chief Financial Officer, the registered financial operations principal and a fifty percent shareholder of HSH.

HSH's Restructuring of Defaulted Municipal Bonds

C. HSH operates primarily as a municipal securities broker-dealer. Approximately fifty percent (50%) of HSH's business relates to the purchase and sale of non-rated municipal bonds. Of that fifty percent, approximately ten percent (10%) consists of transactions involving defaulted or technically defaulted bonds. n1 HSH researches and performs due diligence of municipal bond issues that are at or near the point of technical default to determine their restructuring potential.

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n1 Generally, technical default denotes that some event has occurred which causes non-compliance with a trust indenture agreement (i.e. failure to make coupon payments). A technical default may be monetary or non-monetary.

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Duval County, Florida Housing Authority Multifamily Magnolia Arms Apartment Bonds

D. The municipal bonds at issue in this matter (the "Bonds") were issued on August 7, 1987 by the Duval County, Florida Housing Finance Authority (the "Authority"). The Bonds were issued to finance the acquisition, rehabilitation and permanent financing of a multifamily residential rental housing development located in Jacksonville, Florida, known as Magnolia Arms Apartment Project (the "Project"). Through an Indenture of Trust ("Indenture"), revenues from the Project are used to finance repayment of the Bonds.

Financial Condition of the Bond Issue and Underlying Project Prior to Restructuring

E. The Bonds originally carried a 9.5% coupon requiring semi-annual interest payments on February 15 and August 15 of each year. In December 1993, the Trustee for the Indenture ("Trustee") declared an event of default and advised the bondholders that no further interest payments would be made from revenues because the Project would be generating insufficient revenues. Indeed, the February and August 15, 1994, interest payments were made to bondholders by drawing on a then existing letter of credit.

HSH's Restructuring of the Duval County Bonds

F. As a result of the above-described financial predicament and the declaration of technical default, the Bonds traded at a substantial discount. Following a preliminary analysis of the feasibility of restructuring the Bonds, on September 7, 1994 HSH purchased 5,460 of the Bonds for $51 per bond (face par value $5,460,000). HSH's purchase represented 66.3% of the then outstanding Bonds.

G. Hall and others at HSH performed a more complete financial analysis of the Project and determined that the Bonds could be restructured and support a 5% coupon with semi-annual payments. As part of a successful restructuring, HSH needed to obtain the cooperation of the Trustee and secure the consent of the outstanding bondholders to the restructuring terms.

H. Among other things, HSH: (a) negotiated with the developer of the Magnolia Arms Apartments to spend an additional $210,000 on the project; and (b) spent at least $45,000 and expended approximately $112,000 worth of labor hours restructuring the bonds. n2

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n2 The expense items described in paragraph H do not reflect all expenses HSH incurred in the restructuring.

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I. Prior to the restructuring of the Bonds, the debt service expense for 1996 would have been $735,360. Subsequent to the restructuring, with the lower coupon, the 1996 debt service expense was $337,625. As a result of HSH's actions, bankruptcy of a municipal bond issue was avoided and the apartment complex was enhanced, although the coupon payments were reduced.

Excessive Mark-Ups

J. From September 7, 1994 through October 12, 1994, HSH sold 4,520 of the Bonds to a small group of sophisticated investors, who for the most part were pre-existing clients of HSH, at prices between $61 and $61.46 per Bond (face par value $4,520,000). Hall was personally responsible for setting the sale price.

Based on this price, the Commission finds that HSH charged undisclosed excessive markups between 19% and 21% to its customers. n3

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n3 In calculating the markups charged by HSH, HSH's purchase price of $51 per bond was determined to be the fair market value of the securities at time of subsequent sale in light of the short passage of time (approximately 38 days from first until final sale), and the lack of any significant intervening event.

- - - - - - - - - - - - - - - - -END FOOTNOTES- - - - - - - - - - - - - - - - -

Legal Findings

K. The Commission finds that HSH charged undisclosed excessive markups in the amount of $117,417.

L. From September 7 to October 12, 1994, HSH willfully violated Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-30 promulgated by the Municipal Securities Rulemaking Board, in that it, through the use of the mails or the means and instrumentalities of interstate commerce, taking into consideration all relevant factors, sold municipal securities from HSH's own account to customers at aggregate prices (including markups) that were unfair and unreasonable, as more fully described in paragraphs II.A. - II.J. herein.

M. From September 7 to October 12, 1994, Hall willfully aided and abetted and caused HSH's violations of Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-30 promulgated by the Municipal Securities Rulemaking Board, in that HSH, aided and abetted by Hall, through the use of the mails or the means and instrumentalities of interstate commerce, taking into consideration all relevant factors, sold municipal securities from HSH's own account to customers at aggregate prices (including markups) that were unfair and unreasonable, as more fully described in paragraphs II.A. - II.J. herein.

III.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the remedial sanctions and cease-and-desist order specified in the Offer.

Accordingly, IT IS ORDERED THAT:

A. Respondent HSH cease and desist from committing or causing any violation or future violation of Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-30 promulgated by the Municipal Securities Rulemaking Board;

B. Respondent Hall cease and desist from committing or causing any violation or future violation by a broker-dealer of Section 15B(c)(1) of the Exchange Act and Rules G-17 and G-30 promulgated by the Municipal Securities Rulemaking Board;

C. Respondent Hall is censured;

D. Respondent HSH, within fifteen (15) days from the entry of this Order, pursuant to Section 21B of the Exchange Act, shall pay a civil penalty in the amount of twenty-five thousand dollars ($25,000.00) to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check, or bank money order; (2) made payable to the Securities and Exchange Commission; (3) transmitted to the Comptroller, Securities and Exchange Commission, Mail Stop 0-3, 450 Fifth Street, N.W., Washington, D.C. 20549; and (4) submitted under cover letter that identifies HSH and Hall as Respondents in this proceeding, and the file number of these proceedings (3-9613), a copy of which cover letter and money order or check shall be sent to Frederick M. Lehrer, Esq., Securities and

Exchange Commission, Southeast Regional Office, 1401 Brickell Avenue, Suite 200, Miami, Florida 33131; and

E. Respondent HSH, within fifteen (15) days from the entry of this Order, pursuant to Sections 21B(e) and 21C of the Exchange Act, shall pay disgorgement and prejudgment interest in the amount of $135,412 to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check, or bank money order; (2) made payable to the Securities and Exchange Commission; (3) transmitted to the Comptroller, Securities and Exchange Commission, Mail Stop 0-3, 450 Fifth Street, N.W., Washington, D.C. 20549; and (4) submitted under cover letter that identifies HSH and Hall as Respondents in this proceeding, and the file number of these proceedings (3-9613), a copy of which cover letter and money order or check shall be sent to Frederick M. Lehrer, Esq., Securities and Exchange Commission, Southeast Regional Office, 1401 Brickell Avenue, Suite 200, Miami, Florida 33131.

By the Commission.

In re Kent T. Black, Joel L. Hurst, David E. Lynch, Larry E. Muller, and Robert L. McCook
Exchange Act Release No. 39134, A.P. File No. 3-9440 (September 26, 1997).

The Commission instituted public administrative proceedings against Kent T. Black, Joel L. Hurst, David E. Lynch, Larry E. Muller and Robert L. McCook. The Order alleges that Hurst, Lynch and Muller, operating out of a broker-dealer's now-defunct Houston office, engaged in a scheme to "park" complex mortgage-backed derivative securities with other dealers in order to move the securities off the firm's books. Further, it is alleged that these individuals utilized this scheme to manipulate the price of the derivative securities, thereby charging excessive markups to the firm's customers amounting to over $1.85 million. As a result of this parking scheme, the broker-dealer failed to maintain accurate books and records and incurred numerous net-capital deficiencies.

The Order also alleges that Black made numerous misrepresentations and omissions in connection with the sale of mortgage-backed derivative securities to Escambia County, Florida. Specifically, Black failed to disclose the risks associated with extremely highly risky and volatile securities known as "inverse floaters" and "inverse interest onlys," which he sold to the county. It is also alleged that Black sold certain derivatives to Escambia County with the misrepresentation that the broker-dealer would buy the securities back at a guaranteed profit to the county, and that Black later refused to repurchase those securities. Escambia County lost over $3 million on the securities purchased from Black.

The Order alleges that Black, Hurst, Lynch and Muller willfully violated Section 17(a) of the Securities Act of 1933 and Sections 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, thereunder. Additionally, it alleges Hurst, Lynch, Muller and McCook willfully aided and abetted the broker-dealer's violations of Sections 15(c) and 17(a) of the Securities Exchange Act of 1934.

A hearing will be held to determine whether the staff's allegations are true, and if so, to determine what relief is appropriate and in the public interest.

I.

As a result of an investigation, the Division of Enforcement alleges that:

A. Kent T. Black ("Black") at all relevant times was a registered representative formerly associated with a certain broker-dealer (the "Broker-Dealer") in its Houston office. Black is a resident of Spring, Texas.

B. Joel L. Hurst ("Hurst") at all relevant times was a registered representative and trader associated with the Broker-Dealer in its Houston office. Hurst is a resident of Spring, Texas.

C. David E. Lynch ("Lynch") at all relevant times was a registered representative and trader associated with the Broker-Dealer in its Houston office. Lynch is a resident of Spring, Texas.

D. Larry E. Muller ("Muller") at all relevant times was a registered representative and trader associated with the Broker-Dealer in its Houston office. Muller is a resident of Houston, Texas.

E. Robert L. McCook ("McCook") at all relevant times was a registered representative associated with another registered broker-dealer. McCook is a resident of Midlothian, Virginia.

Background

F. The Broker-Dealer's Houston office was opened by Hurst and Lynch in October 1990. The Houston office was established to sell fixed-income products, primarily mortgage-backed securities, to institutional clients.

G. At all relevant times, the Houston office had the authority to execute riskless principal transactions. The procedure required Respondents Hurst, Lynch and Muller to arrange and confirm both sides of each transaction, and then call the details directly in to a principal in the Broker-Dealer's main office. The principal then would write an order ticket for each transaction, and provide that information to the Broker-Dealer's clearing firm.

Parking, Excessive Markups and Net Capital and Books and Records Violations

H. The Broker-Dealer did not allow the Houston office to hold positions in securities unless they received approval from the main office. In order to circumvent the Broker-Dealer's restriction on holding positions, Respondents Hurst, Lynch and Muller engaged in a parking scheme which enabled them to purchase bonds and secretly hold them "off their books," while still maintaining control of the securities. From October 1992 through March 1994, the Houston traders parked government agency securities on at least seventeen occasions, including every month from March 1993 through March 1994.

I. The parking scheme began in approximately October 1992. On at least two occasions, Respondents Hurst, Lynch and Muller parked securities directly with Respondent McCook, a registered representative with another broker-dealer. Following those transactions, the scheme changed slightly. From that point forward, whenever Respondents Hurst, Lynch and Muller wanted to park securities, they entered into an arrangement with Respondent McCook whereby the Broker-Dealer would sell the bonds to another dealer for settlement that month. That dealer would then sell the bonds to McCook's firm for a fraction higher than it had purchased them from the Broker-Dealer. The Broker-Dealer would then repurchase the bonds from McCook's firm for settlement the next month, with McCook's firm earning a small profit on the transaction. Respondents Hurst, Lynch and Muller used the time between settlement dates to find a customer for the bonds. The parking scheme essentially allowed Respondents Hurst, Lynch and Muller an extra month to find a customer for securities over which they maintained control.

J. Each time Respondents Hurst, Lynch and Muller executed a parking transaction, they filled out tickets for the sale and the repurchase from the other dealers. These trades were then called in to the Broker-Dealer's principal in the main office, who wrote his own tickets. For each of the parking transactions, however, one or more of the order tickets written by the principal contained trade dates different than the trade dates on the Houston tickets.

K. The inaccurate order tickets written in the main office depicted each of the parking transactions as two separate riskless principal trades, thereby enabling the scheme to go undetected.

L. On at least seven occasions Respondents Hurst, Lynch and Muller used the parking scheme to manipulate the price of certain government agency securities and conceal undisclosed excessive markups charged to the Broker-Dealer customers. The excessive markups on the seven transactions alone amounted to approximately $1.85 million.

M. In those instances, Respondents Hurst, Lynch and Muller purchased bonds and marked them up considerably on the sale to the other dealers. These dealers then marked up the securities another 1/32 or 2/32 when selling them to McCook's firm. McCook's firm then marked up the securities another 2/32 when selling them back to the Broker-Dealer. The Broker-Dealer, through Respondents Hurst, Lynch and Muller, would then mark up the securities another 4%-5% when selling them to innocent, bona fide customers.

N. Respondents Hurst, Lynch and Muller dictated the prices on the parking transactions. The other firms acquiesced in these price setting transactions. Therefore, the trades involving the other dealers were fictitious, non-bona fide transactions, and did not indicate or reflect the actual market value of those securities.

O. As a result of the parking scheme described above, the Broker-Dealer maintained inaccurate books and records, insofar as, among other things, the firm's books and records did not reflect the liabilities arising from Respondents Hurst, Lynch and Muller's commitments to repurchase the securities involved, and contained incorrect valuations of the firm's positions. The firm also computed its net capital inaccurately. During the scheme, Respondents Hurst, Lynch, Muller and McCook knew that the parking of these securities caused the Broker-Dealer's books and records and net capital computations to be inaccurate.

P. Properly recording these transactions on the Broker-Dealer's books and records would have adversely affected the Broker-Dealer's computation of net capital and, in some instances, resulted in undisclosed net capital deficiencies as follows:

Reported Adjusted
Excess
Net Excess/(Deficit)
Capital Per Net Capital

Date	the Broker-Dealer	Per SEC
April 1993	$ 533,000	$ (77,735)
May 1993	$ 818,000	$ 627,250
June 1993	$ 874,000	$ 431,646
July 1993	$ 677,000	$ 416,430
August 1993	$ 791,000	$ (49,484)
September 1993	$ 758,000	$ 465,873
October 1993	$ 627,000	$ (65,730)
November 1993	$ 538,000	$ (1,249,532)
December 1993	$ 557,000	$ (69,834)
January 1994	$ 634,000	$ 11,269
February 1994	$ 1,075,000	$ 477,160
March 1994	$ 1,035,000	$ 348,270

Q. The parking scheme also caused the Broker-Dealer to file inaccurate FOCUS reports with the NASD, thereby presenting to regulators a misleading picture of the firm's net worth. Furthermore, the scheme

caused the Broker-Dealer to fail to disclose to the Commission that the firm was in net capital violation on numerous occasions.

Misrepresentations to Escambia County, Florida

R. Escambia County (the "county") began doing business with Respondent Black and the Broker-Dealer in December 1990. Prior to that time, the county had invested almost exclusively in conservative instruments such as treasury securities and certificates of deposit. In September 1991, on Respondent Black's advice, the county began regularly buying and selling complex mortgage-backed derivative securities known as REMICs.

S. Due to their sensitivity to interest rates, certain risks are generally associated with investments in REMICs, including, among others, market, extension, prepayment and liquidity risks. The REMICs sold to Escambia County by Respondent Black were Support Class Inverse Floaters and Inverse Interest Onlys, which are some of the riskiest and most volatile REMICs.

T. Respondent Black misrepresented the market, liquidity, extension and/or prepayment risks of the REMICs he offered and sold to Escambia County. Such information would have enabled Escambia County to appreciate fully the risks attendant to any investment in Inverse Floater and Inverse Interest Only REMICs.

U. Respondent Black also made misrepresentations regarding the returns that the county would receive. Furthermore, the REMICs sold to Escambia County were inconsistent with the county's stated investment objectives (of which Respondent Black was aware), yet Respondent Black never disclosed this to the county.

V. Additionally, Respondent Black offered certain REMICs to Escambia County as "short-term paper, i.e., 30 days, 60 days, 90 days," which the county could purchase and which the Broker-Dealer promised to buy back at a later date at a price that guaranteed a profit to the county. Respondent Black sold securities to Escambia County in this manner on a number of occasions in 1993, and each time the Broker-Dealer repurchased the securities as Respondent Black had promised. These transactions, nevertheless, were falsely described to the county because Respondent Black represented them as simultaneous transactions yet, on at least one occasion, he processed the trades separately. By processing the trades separately, Respondent Black allowed the Broker-Dealer the option of failing to honor the allegedly guaranteed repurchase at a profit to Escambia County. This possibility was not disclosed to Escambia County.

W. In March 1994, Respondent Black again offered REMICs to the county with the promise that he would "take back" the securities in two months. In connection with these trades, Respondent Black misrepresented to Escambia County that the Broker-Dealer would repurchase these securities within a range of prices that guaranteed a positive return for the county. This time, however, Respondent Black refused to repurchase the securities, and Escambia County was forced to hold the securities. The county eventually sold them over a year later at a price approximately sixty percent lower than the price they paid.

Violations

X. As a result of the conduct described above, Respondents Black, Hurst, Lynch and Muller willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Y. As a result of the conduct described above, Respondents Hurst, Lynch, Muller and McCook willfully aided and abetted violations of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder.

II.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest and for the protection of investors that public proceedings be instituted to determine:

A. Whether the allegations set forth in Section I hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defense to such allegations; and

B. Whether the entry of a cease and desist order against Respondents Black, Hurst, Lynch, Muller, and/or McCook is appropriate pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act; and

C. What, if any, remedial sanctions are appropriate in the public interest against Respondents Black, Hurst, Lynch, Muller and/or McCook; and

D. Whether a civil money penalty should be imposed against Respondents Black, Hurst, Lynch, Muller and/or McCook.

III.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section II hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed and before an Administrative Law Judge to be designated by further order as provided by Rule 6 of the Commission's Rules of Practice (17 C.F.R. § 201.6).

IT IS FURTHER ORDERED that each respondent file an answer to the allegations contained in this order for proceedings within 15 days after service upon him of said order, as provided by Rule 7 of the Commission's Rules of Practice (17 C.F.R. § 201.7).

If any respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, he shall be deemed in default and the proceedings may be determined against him upon consideration of this Order for Proceedings, the allegations of which may be deemed to be true as provided by Rules 6(e) and 7(e) of the Commission's Rules of Practice (17 C.F.R. § 201.6(e) and § 201.7(e)).

This Order shall be served upon the respondents personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceedings will be permitted to participate or advise in the decision upon this matter, except as witnesses or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule-making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the Provisions of that Section delaying the effective date of any final Commission action.

By the Commission.

In re Kent T. Black, Exchange Act Release No. 40218, A.P. File No. 3-9440 (July 16, 1998).

I.

The Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Kent T. Black ("Black") on September 26, 1997.

II.

Respondent Black has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of this proceeding and as to Section III.A., which is admitted, Respondent Black by his Offer consents to the entry of findings and remedial sanctions set forth below.

III.

On the basis of this Order Making Findings and Imposing Remedial Sanctions And A Cease-And-Desist Order ("Order") and the Offer submitted by Respondent Black the Commission finds n1 that:

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n1 The findings contained herein are not binding on any other person or entity in this or any other proceeding.

- - - - - - - - - - - - - - - - -END FOOTNOTES- - - - - - - - - - - - - - - - -

A. Kent T. Black ("Black") at all relevant times was a registered representative formerly associated with a certain broker-dealer (the "Broker-Dealer") in its Houston office.

B. Escambia County (the "County") began doing business with Respondent Black and the Broker-Dealer in December 1990. Prior to that time, the County had invested almost exclusively in conservative instruments such as treasury securities and certificates of deposit. In September 1991, on Respondent Black's advice, the County began regularly buying and selling complex mortgage-backed derivative securities known as REMICs.

C. Due to their sensitivity to interest rates, certain risks are generally associated with investments in REMICs, including, among others, market, extension, prepayment and liquidity risks. The REMICs sold to the County by Respondent Black were Support Class Inverse Floaters and Inverse Interest Onlys, which are some of the riskiest and most volatile REMICs.

D. Respondent Black misrepresented the market, liquidity, extension and/or prepayment risks of the REMICs he offered and sold to the County. Such information would have enabled the County to appreciate fully the risks attendant to any investment in Inverse Floater and Inverse Interest Only REMICs.

E. Respondent Black also made misrepresentations regarding the returns that the County would receive. Furthermore, the REMICs sold to the County were inconsistent with the County's stated investment objectives (of which Respondent Black was aware), yet Respondent Black never disclosed this to the County.

F. Additionally, Respondent Black offered certain REMICs to the County as "short-term paper, i.e., 30 days, 60 days, 90 days," which the County could purchase and which the Broker-Dealer promised to buy back at a later date at a price that guaranteed a profit to the County. Respondent Black sold securities to

the County in this manner on a number of occasions in 1993, and each time the Broker-Dealer repurchased the securities as Respondent Black had promised. These transactions, nevertheless, were falsely described to the County because Respondent Black represented them as simultaneous transactions yet, on at least one occasion, he processed the trades separately. By processing the trades separately, Respondent Black allowed the Broker-Dealer the option of failing to honor the allegedly guaranteed repurchase at a profit to the County. This possibility was not disclosed to the County.

G. In March 1994, Respondent Black again offered REMICs to the County with the promise that he would "take back" the securities in two months. In connection with these trades, Respondent Black misrepresented to the County that the Broker-Dealer would repurchase these securities within a range of prices that guaranteed a positive return for the County. This time, however, Respondent Black refused to repurchase the securities, and the County was forced to hold the securities. The County eventually sold them over a year later at a price approximately sixty percent lower than the price they paid.

H. Respondent Black has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest or a civil money penalty. The Commission has reviewed the sworn financial statement and other evidence provided by Black and has determined that Black does not have the financial ability to pay disgorgement of $231,726.00 plus prejudgment interest or a civil money penalty.

I. As a result of the conduct described above, Respondent Black willfully violated Sections 17(a)(1), 17(a)(2) and 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Black and impose the remedial sanctions specified therein.

Accordingly, IT IS ORDERED that Black is hereby barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company;

IT IS FURTHER ORDERED that Black shall cease and desist from committing or causing any violations of, and any future violation of, Sections 17(a)(1), 17(a)(2) or 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

IT IS FURTHER ORDERED that Black shall pay disgorgement of $231,726 plus prejudgment interest, but that payment of such amount be waived, and civil money penalties not be imposed against Black, based on Black's demonstrated financial inability to pay; and

IT IS FURTHER ORDERED that the Division of Enforcement ("Division") may, at any time following entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; (2) determine the amount of disgorgement and civil penalties to be imposed; and (3) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by the Respondent was fraudulent, misleading, inaccurate or incomplete in any material respect and whether additional remedies should be imposed. Respondent may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding.

By the Commission.

In re Larry E. Muller, Securities Act Release No. 7655, Exchange Act Release No. 41166, A.P. File No. 3-9440 (March 12, 1999).

I.

The Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Larry E. Muller ("Muller") on September 26, 1997.

II.

Respondent Muller has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of this proceeding and as to Section III.A., which is admitted, Respondent Muller by his Offer consents to the entry of findings and remedial sanctions set forth below.

III.

On the basis of this Order Making Findings and Imposing Remedial Sanctions And A Cease-And-Desist Order ("Order") and the Offer submitted by Respondent Muller the Commission finds n1 that:

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n1 The findings herein are not binding on anyone other than Muller.

- - - - - - - - - - - - - - - - -END FOOTNOTES- - - - - - - - - - - - - - - - -

A. Larry E. Muller ("Muller") at all relevant times was a registered representative and trader associated with a certain broker-dealer (the "Broker-Dealer") in its Houston office.

B. The Broker-Dealer's Houston office was opened in October 1990. The Houston office was established to sell fixed-income products, primarily mortgage-backed securities, to institutional clients.

C. At all relevant times, the Houston office had the authority to execute riskless principal transactions. However, the Broker-Dealer did not allow the Houston office to hold positions in securities unless they received approval from the main office.

D. Muller began a parking scheme in approximately October 1992. Initially, Muller parked securities directly with a registered representative with another broker-dealer (the "Parking Firm"). Following those transactions, the scheme changed slightly. From that point forward, whenever Respondent Muller wanted to park securities, he entered into an arrangement with the Parking Firm whereby the Broker-Dealer would sell the bonds to another dealer for settlement that month. That dealer would then sell the bonds to the Parking Firm for a fraction higher than it had purchased them from the Broker-Dealer. The Broker-Dealer would then repurchase the bonds from the Parking Firm for settlement the next month, with the Parking Firm earning a small profit on the transaction. Muller used the time between settlement dates to find a customer for the bonds. The parking scheme essentially allowed Muller an extra month to find a customer for securities over which he maintained control.

E. On at least several occasions Muller used the parking scheme to manipulate the price of certain government agency securities and conceal undisclosed excessive markups charged to the Broker-Dealer customers. The excessive markups amounted to approximately $1.85 million. Muller received excessive compensation from these transactions of $225,148.

F. In those instances, Muller purchased bonds and marked them up considerably on the sale to the other dealers. These dealers then marked up the securities another 1/32 or 2/32 when selling them to the Parking Firm. The Parking Firm then marked up the securities another 2/32 when selling them back to the Broker-Dealer. The Broker-Dealer, through Respondent Muller would then mark up the securities another 4%-5% when selling them to innocent, bona fide customers.

G. Muller dictated the prices on the parking transactions. The other firms acquiesced in these price setting transactions. Therefore, the trades involving the other dealers were fictitious, non-bona fide transactions, and did not indicate or reflect the actual market value of those securities.

H. As a result of the parking scheme described above, the Broker-Dealer maintained inaccurate books and records, insofar as, among other things, the firm's books and records did not reflect the liabilities arising from Muller's commitments to repurchase the securities involved, and contained incorrect valuations of the firm's positions. The firm also computed its net capital inaccurately and, in some instances, had undisclosed net capital deficiencies. Muller knowingly and substantially aided the Broker-Dealer's books and records and net capital violations by entering into the parking transactions.

I. The parking scheme also caused the Broker-Dealer to file inaccurate FOCUS reports with the NASD, thereby presenting to regulators a misleading picture of the firm's net worth. Furthermore, the scheme caused the Broker-Dealer to fail to disclose to the Commission that the firm was in net capital violation on numerous occasions.

J. Respondent Muller has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest or a civil money penalty. The Commission has reviewed the sworn financial statement and other evidence provided by Muller and has determined that Muller does not have the financial ability to pay disgorgement of $225,148 plus prejudgment interest or a civil money penalty.

K. As a result of the conduct described above, Muller willfully violated and committed violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and willfully aided and abetted and was a cause of the violations of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Muller and impose the remedial sanctions specified therein.

Accordingly, IT IS ORDERED that Muller be and hereby is barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company;

IT IS FURTHER ORDERED that Muller shall cease and desist from committing or causing any violations of, and any future violation of, Sections 17(a)(1), 17(a)(2) or 17(a)(3) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and from causing any violation and any future violation of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder.

IT IS FURTHER ORDERED that Muller shall pay disgorgement of $225,148 plus prejudgment interest, but that payment of such amount be waived, and civil money penalties not be imposed against Muller, based on Muller's demonstrated financial inability to pay; and

IT IS FURTHER ORDERED that the Division of Enforcement ("Division") may, at any time following entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; (2) determine the amount of disgorgement and prejudgment interest to be imposed; (3) determine the amount

of civil penalties to be imposed; and (4) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by the Respondent was fraudulent, misleading, inaccurate or incomplete in any material respect and whether additional remedies should be imposed. Respondent may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding.

By the Commission.

In re Joel L. Hurst, Securities Act Release No. 7654, Exchange Act Release No. 41165, A.P. File No. 3-9440 (March 12, 1999).

I.

The Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Joel L. Hurst ("Hurst") on September 26, 1997.

II.

Respondent Hurst has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of this proceeding and as to Section III.A., which is admitted, Respondent Hurst by his Offer consents to the entry of findings and remedial sanctions set forth below.

III.

On the basis of this Order Making Findings and Imposing Remedial Sanctions And A Cease-And-Desist Order ("Order") and the Offer submitted by Respondent Hurst the Commission finds n1 that:

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -
n1 The findings herein are not binding on anyone other than Hurst.

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A. Joel L. Hurst ("Hurst") at all relevant times was a registered representative and trader associated with a certain broker-dealer (the "Broker-Dealer") in its Houston office.

B. The Broker-Dealer's Houston office was opened in October 1990. The Houston office was established to sell fixed-income products, primarily mortgage-backed securities, to institutional clients.

C. At all relevant times, the Houston office had the authority to execute riskless principal transactions. However, the Broker-Dealer did not allow the Houston office to hold positions in securities unless they received approval from the main office.

D. Hurst began a parking scheme in approximately October 1992. Initially, Hurst parked securities directly with a registered representative with another broker-dealer (the "Parking Firm"). Following those transactions, the scheme changed slightly. From that point forward, whenever Respondent Hurst wanted to park securities, he entered into an arrangement with the Parking Firm whereby the Broker-Dealer would sell the bonds to another dealer for settlement that month. That dealer would then sell the bonds to

the Parking Firm for a fraction higher than it had purchased them from the Broker-Dealer. The Broker-Dealer would then repurchase the bonds from the Parking Firm for settlement the next month, with the Parking Firm earning a small profit on the transaction. Hurst used the time between settlement dates to find a customer for the bonds. The parking scheme essentially allowed Hurst an extra month to find a customer for securities over which he maintained control.

E. On at least several occasions Hurst used the parking scheme to manipulate the price of certain government agency securities and conceal undisclosed excessive markups charged to the Broker-Dealer customers. The excessive markups amounted to approximately $1.85 million. Hurst received excessive compensation from these transactions of $658,822.

F. In those instances, Hurst purchased bonds and marked them up considerably on the sale to the other dealers. These dealers then marked up the securities another 1/32 or 2/32 when selling them to the Parking Firm. The Parking Firm then marked up the securities another 2/32 when selling them back to the Broker-Dealer. The Broker-Dealer, through Respondent Hurst would then mark up the securities another 4%-5% when selling them to innocent, bona fide customers.

G. Hurst dictated the prices on the parking transactions. The other firms acquiesced in these price setting transactions. Therefore, the trades involving the other dealers were fictitious, non-bona fide transactions, and did not indicate or reflect the actual market value of those securities.

H. As a result of the parking scheme described above, the Broker-Dealer maintained inaccurate books and records, insofar as, among other things, the firm's books and records did not reflect the liabilities arising from Hurst's commitments to repurchase the securities involved, and contained incorrect valuations of the firm's positions. The firm also computed its net capital inaccurately and, in some instances, had undisclosed net capital deficiencies. Hurst knowingly and substantially aided the Broker-Dealer's books and records and net capital violations by entering into the parking transactions.

I. The parking scheme also caused the Broker-Dealer to file inaccurate FOCUS reports with the NASD, thereby presenting to regulators a misleading picture of the firm's net worth. Furthermore, the scheme caused the Broker-Dealer to fail to disclose to the Commission that the firm was in net capital violation on numerous occasions.

J. Respondent Hurst has submitted a sworn financial statement and other evidence and has asserted his financial inability to pay disgorgement plus prejudgment interest or a civil money penalty. The Commission has reviewed the sworn financial statement and other evidence provided by Hurst and has determined that Hurst does not have the financial ability to pay disgorgement of $658,822 plus prejudgment interest or a civil money penalty.

K. As a result of the conduct described above, Hurst willfully violated and committed violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and willfully aided and abetted and was a cause of the violations of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the offer submitted by Hurst and impose the remedial sanctions specified therein.

Accordingly, IT IS ORDERED that Hurst be and hereby is barred from association with any broker, dealer, municipal securities dealer, investment adviser or investment company;

IT IS FURTHER ORDERED that Hurst shall cease and desist from committing or causing any violations of, and any future violation of, Sections 17(a)(1), 17(a)(2) or 17(a)(3) of the Securities Act, Section 10(b)

of the Exchange Act and Rule 10b-5 thereunder and from causing any violation and any future violation of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder.

IT IS FURTHER ORDERED that Hurst shall pay disgorgement of $658,822 plus prejudgment interest, but that payment of such amount be waived, and civil money penalties not be imposed against Hurst, based on Hurst's demonstrated financial inability to pay; and

IT IS FURTHER ORDERED that the Division of Enforcement ("Division") may, at any time following entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; (2) determine the amount of disgorgement and prejudgment interest to be imposed; (3) determine the amount of civil penalty to be imposed; and (4) seek any additional remedies that the Commission would be authorized to impose in this proceeding if Respondent's offer of settlement had not been accepted. No other issues shall be considered in connection with this petition other than whether the financial information provided by the Respondent was fraudulent, misleading, inaccurate or incomplete in any material respect and whether additional remedies should be imposed. Respondent may not, by way of defense to any such petition, contest the findings in this Order or the Commission's authority to impose any additional remedies that were available in the original proceeding.

By the Commission.

In re Kenneth J. Schulte, Exchange Act Release No. 37494, A.P. File No. 3-9051 (July 30, 1996).

The Securities and Exchange Commission (Commission) instituted public administrative proceedings against Kenneth J. Schulte (Schulte), who is alleged to have been employed from Spring 1990 to the present as a registered representative by three broker-dealers. The Order Instituting Public Administrative Proceedings (Order) alleges that, throughout his career Schulte sold volatile and risky mortgage-backed derivatives to at least fourteen Ohio cities, counties and school districts while a registered representative at the three broker-dealers. The Order further alleges that two NASD arbitration Judgments have been entered against Schulte arising from these sales.

The Order also alleges that on April 16, 1996, the United States District Court for the Northern District of Ohio, in the case of Securities and Exchange Commission v. Kenneth J. Schulte (94-CV-2657), entered by default a Final Judgment of Permanent Injunction and Disgorgement (Final Judgment) against Schulte, which Final Judgment permanently enjoins Schulte from further violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and ordered Schulte to pay $398,787.62 in disgorgement. The Commission's complaint in this injunctive action alleged that from the Spring of 1990 to April 1994, Schulte offered and sold several million dollars in mortgage-backed derivatives to at least fourteen Ohio municipalities and school districts. The Commission further alleged that Schulte violated 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, in connection with the offer and sale of the derivatives by making material misrepresentations and omissions concerning, among other things, the nature of derivative securities, the risks involved in derivative securities and the government guarantee of derivative securities.

A hearing will be scheduled to determine what, if any, remedial action would be appropriate against Schulte.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 19(h) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

As a result of an investigation, the Division of Enforcement alleges that:

A. Kenneth J. Schulte ("Schulte"), 37, currently a resident of Delray Beach, Florida, has been employed from the Spring of 1990 to the present as a registered representative by three broker-dealers.

B. The United States District Court for the Northern District of Ohio, in an action captioned SEC v. Kenneth Schulte, Civil Action No. 94 CV 2657, entered by default a Final Judgment of Permanent Injunction and Disgorgement against Schulte on April 16, 1996, which the Court amended on April 22, 1996, which permanently enjoins Schulte from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Court ordered Schulte to pay $398,787.62 in disgorgement.

C. In the complaint in the injunctive action, the Commission alleged that from the Spring of 1990 to April 1994, Schulte offered and sold several million dollars in mortgage-backed derivatives to at least 14 Ohio municipalities and school districts. The Commission alleged that Schulte violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, in connection with the offer and sale of the derivatives by making material misrepresentations and omissions concerning, among other things, the nature of derivative securities, the risks involved in derivative securities and the government guarantee of derivative securities.

II.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest and for the protection of investors that public proceedings be instituted to determine:

A. Whether the allegations set forth in Section I. hereof are true, and in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial sanction is appropriate in the public interest pursuant to Sections 15(b) and 19(h) of the Exchange Act.

III.

ACCORDINGLY, IT IS HEREBY ORDERED that proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act be, and they hereby are, instituted.

IT IS FURTHER ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section II. hereof shall be convened at a time and place to be fixed and before an Administrative Law Judge to be designated by further order as provided by Rule 200 of the Commission's Rules of Practice [17 C.F.R. § 201.200].

IT IS FURTHER ORDERED that the respondent file an answer to the allegations contained in this order instituting public administrative proceedings within twenty days after service of this order, as provided by Rule 220 of the Commission's Rules of Practice [17 C.F.R. § 201.220].

If the respondent fails to file an answer or fails to appear at a hearing after being duly notified, he may be deemed in default and the proceedings my be determined against him upon consideration of this order instituting public administrative proceedings, the allegations of which may be deemed to be true as provided by Rules 310 and 220 of the Commission's Rules of Practice [17 C.F.R. § 201.310 and 201.220].

This order instituting public administrative proceedings shall be served upon the respondent personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice.

Because this proceeding does not constitute "rule making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed subject to the provisions of that section delaying the effective date of any Commission action.

By the Commission.

In re Kenneth J. Schulte, Initial Decision Release No. 110, A. P. File No. 3-9051 (April 10, 1997).

TEXT: INITIAL DECISION

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission ("Commission") initiated this proceeding on July 30, 1996, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act").

I held a hearing in Cleveland, Ohio, on November 4, 1996. n1 The Division of Enforcement ("Division") did not call any witnesses but introduced nineteen exhibits. Mr. Schulte was present at the hearing but chose not to testify and did not call any witnesses or introduce any exhibits. n2 On December 5, 1996, I accepted into evidence five late-filed exhibits offered by Respondent, and on January 6, 1997, I accepted two late-filed exhibits offered by the Division. (Tr. 62-64.)

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n1 I will refer to specific pages of the hearing transcript as "(Tr.)," the August 28, 1996, prehearing conference transcript as "(Aug. Tr.)," and the October 11, 1996, prehearing conference transcript as "(Oct. Tr.)."

n2 I will refer to the exhibits, which are numbered consecutively, as "(Ex.)." The only sworn testimony from Mr. Schulte in evidence is the transcript of the bankruptcy hearing where he was questioned by Division counsel. (Ex. 19 at 63-64.)

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There was a three month delay in the start of the hearing. At a prehearing conference on August 28, 1996, I moved the hearing to Florida and ordered procedures to accommodate the parties since Mr. Schulte, appearing pro se, had relocated to Florida, and claimed he could not afford to return to Ohio for a hearing. n3 At a prehearing on October 11, 1996, I postponed the hearing and moved it to Ohio because in early October Mr. Schulte retained an attorney located in Ohio who was familiar with his situation. n4 I postponed the scheduled start of the hearing based on the attorney's request that he needed additional time because of his pre-existing trial schedule and a serious family illness.

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n3 When I moved the hearing to Florida so Mr. Schulte could attend, I ruled pursuant to Rule 235(a)(5) of the Commission's Rules of Practice, 17 C.F.R. § 201.235(a)(5) (1996), that the Division could introduce in evidence in lieu of oral testimony the transcripts of sworn testimony of persons taken at depositions where Mr. Schulte was represented by counsel. I did this because the Division's public witnesses were scattered throughout Ohio. (Aug. Tr. 14-30.) I affirmed that ruling when the hearing was moved to Cleveland, Ohio. At the hearing, Respondent's counsel objected on grounds that the Division was offering

only partial depositions and that the complete depositions should be admitted. I granted his request. (Tr. 50-63.)

n4 The law firm had represented Mr. Schulte in the civil case but had withdrawn when Mr. Schulte claimed he had no funds to pay for their legal services. Mr. Schulte retained the firm for his criminal case and the attorneys decided to participate in this proceeding on his behalf. (Oct. Tr. 4-5.)

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I received the following post hearing pleadings: (i) Division of Enforcement's Post-Trial Brief, dated December 19, 1996; (ii) Respondent's Reply to the Division of Enforcement's Post-Trial Brief, dated January 14, 1997; and (iii) Division of Enforcement's Rebuttal Reply Brief, dated February 8, 1997.

Allegations

The Division alleges that from the spring of 1990 to April 1994, Mr. Schulte, while a registered representative, violated the antifraud provisions of the federal securities statutes, in connection with the offer and sale of mortgage backed derivatives, in interstate commerce by making material misrepresentations and omissions concerning, among other things, the nature, the risks, and the government guarantees of derivatives, and that a Final Judgment of Permanent Injunction and Disgorgement was entered by default against Mr. Schulte on April 16, 1996, and amended on April 22, 1996. n5

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n5 The term derivative is short for derivative instrument, "a contract whose value is based on the performance of an underlying financial asset, index, or other investment." Barron's Dictionary of Financial and Investment Terms 136 (4th ed. 1995).

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Findings of Fact

My findings and conclusions are based on the record. I applied preponderance of the evidence as the applicable standard of proof. I have considered all proposed findings and conclusions and all contentions, and I accept those that are consistent with this decision.

Kenneth J. Schulte

From the spring of 1990 to April 1994, Mr. Schulte, who held himself out to the investing public as a specialist in mortgage backed securities and their derivatives, was a registered representative with Murchison Investments Bankers, Inc. ("Murchison"), Hart Securities, Inc. ("Hart"), and Comprehensive Capital Corporation ("Comprehensive Capital"). (Exs. 1 at 7; 19 at 7-9, 55-58.) In 1989, when Mr. Schulte began his employment at Murchison in Houston, Texas, he was part of the firm's boiler room operation where thirty or so salespeople stood making continuous telephone calls in which they read from a script to whomever would listen urging them to buy bonds immediately or else they would lose a wonderful investment opportunity. The firm urged its salespeople to "smile and dial," and referred to its procedures as "slamming bonds." (Ex. 20 at 16-24.) In 1991, Mr. Schulte and other salespeople at Hart worked together in a room in Houston, Texas, from which they made continuous phone calls to small financial institutions in various states soliciting sales of Government National Mortgage Association ("Ginnie Mae") and Federal National Mortgage Association ("Fannie Mae") derivative securities which Hart's management had selected. Hart management monitored sales calls and told the sales force what to say. The solicitation calls did not cover the risk or suitability of the investments. (Ex. 22 at 11-24.)

From the spring of 1990 through April 1994, Mr. Schulte sold over 39.4 million dollars worth of derivative securities, including interest only securities ("strips" or "IOs"), inverse IOs, and inverse floaters, to at least thirteen municipalities and school districts in the State of Ohio (the "Ohio Investors"). n6 (Ex. 1 at 7-9.)

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n6 All the products Mr. Schulte sold to Ohio Investors were securities. (Exs. 1 at 7-8; 16 at 2.) According to Mr. Schulte, the sales occurred primarily in 1990-91, and the big losses occurred in 1994. (Ex. 19 at 37.) The customers are not specified in the record but it appears likely that they included the cities of Ashland, Mansfield, Jackson, Hilliard, Englewood, and Painesville; the counties of Preble and Mercer; and the school districts of the Harrison Hills, Shadyside, Strongsville, Vermilion, and Danbarry. (Exs. 8 at 19; 19 at 57-58.)

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Purchasers of IOs are entitled only to the interest stream generated when a government agency, such as Fannie Mae, pools thousands of mortgages together and offers investors different ownership interests in that pool. If interest rates decline, the prepayment of mortgages generally increases and the purchaser of an IO receives interest from a smaller pool of mortgages. (Ex. 1 at 8.) Mr. Schulte's sworn testimony demonstrates a detailed knowledge of sophisticated financial instruments, and leaves no doubt that he knew that IOs are risky investments in that the entire amount of an investor's principal is at risk and the interest stream is not guaranteed. (Ex. 19 at 127-29, 136-37.) In September 1991, Mr. Schulte signed a letter sent to prospective clients in Ohio, including the Ohio Investors, on Hart letterhead stationery that falsely represented "we have chosen to view the quest for high yields subordinate to a product's liquidity and the safety of our clients' investment capital." (Exs. 6 at 46-47; 19 at 61-62, 139.)

The Ohio Investors were not sophisticated investors and did not understand derivatives. (Exs. 12 at 4-10; 13 at 4-9; 21 at 25, 93-94.) They informed Mr. Schulte that they had conservative investment policies and maintained essentially risk-free investment portfolios. (Exs. 1 at 9-10; 6 at 26-34; 12 at 34-39; 19 at 58-60, 121-22; 21 at 49-53.) Mr. Schulte knew that the Ohio Investors investment policies dictated that the securities they purchased had to be guaranteed by the United States government or its agencies, that their main investment objective was the safety and preservation of principal, and that principal was never to be placed at risk. (Exs. 1 at 9-10; 6 at 34-35; 12 at 36-42; 13 at 13-17, 20, 26, 69-72; 19 at 58-59; 21 at 52-53.) Mr. Schulte represented that he understood these investment policies and that he would follow them. (Ex. 1 at 10.)

Mr. Schulte used aggressive and intimidating sales tactics, and conducted all his activities by telephone. He threatened to recommend that the City of Euclid, Ohio, fire Kenneth R. Kentosh, an investment advisor specializing in municipalities, in August or September 1990 because Mr. Kentosh believed IOs were unsuitable investments for public bodies and would not recommend that the city buy IOs from Mr. Schulte. (Ex. 8 at 75-76.) He criticized government officials for not doing their jobs in getting the highest return available on risk-free investments when they hesitated in purchasing IOs. (Ex. 12 at 14, 47-48.) He falsely represented that Richard C. Simpson, an attorney in Columbus, Ohio, with an extensive municipal bond practice, supported his representations. (Ex. 11 at 11 and attachment.) On December 2, 1991, Attorney Simpson informed Mr. Schulte that (1) he would take action against him and Hart if Mr. Schulte used him as a reference in soliciting clients, and (2) he considered the investments Mr. Schulte was selling "far too speculative for investment of public funds, even if they comply with Ohio statutory requirements, which is questionable." (Exs. 11 at 11-17 and attachment; 19 at 66-69.)

Using persistent phone calls, Mr. Schulte pressured the Ohio Investors to purchase derivative securities. (Ex. 21 at 13-14, 98-100.) They relied on his false representations that the IOs were essentially risk-free investments guaranteed by the United States government or a government agency; that their investment principal would not be placed at risk; that the yield was far greater than on certificates of deposit; and that

they had to invest quickly because the opportunity was limited. (Exs. 1 at 9-11; 6 at 50-54; 12 at 12-15, 23-24, 32-33; 21 at 21-24, 50-51; 22 at 25-26.) Mr. Schulte knew that the statements he made to the Ohio Investors were false when he made them, and he persuaded these investors to purchase derivative securities regardless of whether the investment was appropriate for their investment objectives. n7 (Exs. 1 at 9-10; 19 at 61-66.)

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n7 Part of Mr. Schulte's job responsibilities was to "qualify investors," which was to gather information as to an investor's prior investment history, investment objectives, liquidity requirements, and risk tolerance. (Ex. 19 at 104-05.)

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Mr. Schulte did not provide Ohio Investors with written materials which described the derivative securities he offered; he failed to disclose or discuss the substantial risks involved in these investments or that the IOs were sensitive to interest rate fluctuations in that an increase in mortgage prepayments could potentially wipe out their entire investment; and he rarely used the term "interest only strips" to describe the investments and failed to inform some investors of the type of securities they had purchased. n8 (Exs. 1 at 9-11; 12 at 21; 13 at 23-25, 47-52, 74-75; 21 at 24-25, 45.) In 1991, the Ohio Investors began to suffer losses from their purchases of IOs from Mr. Schulte. Nevertheless, Mr. Schulte continued to solicit additional sales of IOs in 1992 when he left Hart and became associated with Comprehensive Capital in Boca Raton, Florida. (Ex. 6 at 62.)

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n8 In October 1993, the Attorney General of Ohio issued an opinion that IOs and certain other investments were illegal because they were not "redeemable" within two years as required by Ohio law. (Ex. 6 at 88-89.)

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As a result of Mr. Schulte's material misrepresentations and omissions in the offer and sale of these Securities, the Ohio Investors sustained losses in excess of $8.2 million. When interest rates declined dramatically beginning in 1991, many consumers refinanced their mortgages so that there were fewer mortgages in the pool and interest payments were reduced to virtually nothing. (Ex. 1 at 8-11.) Mr. Schulte earned almost $400,000 in commissions from the sales of derivative securities to the Ohio Investors. (Exs. 1 at 11; 19 at 34.)

On May 30, 1996, Mr. Schulte had been employed as a registered representative with Comprehensive Capital for almost four and a half years. (Ex. 19 at 8.) His earnings from commissions was $125,987 and $54,500 in 1994 and 1995, respectively. (Id. at 14-16.) On November 4, 1996, Mr. Schulte was an active participant in the securities industry. (Tr. 21.)

Permanent Injunction

The Commission initiated a civil action against Mr. Schulte on December 27, 1994. On April 16, 1996, the United States District Court for the Northern District of Ohio, entered by default an order permanently enjoining Mr. Schulte from violating the antifraud provisions of the federal securities laws, and ordering him to disgorge approximately $400,000 in commissions that he obtained through fraudulent means. SEC v. Schulte, No. 1:94 CV 2657 (N.D. Ohio April 16, 1996)(amended on April 22, 1996). According to the district court:

Schulte's conduct is egregious. Schulte did not disclose the nature of these securities and misrepresented the risks inherent in derivatives including the prepayment risks, the risk to principal and their lack of a government guarantee. Schulte repeatedly violated the antifraud provisions of the federal securities laws. Over a four-year period, Schulte sold over $39.4 million . . . of derivatives in Ohio alone. Schulte's sales were based on cold calling finance directors and treasurers throughout the state.

. . . Schulte was aware that these investors held virtually riskless investments in their portfolio prior to purchasing the IOs and other derivative securities. Schulte knew the nature of the derivative securities and the risks involved in their purchase, but failed to disclose these risks to investors and misrepresented the structure of derivative securities. Schulte also falsely represented these securities to be guaranteed by the government.

(Ex. 1 at 15.)

The district court concluded:

In connection with the offers and sales of derivative securities, including IOs, Schulte engaged in a massive fraud which cost Ohio municipalities and school districts millions of dollars in losses. Consequently, in view of his fraudulent scheme, Schulte violated the antifraud provisions of the federal securities laws. Schulte violated these provisions by making material misrepresentations and omitting to state material facts to investors regarding the nature, risks, and lack of government guarantees associated with derivative securities such as IOs, Inverse IOs and Inverse Floaters.

(Ex. 1 at 11-12.)

The district court found that Mr. Schulte willfully violated the antifraud provisions of the securities statutes; that he had full knowledge of the inappropriateness of his behavior, yet he continued to make material misrepresentations to investors which he knew, or was reckless in not knowing, were false; that his employment in the securities industry presented him with "daily opportunities to commit future violations"; and that it was likely that Mr. Schulte "would continue to solicit investors using the same techniques he used in Ohio."

(Ex. 1 at 13-15.)

Bankruptcy

On March 20, 1996, Mr. Schulte filed a voluntary petition under Chapter 7 of the Bankruptcy Code. Kenneth J. Schulte, No. 96-31108-BKC-SHF (Bankr. S.D. Fla. March 20, 1996). When he was examined by the bankruptcy trustee on May 30, 1996, Mr. Schulte was living in a house in Delray Beach, Florida, that he had purchased with his wife for $320,000. (Ex. 19 at 6.) In a Final Judgment and Order dated December 9, 1996, the United States Bankruptcy Court for the Southern District of Florida ruled that:

Kenneth J. Schulte, is collaterally estopped from denying that he defrauded Ohio investors based on the judgment entered against him by the United States District Court for the Northern District of Ohio in Securities and Exchange Commission v. Kenneth J. Schulte, Case No. 1:94 CV 2657 (N.D. Ohio, April 16, 1996). The Court accordingly GRANTS the Commission's motion for summary judgment and finds that Schulte's $387,787.62 disgorgement debt to the Commission is not dischargeable under Section 523(a)(2)(a) [sic] of the Bankruptcy Code because Schulte obtained that money by false pretenses, false representations and actual fraud.

(Ex. 26, Kenneth J. Schulte, No. 96-31108-BKC-SHF (Bankr. S.D. Fla. December 9, 1996).)

Other Regulatory Authorities

In 1994 and 1995, the National Association of Securities Dealers ("NASD") made two awards in arbitration matters on claims against Mr. Schulte based on the allegations that are the subject of this proceeding. It found Mr. Schulte liable and ordered him to pay the sum of $4,500, interest specifically excluded, in City of Englewood v. Murchison Investment Bankers, Ltd. and Kenneth Schulte, No. 93-03625 (July 27, 1994), and it found him liable and ordered him to pay $169,320, inclusive of interest, in Harrison Hills School District v. Hart Securities, Inc. and Kenneth Schulte, No. 94-00235 (December 5, 1995). (Exs. 14, 15, 16.)

In 1995, the Ohio Commissioner of Securities found that Mr. Schulte was not of "good business repute" as that term is used in the Ohio Code and revoked Mr. Schulte's securities salesman license. Kenneth James Schulte, Final Order of Revocation, Order No. 95-071 (October 6, 1995). Mr. Schulte consented to the order and agreed to a permanent bar from ever reapplying for a license to sell securities in Ohio. (Ex. 5.)

Criminal

On February 11, 1997, a jury found Mr. Schulte guilty of wire fraud, mail fraud, and securities fraud in connection with the same factual allegations set out in the Order Instituting Proceedings ("Order"). United States v. Kenneth J. Schulte, No. 1:96CR305 (N.D. Ohio February 14, 1997). Mr. Schulte had not been sentenced when I issued this decision. The Order does not refer to the criminal case because Mr. Schulte's indictment was returned after the Commission issued the Order. n9 (Ex. 4.)

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n9 I took official notice of the conviction on March 4, 1997. Rule 323 of the Commission's Rules of Practice, 17 C.F.R. § 210.323 (1996).

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Public Interest

Section 15(b) of the Exchange Act requires that the Commission sanction Mr. Schulte if it is in the public interest to do so on several independent bases: because he was associated with a broker-dealer when he willfully violated the securities statutes and regulations; he has been permanently enjoined from further violations of those provisions; and he has been convicted of a felony involving the purchase or sale of a security within ten years of the institution of the administrative proceeding.

To determine the public interest involves consideration of die following factors as well as the need to deter Mr. Schulte and others from similar conduct:

the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, *450 U.S. 91 (1981).* The severity of a sanction depends on the facts of each case and the value of the sanction in preventing a recurrence. *Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n.67 (1976); Leo Glassman, 46 S.E.C. 209, 211-12 (1975).*

In granting the permanent injunction and ordering disgorgement against Mr. Schulte, Judge Oliver considered his actions as measured against the factors the Sixth Circuit considers relevant in determining the likelihood of future violations as set out in *SEC v. Washington Utility District, 676 F.2d 218, 277 & n.19 (6th Cir. 1982).* n10 The district court found Mr. Schulte's actions egregious, willful, and committed

with scienter over a four year period. All of these determinations involve factors as set out in Steadman. SEC v. Schulte, No. 1:94 CV 2657 (N.D. Ohio April 16, 1996)(amended on April 22, 1996).

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n10 The factors are:

1. the egregiousness of the violations,

2. the isolated or repeated nature of the violations,

3. the degree of scienter involved,

4. the sincerity of the defendant's assurances, if any, against future violations,

5. the defendant's recognition of the wrongful nature of his conduct,

6. the likelihood that the defendant's occupation will present opportunities (or lack thereof) for future violations, and

7. the defendant's age and health.

(Ex. 1 at 14.)

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Mr. Schulte's criminal conviction, based on the same facts that are at issue here, demonstrates that Mr. Schulte engaged in intentional wrongdoing of major significance to defraud investors and supports a determination that a bar is required. *Elliott v. SEC, 36 F.3d 86, 87 (11th Cir. 1994); Alexander V. Stein, 59 SEC Docket 1493, 1500-02* (June 8, 1995).

This record leaves no doubt that Mr. Schulte was a willing and knowing participant in a very successful scheme to defraud a specific group of vulnerable investors. The Ohio Investors were small public entities with financially unsophisticated investing officials lacking the expert investment advice available to larger public bodies. Using high pressure, aggressive sales tactics, lies, and deception, Mr. Schulte took advantage of their lack of knowledge and their need to replace income that was no longer available because of falling interest rates on certificates of deposits to cause them to invest public money in unsuitable investments. Mr. Schulte's outrageous business threats to Mr. Kentosh, his unauthorized use of Attorney Simpson as a reference, and his dismissal of advice that he was offering unsuitable and probably illegal investments all demonstrate his determination to defraud investors and his complete lack of business honor.

It is disquieting, and the record does not explain how under the statutory disqualification process administered by the NASD, that Mr. Schulte was able to be active in the securities industry on August 28, 1996, and November 4, 1996, when he had been the subject of a permanent injunction on April 16, 1996. (Tr. 21; Aug. Tr. 7-8.) In issuing the permanent injunction, Judge Oliver found that Mr. Schulte's participation in the industry gave him "daily opportunities to commit future violations." SEC v. Schulte, No. 1:94 CV 2657 (N.D. Ohio April 16, 1996)(amended on April 22, 1996).

As a government agency this Commission has a legitimate interest and obligation, to take strong action to prevent fraud of taxpayers' funds. Mr. Schulte's blatant acts of fraud and deception continued over a four year period and caused losses of over $8 million in public funds, much of which was earmarked for public education. Mr. Schulte received $398,787.62 from these fraudulent activities. The City of Englewood was unable to collect on its arbitration award because Mr. Schulte and Murchison filed for bankruptcy. (Ex. 12

at 51.) The record does not reveal whether the Harrison Hills School District was able to collect its arbitration award, because Hart filed under Chapter 11 of the United States Bankruptcy Code on March 3, 1995. (Ex. 14 at 10.) At least one of the persons who purchased IOs from Mr. Schulte lost his employment in 1993 because of the investments. (Ex. 6 at 68.)

Finally, I postponed the hearing so that Mr. Schulte could attend and be represented but Mr. Schulte did not testify, did not call any witnesses, and the only evidence he offered was complete copies of depositions where the Division had offered partial versions. The Division proved the allegations in the Order with its exhibits. Mr. Schulte did not establish any defenses to the allegations or any evidence on the public interest issue. n11 The clear implication is that Mr. Schulte acted to delay a final determination in this proceeding and in the civil injunctive action so as to remain active in the securities industry for as long as possible. n12 (Ex. 1 at 6-7.) I reject as false his counsel's argument that he has not had a chance fully to defend himself. (Resp. Reply Brief at 8.)

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n11 An adverse inference can be drawn from Mr. Schulte's failure to offer testimony on matters at issue of which he had personal knowledge. *Strathmore Securities, Inc., 43 S.E.C. 575, 590 (1967),* petition for rev. denied, *407 F.2d 722 (D.C. Cir. 1969).* I did not rely on the adverse inference in reaching my decision.

n12 In the civil action, Mr. Schulte hired and withdrew two sets of counsel. Judge Oliver found that Mr. Schulte had been dilatory in his defense and that his failure to attend the trial was willful. (Ex. 1 at 6.)

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It is necessary in the public interest to impose the severest possible sanction for all the reasons stated, and to prevent Mr. Schulte, who has neither recognized that he has committed any wrong nor provided any assurance that he will not commit illegal actions in the future, and other persons who might be inclined to follow his example from future illegal acts.

Record Certification

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b) (1996), I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on February 6, 1997, and corrected on March 4, 1997.

Order

Based on the findings and conclusions set forth above, I ORDER, pursuant to Sections 15(b) and 19(h) of the Exchange Act, that Kenneth J. Schulte is barred from being associated with a broker, dealer, a member of a national securities exchange, or registered securities association, and from participating in an offering of penny stock.

This order shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360 (1996). Pursuant to that rule, a petition for review of this initial decision may be filed within twenty-one days after service of the decision. It shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 360(d)(1) within twenty-one days after service of the initial decision upon him, unless the Commission, pursuant to Rule 360(b)(1), determines on its own initiative to review this initial decision as to any party. If a party timely files a petition for review, or the Commission acts to review as to a party, the initial decision shall not become final as to that party.

Brenda P. Murray

Chief Administrative Law Judge

In re Kenneth J. Schulte, Exchange Act Release No. 38583 (May 8, 1997).

ACTION: NOTICE THAT INITIAL DECISION HAS BECOME FINAL

TEXT: The time for filing a petition for review of the initial decision in this proceeding has expired. No such petition has been filed, and the Commission has not chosen to review the decision on its own initiative.

Accordingly, notice is hereby given, pursuant to Rule 360(e) of the Commission's Rules of Practice, that the initial decision of the administrative law judge * has become the final decision of the Commission. The order contained in that decision bars Schulte from association with a broker, dealer, member of a national securities exchange or registered securities association, and from participation in any offering of penny stock. That order is hereby declared effective.

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* Kenneth J. Schulte, Initial Decision Release No. 110 (April 10, 1997).

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For the Commission by the Office of the General Counsel, pursuant to delegated authority.

In re Richard Taylor Securities Act Release No. 7150, Exchange Act Release No. 35522, Investment Advisors Act Release No. 1480, A.P. File No. 3-8408 (March 22, 1995).

I.

The Securities and Exchange Commission ("Commission") has instituted administrative proceedings pursuant to Section 15B(c) of the Securities Exchange Act of 1934 ("Exchange Act"), and Cease and Desist Proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Exchange Act and Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Richard T. Taylor ("Taylor"). The Commission finds that it has jurisdiction over Taylor and over the subject matter of these administrative proceedings.

In these proceedings, Taylor has submitted an Offer of Settlement ("Offer) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.1 et seq., and, without admitting or denying the matter set forth herein, with the exception of the jurisdiction of the Commission over him and this matter, which he admits, Taylor consents to the findings and sanctions set forth below.

II.

On the basis of the Order Instituting Public Proceedings and the Offer submitted by Taylor, the Commission finds:

A. Synovus Securities, Inc. ("Synovus" or "Synovus Securities") is a registered broker-dealer and registered investment adviser headquartered in Columbus, Georgia. It is a wholly-owned subsidiary of Synovus Financial Corp., a New York Stock Exchange traded bank holding company also headquartered in Columbus, Georgia. Synovus Securities has five branch offices in Georgia and Tennessee.

B. Clark L. Reed, Jr. ("Reed") was, until November 1993, the president, the financial and operations principal and a director of Synovus Securities.

C. Reed was one of six persons employed by the firm as traders.

D. Taylor resides in Ketchum, Idaho. At the time of the conduct alleged herein, Taylor lived in Atlanta, Georgia and earned his living buying and selling securities for his own account under the name Taylor Investments.

E. Reed and Taylor had had a long-standing personal as well as business relationship prior to the violative conduct found herein. They knew each other for over fifteen years. Reed and Taylor participated jointly in several business ventures throughout the 1980s and early 1990s. In addition, Taylor loaned Reed monies which Reed repaid.

F. From 1988 through 1991, Reed interpositioned Taylor or caused Taylor to be interpositioned in 153 municipal bond transactions involving customers of Synovus Securities. In 1988 and 1989, Taylor was interpositioned in thirty-seven trades at prices totalling $15 million; in 1990 Taylor was interpositioned in eighty-seven trades at prices totalling $29 million; and in 1991 Taylor was interpositioned in twenty-nine trades at prices totalling $11 million. Reed placed the trades or caused the trades to be placed with Taylor, who was able, in connection with sales of bonds by customers of Synovus, to sell the bonds, in most instances on the same day, through other broker-dealers at a profit. When Synovus's customers were buying bonds, Taylor was able to purchase the bonds from other broker-dealers and sell them to Synovus at a profit.

G. All of the trades in which Taylor was interpositioned were riskless principal transactions. Of the 153 trades in which Taylor was interpositioned, 123 were sales of bonds by Synovus's customers. The remaining thirty transactions were purchases by Synovus's customers.

H. The trades in which Taylor was interpositioned involved a wide variety of bonds. The bonds were issued by state and local governments from several different states for numerous different purposes. The bonds carried a wide range of maturities and interests rates, including zero-coupon bonds. The transactions in question involved general obligation bonds, revenue bonds and industrial development bonds.

I. Some of the customers defrauded by the interpositioning scheme were investment advisory clients of Synovus Securities at the time of the interpositioning.

J. Synovus's customers were not informed that Taylor had been interpositioned in their transactions or that Taylor was making same-day profits from almost all their trades. The customers were not told of Reed's close relationship and numerous business dealings with Taylor. Taylor was aware, or was reckless in not being aware, that such information was not being disclosed to Synovus's clients.

K. During the period from in or about September 1988 through in or about December 1991, Taylor, as more particularly described in Paragraphs II.A. through II.J. above, willfully aided and abetted and caused violations:

(1) by Synovus Securities and Reed of Section 17(a) of the Securities Act in that Synovus Securities and Reed, aided and abetted by Taylor, directly and indirectly, using the means and instrumentalities of transportation and communication in interstate commerce and the mails, (a) employed devices, schemes, and artifices to defraud; (b) obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made in light of the circumstances under which they were made, not misleading; and (c) engaged in transactions, practices, and a course of business which operated or would have operated as a fraud and deceit upon purchasers, in the offer and sale of securities;

(2) by Synovus Securities and Reed of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that Synovus Securities and Reed, aided and abetted by Taylor, directly and indirectly, using the means and instrumentalities of interstate commerce and the mails, (a) employed devices, schemes and artifices to defraud; (b) made untrue statements of material facts and 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, and (c) engaged in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, in connection with the purchase and sale of municipal securities;

(3) by Synovus Securities of Section 15(c)(1) of the Exchange Act and Rule 15c1-2 thereunder, in that Synovus Securities, aided and abetted by Taylor, made use of the mails and means and instrumentalities of interstate commerce to effect transactions in, and to induce and attempt to induce the purchase and sale of, municipal securities, by means of manipulative, deceptive and other fraudulent devices and contrivances, including acts, practices and courses of business which operated or would have operated as a fraud or deceit on any person, and untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, which statements and omissions were made with knowledge or reasonable grounds to believe that they were untrue or misleading;

(4) by Synovus Securities of Section 15B(c)(1) of the Exchange Act, and Rules G-17 and G-30 of the Municipal Securities Rulemaking Board, in that Synovus Securities, aided and abetted by Taylor, in the conduct of the municipal securities business of Synovus Securities, failed to deal fairly with other persons and engaged in deceptive, dishonest and unfair practices, and purchased municipal securities for the account of Synovus Securities from customers and sold municipal securities for the account of Synovus Securities to customers at aggregate prices that were not fair and reasonable, taking into consideration all relevant factors; and

(5) by Synovus Securities of Sections 206(1) and 206(2) of the Advisers Act, in that Synovus Securities, aided and abetted by Taylor, by use of the mails and means and instrumentalities of interstate commerce, directly and indirectly, employed devices, schemes and artifices to defraud and engaged in transactions, practices, and a course of business which operated as a fraud and deceit upon clients and prospective clients.

L. From on or about January 1, 1989 through at least December 31, 1991, Taylor engaged in activities of a municipal securities dealer as alleged in the order instituting these proceedings, made use of the mails and means or instrumentalities of interstate commerce to effect transactions in, and to induce and attempt to induce the purchase or sale of municipal securities, without being registered in accordance with Section 15B of the Exchange Act thereby willfully violating Section 15B(a)(1) of the Exchange Act.

M. Taylor does not have the financial ability to pay a civil penalty. This determination is based upon the Commission's review of the information concerning Taylor's financial condition contained in his Statement of Financial Condition executed under oath on January 27, 1995 and submitted to the Commission thereafter. The determination not to impose a civil penalty is contingent upon the accuracy and completeness of Taylor's Statement of Financial Condition. If at any time following the date of this Order the staff obtains information indicating that Taylor's representations concerning his assets, income, liabilities, expenses, or net worth were fraudulent, misleading, inaccurate or incomplete in any material respect as of the time such representations were made, the staff may petition the Administrative Law Judge ("ALJ") for an order imposing a civil penalty. In connection with any such petition, the only issues shall be whether the financial information provided by Taylor was fraudulent, misleading, inaccurate or incomplete in any material respect as of the time such representations were made, and the amount of civil penalty to be imposed. Taylor may not, by way of defense of such petition, challenge the validity of his consent, contest the allegations in the Order Instituting Proceedings in this matter, or assert that payment of a civil penalty should not be ordered.

III.

In view of the foregoing, the Commission finds that it is appropriate and in the public interest to impose the sanctions which are set forth in the Offer submitted by Taylor.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) effective immediately, Richard T. Taylor, be and hereby is barred from association with any broker, dealer, municipal securities dealer, investment adviser, or investment company with a right to reapply after fifteen (15) months, but only if the disgorgement imposed under paragraph III (3) herein has been paid, such application to be made to the appropriate self-regulatory organization, or if there is none to the Commission;

(2) Richard T. Taylor cease and desist from committing or causing any violations, or future violations of Section 17(a) of the Securities Act, Sections 10(b), 15(c)(1), 15B(a)(1) and 15B(c)(1) of the Exchange Act, Rules 10b-5 and 15c1-2 thereunder, Rules G-17 and G-30 of the Municipal Securities Rulemaking Board and Sections 206(1) and 206(2) of the Advisers Act; and

(3) Richard T. Taylor disgorge $325,000 representing profits derived from customers through the conduct set forth above, and pay interest dating from the dates of the transactions to the date of the order, at the prejudgment interest rate, provided, however, that the payment of all but $40,000, which shall be paid in two installments of $20,000 each, the first installment within thirty (30) days of the receipt of this order and the second within six (6) months from the date of receipt of this order, is waived based upon Taylor's inability to pay. This waiver is conditioned upon Taylor having stated fully and truthfully in all material respects about the information concerning his financial condition contained in his Statement of Financial Condition described above. The staff, at any time following the entry of this Order, may petition the ALJ to reopen this matter to reconsider Taylor's inability to disgorge funds if the staff obtains information from any source indicating that Taylor's Statement of Financial Condition was inaccurate or incomplete in any material respect. In connection with any such petition, the ALJ may consider ordering Taylor to pay the balance of $285,000 plus interest. The $285,000 is predicated upon Taylor having paid the $40,000 above. If he has not paid the $40,000 in full, the balance may be added to the $285,000. Taylor may not, by way of a defense to such petition, challenge the validity of his consent or contest the allegations of the Order Instituting Proceedings in this matter or the appropriateness or amount of disgorgement. The two payments of $20,000 described above shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 5th Street, N.W. Washington, D.C. 20549; and (d) submitted under cover letter which identifies Richard T. Taylor as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Joseph L. Grant, District Counsel, Securities and Exchange Commission, 3475 Lenox Road, N.E., Suite 1000, Atlanta, Georgia 30326-1232.

By the Commission.

In re Synovus Securities, Inc., and Clark L. Reed, Jr., Securities Act Release No. 7070, Exchange Act Release No. 34313, Investment Advisers Act Release No. 1423, A.P. File No. 3-8407 (July 5, 1994).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(f) of the Investment Advisers Act of 1940

("Advisers Act"), and Cease-and-Desist Proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Exchange Act and Section 203(k) of the Advisers Act be and hereby are instituted against Synovus Securities, Inc., and Clark L. Reed, Jr.

II.

In anticipation of the institution of these proceedings, Synovus Securities, Inc. and Clark L. Reed, Jr. have submitted Offers of Settlement which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, without admitting or denying the factual statements and findings contained herein, except that they admit paragraphs III.A and III.B herein, Synovus Securities, Inc. and Clark L. Reed, Jr., admit the jurisdiction of the Commission over them and the subject matter of this proceeding and consent to the entry of this Order instituting this proceeding, making findings and imposing remedial sanctions.

III.

On the basis of this Order and the Offers of Settlement submitted by Synovus Securities, Inc. and Clark L. Reed, Jr., the Commission finds n1 that:

A. Synovus Securities, Inc., ("Synovus") is registered with the Commission and has been registered as an investment adviser since September 1, 1983, and is registered with the Commission as a broker-dealer and has been registered since October 21, 1986.

n1 The findings and conclusions herein and the entry of this Order are solely for the purposes of this proceeding and shall not be binding on any person or entity named in any other proceeding.

B. Clark L. Reed, Jr., ("Reed") was president and a director of Synovus from at least in or about August 1985 until in or about November 1993.

C. From in or about September 1988 through in or about December 1991, in over 120 municipal bond transactions involving Synovus dealing as a principal with certain of its customers, some of whom were investment advisory clients of Synovus, Synovus, acting through Reed, did not get the best market price for the customers, but instead Reed and Synovus placed the transactions with an individual who was able to promptly sell the bonds to or buy the bonds from other brokers at a profit. The practice was not always disclosed to Synovus' customers.

D. During the period from in or about September 1988 through in or about December 1991, Synovus and Reed, in the offer and sale of securities, willfully violated Section 17(a) of the Securities Act by using the means and instruments of transportation and communication in interstate commerce and the mails to, directly and indirectly, employ devices, schemes, and artifices to defraud; obtain money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made in light of the circumstances under which they were made, not misleading, and engage in transactions, practices, and a course of business which operated or would have operated as a fraud and deceit upon purchasers, as more particularly described in Paragraph C. above.

E. During the period from in or about September 1988 through in or about December 1991, Synovus and Reed, in connection with the purchase and sale of securities, willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by using the means and instrumentalities of interstate commerce and the mails to, directly and indirectly: (1) employ devices, schemes and artifices to defraud, (2) make untrue statements of material facts and omit 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, and (3) engage in acts, practices, and a course of business which operated or would have operated as a fraud and deceit upon persons, as more particularly described in Paragraph C. above.

F. During the period from in or about September 1988 through in or about December 1991, Synovus willfully violated and Reed willfully aided and abetted and caused violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-2 thereunder, by making use of the mails and means and instrumentalities of interstate commerce to effect transactions in, and to induce and attempt to induce the purchase and sale of, securities, by means of manipulative, deceptive and other fraudulent devices and contrivances, including acts, practices and courses of business which operated or would have operated as a fraud or deceit on any person, and untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, which statements and omissions were made with knowledge or reasonable grounds to believe that they were untrue or misleading, as more particularly described in Paragraph C. above.

G. During the period from in or about September 1988 through in or about December 1991, Synovus willfully violated and Reed willfully aided and abetted and caused violations of Section 15B(c)(1) of the Exchange Act, and Rules G-17 and G-30 of the Municipal Securities Rulemaking Board in the conduct of the municipal securities business of Synovus by not dealing fairly with other persons and engaging in deceptive, dishonest and unfair practices, and by purchasing municipal securities for the account of Synovus from customers and selling municipal securities for the account of Synovus Securities to customers at aggregate prices that were not fair and reasonable, taking into consideration all relevant factors, as more particularly described in Paragraph C. above.

H. During the period from in or about September 1988 through in or about December 1991, Synovus willfully violated and Reed willfully aided and abetted and caused violations of Sections 206(1) and 206(2) of the Advisers Act, in that Synovus, by use of the mails and means and instrumentalities of interstate commerce, directly and indirectly, employed devices, schemes and artifices to defraud and engaged in transactions, practices, and a course of business which operated as a fraud and deceit upon clients and prospective clients as more particularly described in Paragraph C. above.

IV.

Based upon the foregoing, the Commission deems it appropriate and in the public interest to accept the Offers of Settlement of Synovus Securities, Inc. and Clark L. Reed, Jr.

Accordingly, IT IS ORDERED THAT:

(1) Effective immediately, Synovus Securities, Inc. be and hereby is censured;

(2) Synovus Securities, Inc. pay a civil money penalty in the amount of $200,000 within thirty (30) days of the receipt of this order. Such payment shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 5th Street, N.W. Washington, D.C. 20549; and (d) submitted under cover letter which identifies Synovus Securities, Inc., as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter, and money order or check shall be sent to William P. Hicks, District Trial Counsel, Securities and Exchange Commission, 3475 Lenox Road, N.E., Suite 1000, Atlanta, Georgia 30326-1232;

(3) Synovus Securities, Inc. comply with its undertakings:

(a) to maintain a compliance officer and to adopt procedures reasonably designed to prevent officers or agents of Synovus Securities, Inc., from interpositioning anyone between its customers and/or clients and the market thereby preventing the customer or client from obtaining a higher price for a security sold or a lower price for a security purchased; and

(b) at its own expense, to engage a consultant, within two months, who is not unacceptable to the staff to conduct a review of its procedures referred to above and to adopt and implement any recommendations or

suggestions to improve such procedures; provided, however, that as to any of the consultant's recommendations that Synovus determines is unduly burdensome or impractical, Synovus may suggest an alternative procedure designed to obtain the same objective, submitted in writing to the consultant and to the staff of the Commission. The consultant shall reasonably evaluate Synovus' alternative procedure and approve the alternative if it is not unreasonable. Synovus will abide by the consultant's determination with regard thereto and adopt those recommendations deemed appropriate by the consultant. Synovus shall, within six months, report in a letter to the staff of the Commission, attest to, and set forth the details of its implementation of the recommendations contained in the report.

(4) effective immediately, Clark L. Reed, Jr., be and hereby is barred from association with any broker, dealer, municipal securities dealer, investment adviser, or investment company with a right to reapply after eighteen (18) months, such application to be made to the appropriate self-regulatory organization, or if there is none to the Commission;

(5) Clark L. Reed, Jr. pay a civil penalty in the amount of $50,000 within thirty (30) days of the receipt of this order. Such payment shall be (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 5th Street, N.W. Washington, D.C. 20549; and (d) submitted under cover letter which identifies Clark L. Reed, Jr., as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to William P. Hicks, District Trial Counsel, Securities and Exchange Commission, 3475 Lenox Road, N.E., Suite 1000, Atlanta, Georgia 30326-1232; and

(6) Synovus Securities, Inc. and Clark L. Reed, Jr. cease and desist from committing or causing any violation, or future violations of Section 17(a) of the Securities Act, Sections 10(b), 15(c)(1) and 15B(c)(1) of the Exchange Act, Rules 10b-5 and 15c1-2 thereunder, Rules G-17 and G-30 of the Municipal Securities Rulemaking Board and Sections 206(1) and 206(2) of the Advisers Act.

By the Commission.

In re Joseph H. Stafford, Exchange Act Release No. 23366, A.P. File No. 3-6626 (June 22, 1986).

I.

In these proceedings, instituted on March 24, 1986 pursuant to Sections 15(b), 15B(c) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act"), n1 Respondent Joseph H. Stafford ("Stafford") has submitted an Offer of Settlement which the Commission has determined to accept. Without admitting or denying the allegations contained in the Order for Proceedings or the findings in this Order, Stafford consents to the entry of the findings and sanctions contained in this Order. n2

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n1 In the *Matter of Donald T. Sheldon, et al., Exchange Act Release No. 23058 (March 24, 1986), 35 SEC Docket 557.*

n2 The findings herein are not binding on any other respondents named in these proceedings.

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II.

On the basis of the Order for Proceedings and the Offer of Settlement submitted by Stafford, the Commission makes the following findings:

A. Respondent Joseph H. Stafford was employed as a salesman in the Houston, Texas office of Donald Sheldon & Co., Inc., a registered broker-dealer, from January 1983 until in or about July 1984. From October 1984 until March 1985, Stafford was employed at another registered broker-dealer located in Austin, Texas. Stafford is, and has been at all times relevant herein, registered with the National Association of Securities Dealers as a registered representative.

B. During the period from in or about December 1983 to in or about March 1985, Stafford, in connection with the offer, purchase and sale of securities, including municipal securities in the form of Cheneyville Louisiana Westside Habilitation Center Revenue Bonds ("C-Bonds") and Vanceburg Kentucky Bond Anticipation Notes ("V-Bonds") and by use of the mails and the means and instrumentalities of interstate commerce, willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in that, he, directly and indirectly, employed manipulative and deceptive devices and contrivances, employed devices, schemes and artifices to defraud, obtained money and property by means of and otherwise made untrue statements of material facts and 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, and engaged in acts, transactions, practices and a course of business which operated and would operate as a fraud and deceit upon the purchasers of such securities. As a part of the aforesaid conduct, Stafford, among other things, made untrue statements of material facts and omitted to state material facts concerning, among other things:

1. the safety of investments in C-Bonds and V-Bonds;

2. financial factors affecting the value of C-Bonds and V-Bonds, including future revenues expected to be received by the issuers;

3. the existence of litigation adversely affecting the issuers of the C-Bonds and V-Bonds;

4. the rate of return to be earned on the C-Bonds and V-Bonds;

5. the probability of payment of principal and interest on the C-Bonds and V-Bonds; and

6. the rating or lack of rating of the C-Bonds and V-Bonds.

C. During the period from in or about December 1983 to in or about March 1985, Stafford willfully violated and/or willfully aided and abetted violations of Section 15B(c)(1) of the Exchange Act and Rule G-17 of the Municipal Securities Rulemaking Board ("MSRB") promulgated under the Exchange Act. As a part of the aforesaid conduct, Stafford, among other things, engaged in the acts and practices described in paragraph B above.

D. During the period from in or about December 1983 to in or about March 1985, Stafford willfully violated and/or willfully aided and abetted violations of Section 17(a) of the Securities Act and Sections 10(b) and 15B(c)(1) of the Exchange Act and Rule 10b-5 and MSRB Rule G-19(c) thereunder, in that, in connection with the purchase of C-Bonds and V-Bonds, he recommended that his customers purchase these securities even though he lacked reasonable grounds, based upon information available from the issuers of such securities or otherwise, for recommending such purchases and lacked reasonable grounds to believe that his recommendations concerning such purchases were suitable for his customers in light of their financial background and investment objectives.

III.

In view of the foregoing, it is in the public interest to impose the sanctions specified in Stafford's Offer of Settlement.

Accordingly, IT IS ORDERED that Stafford be and hereby is:

1. Censured;

2. Suspended from association with any broker or dealer, investment adviser, investment company or municipal securities dealer for a period of 75 Calendar days, said suspension to commence at the opening of business on the first Monday following the date of this Order; and

3. Barred from association with any broker or dealer, investment adviser, investment company or municipal securities dealer in a supervisory or proprietary capacity, provided that after a period of one year, Stafford may make application to the appropriate self-regulatory organization or, where there is no appropriate self-regulatory organization, to the Commission, to become associated in a supervisory or proprietary capacity.

IT IS FURTHER ORDERED that Stafford shall comply with his undertaking to file with the Houston Branch Office of the Commission, within fifteen days after the expiration of the suspension period, an affidavit affirming that he has complied with the terms of the suspension contained in this Order.

By the Commission.

In re Hanauer, Stern & Co., Inc., et al., Exchange Act Release No. 21313; A.P. File No. 3-6408 (September 11, 1984).

I.

The Commission deems it appropriate that public administrative proceedings be instituted pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act) with respect to Hanauer, Stern & Co., Inc., (Registrant), Robert E. DeMary (DeMary), Paul R. Konsig (Konsig) and Eugene L. Stern (Stern). In anticipation of these proceedings, the Respondents have submitted Offers of Settlement which the Commission has determined to accept.

Solely for the purpose of these proceedings and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the allegations and findings contained herein, Respondents consent to entry of the findings and imposition of the remedial sanctions set forth below.

II.

Accordingly, it is ordered that proceedings pursuant to Section 15(b) and 19(h) of the Exchange Act be, and they hereby are, instituted.

III.

On the basis of this Order Instituting Proceedings and Imposing Remedial Sanctions and the Offers of Settlement submitted by the Respondents, the Commission finds that:

A. Registrant has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since December 1, 1975. Registrant is a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15A of the Exchange Act.

B. At all times relevant hereto, DeMary was senior vice-president of Registrant.

C. At all times relevant hereto, Konsig was executive vice-president of Registrant.

D. At all times relevant hereto, Stern was president of Registrant.

E. During the period from in or about January 1979 to in or about December 1981, Registrant, DeMary, Konsig and Stern willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and Registrant willfully violated and DeMary, Konsig and Stern willfully aided and abetted violations of Rule G-30 promulgated by the Municipal Securities Rulemaking Board (MSRB) pursuant to Section 15B(b)(2) of the Exchange Act, in that, in the offer or sale and in connection with the purchase or sale of securities said respondents directly and indirectly engaged in acts, practices and courses of business which would and did operate as a fraud and deceit upon various persons. As part of the aforesaid conduct:

1. DeMary, Konsig and Stern caused Registrant to engage in adjusted trading with a bank, thereby enabling an official of the bank to conceal from bank shareholders and others material losses in the value of the bank's securities portfolio. At the request of the bank official, Registrant purchased municipal bonds and other securities from the bank at prices materially higher than the market value of such securities. In offsetting transactions, Registrant sold municipal bonds and other securities to the bank at prices materially higher than market prices.

2. Registrant charged excessive markups on municipal securities in eleven transactions with various customers.

F. During the period from in or about January 1979 to in or about December 1981, Registrant willfully violated and DeMary, Konsig and Stern willfully aided and abetted violations of Section 17(a) of the Exchange Act, Rule 17a-3 thereunder and MSRB Rule G-8 in that Registrant failed to accurately make and keep current certain of its reguired books and records, including memoranda showing the terms and conditions of the adjusted trading with the bank. In addition, Registrant's required books and records failed to reflect agreements by at least two customers to repurchase certain municipal bonds from Registrant at predetermined prices thirty days after the customers sold such bonds to Registrant.

IV.

In view of the foregoing, it is in the public interest to impose the remedial sanctions and to order compliance with the undertakings set forth in the Respondents' Offers of Settlement.

Accordingly, IT IS ORDERED that effective on the date of this Order:

A. Registrant be, and hereby is, censured;

B. Respondent DeMary be, and hereby is, suspended from association with any broker, dealer, or municipal securities dealer for a period of thirty (30) days;

C. Respondent Konsig be, and hereby is, suspended from association with any broker, dealer, or municipal securities dealer for a period of thirty (30) days;

D. Respondent Stern be, and hereby is, suspended from association with any broker, dealer, or municipal securities dealer for a period of thirty (30) days; and

E. Within thirty (30) days after completion of the above suspensions, Respondents DeMary, Konsig and Stern shall each deliver to the Commission's Washington Regional Office an affidavit stating that he has complied with the sanction imposed by the Commission.

By the Commission.

<u>In re Robert D. Peterson, et al.</u>, Exchange Act Release No. 19764, A.P. File No. 3-6249 (May 13, 1983).

William D. Goldsberry, Administrator, Chicago Regional Office, announced that the Commission has ordered public administrative proceedings pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act) against Channer-Newman Securities Company (Channer-Newman), a registered broker-dealer engaged in the trading and underwriting of municipal securities with its principal place of business in Chicago, Illinois; Frederick W. Channer (Channer), the firm's chief operating officer; Michael J. Wyvill (Wyvill), a former president and officer of Channer-Newman; and Robert D. Peterson (Peterson), an account executive formerly employed at Channer-Newman.

The Order for Proceedings alleges that from in or about December 1978 to on or about December 31, 1979, Peterson willfully violated the antifraud provisions of the Securities Act of 1933 (Securities Act), the Securities Exchange Act of 1934 (Exchange Act), and the rules of the Municipal Securities Rulemaking Board (MSRB) which were promulgated pursuant to the Exchange Act. The Order also charges that Peterson aided and abetted violations of Commission and MSRB rules relating to books and records, customer confirmations and required deposits in a "Special Reserve Account for the Exclusive Benefit of Customers" (Reserve Bank Account).

Specifically, the Order alleges that from in or about December 1978 through on or about December 31, 1979, Peterson caused municipal bonds and confirmations of sales of municipal bonds to be sent to customers who had not ordered the securities. In addition, Peterson is charged with inducing and attempting to induce customers to purchase unordered municipal securities by agreeing that Channer-Newman would repurchase the securities either at a profit or no loss to the customer, while failing to disclose that Channer-Newman's sales policies strictly prohibited such repurchase agreements.

The Order also alleges that Peterson caused Channer-Newman to keep inaccurate books and records including, among other things, order tickets and confirmations reflecting apparent sales of municipal bonds to customers who had not ordered them, as well as ledgers, trial balances, and other records reflecting assets, liabilities, income and capital. Peterson is also charged with causing Channer-Newman to make insufficient deposits to its Reserve Bank Account.

Channer, Wyvill and Channer-Newman are charged with a failure reasonably to supervise Peterson. with a view toward preventing his violations, as alleged in the Order. Without admitting or denying these allegations, Channer, Wyvill and Channer-Newman submitted offers of settlement which have been accepted by the Commission. In their offers of settlement, Channer, Wyvill and Channer-Newman each consented to findings that he or it failed reasonably to supervise Peterson as alleged in the Order and to sanctions in which each respondent was censured. Channer-Newman also consented to undertakings requiring it to review and revise, if appropriate, its procedures respecting extensions of settlement date and cancellation of orders.

A hearing will be scheduled to take evidence against the remaining respondent, Robert D. Peterson. The purpose of the hearing is to determine whether or not the allegations against Peterson are true, and if so, what if any remedial sanction is necessary in the public interest.

<u>In re Robert D. Peterson, et al.</u>, Exchange Act Release No. 20293, A.P. File No. 3-6249 (October 17, 1983).

In these proceedings ordered pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act), Respondent Robert D. Peterson (Peterson) has submitted an Offer of Settlement which the Commission has determined to accept. n1 Solely for the purpose of settling these proceedings and without admitting or denying the allegations contained in the Order for Proceedings, Respondent Peterson consents to the findings of violations and sanctions contained in this Order. n2

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n1 In the Matter of Robert D. Peterson, et al., instituted May 13, 1983. (See *Order for Public Proceedings, Exchange Act Release No. 19764 (May 13, 1983), 27 SEC Docket 1620* (May 13, 1983)

n2 The findings herein are not binding on any other respondent named in these proceedings.

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On the basis of the Order for Public Proceedings and the Offer of Settlement, the Commission finds that from in or about December 1978 until in or about August 1980, Peterson willfully violated Section 17(a) of the Securities Act of 1933 (Securities Act), Sections 10(b) and 15B(c)(1) of the Exchange Act, Rule 10b-5 thereunder, and Rules G-17 and G-25(b) of the Municipal Securities Rulemaking Board (MSRB); and, that Peterson willfully aided and abetted violations of Sections 15(c)(3), 17(a), and 15B(c)(1) of the Exchange Act, Rules 15c3-3 and 17a-3 thereunder, and MSRB Rules G-8 and G-15, all as alleged in the Order for Proceedings.

In view of the foregoing, it is in the public interest to impose the sanctions specified in the Offer of Settlement.

Accordingly, IT IS ORDERED THAT:

Peterson be, and hereby is, suspended from association with any broker, dealer, municipal securities dealer, investment adviser, investment company or affiliate thereof, for a period of 90 days.

IT IS FURTHER ORDERED THAT:

The Commission having accepted Respondent Peterson's Offer of Settlement on September 7, 1983, but, through inadvertence, no Findings and Order Imposing Remedial Sanctions having been issued; nunc pro tunc this Findings and Order Imposing Remedial Sanctions is effective as of opening of business on September 8, 1983.

By the Commission.

In re J.B. Hanauer & Co., et al., Securities Act Release No. 6381, Exchange Act Release No. 18483, A.P. File No. 3-6095 (February 11, 1982).

The Commission deems it appropriate and in the public interest that proceedings be instituted against J.B. Hanauer & Co. ("Hanauer"), Elliot Friedman ("Friedman"), Melvin Frank ("Frank"), John Palumbo ("Palumbo"), Charles W. Tomasheski ("Tomasheski"), Eugene H. Goodman ("Goodman"), Robert H. Wolfson ("Wolfson"), Melvin A. Glucksman ("Glucksman"), Michael Jacobson ("Jacobson"), Alfred J. Marcus ("Marcus"), Alan Z. Appelbaum ("Appelbaum"), Sheldon S. Stein ("Stein"), Alexander Altman ("Altman"), Bruce A. Heller ("Heller"), Neil Cohen ("Cohen"), Ronald N. Cookler ("Cookler"), Fred Tessler ("Tessler"), Michael Ehrlich ("Ehrlich") and Mitchell L. Silverman ("Silverman"), pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (the "Exchange Act"). The proceedings are to determine whether such persons have willfully violated or willfully aided and abetted violations of provisions of the Securities Act of 1933 (the "Securities Act") and the Exchange Act and Rules thereunder and Rules of the Municipal Securities Rulemaking Board (the "MSRB") and whether, in addition, Hanauer, Friedman, Glucksman, Frank, Jacobson, Marcus, and Silverman have failed to reasonably supervise persons subject to their supervision with a view to preventing violations of the provisions and Rules referred to above. n1

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n1 On February 11, 1982, the United States District Court for the District of New Jersey entered a Final Judgment against Hanauer in a Commission enforcement action. The District Court enjoined Hanauer from violating provisions of the Federal securities laws and Rules of the Commission and of the Municipal Securities Rulemaking Board. The defendant was also enjoined from violating provisions of the Currency and Foreign Transactions Reporting Act and Regulations of the Department of the Treasury thereunder. Hanauer consented to entry of the Final Judgment without admitting or denying the allegations in the Complaint.

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Simultaneous with the institution of these proceedings, the Respondents have submitted Offers of Settlement for the purpose of disposing of the issues raised in these proceedings. Under the terms of their Offers of Settlement, the Respondents, solely for the purposes of these proceedings and without admitting or denying any of the findings set forth herein, have consented to the issuance of this Order by the Commission.

The Commission has deemed it appropriate and in the public interest to accept the Offers of Settlement of the Respondents and accordingly issues this Order.

I. FACTS

The Respondents

1. Hanauer is a New Jersey corporation with headquarters in Livingston, New Jersey and branch offices in North Miami Beach, Palm Beach and West Palm Beach, Florida. The firm is registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act. Hanauer is also a member of the National Association of Securities Dealers, Inc. The firm specializes in selling municipal securities to retail customers.

2. Friedman served as President of Hanauer until January 1980 and as the Chairman of the Board of Directors of Hanauer from January 1980 until March 31, 1981 when he relinquished that position. From March 31, 1981 through the present, Friedman has served as a consultant and a commission salesman. He was the largest shareholder in Hanauer.

3. Glucksman served as an Executive Vice-President until January 1980. Glucksman served as president of Hanauer from January 1980 until December 31, 1981 at which point he became Chairman of the Board. Glucksman is also a shareholder.

4. Frank is an Executive Vice-President, a director and shareholder and also was the Senior Sales Manager of Hanauer.

5. Jacobson is a Vice-President of Hanauer, a director and a shareholder.

6. Marcus is the Secretary and Treasurer of Hanauer, a director and a shareholder.

7. Appelbaum is a Senior Vice-President of Hanauer, a director and shareholder and manages the firm's North Miami Beach office.

8. Silverman is a Vice-President and manager of Hanauer's Palm Beach and West Palm Beach offices.

9. Altman is a Vice-President of Hanauer.

10. Cookler is an Assistant Vice-President of Hanauer.

11. Palumbo is a registered representative with Hanauer.

12. Tomasheski is a registered representative with Hanauer.

13. Goodman is a registered representative with Hanauer.

14. Wolfson is a registered representative with Hanauer.

15. Stein was a registered representative with Hanauer.

16. Heller is a registered representative with Hanauer.

17. Cohen is a registered representaive with Hanauer.

18. Tessler is a registered representative with Hanauer.

19. Ehrlich is a registered representative with Hanauer.

Hanauer's Customers

Hanauer encouraged its salesmen to seek the business of persons, who, for income tax or other reasons, sought anonymity in purchasing municipal bonds. Such customers generally paid for bond purchases with currency. New cash customers frequently inquired concerning the types of records generated by Hanauer in the purchase and sale of municipal securities and whether governmental authorities had access to those records. Certain of the cash customers advised Hanauer's salesmen that they wanted to purchase municipal securities but did not want any records identifying them as the purchasers.

Hanauer's registered representatives accommodated their customers' requests for anonymity. The salesmen opened accounts in the real names of certain of the purchasers, executed transactions for such customers in the new accounts but prevented the delivery of any documents to such customers identifying them as the purchasers. For other persons, the registered representatives opened accounts in names and addresses which they knew or had reason to know were fictitious. Hanauer's registered representatives sometimes supplied the fictitious names and addresses from telephone directories and other sources.

In addition, Hanauer took other steps to facilitate its customers' requests for anonymity, including failing to file reports of large transactions in currency as required pursuant to the Currency and Foreign Transactions Reporting Act (the "Currency Act") and arranging for bank deposits to be made in such a manner that the banks would not file such reports. Hanauer also engaged in certain activities to prevent the detection of its illegal activities by other persons.

Hanauer's Policies and Procedures

Hanauer's Books and Records

Under Hanauer's policies and procedures, registered representatives were permitted to open customer accounts without complying with rules governing new account information. Hanauer's registered representatives accepted the information provided by new customers and neither they nor the Hanauer supervisory staff attempted to independently verify any of the information furnished by customers. Frequently, new accounts were opened by registered representatives and approved by Hanauer's senior personnel where the only customer information known by Hanauer was the names and addresses provided by the customer, which in some instances were not the actual names and addresses of the customers.

Hanauer's registered representatives did not obtain customer telephone numbers, occupations, names of employers or tax identification or social security numbers.

Purchase and sale orders for municipal securities were placed by certain of Hanauer's customers who requested anonymity. Hanauer, through its registered representatives, prepared order tickets for these transactions in the fictitious names supplied by its customers or in the fictitious names selected by the registered representatives.

A confirmation identifying the customer and describing municipal securities purchased or sold, price, trade date, settlement date and quantity was prepared by Hanauer for each customer transaction. Confirmations for municipal securities transactions by Hanauer's customers who requested anonymity were prepared in the fictitious names supplied by the customers or in the fictitious names selected by Hanauer's registered representatives. Hanauer recorded the purchases and sales of municipal securities by its customers who requested anonymity on its blotter in the fictitious names. Hanauer carried these accounts in fictitious names and addresses on its customer account ledger and recorded transactions in these accounts.

Delivery of Customer Confirmations

The confirmations were prepared by a computer service, under contract to Hanauer, and delivered to Hanauer's back office personnel. Until mid-1980, the confirmations were sorted and distributed to the registered representatives for delivery to their customers.

Until recently, n2 Hanauer did not have an established policy with respect to the method of delivery of confirmations to customers. Hanauer's registered representatives were free to hand deliver confirmations to customers or to mail them. This made possible the use of fictitious names and addresses for customer accounts and other violative activity described below.

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n2 In mid-1980, after the initiation of the Commission's investigation, Hanauer changed its procedure for the delivery of confirmations to customers. Under the revised procedure, customer copies of confirmations were not distributed to the registered representatives. Confirmations were instead routed from the back office to a senior Hanauer officer, Jacobson, for his review and then to Hanauer clerical personnel for mailing to the customer.

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Methods of Payment and Delivery of Bonds

There were several forms of payment for municipal securities acceptable to Hanauer and a variety of means by which Hanauer delivered bonds to its customers. Purchasers of municipal securities made payment with currency, personal checks, cashier's checks, certified checks, coupons, or other bonds. Municipal bonds were sent by registered mail to the customer, delivered by messenger or by mail from Hanauer's clearing bank to the customer's bank, or delivered by Hanauer's registered representative to the customer.

Due to the fact that most of the municipal securities sold by Hanauer were bearer instruments, payment was generally required prior to the delivery of the bonds to the customer. Where Hanauer's customers remitted in currency, the bonds often were exchanged for the currency in face-to-face transactions. Such transactions have been termed "hand deliveries" by Hanauer's personnel. Hand deliveries took place at Hanauer's offices, the customers' places of business, customers' residences, restaurants, bars and, on one occasion, in an airport parking lot.

Hanauer's Procedures for Currency

Hanauer received a substantial amount of currency from its customers, and these receipts were often in amounts greater than $10,000. n3 The firm adopted a policy of depositing currency only in amounts under $10,000, thereby attempting to conceal the fact that they were receiving these large amounts of cash from the Treasury Department. In light of the volume of cash business in which Hanauer's account executives engaged, this required the preparation of numerous deposit tickets. Accordingly, Hanauer's management adopted a policy whereby each registered representative in Hanauer's New Jersey office was responsible for depositing currency received from his customers. Hanauer's Cashier processed currency received by the firm's principals. The administrative office managers of Hanauer's Florida offices, pursuant to instructions by Marcus, the Secretary and Treasurer, instituted a practice whereby currency received from customers in amounts greater than $10,000 was divided into amounts less than $10,000, and separate deposit tickets were prepared for each such amount. This practice was adopted in order to prevent the depository bank from filing Currency Transaction Reports with the Internal Revenue Service which

Hanuaer employees believed the bank would be required to file. Moreover, Hanauer also broke down the receipt of cash in a similar manner on its own books, and did not file the required reports.

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n3 Section 221 of the Currency Act and Treasury Regulation 103.22 requires financial institutions to file a report upon receipt of cash in amounts in excess of $10,000. Hanauer, a financial institution for purposes of the Currency and Foreign Transactions Reporting Act, did not file any Currency Transaction Reports until after the inception of the investigation.

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Overcharges

Hanauer's policies and procedures including the acceptance of currency and the delivery of confirmations afforded an opportunity for certain of its registered representatives to overcharge customers. In connection with cash transactions certain of the individual respondents overstated the firm's offering price for municipal securities to customers. They then failed to deliver customer confirmations or prepared confirmations themselves showing the higher prices, received the inflated amount from the customer and remitted the actual amount due to the firm, misappropriating the excess funds.

Fictitious Accounts and Failure to Deliver Confirmations

Tomasheski

Tomasheski had four customers who purchased municipal bonds with currency, requested anonymity and who advised him that they did not want documents concerning transactions sent to their residences or places of business. In order to accommodate these customer requests, Tomasheski opened accounts at Hanauer in at least ten fictitious names. Tomasheski prepared new account cards with fictitious names and addresses and other false information for each account. Transactions were affected and confirmations prepared for the accounts opened in each of these fictitious names. The purchases and sales for Tomasheski's customers were recorded on Hanauer's blotter and customer account ledger in the fictitious names. Tomasheski acceded to his customers' requests concerning records by destroying the customer copies of the confirmations.

Wolfson

Wolfson had a customer who maintained an account in his own name and also directed purchases and sales in an account maintained in the name of a corporation which he owned. This customer subsequently requested that transactions be executed through accounts in different names. Wolfson accomodated this request by opening accounts in fictitious names provided by the customer and purchasing municipal securities for the accounts. Confirmations were prepared in false names and addresses. The purchases were recorded on Hanauer's blotter and customer account ledger in the fictitious names. Wolfson

delivered the bonds purchased and received payment from the same customer for transactions in all of these accounts. Wolfson delivered customer copies of confirmations for transactions in these accounts only to this person.

On other occasions, Wolfson was asked to execute transactions for this same customer in accounts to be opened in fictitious names selected by Wolfson. Wolfson created fictitious addresses, occupations and telephone numbers for each of these accounts. Customer confirmations for transactions in these fictitious accounts were prepared and delivered to the same customer. The purchases were recorded on Hanauer's blotter and customer account ledger in the fictitious names.

Stein

Stein had a number of customers who purchased municipal securities with currency. Certain of his cash customers requested anonymity with respect to their transactions. Stein accommodated these requests by opening and executing securities transactions for at least twelve accounts in names which he created, or selected from telephone directories. Confirmations for these transactions were prepared in the fictitious names. The purchases were recorded on Hanauer's blotter and customer account ledger in fictitious names.

As discussed above, following the initiation of the Commission's investigation, Hanauer implemented new procedures with respect to the handling of customer confirmations. Under the revised procedures, confirmations were no longer distributed to registered representatives for delivery to the customer. In order to circumvent the revised procedures, Stein inquired of Palumbo, who was then employed in the Palm Beach office, if he knew of an address that Stein might use to send a confirmation. Palumbo provided Stein with such an address that he had received from another Hanauer registered representative in the Palm Beach office. The confirmation for a transaction in a fictitious account opened by Stein was sent by Hanauer to the address provided by Palumbo. The confirmation was never delivered to the customer.

Jacobson

Jacobson opened four accounts in fictitious names at the request of one person. Jacobson never met or spoke to anyone other than this person in connection with transactions in these accounts. All orders for transactions in such accounts were placed by that person, payment for the bonds was made by that person in currency and Jacobson delivered the bonds and customer copies of the confirmations and a check issued by Hanauer in the amount of $40,411.25 made payable to one of the fictitious persons to the individual who requested the opening of fictitious accounts. Jacobson also complied with a request by this person not to mail any conformations or other materials to any of the purported customers.

Jacobson had at least three customer accounts which had been opened in the names and with addresses of persons who had no interests in or knowledge of the accounts in their names at Hanauer. Transactions were executed in each account. Confirmations for these transactions were prepared in the names of persons who did not actually maintain accounts at Hanauer. Purchases were recorded on Hanauer's blotter and customer account ledger in these names. Only one of the three persons listed as customers had any contact with Hanauer. This person had asked in the past that his name be put on a mailing list in response to a newspaper advertisement.

Jacobson had other customers who requested confidentiality with respect to their bond transactions. The only new account information provided by such customers were names and addresses. They did not provide telephone numbers and specifically requested that correspondence or documents not be sent to them by mail. Jacobson executed municipal securities transactions in these names. Confirmations for these transactions were prepared in the names supplied and the transactions were recorded on Hanauer's blotter and customer account ledger in these same names.

Goodman

Goodman opened six accounts in fictitious names and addresses provided by persons who in each instance refused to provide telephone numbers and told him that no attempt should be made to contact them and that payment would be made in currency. These persons explicitly told Goodman that they did not want any records concerning their transactions. Goodman made no attempt to obtain the required new account information. Goodman executed transactions for these persons in the fictitious names provided to him. Confirmations for these transactions were prepared in the names. Hanauer recorded these transactions in fictitious names on its blotter and customer account ledger.

At least four persons listed as accounts of Goodman were found by the Commission's staff to have never had a beneficial interest in any account at Hanauer.

In order to accommodate requests of his cash customers, Goodman destroyed the customer copies of confirmations that were given to him for delivery. After Hanauer adopted new procedures for the mailing of confirmations to customers, Goodman listed his brother's residence as the address of certain of his cash customers on Hanauer's records. As a result, the confirmations were sent to Goodman's brother's address and his brother, upon receipt, forwarded them to Goodman who destroyed them.

Altman

Altman opened accounts in the names of two persons who had no interests in such accounts and who never transacted business with Hanauer. Altman also opened at least five accounts in which the persons in whose names the accounts were opened did not reside at the addresses indicated. Altman executed transactions for customers in the names provided to him. Confirmations for these transactions were prepared in the fictitious names. Hanauer recorded these transactions on its blotter and customer account ledger in the fictitious names.

Palumbo

Palumbo opened at least three accounts in fictitious names. Palumbo executed a transaction in one of the fictitious accounts for a person who also maintained an account at Hanauer in his true name. The address indicated for this fictitious account was an address over which Palumbo exercised control. The customer confirmation for this transaction was prepared in the fictitious name and was sent to this address and obtained and destroyed by Palumbo. The account was opened by Palumbo in the fictitious name and address on his own initiative. Palumbo did this to circumvent the firm's revised policy of mailing confirmations directly to the customer and also to conceal from the principals at Hanauer that he was transacting business with the customer of another registered representative.

Palumbo also opened accounts on his own initiative in the two other fictitious names for similar reasons. Confirmations for transactions in these two accounts were prepared in fictitious names and obtained and destroyed by Palumbo. These transactions were recorded by Hanauer on its blotter and customer account ledger in the fictitious names.

In connection with simultaneous purchase and sale transactions in one of the fictitious accounts Palumbo obtained a check issued by Hanauer, endorsed the check in the fictitious name and negotiated the check.

Cookler

A number of Cookler's customers requested confidentiality with respect to their transactions. Cookler accommodated these requests by opening accounts in the names of two persons who had no interests in the accounts. Transactions were executed in both accounts. Confirmations for these transactions were prepared in the fictitious names. Hanauer recorded these transactions on its blotter and customer account

ledger in the false names. In accordance with his customers' requests, Cookler obtained and destroyed confirmations for transactions in the two accounts.

He also destroyed customer confirmations for transactions in an account of another customer.

Heller

Heller opened a number of fictitious accounts for cash customers who sought anonymity. Heller opened these accounts with no new account information other than names and addresses. He executed transactions for these persons in false names. Confirmations for the transactions were prepared in false names and Hanauer recorded these transactions on its blotter and customer account ledger in the fictitious names. He complied with requests not to mail any documents concerning transactions to the addresses provided. Heller personally delivered municipal bonds to these purchasers in restaurants and bars.

One account was opened in the name of a person who had never maintained an account with Hanauer or transacted business with Hanauer. Nine other purported customers of Heller were found not to reside at the addresses indicated on Hanauer's books and records.

Appelbaum

Appelbaum accommodated the confidentiality requests of eight cash customers. Each customer requested that Appelbaum not send documents to them concerning their transactions. Appelbaum opened new accounts for these customers indicating 304 Lucerne Avenue, Lake Worth, Florida as the address for each account. The 304 Lucerne Avenue address is occupied by an answering service, used by another Hanauer registered representative, Tessler, as a mail drop. Customer confirmations for transactions in Appelbaum's accounts requesting confidentiality were mailed to this address. The confirmations were thereafter picked up by Tessler who either personally destroyed them or gave them to Appelbaum who destroyed them.

Cohen

Cohen also accommodated the requests of certain cash customers for confidentiality. Cohen opened six accounts in fictitious names provided by an individual with whom Cohen had transacted business prior to becoming associated with Hanauer. All orders for municipal securities transactions were placed by that individual but executed in accounts in fictitious names which he provided. Confirmations for these transactions were prepared in fictitious names. Hanauer recorded these transactions on its blotter and customer account ledger in the fictitious names. Bonds and confirmations were delivered to that person by Cohen, in exchange for payment in currency.

One such account opened by Cohen was in the name of a person who had no interest in the account and who never transacted business with Hanauer. At least the addresses of the five other persons in whose name Cohen opened accounts were fictitious.

Cohen opened five other accounts in fictitious names and addresses provided by a single individual. Orders were placed in these accounts, bonds and confirmations were received and payment was made by one or two individuals.

Friedman

Friedman opened at least six accounts in fictitious names and addresses and he executed municipal securities transactions in these accounts. Confirmations for these transactions were prepared in fictitious names and Hanauer recorded these transactions on its blotter and customer account ledger in the false names.

Frank

Frank opened at least five accounts in fictitious names and addresses. Frank executed municipal securities transactions in these accounts. Confirmations for these transactions were prepared in false names and Hanauer recorded these transactions on its blotter and customer account ledger in fictitious names.

Tessler

Hanauer's customer account cards and customer account ledgers indicate that a significant number of Tessler's accounts have the same address: 304 Lucerne Avenue, Lake Worth, Florida. As discussed above, this is the address of an answering service used by Tessler as a mail drop for confirmations and other customer mailings by Hanauer. Customer confirmations for transactions in these accounts were sent to this address and obtained by Tessler who destroyed them.

Overcharges

Friedman

Friedman was the designated registered representative for the account of a resident of Shreveport, Louisiana. During 1978, this customer purchased municipal securities through Friedman on four separate occasions. In each instance, Friedman delivered the bonds along with a document referred to as a "portfolio page" which purported to describe the transactions. The customer never received a customer confirmation for any of his transactions. With respect to the fourth transaction the purchase price on the portfolio page and the amount the customer remitted to Friedman in currency is $9,000 greater than the corresponding entries on Hanauer's blotter and customer account ledger. Friedman diverted this amount to his own use.

In a similar manner, Friedman overcharged the same customer $5,500 in connection with the purchase of additional municipal bonds in February 1979.

Frank

A Hanauer customer from Jamaica, New York, purchased municipal securities from Hanauer on two occasions in 1979. Both transactions were executed by Frank. Frank overcharged the customer by $7,503.97 on these transactions, which amount he diverted to his own use.

Upon receipt of a subpoena, issued by the Commission's staff in the investigation preceding this action, the customer and her husband contacted Frank and inquired why the subpoena had been issued. Frank advised them that the subpoena was issued in the course of a routine inquiry. Frank suggested that they return to him their records concerning their transactions in order to be certain that everything was proper. As a result of this conversation they met with Frank several days later. At their meeting they gave Frank what they then believed to be all their records. Frank took the documents and gave them four new documents which described their bond transactions and four photostats of salesmen copies of confirmations for delivery to the Commission in response to the subpoena. The customer's original documents indicated a total purchase price of $70,771.92, the amount actually paid by the customer to Frank. The confirmations which Frank gave them indicated a total purchase price of $63,267.95, a difference of $7,503.97, which amount Frank misappropriated and diverted to his own use.

Tomasheski

As discussed above, Tomasheski was the registered representative for several customers who requested anonymity and Tomasheski accommodated these requests by opening accounts in fictitious names and destroying confirmations. Two customers of Tomasheski who made such requests were New Jersey residents. They purchased municipal securities through a joint account with currency and asked not to receive any documents concerning their transactions. Relying upon the fact that the customers did not

receive confirmations and that their remittance was in the form of currency, Tomasheski overcharged them at least $700 on a municipal securities transaction in February 1978.

Palumbo

In April 1980, Palumbo solicited Friedman's customer who resided in Shreveport, Louisiana. The customer subsequently placed an order with Palumbo to purchase certain municipal securities. As discussed above, Palumbo opened a new account in a fictitious name and executed the order in this account. The customer's transaction with Palumbo was handled in substantially the same manner as his transactions with Friedman. Palumbo, like Friedman, gave the customer a portfolio page rather than a confirmation. The price listed on the portfolio page and the amount of currency which the customer paid to Palumbo is $2,000 greater than the corresponding entry on Hanauer's records. Palumbo converted this money to his own use.

As indicated above, Palumbo opened several accounts in fictitious names and did not provide customer confirmations for transactions in these accounts. Palumbo executed municipal securities transactions for a resident of Margate, New Jersey, in two fictitious accounts. In connection with several transactions in which the customer exchanged with Hanauer certain bonds which he owned for other bonds, Palumbo provided him with portfolio pages for these transactions which indicate municipal bond prices totalling $9,231.05 more than the corresponding entries on Hanauer's records. Palumbo misrepresented the price of the bonds in order to conceal from the customer a market loss in the bonds he had exchanged.

Goodman

Goodman was the registered representative for several cash customers who did not receive confirmations. Certain of Goodman's cash customers refused to provide Goodman with a telephone number or other means by which they might be contacted. Goodman arranged for the exchange of the municipal securities and currency with such customers. Goodman overcharged certain of his cash customers who did not receive customer confirmations, in order to reimburse himself for expenses incurred in connection with those customers' transactions.

In connection with several municipal securities transactions checks were issued by Hanauer in the names of certain of Goodman's purported customers. Goodman obtained these checks and endorsed the checks with the fictitious names and converted the funds to his own.

Wolfson

Wolfson had a number of customers that were habitually late in making payment for municipal securities. Due to this fact Wolfson was occasionally charged with interest expenses. Wolfson overcharged certain of his customers on subsequent transactions to compensate him for the interest expenses he paid when they had failed to remit by settlement date.

Ehrlich

Several of Ehrlich's customers purchased municipal securities with currency. One cash customer with whom Ehrlich had previously transacted business contacted Ehrlich in late 1979 and stated that he had a certain amount of money to invest and asked Ehrlich to select bonds within certain parameters. Ehrlich subsequently contacted this customer and informed him that he had selected bonds meeting the customer's criteria and quoted him a price for the particular municipal securities. Shortly thereafter, Ehrlich contacted the customer again and stated that the price for the same municipal securities would be $2,000 more than the original quote. Ehrlich's attempt to overcharge the customer was unsuccessful due to an inquiry made by the customer to the branch manager of the Hanauer office to which Ehrlich was assigned.

Failure to Supervise

The Respondents Hanauer, Friedman, Glucksman, Frank, Jacobson, Marcus and Silverman failed reasonably to supervise persons subject to their supervision with a view to preventing violations of various provisions of the Securities Act, the Exchange Act and Rules of the Commission and of the MSRB. Hanauer and persons in its management responsible for supervision not only neglected their responsibilities under existing procedures but failed to impose even elementary new procedures to prevent violations, even after learning of violative conduct by persons under their supervision.

Hanauer, Friedman, Glucksman, Frank, Jacobson and Marcus failed to establish procedures for obtaining and verifying even required customer information before effecting transactions in new accounts. As a result, accounts were opened without required information, and in fictitious names. Further, confirmations were prepared in fictitious names and addresses and such names and addresses were entered on Hanauer's blotter and customer account ledger.

The firm also lacked reasonable procedures and failed to enforce existing procedures for the delivery of confirmations to customers. Hanauer's registered representatives were given access to customer confirmations. As a result, Hanauer's registered representatives destroyed or failed to deliver customer confirmations to Hanauer's customers in connection with their transactions in municipal securities.

Hanauer also lacked procedures designed to prevent registered representatives from handling customer confirmations and currency received from customers in payment for municipal securities. As a result, Hanauer's customers were unable to verify salesmen's representations on the costs of transactions and Hanauer had no control over the customer funds received by its salesmen. This enabled certain of Hanauer's registered representatives to overcharge customers.

On those occasions when Hanauer's senior personnel became aware of improper conduct and violations they failed to impose any sanctions upon the responsible persons or to institute procedures adequate to prevent and detect recurrences of the violative conduct.

In one instance, Friedman and Glucksman became aware of a rumor that a salesmen had overcharged a customer as discussed above. Friedman subsequently called a meeting of the sales staff. He informed the sales staff that he had learned of an instance in which a customer was overcharged and suggested that the responsible registered representative should come forward and identify himself. Tomasheski, however, did not come forward at that time. Several days after the meeting, Tomasheski approached Glucksman, who was then an Executive Vice President and who had hired Tomasheski, and advised him that he had overcharged a customer. Glucksman then told Tomasheski that he should see Friedman at once. Glucksman escorted Tomasheski to Friedman's office. Friedman told Tomasheski that he had learned of the overcharge after the customer contacted the firm to verify the price of the bonds purchased. Friedman further told Tomasheski that his conduct was unlawful and that the could be barred from the securities industry for such actions. At Friedman's request, Tomasheski gave him the difference between the amount received on the transaction and the purchase price recorded on Hanauer's records. Friedman did not return the money to the customer because he did not know which of Tomasheski's customers had been overcharged. He has advised our staff that he made a charitable donation of the money but the purported donation was made in such a manner that there is no documentary evidence of the contribution. Neither Friedman nor any other Hanauer supervisory official took any action against Tomasheski or imposed any restrictions upon his activities. Further, no federal, state, local or self-regulatory authority was informed of the overcharge.

In another instance, a new account was opened by Wolfson at Hanauer in the name of a New York City attorney who had no interest in or knowledge of the account. The attorney subsequently received a confirmation for a municipal securities transaction from Hanauer. The attorney then wrote a letter to the National Association of Securities Dealers, Inc. and the New York Attorney General's Office to complain that he had received a securities confirmation for a transaction with a firm with which he did not maintain an account and had never transacted any business. He also sent a complaint letter to Glucksman,

Hanauer's President. Glucksman responded to the attorney's complaint by sending him a letter indicating that the transaction described in the confirmation had been cancelled and that his name had been removed from Hanauer's customer records. Glucksman did not seek an explanation from Wolfson or take any other action.

In another instance, Silverman, while the Branch Manager of Hanauer's Palm Beach office was informed by a registered representative in that office that one of his customers had requested that he open an account in a fictitious name. The registered representative told Silverman that he had opened the account in a name provided by the customer and that he had executed a transaction for his customer in that account. Silverman responded to this disclosure by telling the salesmen not to say anything further and that he did not want to know about it.

II. FINDINGS

Based upon the foregoing, we find that:

(a) Hanauer, Friedman, Frank, Palumbo, Tomasheski, Goodman and Wolfson willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

(b) Ehrlich willfully violated Section 17(a) of the Securities Act;

(c) Hanauer willfully violated and Friedman, Glucksman, Frank, Jacobson, Marcus, Palumbo, Tomasheski, Goodman, Wolfson, Appelbaum, Stein, Altman, Heller, Cohen, Cookler and Tessler willfully aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder;

(d) Hanauer willfully violated and Friedman, Frank, Palumbo, Tomasheski, Goodman and Wolfson willfully aided and abetted violations of Section 15(c)(1) of the Exchange Act and Rule 15c1-2 thereunder;

(e) Hanauer willfully violated and Friedman, Glucksman, Frank, Jacobson, Marcus, Palumbo, Tomasheski, Goodman, Wolfson, Appelbaum, Stein, Altman, Heller, Cohen, Cookler and Tessler willfully aided and abetted violations of Rules G-8, G-15 and G-26 of the MSRB and Section 15B(c)(1) of the Exchange Act; and

(f) Hanauer, Friedman, Glucksman, Frank, Jacobson, Marcus and Silverman failed reasonably to supervise, with a view to preventing the foregoing violations, persons who committed such violations while subject to their supervision.

III. OFFERS OF SETTLEMENT

The Respondents have submitted offers of Settlement in which, without admitting or denying the findings herein, they consent to the issuance of this Order containing the Findings and remedial sanctions set forth herein.

IV. ORDER

In view of the foregoing, the Commission deems it appropriate and in the public interest that administrative proceedings pursuant to Sections 15(b)(4) and (6) and 19(h) of the Exchange Act be instituted.

Accordingly, IT IS HEREBY ORDERED that proceedings pursuant to Sections 15(b)(4) and (6) and 19(h) of the Exchange Act be and they are hereby instituted and that the Respondents' Offers of Settlement are accepted.

IT IS FURTHER ORDERED that the registration of Hanauer as a broker-dealer be, and it hereby is, suspended for a period of one hundred twenty (120) days; PROVIDED HOWEVER, that during the period of the suspension ordered herein, Hanauer shall be permitted to engage in the following activities and only those activities: government or municipal bond dealer, mutual fund underwriter or sponsor, mutual fund retailer, solicitor of savings and loan accounts, and broker or dealer selling oil and gas interests;

IT IS FURTHER ORDERED that Hanauer comply with its undertakings in its Offer of Settlement to adopt, implement and maintain the following procedure, policies and controls by March 1, 1982:

A. To require independent periodic review of all new accounts by a senior officer of Hanauer other than the approving municipal securities principal;

B. To designate an officer of the firm who, for a period of two years, will contact, in person or by telephone, each person for whom a new customer account is opened and verify the information obtained by the Hanauer registered representative who opened the account and certify in writing to the Compliance Officer that to the best of his knowledge the information contained on the new account form is accurate and complete.

C. To provide to each customer written notification within five days after the time of opening the account or, in the case of existing accounts for a period of 18 months, within five days after the execution of the next securities transaction following entry of this Order, that the rules of the Securities and Exchange Commission and the Municipal Securities Rulemaking Board require Hanauer to give or send to each customer a written confirmation of each transaction containing specified information;

D. To establish, implement and maintain policies and procedures restricting access to blank customer confirmations to firm personnel not engaged in sales (other than Branch managers) to cause all customer confirmations to be delivered to customers by mail, and to prohibit physical delivery of confirmations by firm personnel, except after obtaining written authorization to do so from Hanauer's President or Compliance Officer;

E. To restrict access to blank confirmations to Branch Managers, compliance personnel and personnel responsible for preparation of confirmations;

F. To appoint a person who will devote substantially all of his working time at Hanauer to compliance and related recordkeeping and administrative work;

G. To establish, implement and maintain a policy and procedure requiring the notification and written approval of one or more designated senior officers of the firm prior to the execution of a municipal securities transaction in which the registered representative knows or has reason to believe that payment is to be made in currency in an amount in excess of $5,000;

H. To establish, implement and maintain a policy and procedure that all currency received from customers in payment for municipal securities is to be given to the senior officer approving the transaction who shall verify the amount received and who shall deliver the currency to Hanauer's Treasurer, Cashier, Assistant Cashiers, or Compliance Officer. At the time that currency in an amount in excess of $10,000 is delivered to the senior officer approving the transaction the responsible registered representative shall provide in writing the information required by Internal Revenue Service Form 4789;

I. To identify currency as the form of payment with respect to customer purchase transactions paid for with currency on all records required to be made and kept including the blotter, credit memoranda and the customer account ledger;

J. To restrict access to deposit tickets for Hanauer's bank accounts to Hanauer's Branch Managers, Treasurer, Cashier, Assistant Cashiers and Compliance Officer;

K. To establish and implement a policy that currency received by Hanauer in payment for municipal Securities shall be prepared for deposit to Hanauer's bank accounts only by Hanauer's Cashier or Assistant Cashiers or Compliance Officer and that such person shall initial each deposit ticket prepared by him;

L. To designate senior officers to prepare, file and maintain copies of, in Hanauer records, Currency Transaction Reports on Form 4789 or other prescribed form to the extent, at the time and for the time required by applicable law;

M. To designate a senior officer, for a period of one year from the date of entry of this Order, to review and initial all orders relating to the purchase, sale or redemption of municipal securities executed by employees of Hanauer named as Respondents in this Order;

N. Not later than one month after the date of this Order, to contribute a sum equal to the amount of all overcharges specifically alleged by the Commission in the Findings and Order to have occurred to the United States Treasury;

O. Not later than seven months after the date of the entry of this Order, to contribute to the United States Treasury an amount equal to that portion of Hanauer's net income after taxes for the four calendar months next after the date of the entry of this Order which is attributable to new customers, namely those customer accounts not listed as customer accounts on Hanauer's customer account ledger as of the first day of the month immediately following the date of the entry of this Order;

P. To retain an independent public accounting firm, other than the accounting firm which performed the most recent audit of Hanauer's financial statements, to conduct a special audit to confirm the existence and identity of each customer account of Hanauer, as of March 31, 1982, and to verify the customers' addresses indicated on Hanauer's records as the actual residence or principal business address. Such audit is to be completed by June 30, 1982. The independent public accounting firm will prepare a report of the audit and Hanauer will furnish a copy of the report to the Commission; and

Q. To permit the Commission to conduct such special examinations as are necessary to ensure compliance by Hanauer with the terms of this Order.

IT IS FURTHER ORDERED that Frank shall not become associated with any broker, dealer or municipal securities dealer without first obtaining the prior written permission of the Commission.

IT IS FURTHER ORDERED that Friedman shall not become associated with any broker, dealer or municipal securities dealer without first obtaining the prior written permission of the Commission.

IT IS FURTHER ORDERED that Palumbo be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of one hundred and twenty days commencing on March 1, 1982, and he shall not act in a supervisory capacity for a period of three years without the prior written permission of the Commission; PROVIDED HOWEVER that an order shall be entered barring Palumbo from being associated with any broker, dealer or municipal securities dealer, to which Palumbo consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, that he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act, the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board.

IT IS FURTHER ORDERED that Goodman be, and he hereby is, suspended from being associated with any broker, dealer, or municipal securities dealer, for a period of one year commencing on March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Goodman from being associated with any

broker, dealer or municipal securities dealer, to which Goodman consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act, the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board.

IT IS FURTHER ORDERED that Jacobson be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of one hundred and twenty days commencing on May 1, 1982, and shall not, except after first obtaining the written permission of the Commission, assume responsibility for or supervise the person or persons at Hanauer who are charged with the responsibility for compliance by Hanauer or its employees with the requirements of the Federal securities laws, or the rules and regulations of the National Association of Securities Dealers, Inc. or the Municipal Securities Rulemaking Board.

IT IS FURTHER ORDERED that Marcus be, and he hereby is, suspended from being associated with any broker, dealer, or municipal securities dealer, for a period of ninety days commencing on September 1, 1982, and shall not, except after first obtaining the written permission of the Commission, assume the responsibility for or supervise the person or person at Hanauer who are charged with the responsibility for compliance by Hanauer or its employees with the requirements of the Federal securities laws, or the rules and regulations of the National Association of Securities Dealers, Inc. or the Municipal Securities Rulemaking Board.

IT IS FURTHER ORDERED that Glucksman be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of sixty days commencing on March 1, 1982, and shall not, except after first obtaining written permission of the Commission, assume the responsibility for or supervise the person or persons at Hanauer who are charged with the responsibility for compliance by Hanauer or its employees with the requirements of the Federal securities laws, or the rules and regulations of the National Association of Securities Dealers, Inc. or the Municipal Securities Rulemaking Board.

IT IS FURTHER ORDERED that Erhlich be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of sixty days commencing on March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Erhlich from being associated with any broker, dealer or municipal securities dealer, to which Erhlich consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act, the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board;

IT IS FURTHER ORDERED that Stein be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of sixty days commencing on March 1, 1982;

IT IS FURTHER ORDERED that Wolfson be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities for a period of forty-five days commencing March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Wolfson from being associated with any broker, dealer or municipal securities dealer, to which Wolfson consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act, the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board;

IT IS FURTHER ORDERED that Tomasheski be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of forty-five days commencing on March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Tomasheski from being associated

with any broker, dealer or municipal securities dealer, to which Tomasheski consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or has willfully aided and abetted the violation of any provision of the Securities Act, the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board;

IT IS FURTHER ORDERED that Cookler be, and he hereby is, suspended from being associated with any broker, dealer, or municipal securities dealer, for a period of forty-five days commencing March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Cookler from being associated with any broker, dealer or municipal securities dealer, to which Cookler consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act or the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board;

IT IS FURTHER ORDERED that Altman be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of forty-five days commencing on March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Altman from being associated with any broker, dealer or municipal securities dealer, to which Altman consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act, the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board;

IT IS FURTHER ORDERED that Heller be, and he hereby is, suspended from being associated with any broker, dealer, or municipal securities dealer, for a period of forty-five days commencing on March 1, 1982; PROVIDED HOWEVER that an order shall be entered barring Heller from being associated with any broker, dealer or municipal securities dealer, to which Heller consents in his offer of settlement submitted herein, upon any finding by the Commission that, after the entry of the Order herein, he has willfully violated or willfully aided and abetted the violation of any provision of the Securities Act or the Exchange Act or rules promulgated thereunder or the rules of the Municipal Securities Rulemaking Board;

IT IS FURTHER ORDERED that Cohen be, and he hereby is, suspended from being associated with any broker, dealer or municipal securities dealer for a period of twenty days commencing on March 1, 1982;

IT IS FURTHER ORDERED that Tessler be, and he hereby is, censured;

IT IS FURTHER ORDERED that Silverman be, and he hereby is, censured; and

IT IS FURTHER ORDERED that Appelbaum be, and he hereby is, censured.

By the Commission.

In re Richard C. Flick, Exchange Act Release No. 13777 (July 20, 1977).

The Securities and Exchange Commission has ordered public administrative proceedings under the Securities Exchange Act of 1934, as amended ("Exchange Act"), against Richard C. Flick of Memphis, Tennessee.

The proceedings are based upon allegations of the Commission's staff that Flick has violated the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 in the offer and sale of municipal bonds, and the fact that Flick has been enjoined from further violations of these sections of the

securities laws in the case of SEC v. Shelby Bond Service Corporation, et al., which was brought in Memphis, Tennessee.

A hearing will be scheduled by further order to take evidence on the staff allegations and to afford the respondent an opportunity to offer any defenses thereto, for the purpose of determining whether the allegations are true and, if so, whether any action of a remedial nature is necessary or appropriate in the public interest.

In re Richard C. Flick, Exchange Act Release No. 14629, A.P. File No. 3-5256 (April 3, 1978).

In these broker-dealer proceedings instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 n1 ("Exchange Act") Richard C. Flick ("Flick") has submitted an Offer of Settlement, without admitting or denying the allegations contained in the Order for Public Proceedings, which the Commission has determined to accept.

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n1 In the Matter of Richard C. Flick, instituted June 28, 1977.

On the basis of the Order for Public Proceedings and the Offer of Settlement, it is found that Flick willfully violated, and was permanently enjoined by consent from further violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in connection with the offer and sale of municipal securities as alleged in the Order.

The Commission further finds that it is in the public interest to impose the sanctions specified in the Offer of Settlement.

ACCORDINGLY IT IS ORDERED that, effective the first Monday after the date of this order:

Flick be, and hereby is, suspended for a period of 150 days from association with any broker or dealer;

Flick be, and hereby is, barred from association with any broker or dealer in a supervisory capacity; provided, however, that he may apply to become associated with a broker or dealer in a supervisory capacity after the expiration of one year from the effective date of this order.

By the Commission, by its Secretary, pursuant to delegated authority.

In re First Mississippi Securities, Inc., et al., Exchange Act Release No. 13779 (July 20, 1977).

The Securities and Exchange Commission has ordered public administrative proceedings under the Securities Exchange Act of 1934, as amended, ("Exchange Act") against First Mississippi Securities, Inc. ("Registrant"), a Pearl, Mississippi, municipal securities broker-dealer, Ralph K. Hall, the president, treasurer, and a principal stockholder of Registrant, Larry K. Klos, the vice-president, secretary, and a principal stockholder of Registrant, and Sam Stalvey, a vice-president and salesman of Registrant.

The proceedings are based upon allegations of the Commission's staff that, during the period of February 10, 1977, to the present, Registrant, Hall, Klos, and Stalvey violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in the offer and sale of municipal bonds.

A hearing will be scheduled by further order to take evidence on the staff allegations and to afford the respondents an opportunity to offer any defenses thereto, for the purpose of determining whether the allegations are true and, if so, whether any action of a remedial nature is necessary or appropriate in the public interest.

<u>In re First Mississippi Securities, Inc., et al.</u>, Exchange Act Release No. 14230, A.P. File No. 3-5257 (December 5, 1977).

In these proceedings pursuant to the Securities Exchange Act of 1934 ("Exchange Act"), n1 First Mississippi Securities, Inc. ("Registrant"), Ralph K. Hall, Larry K. Klos, and Sam Stalvey have submitted an offer of settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and without admitting or denying the findings herein, respondents consent to the findings and sanctions set forth below.

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n1 In the Matter of First Mississippi Securities, Inc. instituted June 23, 1977.

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On the basis of the Order for Proceedings and the offer of Settlement, it is found that Registrant, Hall, Klos, and Stalvey willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondents make the following undertakings in connection with their Offer of Settlement:

(1) To refrain from publishing or otherwise disseminating to the general public any information or literature about the financial status of municipal securities or of a corporation or other entity being financed through the issuance of securities without first obtaining financial statements for the most recent period available, and any other information necessary in order to assure that the statements disseminated are accurate and complete;

(2) Hall, Klos, and Stalvey undertake to contact purchasers of certain municipal securities, make certain disclosures about the securities, and offer to rescind the transactions as set forth in the Amended Offer of Settlement; and

(3) Hall, Klos and Stalvey undertake to enroll in and successfully complete a course of continuing education for broker-dealers and securities salesmen.

In view of the foregoing, it is in the public interest to accept the offer of settlement by the Respondents and to impose the sanctions specified in the offer of settlement Settlement.

ACCORDINGLY, IT IS ORDERED that:

(1) The registration of First Mississippi Securities, Inc., be, and hereby is, suspended for a period of 20 calendar days, effective at the opening of business on the second Monday after the date of this Order;

(2) Ralph K. Hall, Larry K. Klos, and Sam Stalvey be, and hereby are, suspended from association with any broker or dealer for a period of 20 calendar days, effective at the opening of business on the second Monday after the date of this order, except as may be necessary to complete the undertakings contained in the offer of settlement and

(3) The Respondents comply with the undertakings set forth in the offer of settlement.

<u>In re James L. Cody, Inc., James L. Cody</u>, Exchange Act Release No. 10505, A.P. File No. 3-4389 (November 16, 1973).

In these proceedings pursuant to Sections 15(b) and 15A of the Securities Exchange Act, offers of settlement were submitted by James L. Cody, Inc. ("Cody Inc."), formerly a registered broker-dealer, n1 and James L. Cody, its president.

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n1 The firm's broker-dealer registration was withdrawn effective June 23, 1973.

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Solely for the purpose of these proceedings, and without admitting or denying the allegations in the order for proceedings, respondents consented to findings of misconduct as alleged in that order and to the imposition of certain remedial sanctions.

Upon the recommendation of its staff, the Commission determined to accept the offers of settlement. On the basis of the order for proceedings and the offers, it is found that: n2

1. During the period from about June 1, 1971 to March 31, 1973, Cody Inc., willfully aided and abetted by Cody, willfully violated Section 15(c) (3) of the Exchange Act and Rule 15c3-1 thereunder, in that Cody Inc. effected securities transactions when its aggregate indebtedness to all other persons exceeded 2,000 per centum of its net capital and it did not have and maintain net capital of not less than $5,000.

2. During the period from about September 15, 1971 to March 31, 1973, Cody Inc., willfully aided and abetted by Cody, willfully violated Section 17(a) of the Exchange Act and Rule 17a-11 thereunder in that Cody Inc. failed to file required reports concerning its net capital condition.

3. In connection with the offer, sale and purchase of certain municipal bonds during the period from about March 1, 1972 to March 31, 1973, respondents willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in that, among other things, they induced customers to purchase such bonds from or sell them to Cody Inc. at prices which were unreasonable in relation to Cody Inc.'s contemporaneous cost or to the prices at which other dealers were quoting them contemporaneously. In addition, respondents failed reasonably to supervise persons under their supervision with a view to preventing the above violations.

4. Cody Inc., willfully aided and abetted by Cody, willfully violated Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder by failing properly to file an amendment to Cody Inc.'s registration form reflecting the fact that a 50% stockholder of Cody Inc. was permanently enjoined on July 26, 1972 from violating certain provisions of the Exchange Act.

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n2 The findings herein are binding only upon the above-captioned respondents.

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The settlement offers provide that Cody Inc. and Cody may be barred from association with any broker-dealer, provided that after seven months Cody may apply to the Commission to become so associated upon showing that he will be adequately supervised.

In view of the foregoing, it is in the public interest to impose the specified sanctions.

Accordingly, IT IS ORDERED that James L. Cody, Inc. and James L. Cody be, and they hereby are, barred from association with any broker or dealer, provided, however, that after seven months from the date of this Order Cody may apply to the Commission to become associated with a broker-dealer upon showing that he will be adequately supervised.

For the Commission, by the Office of Opinions and Review, pursuant to delegated authority.

Administrative Law Judge Decision

In re Lawrence A. Luebbe, A.P. File No. 3-5175 (September 23, 1977).

BEFORE:

Max O. Regensteiner, Administrative Law Judge

TEXT: INITIAL DECISION

In these public proceedings instituted by the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and (f) of the Investment Advisers Act of 1940, the issues to be considered are (1) whether Lawrence A. Luebbe ("respondent") engaged in misconduct as alleged by the Division of Enforcement and (2) what if any remedial action is appropriate in the public interest in the light of an injunction which has been entered against respondent and such misconduct as may be found herein. n1

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n1 The order instituting the proceedings named three other respondents. The proceedings as to them have been disposed of on the basis of settlement offers accepted by the Commission and a default, respectively.

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The allegations as well as the injunction pertain to the offer and sale, during the period from July through October 1975, of general obligation bond anticipation notes issued by Reclamation District No. 2090, a California public agency. Respondent, who was then president of a registered broker-dealer, is charged with willfully violating and willfully aiding and abetting violations of antifraud provisions of the securities laws by recommending and selling such notes without having made a reasonable and diligent inquiry into the District's financial condition and in disregard of information regarding such condition and by making false and misleading statements concerning specified matters. On November 9, 1976, respondent was permanently enjoined, with his consent, from violating antifraud provisions in the offer or sale of the notes or any other security. n2

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n2 S.E.C. v. Reclamation District No. 2090, Civil Action No. C-76-1231 RHS (N.D. Cal.). Respondent neither admitted nor denied the allegations of the complaint.

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Following hearings, at which respondent represented himself, the parties filed proposed findings and conclusions and supporting briefs, and the Division filed a reply brief.

The findings and conclusions herein are based on the record and on observation of the witnesses' demeanor. Clear and convincing evidence is the standard of proof applied. n3

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n3 The Commission has traditionally employed the "preponderance of the evidence" standard of proof. However, in its recent decision in Collins Securities Corporation v. S.E.C., C.A.D.C., August 12, 1977, the Court held that at least in cases involving alleged fraud and potentially severe sanctions, the higher "clear and convincing evidence" standard must be met. In the instant case, where there are no factual disputes of substance, the application of either standard yields the same results.

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The Respondent

Respondent, who is 56 years old, has worked in the securities business since 1959, for the last 16 years on a full-time basis. After serving as branch manager of a broker-dealer for several years, he founded his own firm, MFAI Associates, in 1966 and has at all times been its president and sole shareholder. MFAI was registered as a broker-dealer from 1966 until the end of 1976, when it withdrew its registration. At the present time, MFAI is a "division" of another registered broker-dealer. The office out of which respondent operates is in his home, and his wife is the office supervisor.

Respondent was also for a number of years president and a director of a registered investment company. He was forced to resign from those positions in late 1976 because of the injunction against him. In addition, he has been secretary and a director of the investment company's management company and principal underwriter, which is registered both as an investment adviser and broker-dealer. n4

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n4 Respondent, who was also a shareholder of that company, states in his proposed findings that its ownership has recently been sold, but does not indicate whether he is still an officer or director. Section 9(a) of the Investment Company Act would appear to preclude such affiliation because of the injunction to the same extent it compelled him to resign his positions with the investment company.

The District

The District, which was apparently created in 1955, n5 encompasses about 983 acres in the Sacramento River Delta, some 55 miles east of San Francisco. It was formed by the owners of that land, pursuant to California's Water Code, with a view to raising funds for and engaging in reclamation and other projects. As of 1975, the District itself owned all but about 200 acres of the land within its boundaries. Thus, while it had the power to assess taxes on privately-owned land, its tax base was negligible.

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n5 The information in the record concerning the District's history, operations and management is rather skimpy.

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In January 1975, the District authorized the issuance of $50 million in bond anticipation notes. As its name indicates, a bond anticipation note is a short-term note issued in anticipation of a bond issue. Such notes are normally retired with the proceeds of the bond issue. Alternatively, the bonds may be offered to the noteholders in exchange for the notes. The District's notes, which carried interest at the rate of eight percent, were payable on April 1, 1976. By their terms, stated on the face of the notes, they were secured by revenues to be received or accrued by the District during the fiscal year ended June 30, 1975 and were to be paid from the proceeds of bonds to be issued by the District in accordance with an offer to purchase the bonds on file with the District's secretary. The notes further stated that notwithstanding the specified provisions for payment, they constituted a general obligation of the District and to the extent not paid from revenues or bonds would be paid from other available monies. n6

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n6 The opinion of bond counsel attached to each note stated the basis for payment somewhat differently. It stated that the notes were payable out of revenues to be received or accrued by the District during its 1975 fiscal year, "and more specifically" from the proceeds of bonds for whose purchase the District had a commitment, and that if "such revenues" were insufficient, the notes were payable from all available monies and constituted general obligations for which the District's full faith and credit was pledged.

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It appears that out of the $50 million in notes which were authorized, only $5 million was actually issued. Those notes were issued to one James Dondich in exchange for property in Colombia, South America. About $1.22 million of the notes were sold to public investors. Dondich sold $400,000 face amount of notes at substantial discounts to National Municipal Bond Company ("National"), a municipal securities

dealer of which one Roger Osness was a principal. National, which as a dealer exclusively in municipal securities was at that time not subject to registration under the Exchange Act, n7 in turn marketed $55,000 of the notes through MFAI. n8 In or about May 1975, the District also authorized the issuance of $1 million in general obligation negotiable promissory notes; these were subsequently sold, apparently to public investors.

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n7 The provisions of the Securities Acts Amendments of 1975 requiring the registration of broker-dealers dealing in municipal securities did not become effective until December 1, 1975.

n8 The record does not indicate how the balance of the $1.22 million face amount of the notes reached public investors.

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The financial reports of the District to the State Controller for the fiscal years ended June 30, 1974 and 1975 (the latter filed on August 1, 1975) and its certified financial statements for the 1974 fiscal year showed, among other things, that the District had no revenues from taxes or assessments in either year; that in the earlier year, its total revenues were about $437,000, consisting almost entirely of a non-recurring prepaid rental item, and net revenues over expenditures amounted to about $174,000; and that in fiscal 1975 revenues totalled only about $43,000 and the District lost over $154,000 on operations.

When the notes and interest thereon became due in April 1976, the District defaulted. And the bond issue referred to in the notes never materialized. In June 1976, the District filed a petition under Chapter IX of the Bankruptcy Act, n9 alleging that it was unable to pay its debts as they matured. For reasons which do not appear in the record, the petition was dismissed in April 1977. n10

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n9 Chapter IX provides for the adjustment of debts of political subdivisions and public agencies.

n10 According to the Division's reply brief, on June 26, 1977 the Court reopened the Chapter IX proceeding upon the District's petition.

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Violations in Sale of Notes

During the period from July 10 to October 28, 1975, MFAI sold bond anticipation notes in the total amount of $55,000 to eight customers. Respondent personally sold notes totalling $20,000 to three customers during July. He knew that those persons were principally concerned with the safety of their investments. Yet he recommended these securities to them despite the fact that he had little information of a reliable nature about the District and in particular had no reliable financial data.

Two of respondent's customers testified at the hearing. Their testimony, which is undisputed, is credited. One of them advised respondent that he planned to retire in two years from his job as proofreader, had a maximum of $5,000 to invest, and wanted an investment that was secure. Respondent recommended a $5,000 note to him and stressed that it was a safe investment. The customer thereupon purchased the note. The other investor-witness and her husband, who together also invested $5,000 in a note, are both employed by the U.S. Postal Service, she as a clerk and he as a carrier. She testified that they advised respondent they were interested in investing for their retirement and needed a secure investment. Respondent assured them the note was a good and safe investment. MFAI distributed to these customers and to others a flyer, under National's name, which contained some general information about the notes, but none about the District. The contents of the flyer are described in more detail below. As of the time of the hearing in April 1977, more than a year beyond the maturity date of the notes, the investors had not received any payment of interest or principal.

Such information as respondent had concerning the District came almost entirely from National and Osness. The latter had made a "cold" call on MFAI in late 1974 to interest that firm in selling municipal securities distributed by National. Discussions culminated in a contract between National and MFAI in December 1974 under which the latter would sell municipal bonds made available to it by National in return for an eight percent commission. Notwithstanding the extent of his reliance on Osness, respondent did not inquire into Osness's experience with the securities regulatory agencies and thus was not aware that Osness had been sanctioned by the Commission. n11

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n11 In 1973 Osness, who had been an officer of a registered broker-dealer, was barred by the Commission from association with any broker-dealer, provided that after seven months he could apply for re-entry into the securities business in a supervised capacity on condition that he would handle only certain types of securities. Securities Exchange Act Release No. 10263 (July 3, 1973), 2 SEC Docket No. 3, p. 88. The Commission's order was based on a settlement offer submitted by Osness. In those proceedings, Osness was charged, among other things, with violations of antifraud provisions of the securities laws.

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While National made several municipal securities available to MFAI, the latter offered only two to its customers: an industrial revenue bond and the District notes. In the case of the revenue bonds, respondent arranged through Osness to have sales cancelled and money refunded to MFAI customers who had bought the bonds, when respondent ascertained that as a result of weather-related problems there would be a delay in moving the industrial enterprise in question into the municipally-owned facility.

With respect to the District notes, Osness and an associate furnished respondent with three items of written information. One was a specimen copy of the note. The second item, which was furnished in quantity and as noted was distributed by MFAI to prospective purchasers, was the above-mentioned flyer. It stated that the notes were tax-exempt, were due on April 1, 1976, and were to be redeemed by full payment plus accrued interest or by the issuance of ten-year general obligation bonds bearing eight percent interest. It listed the name and address of the District's counsel, and it stated that the offering was subject to approval of legality by named bond counsel and that only $5 million of notes, out of the total $50 million issue, had been issued. The balance of the flyer consisted of a reproduction of the text on the face of the note. Thus, as noted by the Division, the flyer said nothing about the District's financial condition or tax base, the background of its management, its existing debt structure or other matters of a material nature.

The final item which National provided to respondent was a one-page sheet entitled "Background Information." Osness informed respondent that this sheet had not been cleared for customer use. The sheet stated, among other things, that the District was engaged primarily in developing innovative concepts of aquaculture which were receiving world-wide attention and secondarily in developing recreational and educational facilities.

Prior to the time MFAI began to sell the notes, Osness, in answer to respondent's questions, orally gave him certain additional information concerning the District. Some of the information pertained to the District's present and proposed operations and the identity of its management. The financial information conveyed was, in respondent's words, "only general." Osness told respondent that the District's books, which he said he had seen, showed that its assets exceeded $100 million, including a substantial interest in land in South America, and its liabilities were less than $10 million. When respondent asked Osness to get him copies of "this," Osness said he would attempt to do so, but respondent received no copies before the sales began. Later Osness advised respondent that he had received "additional statements, the written ones," but that District officials had asked him not to divulge those and had indicated they would give them to respondent directly. Osness said that, pursuant to respondent's request, he would arrange for a visit by respondent to the District and see to it that respondent received financial statements at that time. As it happened, respondent did not see the District until about October 1976. Beginning in early July 1975, respondent had some telephone conversations with the District's general manager concerning a

visit. The latter at first promised to arrange for a prompt visit, but thereafter interposed a series of delays. Respondent obtained no written financial data until August 1976, when Osness furnished him with unaudited material purportedly emanating from the District.

At or about the time MFAI began selling the notes, respondent also contacted the District's counsel and bond counsel. The record does not indicate the nature of his discussions with the latter. Respondent asked district counsel whether the District had financial problems, and the latter responded that any organization can have financial problems. Counsel also informed respondent that the District was having problems with the county in which it was located regarding the intended land use, but further stated that "if that didn't work out they had alternate methods of operation." (Tr. 232) Respondent did not ask counsel how much money the District had made in the past year.

The crux of the case against respondent is that he recommended the District notes to his customers, caused MFAI salesmen to recommend them to their customers and assured customers these were safe investments even though he had failed to make a diligent and reasonable inquiry into the material facts concerning the District, in particular its financial condition, and thus had no adequate basis for such recommendations and representations. As the Court of Appeals for the Second Circuit pointed out in an oft-quoted statement, a securities salesman

". . . cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation." n12

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n12 *Hanly v. S.E.C., 415 F.2d 589, 597* (C.A. 2, 1969).

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While there may be significant differences under the securities laws in the treatment to be accorded transactions in municipal as distinguished from corporate securities, n12a the Commission made clear many years ago that the duty of diligent inquiry encompasses dealers who recommend the purchase of municipal securities to their customers. n13 That duty is particularly apparent and important where the issuing agency is as obscure as the one involved here.

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n12a See, e.g., Doty and Peterson, The Federal Securities Laws and Transactions in Municipal Securities, 71 Northwestern University Law Review 283 (1976).

n13 *Walston & Co., Inc., 43 S.E.C. 508 (1967).*

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In one of its recent decisions, the Commission, dealing with a situation closely analagous to that presented here, said:

"A professional who recommends the unknown securities of obscure issuers is under a duty to investigate and to see to it that his recommendations have a reasonable basis. In prior cases we pointed out that a salesman cannot recommend the equity securities of such issuers without reliable financial data. This proposition is even more compelling when we deal, as here, with debt securities." (Footnotes omitted) n14

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n14 *Willard G. Berge, Securities Exchange Act Release No. 12846 (September 30, 1976), 10 S.E.C. Docket 600, 602.*

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Addressing itself to the contention of respondents in that case that they properly relied on the advice of the presidents of their respective broker-dealer firms that the issuer's financial condition was satisfactory, the Commission went on to state:

". . . oral assurances . . . could not be used as a substitute for the concrete financial data called for in situations such as this . . . no salesman can recommend an unknown or little known security unless he has himself seen reliable financial data that supply him with a reasonable basis for his recommendation. This is especially true of debt securities. Having no current financial data, respondents could not possibly have had an adequate basis for recommending [the] notes." (Footnote omitted) n15

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n15 Ibid.

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Respondent contends that at the time he began to sell the notes, he did have financial information concerning the District, in the form of Osness's statements regarding the District's assets and liabilities. He urges that it was only a technicality that he did not have at that time copies of the written financial material on which those statements were based, and that when he received such material in August 1976 it bore out the accuracy of Osness's statements. These arguments are without merit. Even aside from the propriety of respondent's almost exclusive reliance for information on National and Osness, about whom he knew very little, n16 oral information regarding an issuer's financial situation is, as noted above, not a substitute for review of reliable written financial data. Indeed, respondent's inability to obtain such data should have served as a "red flag." Moreover, the oral information which respondent received from Osness amounted at best to the bottom lines of a balance sheet. It revealed nothing concerning the District's revenues, income (or loss) from operations, or its tax base. Respondent's assertion that in the case of a general obligation note or bond, the public agency's total assets, not only its taxing capacities, are subject to the security holders' claims appears to be unfounded. n17 Moreover, the little information which respondent had concerning the District's assets should have served as a "red flag" rather than satisfying him that the notes represented sound investments for his customers. Osness told him that the District had substantial land holdings in South America. The nature of this purported asset should have raised questions in respondent's mind regarding the legitimacy of the District's operations or at least the quality of its management. n18

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n16 See *Cortlandt Investing Corporation, 44 S.E.C. 45, 51 (1969):*

"While in an appropriate case an employee may be entitled to rely upon his own employer for information respecting a security he undertakes to sell, a higher standard of care is required of those engaged in the securities business who would place reliance upon market letters or other materials or information respecting a security which was prepared or supplied by another broker-dealer."

n17 The District's notes by their terms subjected only the District's "available monies," not its assets, to the claims of noteholders.

n18 The Division maintains that the District never obtained title to the South American property. There is no evidence in the record to that effect. The record does, however, raise serious questions as to the legitimacy and value of this asset. According to the financial data which Osness furnished to respondent in August 1976, the District's total assets at June 30, 1975 were almost $108 million, including a 350,000-acre ranch in Colombia valued at $ 96 million. A footnote to the list of assets stated, however, that the ranch was "not listed in capital assets on accountant's report as it was not recorded as of June 30, 1975," but that it would be included in the 1976 accounting period. The financial report for fiscal 1975 filed by the District with the State of California showed total assets at June 30, 1975 of only $3.4 million, including land carried at $927,321. Among the obvious questions which come to mind are: why would

Dondich exchange land with a $96 million value for $5 million in notes? And why would a California reclamation district want to own land in far-away South America?

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Respondent also argues that at the time MFAI began to sell the notes, it was not yet possible to get a current audited financial report for the District since the District's fiscal year had ended only a short time before then. The argument misses the point, which is that it was respondent's obligation not to offer or sell the notes in the absence of reliable financial information.

The fact that under the terms of the notes they were payable from the proceeds of bonds to be issued by the District does not affect the conclusions expressed above. n19 The District's financial condition and particularly its ability to service any bonds issued were of course critical to its ability to sell a bond issue. Respondent had no reliable information bearing on these basic matters.

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n19 The flyer, somewhat inconsistently with the terms of the notes, stated that the notes were to be redeemed by full payment plus accrued interest from the date of purchase or by the issuance of ten-year general obligation bonds.

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The order for proceedings alleges, and the Division contends, that respondent, in addition to his failure to make a diligent investigation, made false and misleading statements of material facts. Aside from stressing the safety of the investment, respondent said little to his customers about the District or its notes. He did, however, distribute the flyer. And that contained some materially misleading statements. n20 In particular, it was misleading to state that the notes were secured by revenues to be received or accrued during the 1975 fiscal year when, at the time MFAI and respondent sold the notes, that year had already been completed and the District had had only minimal revenues and had lost over $150,000 on its operations. Further, the representation that the notes, as general obligations of the District, would be paid from any other available monies if not paid from revenues or bonds, was misleading in the absence of disclosure concerning the District's financial condition and its negligible tax base.

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n20 Certain of the alleged misrepresentations are not clearly established by the record which contains little or no information about such matters as the District's operations and the reason why the proposed issue of general obligation bonds never materialized.

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Based on the above findings, it is concluded that respondent willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. n21

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n21 The term "willfully" within the meaning of Section 15(b) of the Exchange Act and Section 203(f) of the Investment Advisers Act means intentionally committing the acts which constitute the violations. It does not require an awareness that the law is being violated. See *Tager v. S.E.C., 344 F.2d 5, 8* (C.A. 2, 1965); *Lipper v. S.E.C., 547 F.2d 171, 180* (C.A. 2, 1976); *Roman S. Gorski, 43 S.E.C. 618, 621 (1967).*

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Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest. The Division, stressing the seriousness of respondent's misconduct and his "misbegotten notion" of his responsibilities to customers as reflected in his testimony, recommends that he be barred from association with any broker-dealer, with the proviso that after one year he be permitted to return to the securities business in a non-supervisory capacity upon a showing of adequate supervision. n22 For the reasons

discussed below, I conclude that a somewhat less stringent and more discriminating sanction will adequately protect the public interest.

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n22 The Division's proposed sanction would also bar respondent from association with a municipal securities dealer. Such a sanction cannot be imposed in these proceedings, however, since the order for proceedings did not encompass Section 15B of the Exchange Act relating to municipal securities dealers. The Division did not recommend the imposition of any sanctions under the Investment Advisers Act.

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Both the Division and respondent place some emphasis on respondent's actions in connection with termination of MFAI's sales of the notes and subsequent thereto. As indicated previously, MFAI's last sale of District notes took place on October 28, 1975. The Division asserts that the termination of sales was due to the fact that National went out of business in November 1975. However, I credit respondent's testimony that it was attributable rather to his increasing concern about the legitimacy of the District's operations. That concern was fueled by the fact that the visit to the District which had been promised him and the related furnishing of financial statements to him were continually put off. The final straw was that respondent was advised that the District's general manager was away on an extended trip and that no one else at the District could answer his questions. In early November 1975, respondent wrote to both the county attorney's office and the state attorney general's office seeking information about the District. In addition, he contacted the Commission's San Francisco office to express his concern.

Respondent's recognition, albeit belated, that sales should not continue, and his communications to the authorities, are entitled to some consideration as mitigating factors. On the other hand, that effect is largely dissipated by respondent's failure to advise the customers who had purchased the notes of the fact that he had terminated sales because of his serious concern about the District. Moreover, his communications to those persons after the District had already defaulted on its obligations smack of obfuscation, to put the best face on them. In early April 1976 he requested certain information from each customer on behalf of the District and added that "on receipt of this information from you, the District should be sending your interest payments and the anticipated 10-year General Obligation Bond." When he wrote this, respondent knew that the District was in default. And he had no basis, except apparently a further representation by Osness, for making such a statement. Respondent's argument that he was merely advising the customers of the District's obligations under the terms of the notes and not that it "would" take the indicated action can only be characterized as disingenuous. Moreover, even if the communications could be read that way, they would still have been misleading since there was no disclosure that respondent had no reasonable basis for believing that the District could or would belatedly comply with its obligations.

The concern expressed by the Division regarding respondent's understanding of his responsibilities to customers in connection with the recommendation of securities seems well founded. Even today, respondent continues to insist that he had an adequate basis for recommending the notes. And he testified that he had not considered making restitution to the note-purchasers, because "these were the risks involved in securities." (Tr. 331) Respondent went on to explain that if he reimbursed those customers, he would also have to reimburse others whose investments had declined in value. These statements reflect a fundamental misconception of the principles involved here. While every securities investor assumes the risk of a decline in the value of his investment, the securities laws were designed in part to relieve him of the risk that his broker would recommend an investment without a reasonable basis for doing so.

Finally, in the assessment of the action that is appropriate and necessary in the public interest and for the protection of investors, certain factors that weigh in respondent's favor need to be considered. Thus, his actions to make customers whole in connection with the revenue bonds were commendable. Moreover, in his 18 years in the securities business, during which his experience has been confined largely to the retail sale of mutual fund shares, he has not been the subject of any other disciplinary action. The rather impressive character testimony presented in his behalf is also entitled to some consideration. Giving due

regard to all pertinent facts and circumstances, I conclude that a relatively brief suspension of respondent from the mutual fund business, coupled with exclusion for at least nine months from other areas of the securities business, will appropriately protect the public interest from future harm. n23

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n23 Cf. *Bruce W. Zimmerman, Securities Exchange Act Release No. 12690 (August 5, 1976), 10 SEC Docket 175,* rehearing denied, *Securities Exchange Act Release No. 12790 (September 13, 1976), 10 SEC Docket 458.*

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Accordingly, IT IS ORDERED that Lawrence A. Luebbe is hereby barred from being associated with a broker or dealer, provided that

(1) After three months he may become so associated for the sole purpose of engaging in the offer and sale at retail of redeemable securities issued by investment companies registered under the Investment Company Act of 1940; and

(2) After nine months he may apply to the Commission for permission to become so associated on a basis not so restricted, but only in a non-supervisory position and upon a showing of adequate supervision. n24

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n24 All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision they are accepted.

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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(a) 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.

FAILURE TO SUPERVISE

Administrative Proceedings - Commission Decisions

In re Sheldon, et al., Exchange Act Release No. 31475, A.P. File No. 3-6626 (November 18, 1992).

See "SALES PRACTICES" section.

In re Boettcher and Company, Exchange Act Release No. 8393, A.P. File No. 3-544 (August 30, 1968).

See "THE UNDERWRITER" section.

Commission Orders - Settled Administrative Proceedings

<u>In re Brian M. Cohen</u>, Exchange Act Release No. 40450, A.P. File No. 3-9708 (September 18, 1998).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to institute public administrative proceedings pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent Brian M. Cohen ("Cohen" or "Respondent").

II.

In anticipation of the institution of these proceedings, Cohen has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of this proceeding, and except as to paragraphs III.A. and III.B. below, which are admitted, Respondent Cohen, by his Offer, consents to the entry of findings and remedial sanctions set forth below.

Accordingly, it is ordered that proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act be, and, they hereby are, instituted.

III.

On the basis of this Order Instituting Administrative Proceedings Pursuant To Sections 15(b) and 19(h) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions ("Order") and Respondent's Offer, the Commission finds n1 that:

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n1 The findings contained in the Order are not binding on any other person or entity in this or any other proceeding.

- - - - - - - - - - - - - - - - -END FOOTNOTES- - - - - - - - - - - - - - - - -

A. First Montauk Securities Corp. ("First Montauk") is, and at all relevant times was, a broker-dealer registered with the Commission, with approximately 125 branch offices and 75 offices of supervisory jurisdiction.

B. Cohen at all relevant times was a registered principal of First Montauk in its main office in Red Bank, New Jersey. Cohen is a resident of Tom's River, New Jersey.

C. First Montauk's Houston office was opened by certain individuals with prior experience trading government securities (hereafter the "Houston traders") in October 1990. The Houston office was established to sell fixed-income products, primarily REMICs and other mortgage-backed securities, to institutional clients. Prior to the opening of the Houston office, fixed-income products were a minor part of the First Montauk's business, and the firm had relatively few institutional clients. By opening the Houston branch to sell REMICs and other mortgage-backed securities, First Montauk was expanding into an area in which the firm previously had very limited experience. The Houston office was one of only three First Montauk branches that was allowed to execute their own trades. This distinct trading activity required stringent home office supervision, but First Montauk did not have procedures in place to review the Houston office's trading activity.

D. Cohen, at all relevant times a principal in First Montauk's main office in New Jersey, by reason of his greater experience in mortgage-backed securities, was delegated responsibility for supervising certain of the Houston office's operations, including the branch's trading activity.

E. At all relevant times, the Houston office had the authority to execute riskless principal transactions. The procedure required the Houston traders, who directed the Houston office's activities, to arrange and confirm both sides of each transaction, and then call the details directly in to Cohen in New Jersey. Cohen then would write an order ticket for each transaction, and provide that information to First Montauk's clearing firm.

Parking, Excessive Markups and Net Capital and Books and Records Violations

F. First Montauk did not allow the Houston office to hold positions in securities unless they received approval from the main office. In order to circumvent Respondent First Montauk's restriction on holding positions, the Houston traders engaged in a parking scheme which enabled them to purchase bonds and secretly hold them "off their books," while still maintaining control of the securities. From October 1992 through March 1994, the Houston traders parked government agency securities on at least seventeen occasions, including every month from March 1993 through March 1994.

G. The parking scheme was conceived and carried out by the Houston traders in the following manner. Whenever the Houston traders wanted to park securities, they entered into an arrangement with two other broker dealers (Dealers One and Two) whereby First Montauk would sell the bonds to Dealer One for settlement that month. Dealer One would then sell the bonds to Dealer Two for a fraction higher than it had purchased them from First Montauk. The Houston traders then caused First Montauk to repurchase the bonds from Dealer Two for settlement the next month, with Dealer Two earning a small profit on the transaction. The Houston traders used the time between settlement dates to find a customer for the bonds. The parking scheme essentially allowed the Houston traders an extra month to find a customer for securities over which they maintained control.

H. Each time the Houston traders executed a parking transaction, they filled out tickets for the sale and the repurchase from the other dealers. These trades were then called in to Cohen in New Jersey, who wrote tickets for processing by First Montauk's clearing agent. Cohen never saw the order tickets which were prepared in the Houston office. For each of the parking transactions, however, one or more of the order tickets written by Cohen contained trade dates different than the trade dates on the Houston tickets. These order tickets depicted each of the parking transactions as two separate riskless principal trades, thereby enabling the scheme to go undetected.

I. On at least seven occasions, the Houston traders used the parking scheme to manipulate the price of certain government agency securities and conceal from First Montauk and others undisclosed excessive markups charged to First Montauk customers. The excessive markups on the seven transactions alone amounted to approximately $1.85 million, of which approximately $1.66 million was paid directly to the Houston traders, while the remainder, less clearing fees, was retained by First Montauk.

J. In those instances, the Houston traders purchased bonds and marked them up significantly on the sale to Dealer One. Dealer One then marked up the securities another 1/32 or 2/32 when selling them to Dealer Two. The Houston traders would then mark up the securities another 4% - 5% when selling them to First Montauk customers.

K. As a result, the Houston traders violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5, thereunder.

L. In response to regulatory inquires in April 1994, the firm undertook an investigation of trading activity in the Houston office.

M. As a result of the parking scheme carried out by the Houston traders, the Houston traders aided and abetted First Montauk's violations of Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder, by causing the firm to maintain inaccurate books and records, insofar as, the firm's books and records did not reflect the liabilities arising from the Houston traders' commitments to repurchase the securities involved, and contained incorrect valuations of the firm's positions. This conduct also caused the firm to compute its net capital inaccurately.

N. The parking scheme of the Houston traders also caused First Montauk to file inaccurate FOCUS reports with the NASD, thereby presenting to regulators a misleading picture of the firm's net worth. Furthermore, the Houston trader's scheme caused First Montauk to fail to disclose to the Commission that the firm was in net capital violation on numerous occasions. n2

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n2 On June 25, 1997, the Commission issued an Order, by consent, which found that First Montauk: (a) violated Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11; (b) ordered First Montauk to cease-and-desist from committing and/or causing any violation or future violation of the aforementioned sections and rules, and (c) found that First Montauk failed reasonably to supervise one or more individuals subject to its supervision within the meaning of Section 15(b) of the Exchange Act. First Montauk was also ordered to comply with various undertakings, pay disgorgement and prejudgment interest and a civil penalty.

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Cohen's Failure to Supervise

O. Cohen failed reasonably to supervise the trading activity of the Houston branch office, which was subject to his supervision. Cohen wrote the order ticket for each transaction executed by the Houston office. Despite his responsibility for supervising the trading activity of the Houston office, Cohen failed to check the accuracy of the information he was given, failed to review the Houston office's trade blotter, failed to review the monthly or quarterly trade run or the proprietary trading account, and otherwise failed to perform a review. If he had conducted such reviews of the office's activity, he would have discovered the unusual trading patterns. Cohen also failed to act in response to other red flags. By July 1993, for example, the Houston office had repeatedly asked for permission to engage in "repurchase" transactions with other dealers and had, in fact, engaged in transactions of nearly identical blocks of bonds on numerous occasions. Despite this notice, Cohen failed to conduct a review calculated to prevent the parking scheme from continuing for another eight months.

P. Cohen also failed to perform compliance exams in accordance with First Montauk's own procedures. First Montauk's procedures state that someone from First Montauk's main office shall conduct a branch office examination at least once annually. Cohen, however, allegedly performed only one examination during the violative period. Moreover, when Cohen did perform a branch office examination, he failed to review the Houston office's trading operations.

Q. As a result of the conduct described above, Cohen failed reasonably to supervise the Houston traders who were subject to his supervision within the meaning of Section 15(b) of the Exchange Act with a view to preventing their violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5, thereunder, and their aiding and abetting violations of 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11, thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by Cohen and impose the sanctions specified therein.

Accordingly, IT IS ORDERED that:

A. Cohen be, and hereby is, suspended from association with any broker or dealer for a period of four (4) months, effective on the second Monday following entry of this Order. Cohen shall provide an affidavit of compliance to the Securities and Exchange Commission, Southeast Regional Office, 1401 Brickell Avenue, Suite 200, Miami, FL 33131, within ten (10) days following the suspension period stating that he has complied fully with the terms of the suspension.

B. IT IS FURTHER ORDERED that following the period of his suspension from association, Cohen be; and hereby is, barred from association in a supervisory capacity with any broker or dealer with a right to reapply after one year to become so associated with the appropriate self-regulatory organization or, where there is none, to the Commission.

C. IT IS FURTHER ORDERED Cohen shall, within thirty (30) days of the entry of the Order, pay a civil money penalty in the amount of $5,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order, (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Cohen as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to David Nelson, Southeast Regional Office, Securities and Exchange Commission, 1401 Brickell Avenue, Suite 200, Miami, FL 33131.

By the Commission.

In re CS First Boston Corp., Jerry L. Nowlin and Douglas J. Montague, Securities Act Release No. 7498, Exchange Act Release No. 39595, A.P. File No. 3-9535 (January 29, 1998).

See “THE UNDERWRITER” section.

In re Christopher LaPorte and Government Securities Corporation, Exchange Act Release No. 39171, A.P. File No. 3-9472 (September 30, 1997).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public proceedings be, and hereby are, instituted, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") against Christopher LaPorte ("LaPorte") and Government Securities Corporation ("GSC").

In anticipation of the institution of these proceedings, LaPorte and GSC have submitted an Offer of Settlement to the Commission, which the Commission has determined to accept. Solely for the purposes of this proceeding and any other proceeding brought by or on behalf of the Commission or in which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.1 et seq., and, without admitting or denying the findings contained herein, except those contained in paragraphs II. A. and B., which are admitted, LaPorte and GSC consent to the issuance of this Order Instituting Proceedings, Making Findings, and Imposing Remedial Sanctions, and to the entry of the findings and the Order set forth below.

Accordingly, IT IS ORDERED that administrative proceedings pursuant to Sections 15(b) and 19(h) of the Exchange Act be, and hereby are, instituted against Christopher LaPorte and Government Securities Corporation.

II.

On the basis of this Order and the Offer submitted by LaPorte and GSC the Commission finds n1 that:

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n1 The findings herein are not binding on anyone other than Respondents.

- - - - - - - - - - - - - - - - -END FOOTNOTES- - - - - - - - - - - - - - - - -

A. LaPorte is a resident of Houston, Texas, and was a founder, director, president and a registered general securities principal of GSC, a broker-dealer registered with the Commission.

B. GSC (File No. 8-36869), formerly Government Securities Corporation of Texas, has been registered with the Commission as a broker-dealer since July 25, 1987. GSC, located in Houston, is owned by GSC Group, Inc., a holding company whose majority shareholder is Christopher LaPorte.

C. During the period from at least March 1989 through March 1993, three of GSC's registered representatives (other than LaPorte) and two other GSC employees willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder while engaged in offering and selling to public clients certain collateralized mortgage obligation securities ("CMOs"). These CMOs were sold to public clients, including municipalities and state educational institutions, whose investment objectives stressed safety of principal, liquidity, market stability, short maturities and low risk. GSC, through its representatives, sold these clients Interest Only strips ("IOs"), Inverse IOs, and Inverse Floater CMOs. IOs and Inverse IOs are highly sensitive to changes in interest rates and prepayment speeds, and thus subject investors to risks, including loss of principal, market, extension and liquidity risks. Although Inverse Floaters provide guaranteed return of principal, these instruments are extremely sensitive to changes in interest rates and prepayment speeds and thus subject investors to various risks, including market, extension and liquidity risks.

D. To induce the public clients to purchase high-risk CMOs, three of GSC's registered representatives and two other employees made various misrepresentations and omissions to them, including the following:

1. misrepresenting the high-risk CMOs as suitable investments which were consistent with clients' objectives of safety of principal, liquidity, market stability, short duration and low risk;

2. referring to the high-risk CMOs as "Fannie Mae," "Freddie Mac," or "FNMA" securities, while omitting to disclose that the instruments were volatile CMO tranches;

3. misrepresenting the IOs and Inverse IOs as government guaranteed and that their principal was fully protected;

4. failing to disclose that the IOs and Inverse IOs carry an inherent risk of loss of principal and illiquidity;

5. failing to disclose that the market value and yield of the IOs and Inverse IOs are highly sensitive to changes in interest rates and prepayment speeds;

6. guaranteeing one public client that the client "would not lose a dime" on the Inverse IOs;

7. failing to disclose that the characteristics of the Inverse Floaters, including duration and yield, were highly sensitive to changes in interest rates;

8. failing to disclose that the Inverse Floaters were subject to extension risk of as much as 30 years;

E. In March 1994, one of the GSC registered representatives and two other GSC employees induced a public client to enter into an adjusted trade, pursuant to which GSC purchased from the client, at above-market prices, three conservative securities and sold to the public client, through numerous oral and written misrepresentations, an Inverse Floater at an undisclosed markup of more than 10 percent above market value ("March Swap").

F. One of the employees involved in the conduct set forth in Paragraphs II. C. through E. was barred by the Commission from being associated with any registered broker or dealer with the right, after one year, to reapply to become associated with a broker-dealer as a supervised employee in a non-supervisory capacity. As a consequence, he was subject to a statutory disqualification from exercising supervisory responsibility over GSC's sales personnel. In violation of Section 15(b)(6)(B)(i) of the Exchange Act, he became Sales Manager of GSC and, in 1993, he accepted a promotion to the position of Executive Vice President and Managing Director of GSC. In these positions, he was the person chiefly responsible for supervising GSC registered representatives.

III.

A. GSC and LaPorte failed reasonably to supervise GSC representatives and other employees, who were subject to their supervision, within the meaning of Section 15(b)(4) of the Exchange Act, with a view toward preventing the violations described in Paragraphs II. C. through F. by the representatives of the federal securities laws, in that:

1. GSC written supervisory policies failed to designate a particular partner, officer or manager with overall supervisory responsibility and failed to provide adequate written guidance concerning responsibility for enforcing various policies and procedures, with the result that GSC supervisors often assumed that one of the other supervisors had responsibility for enforcing various policies and procedures;

2. GSC had inadequate procedures for monitoring accounts to detect unsuitable transactions;

3. GSC's policies and procedures were inadequate to control or monitor the quality of written and oral disclosure to clients concerning the characteristics and risks of CMOs.

4. LaPorte appointed a statutorily disqualified individual to act as the person chiefly responsible for supervising registered representatives. GSC and LaPorte permitted that statutorily disqualified individual to act in this capacity with nearly unfettered discretion, even though GSC and LaPorte were aware that the employee was statutorily disqualified. Moreover, GSC and LaPorte represented in an application filed with the NASD that the employee would have no supervisory duties, and agreed to provide the employee with adequate supervision. The statutorily disqualified individual was one of the GSC employees who engaged in the conduct that was violative of the federal securities laws delineated in Paragraphs II. C. through E.

5. There were ample "red flags" which were sufficient to alert LaPorte and GSC that GSC's compliance and supervisory policies were inadequate and to place any reasonable supervisor on notice of the possibility of violations of the federal securities laws. These "red flags" included, but were not limited to, the following:

a. LaPorte was aware throughout the relevant period that GSC registered representatives were offering and selling IOs, Inverse IOs, and Inverse Floaters to public clients with conservative investment objectives;

b. LaPorte was warned on several occasions by other GSC employees that the mortgage derivative securities being sold to public clients appeared to be inconsistent with the investment policies and objectives specifically delineated by these clients in written investment policies or account opening forms and were also inconsistent with certain internal GSC policies;

c. LaPorte was repeatedly warned by other GSC employees that there were unusually high concentrations of high-risk CMOs in the accounts of public clients;

d. LaPorte was aware that one of the registered representatives had repeated disagreements with one of GSC's department heads about how to present the characteristics of mortgage derivative securities in written documents;

e. LaPorte was informed, prior to the settlement of the March swap, about serious questions concerning the terms of the transaction and the oral and written representations made to the client, but did not take reasonable steps to make certain that the trade comported with the federal securities laws.

IV.

As set forth in Paragraph II. F. and Paragraph III. A. 4., GSC willfully n2 violated Section 15(b)(6)(B)(ii) by permitting a statutorily disqualified individual to become and remain associated with GSC in contravention of his disqualification.

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n2 In applying the term "willful" in Commission administrative proceedings instituted pursuant to Sections 15(b), 15B, 15C, 17A, 19(h) and 21B of the Securities Exchange Act, Section 9 of the Investment Company Act, and section 203 of the Investment Advisers Act, the Commission evaluates on a case-by-case basis whether the respondent knew or reasonably should have known under the particular facts and circumstances that his conduct was improper. In this case, as in all Commission administrative proceedings charging a willful violation under these statutory provisions, the Commission applies this standard to persons -- specifically, securities industry professionals -- who are directly subject to Commission jurisdiction and who have a responsibility to understand their duties to the investing public and to comply with the applicable rules and regulations which govern their behavior.

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V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions that are set forth in the Offer submitted by LaPorte and GSC.

Accordingly, IT IS ORDERED that:

A. LaPorte be, and hereby is, suspended from association with any broker, dealer, municipal securities dealer, investment adviser or investment company for a period of 12 months, effective on the second Monday following the entry of this Order. LaPorte agrees to deliver an affidavit of compliance to the Securities and Exchange Commission, Fort Worth District Office, 801 Cherry Street, Suite 1900, Fort Worth, Texas 76102, within ten (10) days following the suspension period stating that he has complied fully with the terms of the suspension; and

B. LaPorte be, and hereby is, barred from association in a supervisory capacity with any broker, dealer, investment company, investment adviser or municipal securities dealer; provided that after a period of three years LaPorte may make application to reapply to the appropriate self-regulatory organization, and where there is none, to the Commission; and

C. LaPorte shall, within 21 days of the entry of this Order, pay a civil money penalty in the amount of $50,000.00 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312; and (D) submitted under cover letter that identifies LaPorte as a Respondent in these proceedings, and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Harold F. Degenhardt, the District Administrator of the Fort Worth District Office, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, Texas 76102; and

D. GSC shall comply with its undertaking to file a Form BDW to withdraw its registration as a broker-dealer within 21 days of the date of the Order; and

E. GSC shall, within 21 days of the entry of this Order, pay a civil money penalty in the amount of $200,000.00 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Comptroller, Securities and Exchange Commission, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312; and (D) submitted under cover letter that identifies GSC as a Respondent in these proceedings, and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Harold F. Degenhardt, the District Administrator of the Fort Worth District Office, Securities and Exchange Commission, 801 Cherry Street, Suite 1900, Fort Worth, Texas 76102.

By the Commission.

<u>In re Smith Barney, Inc</u>., Exchange Act Release No. 39118, A.P. File No. 3-9426 (September 23, 1997).

See “THE UNDERWRITER” section.

<u>In re First Montauk Securities Corp.</u>, Exchange Act Release No. 38775, A.P. File No. 3-9342 (June 25, 1997).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to institute public administrative and cease-and-desist proceedings pursuant to Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondent First Montauk Securities Corp. ("First Montauk" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent First Montauk has submitted an Offer of Settlement ("Offer") to the Commission, which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceeding brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained herein, except as to the jurisdiction of the Commission over Respondent and over the subject matter of this proceeding

and except as to Section III.A. below, which is admitted, Respondent First Montauk, by its Offer, consents to the entry of findings, remedial sanctions and cease-and-desist order set forth below.

Accordingly, IT IS ORDERED that proceedings pursuant to Sections 15(b), 19(h) and 21C of the Exchange Act be, and, they hereby are, instituted.

III.

On the basis of this Order and the Offer submitted by Respondent First Montauk, the Commission finds n1 that:

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n1 The findings herein are made pursuant to Respondent First Montauk's Offer and are not binding on any other person or entity named as a Respondent in this or any other proceeding.

- - - - - - - - - - - - - - - - -END FOOTNOTES- - - - - - - - - - - - - - - - -

A. First Montauk is, and at all relevant times was, a broker-dealer registered with the Commission, with approximately 125 branch offices and 75 offices of supervisory jurisdiction.

B. First Montauk employed at all relevant times, a registered principal in its main office in Red Bank, New Jersey ("the Supervisor").

C. First Montauk's Houston office was opened by certain individuals with prior experience trading government securities (hereafter the "Houston traders") in October 1990. The Houston office was established to sell fixed-income products, primarily REMICs and other mortgage-backed securities, to institutional clients. Prior to the opening of the Houston office, fixed-income products were a minor part of the First Montauk's business, and the firm had relatively few institutional clients. By opening the Houston branch to sell REMICs and other mortgage-backed securities, First Montauk was expanding into an area in which the firm previously had very limited experience. The Houston office was one of only three First Montauk branches that was allowed to execute its own trades. This distinct trading activity required stringent home office supervision, but First Montauk did not have procedures in place to review the Houston office's trading activity.

D. First Montauk did not effectively designate any one individual in the Houston office to supervise sales practices on a day to day basis. Among other things, the firm failed to require the Houston office to assign an individual with responsibility for supervising daily sales practices. The Supervisor, at all relevant times a principal in First Montauk's main office in New Jersey, by reason of his greater experience in mortgage-backed securities, was delegated responsibility for supervising certain of the Houston office's operations, including the branch's trading activity.

E. At all relevant times, the Houston office had the authority to execute riskless principal transactions. The procedure required the Houston traders, who directed the Houston office's activities, to arrange and confirm both sides of each transaction, and then call the details directly in to the Supervisor in New Jersey. The Supervisor then would write an order ticket for each transaction and provide that information to First Montauk's clearing firm.

Parking, Excessive Markups and Net Capital and Books and Records Violations

F. First Montauk did not allow the Houston office to hold positions in securities unless it received approval from the main office. In order to circumvent First Montauk's restriction on holding positions, the Houston traders engaged in a parking scheme which enabled them to purchase bonds and secretly hold them "off their books," while still maintaining control of the securities. From October 1992 through

March 1994, the Houston traders parked government agency securities on at least seventeen occasions, including every month from March 1993 through March 1994.

G. The parking scheme was conceived and carried out by the Houston traders in the following manner. Whenever the Houston traders wanted to park securities, they entered into an arrangement with two other broker dealers (Dealers One and Two) whereby First Montauk would sell the bonds to Dealer One for settlement that month. Dealer One would then sell the bonds to Dealer Two for a fraction higher than it had purchased them from First Montauk. The Houston traders then caused First Montauk to repurchase the bonds from Dealer Two for settlement the next month, with Dealer Two earning a small profit on the transaction. The Houston traders used the time between settlement dates to find a customer for the bonds. The parking scheme essentially allowed the Houston traders an extra month to find a customer for securities over which they maintained control.

H. Each time the Houston traders executed a parking transaction, they filled out tickets for the sale and the repurchase from the other dealers. These trades were then called in to the Supervisor in New Jersey, who wrote tickets for processing by First Montauk's clearing agent. The Supervisor never saw the order tickets which were prepared in the Houston office. For each of the parking transactions, however, one or more of the order tickets written by the Supervisor contained trade dates different than the trade dates on the Houston tickets. These order tickets depicted each of the parking transactions as two separate riskless principal trades, thereby enabling the scheme to go undetected.

I. On at least seven occasions, the Houston traders used the parking scheme to manipulate the price of certain government agency securities and conceal from First Montauk and others undisclosed excessive markups charged to First Montauk customers. The excessive markups on the seven transactions alone amounted to approximately $1.85 million, of which approximately $1.66 million was paid directly to the Houston traders, while the remainder, less clearing fees, was retained by First Montauk.

J. In those instances, the Houston traders purchased bonds and marked them up significantly on the sale to Dealer One. Dealer One then marked up the securities another 1/32 or 2/32 when selling them to Dealer Two. The Houston traders would then mark up the securities another 4% - 5% when selling them to First Montauk customers.

K. In response to regulatory inquiries in April 1994, the firm undertook an investigation of trading activity in the Houston office. After that date, there were no further trades in furtherance of the parking scheme described above.

L. As a result of the parking scheme carried out by the Houston traders, First Montauk failed to maintain accurate books and records, insofar as, among other things, the firm's books and records did not reflect the liabilities arising from the Houston traders' commitments to repurchase the securities involved, and contained incorrect valuations of the firm's positions. This conduct also caused the firm to compute its net capital inaccurately.

M. Proper recordation by the Houston traders of these transactions on First Montauk's books and records would have adversely affected Respondent First Montauk's computation of net capital and, in some instances, resulted in undisclosed net capital deficiencies.

N. The parking scheme of the Houston traders also caused First Montauk to file inaccurate FOCUS reports with the National Association of Securities Dealers, Inc., thereby presenting to regulators a misleading picture of the firm's net worth. Furthermore, the Houston trader's scheme caused First Montauk to fail to disclose to the Commission that the firm was in net capital violation on numerous occasions.

Misrepresentations to Escambia County, Florida

O. Escambia County (the "county") began doing business with the Houston office of First Montauk and one of the office's registered representatives ("RR") in December 1990. In connection with the offer and sale of certain complex mortgage-backed derivative securities known as REMICs, the RR misrepresented information regarding the risks of these securities. The RR also made misrepresentations regarding, among other things, the returns that the county would receive.

First Montauk's Failure to Supervise

P. First Montauk's compliance procedures were inadequate to detect the parking scheme. There was no system of follow up and review to determine if the supervisory responsibilities delegated to the Supervisor were being diligently exercised. There also was no specific procedure for anyone to review the activity in the proprietary trading account or the trade blotter for the Houston office. Such a review, on either a monthly or quarterly basis, might well have alerted the firm to the Houston office's parking scheme, its books and records violations and its net capital deficiencies.

Q. Additionally, First Montauk had inadequate procedures for conducting compliance audits. No guidance is given in First Montauk's compliance manual as to how to perform audits, nor was the Supervisor given any training. There was no specific procedure to review the branch's trade blotter, or even to determine if the branch kept one, despite the fact that the firm's compliance manual requires that every office maintain a blotter. There also were no procedures for the examiner to review any of the Houston office's records (i.e. broker's books or trade tickets). Proper procedures would have alerted the Supervisor to the parking scheme being carried out in the Houston office and the resulting excessive markups.

R. In addition to having inadequate compliance and review procedures as detailed above, First Montauk failed to effectively designate a supervisor for the Houston branch office, allowing inadequate supervision of the office's daily sales practices. Among other things, the firm failed to require the Houston office to assign an individual with responsibility for supervising daily sales practices.

Violations

S. As a result of the conduct described above, First Montauk willfully violated Sections 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5 and 17a-11.

T. As a result of the conduct described above, First Montauk failed reasonably to supervise one or more individuals subject to its supervision within the meaning of Section 15(b) of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept the Offer submitted by First Montauk and impose the sanctions specified therein.

Accordingly, IT IS ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, First Montauk is ordered to cease and desist from committing and/or causing to commit any violation or future violation of Section 15(c) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-3, 17a-5, and 17a-11;

B. First Montauk shall be, and hereby is, censured;

C. First Montauk shall comply with the undertakings described below:

1. First Montauk undertakes that, within thirty (30) days of the entry of the Order, First Montauk will supplement its compliance and supervisory policies and procedures to address those deficiencies raised in

sections III.P. - III.R. above, relating to the firm's affiliate program and the supervision of the firm's branch offices by the main office.

2. First Montauk undertakes to maintain the modified supervisory and compliance policies and procedures, as well as existing supervisory and compliance policies and procedures, except as they may be inconsistent with, or superseded by, any new policies or procedures adopted in accordance with Paragraph C.3. below;

3. First Montauk undertakes to retain, within sixty (60) days of the date of the Order, at First Montauk's expense, an Independent Consultant ("Consultant"), not unacceptable to the Commission's staff, to conduct a review of, and to report and make recommendations as to First Montauk's supervisory and compliance policies and procedures, particularly those subject matters and areas of First Montauk's operations discussed in sections III.P. - III.R. above, relating to the firm's affiliate program and the supervision of the firm's branch offices by the main office.

4. First Montauk undertakes to cooperate fully with the Consultant in this review, including making such non-privileged records available, as the Consultant may reasonably request; and by permitting and requiring First Montauk's employees and agents to supply such non-privileged information as the Consultant may request for the Consultant's review.

5. At the conclusion of such review, which in no event shall be more than 120 days after the date of the retention of the Consultant, the Consultant shall submit to First Montauk a draft report ("Draft Report") which shall address the adequacy of First Montauk's policies and procedures to detect and prevent federal securities laws violations of the nature involved in this matter and shall include the Consultant's recommendations therein.

6. Within forty-five (45) days of transmittal of the Consultant's Draft Report, First Montauk shall in writing advise the Consultant of any recommendation which First Montauk has determined to accept and of any recommendation which First Montauk has determined to reject. With respect to any recommendation of the Consultant which First Montauk has rejected, First Montauk will select and set forth an alternative policy or procedure designed to achieve the same objective or purpose. With respect to the latter, First Montauk and the Consultant shall then attempt in good faith to reach agreement on any policy or procedure as to which there is a dispute.

7. Within ninety (90) days after transmittal of the Consultant's Draft Report, First Montauk shall in writing advise the Consultant of any recommendation which First Montauk and the Consultant have agreed upon and which First Montauk has determined to accept. In the event the Consultant and First Montauk are unable to agree on an alternative proposal, First Montauk shall abide by the recommendation of the Consultant.

8. The Consultant shall complete the aforementioned reviews and submit a written final report ("Final Report") thereon to First Montauk and to the Commission's staff within 330 days after the date of the Order. The Final Report shall describe the efforts undertaken by the Consultant to review First Montauk's supervisory and compliance policies and procedures, shall set forth the Consultant's recommendations, and shall specify those recommendations which have been accepted by First Montauk and those recommendations as to which there has been agreement as to an alternative policy or procedure. The Final Report shall set forth the alternative policy or procedure selected by First Montauk and agreed to by the Consultant.

9. Within sixty (60) days of transmittal of the Consultant's Final Report, First Montauk undertakes to adopt and implement all of the Consultant's recommendations or alternative policies or procedures which have been agreed upon in the Final Report.

10. Within ninety (90) days of transmittal of the Consultant's Final Report, First Montauk shall submit to the Commission's staff an Affidavit of Compliance setting forth the details of its implementation of the recommendations and accepted alternative policies or procedures contained in the Consultant's Final Report and all other undertakings set forth in Section IV. herein. For good cause shown, the Commission's staff may extend any of the procedural dates set forth above, provided that the Affidavit of Compliance is received within eighteen (18) months from the date of entry of the Order.

11. To ensure the independence of the Consultant, First Montauk: (i) shall not have the authority to terminate the Consultant, without the prior written approval of the staff of the Southeast Regional Office; (ii) shall compensate the Consultant, and persons engaged to assist the Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; (iii) shall not, without prior written consent of the staff of the Southeast Regional Office, enter into any legal, business, or other financial relationship with the Consultant, any firm with which he or she is affiliated or of which he or she is a member, or any person engaged to assist the Consultant in the performance of his or her duties under this Order, during the period of their engagements and for a period of two years following the completion of their duties described in this Order; and (iv) shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Consultant from transmitting any information, reports, or documents to the Commission or its staff.

D. First Montauk shall pay to the Commission, within 30 business days after the entry of the Order, (i) disgorgement in the amount of $175,458; (ii) prejudgment interest in the amount of $51,584; and (iii) a civil money penalty in the amount of $50,000. Such payment shall be: (a) made by United States postal money order, certified check, bank cashier's check or bank money order; (b) made payable to the Securities and Exchange Commission; (c) hand-delivered to the Comptroller, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, Mail Stop 0-3; and (d) submitted under cover letter which identifies First Montauk as a respondent in this proceeding, the file number of this proceeding, a copy of which cover letter and money order or check shall be sent to David Nelson, Southeast Regional Office, Securities and Exchange Commission, 1401 Brickell Avenue, Suite 200, Miami, FL 33131.

By the Commission.

REINVESTMENT OF PROCEEDS

Injunctive Proceedings

Securities and Exchange Commission v. Rauscher Pierce Refsnes, Inc. and James R. Feltham, Civ. Action No. CV-98-0027 PHX ROS (D. Ariz.), Litigation Release No. 15613 (January 8, 1998) (complaint).

The Securities and Exchange Commission today filed a civil fraud action against Rauscher Pierce Refsnes, Inc. and its former Senior Vice President, James R. Feltham, in the United States District Court for the District of Arizona. The Commission's complaint alleges that Rauscher and Feltham defrauded their financial advisory client, the State of Arizona Department of Administration ("DOA" or the "State"), in connection with DOA's issuance of $129,640,000 of Series 1992B Refunding Certificates of Participation (the "1992B COPs"). As part of the 1992B COPs offering, the defendants allegedly sold certain United States Treasury securities (the "escrow securities") to the State at above-market prices. According to the complaint, inflating the escrow securities' prices reduced the yields on those securities and enabled Rauscher to make illegal profits at the expense of the federal government while purporting to comply with the federal tax laws governing the 1992B COPs offering, a practice commonly referred to as "yield burning." Rauscher allegedly took an undisclosed $707,037 profit on its sales to DOA. The complaint

further alleges that Rauscher and Feltham failed to inform their client of this profit or that any of the sales prices of the escrow securities had been inflated. Instead, Rauscher and Feltham issued a materially false tax certification (the "Certification") in connection with the sale of the escrow securities which falsely stated that Rauscher's sale prices for the escrow securities equaled their "fair market value," that Rauscher's sale of the securities was an "arm's length transaction," and that Rauscher had priced the escrow securities without regard to the yield of those securities.

The Commission's complaint further charges that the State's ability to successfully market the 1992B COPs depended on the securities' tax-exempt status under federal law, and that the defendants' alleged overcharges in violation of applicable tax laws and regulations jeopardized the tax-exempt status of the 1992B COPs.

According to the complaint, Rauscher and Feltham charged DOA a fraudulent and excessive undisclosed markup on the escrow securities, in that the prices charged DOA for such securities were not reasonably related to prevailing market prices, and Rauscher's $707,037 profit from the sale of such securities was unreasonable in light of the circumstances surrounding the sale.

Finally, the complaint alleges that in their capacities as financial adviser and investment adviser to DOA, Rauscher and Feltham owed DOA fiduciary duties to provide DOA with complete information and unbiased advice and assistance in all aspects of the 1992B COPs offering. The defendants allegedly violated these duties by failing to disclose the conflict of interest inherent in their selling DOA the escrow securities as principal from Rauscher's own account and taking the secret $707,037 profit while at the same time purporting to give DOA independent investment advice.

The complaint requests the Court to enjoin Rauscher from violating the antifraud provisions of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), (2), (3) of the Investment Advisers Act of 1940; to enjoin Feltham from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder; and to enjoin Feltham from aiding and abetting violations of Sections 206(1), (2), and (3) of the Investment Advisers Act of 1940.

The complaint further requests the Court to order Rauscher and Feltham to disgorge the profits from their illegal conduct and to impose civil monetary penalties against them.

SEC v. Rauscher Pierce Refsnes, Inc., James R. Feltham and Dain Rauscher Inc., 1998 U.S. Dist. LEXIS 13164 (August 24, 1998).

OPINION BY: ROSLYN O. SILVER

OPINION: AMENDED ORDER

BACKGROUND

In 1988, the Department of Administration of the State of Arizona (the "DOA") issued $121,830,000 of tax-exempt certificates of participation (the "1988 COPs") to finance the construction of six state buildings. The 1988 COPs could not be redeemed until July of 1998, and bore an average interest rate of 7.55%. In 1990, Defendant Rauscher Pierce Refsnes, Inc. n1 ("Rauscher") became the financial adviser to the DOA for lease purchases and bond transactions. Rauscher's contract was renewed by the DOA in 1991 and 1992. By 1992, interest rates had fallen well below the 7.55% the state was paying on its 1988 COPs, and Defendants recommended that the DOA take advantage of this situation by advance refunding the 1988 COPs. (Compl. P 14.) Defendants advised the DOA to issue new tax-exempt municipal securities (the "1992B COPs") bearing a lower interest rate than that of the 1988 COPs, and invest the proceeds into United States Treasury securities, to be held in an escrow account and used to make debt service payments

on the 1988 COPs until they were redeemed in 1998. Id. In addition to providing the DOA with advice on the 1992B COPs offering, Defendants assigned themselves the responsibility of selling the DOA the United States Treasury securities it would buy with the proceeds from the 1992B COPs bond offering. Id. P 18.

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n1 Rauscher Pierce Refsnes, Inc., was a Delaware corporation with its principal place of business in Dallas, Texas. (Rauscher Mot. at 2.) On January 2, 1998, Rauscher merged with its sister company, Dain Bosworth Incorporated, to become Dain Rauscher. Id. Dain Rauscher then merged with a Minnesota corporation to become Dain Rauscher Incorporated. Id. James Feltham was the Senior Vice President at Rauscher's Phoenix office who supervised Rauscher's participation in the 1992B COPs offering. Id.

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On June 10, 1992, the underwriters of the 1992 offering priced the 1992B COPs. On that same day, Defendants purchased a portfolio of Treasury securities and priced them for delivery on June 16, 1992. Id. P 19. On June 16, 1992, the bond offering closed with the DOA issuing $129,640,000 of the 1992B COPs. The proceeds from the sale were turned over to an escrow trustee who then bought the Defendants' portfolio of United States Treasury securities. Id. Plaintiff, the Securities Exchange Commission (the "SEC"), filed a lawsuit against Defendants on January 8, 1998, alleging that during their participation in the 1992B COPs offering, Defendants violated federal securities laws by making materially false and misleading statements in connection with the sale of securities, by omitting to disclose material information that they were under a duty to disclose, and by charging their client excessive markups. Plaintiff requests that this Court order Defendants to return the profits from their allegedly illegal conduct, impose civil penalties upon Defendants, and enjoin Defendants from violating the securities laws in the future. On March 31, 1998, Defendants James Feltham and Dain Rauscher filed motions to dismiss the Amended Complaint (hereinafter "Complaint") in its entirety, pursuant to Rule 12(b)(6) for failure to state a claim upon which relief can be granted.

On August 7, 1998, the Court conducted oral argument and took the matter under advisement. The Court has resolved to deny Defendants' motions to dismiss, but also to allow Plaintiff to allege with particularity the market standard.

LEGAL STANDARD

The Ninth Circuit Court of Appeals has held that "the conditions that must be met before a motion may be granted under Fed. R. Civ. P. 12(b)(6) are quite strict." *Church of Scientology of California v. Flynn, 744 F.2d 694, 695-96 (9th Cir. 1984).* This Court may only dismiss the Complaint if "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Id. at 696* (quoting *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)).* In considering a motion to dismiss, this Court must take "as true the facts alleged in the complaint . . . drawing all reasonable inferences in the plaintiff's favor." *Jackson Nat'l Life Ins. Co. v. Merrill Lynch Co., 32 F.3d 697, 699-700 (2d Cir. 1994).*

DISCUSSION

Plaintiff argues that it has adequately stated three claims in its Complaint. First, Plaintiff asserts that Defendants violated Section 17(a) of the Securities Act of 1933, *15 U.S.C. § 77q*(a) n2; Section 10(b) of the Securities Exchange Act of 1934, *15 U.S.C. § 78j*(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5 n3; and Sections 206(1), (2), and (3) of the Investment Advisers Act of 1940, *15 U.S.C. § 80b-6* n4; by making false and misleading statements in the tax compliance certificate they issued to the DOA's bond counsel. Second, Plaintiff asserts that Defendants violated the aforementioned statutes by failing to disclose material information concerning their sale of Treasury securities to their client the DOA. Third, Plaintiff contends that Defendants violated the aforementioned statutes by failing to disclose that they were charging the DOA excessive markups on the Treasury securities they sold them.

Defendants contend that Plaintiff has pled no facts in support of its allegations, and therefore, this Court must dismiss each claim pursuant to Rule 12(b)(6) for failure to state a claim. Each of Plaintiff's claims will be examined in turn.

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n2 The relevant portion of *15 U.S.C. § 77q* states:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly-

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. *15 U.S.C. § 77q*(a)(1), (2), (3).

n3 Rule 10b-5 states:

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national security exchanges

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. 17 C.F.R. § 240.10b-5.

n4 The relevant portion of *15 U.S.C. § 80b-6* provides:

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;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and the obtaining consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction. *15 U.S.C. § 80b-6*(1), (2), (3).

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A. Plaintiff's Claim of False and Misleading Statements

In order for Plaintiff to succeed in proving a claim of securities fraud, Plaintiff must prove that "(1) in connection with the purchase or sale of a security; (2) the defendant acting with scienter n5; (3) made a material misrepresentation . . . ." *Grandon v. Merrill Lynch & Co., Inc., 147 F.3d 184, 1998 U.S. App. LEXIS 13027,* at *8, *1998 WL 321695,* at *3 (2d Cir. 1998). Because Plaintiff's claim involves fraud, Rule 9(b) requires that "the circumstances constituting fraud or mistake, shall be stated with particularity." Fed. R. Civ. P. 9(b). This requirement of particularity "usually requires the claimant to allege at a minimum the identity of the person who made the fraudulent statement, the time, place, and content of the misrepresentation, the resulting injury, and the method by which the misrepresentation was communicated." 2 James Wm. Moore, Moore's Federal Practice § 9.03[1][b] (3d ed. 1998). In addition to these minimum requirements, the Ninth Circuit has held that in order to satisfy Rule 9(b) in a securities fraud case:

a plaintiff must set forth more than the neutral facts necessary to identify the transaction. The plaintiff must set forth what is false or misleading about a statement, and why it is false. In other words, the plaintiff must set forth an explanation as to why the statement or omission complained of was false or misleading.

In Re Glenfed, Inc., Secs. Litig., 42 F.3d 1541, 1548 (9th Cir. 1994) (en banc). The Ninth Circuit has explained that "a pleading is sufficient under Rule 9(b) if it identifies the circumstances of the alleged fraud so that the defendant can prepare an adequate answer." *Kaplan v. Rose, 49 F.3d 1363, 1370 (9th Cir. 1994);* see also *Warshaw v. Xoma Corp., 74 F.3d 955, 960 (9th Cir. 1996).*

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n5 The Supreme Court has held that scienter is a requirement for claims brought under Rule 10b-5 and *15 U.S.C. § 77q*(a)(1), but that no scienter requirement exists for claims brought under *15 U.S.C. § 77q*(a)(2), (3). *Aaron v. SEC, 446 U.S. 680, 695-97, 64 L. Ed. 2d 611, 100 S. Ct. 1945 (1980).* The Supreme Court has also held that no scienter requirement exists for claims brought under Section 206(2) of the Investment Advisers Act, *15 U.S.C. § 80b-6*(2). *SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195, 11 L. Ed. 2d 237, 84 S. Ct. 275 (1963).* The Supreme Court has not determined whether scienter is required for claims brought under Section 206(1) of the Investment Advisers Act, *15 U.S.C. § 80b-6*(1), but lower courts have held that it is required. See *SEC v. W. Steadman, 296 U.S. App. D.C. 269, 967 F.2d 636, 641 (D.C. Cir. 1992).*

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There can be no question that Plaintiff has met the minimum requirements for pleading fraud. n6 The only remaining question is whether Plaintiff has adequately explained what is false about each of Defendants' statements. Plaintiff argues that its complaint adequately explains which statements were false and the reasons why each was false or misleading. Defendants argue that Plaintiff's complaint is insufficient because Plaintiff cites no facts and relies entirely on conclusory allegations of fraud to explain why Defendants' statements are false. n7 Plaintiff is only required to identify which of Defendants' statements are false or misleading, and explain why those statements were false or misleading when they were made. Plaintiff has met the burden.

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n6 The Complaint clearly alleges three false or misleading statements were made in a Tax Certification Certificate (the "Certificate") issued by Rauscher on June 16, 1992, knowing that the DOA's bond counsel would rely on the Certificate in rendering its opinion on whether the interest paid on the 1992B COPs would be tax-exempt. (Compl. PP 30-31.)

n7 In reality, Defendants' argument is that Plaintiff has not alleged enough facts, and that the facts that have been alleged cannot be proven. This argument is misplaced in a motion to dismiss. A court must take all of Plaintiff's allegations as true, and draw all reasonable inferences in Plaintiff's favor. Further, the Ninth Circuit has held that "in certain cases, . . . the requisite particularity might be supplied with great

simplicity." *Glenfed, 42 F.3d at 1548.* The Ninth Circuit has indicated that securities fraud cases generally require a more detailed pleading because they: often involve some more or less catastrophic event occurring between the time the complained-of statement was made and the time a more sobering truth is revealed (precipitating a drop in stock price). Such events might include, for example, a general decline in the stock market, a decline in other markets affecting the company's product, a shift in consumer demand, the appearance of a new competition, or a major lawsuit. When such an event has occurred, it is clearly insufficient for plaintiffs to say that the later, sobering revelations make the earlier, cheerier statement a falsehood. *Id. at 1548.* This is not the type of securities fraud noted in Glenfed because there was no "intervening catastrophe between the time the complained-of statement was made and the time a more sobering truth was revealed." Id. Accordingly, this is a securities fraud case where particularity may be satisfied with fewer facts.

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Plaintiff contends that Defendants' statement that the sale of the escrow securities "was an arm's length transaction" is false and misleading because Defendants were involved on both sides of the transaction. (Compl. P 33.) Plaintiff alleges that Defendants recommended to the DOA that they buy securities, and then sold the DOA the securities they recommended it buy. Id. P 18. Plaintiff alleges that it was impossible for Defendants to truthfully state in the Certificate that the transaction was made at arm's length in light of Defendants' fiduciary relationship with the DOA and their undisclosed material financial interest in the sale of the securities. Id. P 33. Defendants argue that the statement was not false because the sale was conducted at arm's length, meaning the sale was between a willing buyer and a willing seller. (Rauscher Reply at 22.) Defendants further contend that Plaintiff's allegation that a financial adviser cannot enter into an "arm's length" transaction with an issuer client for tax purposes is contrary to the SEC and IRS regulations that existed in 1992, which allowed interested sellers to state that they sold securities in an arm's length transaction. (Rauscher Reply at 16-17.) These arguments go to Plaintiff's ultimate ability to prove this allegation, they do not establish that Plaintiff cannot, as a matter of law, prove that the statement was misleading or false.

Plaintiff's second allegation is that Defendants' statement that the escrow securities were priced "without regard to any amount paid to reduce the yield" and that "the price was no higher than the price Rauscher would have charged any other customer . . . in a transaction in which the yield on the [escrow securities] was not subject to any limitation" is false. (Compl. P 34.) Plaintiff contends that this statement is false because at the time Rauscher priced the escrow securities it knew or should have known that a positive arbitrage situation existed and priced the securities in part on the amount of the yield that was available to be burned. Id. In essence, Plaintiff alleges that Defendants did charge the DOA a higher price than they would have charged other customers because they knew the yield could be burned, and that Defendant did burn the yield. n8 Defendants argue that this charge is merely a legal conclusion couched as a factual allegation, but Plaintiff has clearly identified why the statement is false.

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n8 In a typical advance refunding transaction like the one in this case, the municipality issues a new offering of tax-exempt bonds to retire a pre-existing issue of bonds bearing higher interest rates. See *In Re Meridian Securities, Inc., SEC File No. 3-9582, 1998 WL 195679,* at *3. The proceeds of the new bond offering are then invested in Treasury securities. Id. Federal Tax laws restrict the yield that issuers can receive on these investments to the yield on the new offering of bonds. Id. If investments generate a yield that is greater than the yield on the new offering of bonds, an impermissible arbitrage profit is created. Id. Under those circumstances, the Internal Revenue Service (the "IRS") could declare the bonds taxable. Id. IRS regulations effectively require that arbitrage profit be reduced by investing a portion of the account in State and Local Government Series--customized securities issued by the Treasury at below market interest rates specifically for the purpose of allowing municipal issuers to comply with the IRS yield restrictions. Id.

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The other way to circumvent the yield restrictions is through the practice known as yield burning. Yield burning occurs when a seller excessively increases the price an issuer pays for securities. Id. at 4. By adding unjustified markups to the price of advance refunding escrow securities, the refunding escrow's yield is artificially depressed below what it would have been had the securities been fairly priced. Id. In other words, the yield has been burned, and the broker has cheated the Treasury out of the arbitrage profit the municipalities would have had to pay to the Treasury, had the securities been fairly priced. Id.

Plaintiff's third allegation is that Defendants' statement that the escrow securities were priced "at fair market value" is false. Id. P 32. Plaintiff contends that the statement is false because the securities were sold to the DOA at prices that exceeded "the mean of the bid and offered prices for those securities on an established market." Id. Plaintiff also contends that the statement is false because the securities were sold to the DOA at prices above the market price. Id. Plaintiff contends that if a firm charges a buyer a price higher than the market price, that firm can only claim that they sold the securities at fair market value, if the transaction was made at "arm's length without regard to any amount paid to reduce the yield on the obligation." Id. PP 17, 32. Plaintiff contends that Defendants' statement is false because Defendants charged a price above the market price in a transaction that was not made at arm's length without regard to any amount paid to reduce the yield on the obligation. Id. Defendants contend that the statement was not false because they were not issuing an opinion regarding whether the 1992B COPs would be tax exempt. (Rauscher Mot. at 24.) Defendants further contend that Treasury regulations defined "market price" as: (1) the actual price paid for the securities, if the securities are purchased in "an arm's length transaction without regard to any amount paid to reduce the yield"; or (2) the mean and bid offered prices published by appropriate publications on an established market price. Id. at 25. Plaintiff does not contend that only one definition of market value can apply; but that Defendants meet neither definition. (Compl. PP 17, 32.)

While Defendants have raised doubts concerning Plaintiff's ability to ultimately prove that a material misrepresentation was made, Defendants have not proved that Plaintiff cannot, as a matter of law, state a claim for misrepresentation under the Securities Act of 1933, *15 U.S.C. § 77q*(a); the Securities Exchange Act of 1934, *15 U.S.C. § 78j*(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; and §§ 206(1), (2), and (3) of the Investment Advisers Act of 1940, *15 U.S.C. § 80b-6.*

B. Plaintiff's Omission Claim Based on Fiduciary Duty

For Plaintiff to succeed in proving an omissions claim Plaintiff must prove that "(1) in connection with the purchase or sale of a security; (2) the defendant acting with scienter n9; (3) made . . . (where there exists a duty to speak) a material omission." *Grandon, 147 F.3d 184, 1998 U.S. App. LEXIS 13027, 1998 WL 321695,* at *3. Plaintiff's omission claim must also be pleaded with "particularity." Fed. R. Civ. P. 9(b). In addition to these requirements, Plaintiff must also establish that Defendants had an affirmative duty to disclose the disputed information. The Supreme Court held in *Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17, 99 L. Ed. 2d 194, 108 S. Ct. 978 (1988),* that "silence, absent a duty to disclose, is not misleading under Rule 10b-5." Even if the information that was not disclosed is deemed to be material, "there is no liability under Rule 10b-5 unless there is a duty to disclose it." *Glazer v. Formica Corp., 964 F.2d 149, 156 (2d Cir. 1992).*

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n9 See supra note 5.

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Plaintiff alleges that Defendants had a fiduciary relationship with the DOA which arose from their contract with the DOA, their relationship with the DOA, or both. (Compl. PP 25, 26.) Plaintiff further alleges that Defendants' fiduciary relationship imposed a duty upon them to disclose all information material to the 1992 COPs issue, including all facts material to the DOA's purchase of the escrow securities. Id. P 27. Plaintiff contends that Defendants failed to disclose prior to the closing of the 1992B COPs offering that: (1) Rauscher would act as principal for its own account in selling the escrow

securities to DOA; (2) Rauscher would make a substantial profit from the sale; (3) the amount of the undisclosed profit; (4) the escrow could be purchased for a lower price from other dealers; (5) the prices DOA was charged exceeded the mean of the bid and offered prices for the securities on an established market; and (6) the profit received by Rauscher could jeopardize the tax exempt status of the 1992B COPs. Id. P 28. Plaintiff asserts that these were material omissions that Defendants made knowingly, recklessly, or negligently. Id. Defendants deny that they had any statutory, regulatory, or fiduciary duty to disclose any of the aforementioned information to the DOA. (Rauscher Mot. at 13-20.) Accordingly, Defendants argue that Plaintiff's omissions claim must be dismissed because, even if the aforementioned information was material, they had no duty to disclose it to the DOA.

The Supreme Court has held that parties have a duty of disclosure to one another when a fiduciary or agency relationship exists, or when circumstances exist such that one party has placed trust and confidence in the other. See *Chiarella v. United States, 445 U.S. 222, 232, 63 L. Ed. 2d 348, 100 S. Ct. 1108 (1980).* The Ninth Circuit has held that in order to determine whether a party has a duty to disclose, a court must examine: (1) the relationship of the parties, (2) their relative access to information, (3) the benefit that the defendant derives from the relationship, (4) the defendant's awareness that the plaintiff was relying upon the relationship in making his investment decision, and (5) the defendant's activity in initiating the transaction. See *Jett v. Sunderman, 840 F.2d 1487, 1493 (9th Cir. 1988).* As part of the inquiry required by Jett, a court must look to Arizona law to determine if the relationship between the parties creates a fiduciary duty. Arizona courts have held that a fiduciary duty exists when there is a "great intimacy, disclosure of secrets, entrusting of power, and superiority of position in the case of the representative," and that "to establish a fiduciary (confidential) relationship there must be something approximating business agency, professional relationship, or family tie." *Rhoads v. Harvey Publications, Inc., 145 Ariz. 142, 700 P.2d 840, 847 (Ariz. Ct. App. 1984).* The Arizona Supreme Court has held that a confidential relationship exists between a client and his or her financial adviser when there is an imbalance of knowledge so that the client relies heavily on the adviser for advice. See *Stewart v. Phoenix Nat'l Bank, 49 Ariz. 34, 64 P.2d 101, 106 (Ariz. 1937)* (holding that a confidential relationship existed when the bank had acted as the plaintiff's financial adviser for many years and he relied upon the bank's advice). Arizona and federal courts are in agreement that generally the question of whether a fiduciary relationship exists is a question of fact. See *Rhoads, 700 P.2d at 846; Firestone v. Firestone, 316 U.S. App. D.C. 152, 76 F.3d 1205, 1211 (D.C. Cir. 1996).* In Rhoads, the Arizona Court of Appeals held that the question of whether a confidential relationship exists is a question of fact "provided there is sufficient evidence to submit the issue." *700 P.2d at 846.* In Firestone, the D.C. Circuit held that the "existence of a fiduciary relationship is a fact-intensive question involving a searching inquiry into the nature of the relationship, the promises made, the type of services or advice given and the legitimate expectations of the parties." *76 F.3d at 1211.* While Defendants raise questions concerning Plaintiff's ability to ultimately prove their material omissions claim, this Court finds that Plaintiff has alleged enough facts to state an omissions claim.

Plaintiff alleges that Defendants' financial advisory contract with the DOA created a fiduciary relationship between Defendants and the DOA. (Compl. P 25.) Plaintiff contends that the contract required Defendants to provide advice and assistance in all aspects of the issuance of the 1992B COPs. Id. Plaintiff further contends that the contract explicitly stated that the DOA would pay no expense for Defendants' services other than a financial advisory fee of $71,856 for the 1992B COP offering. Id. P 13.

Defendants deny that their contract with the DOA created a fiduciary relationship. Defendants contend that there was no fiduciary relationship between the parties because the express terms of the contract provided that each party would "act in its individual capacity and not as an agent of the other." (Rauscher Mot. at 17.) Defendants claim that this case is indistinguishable from *Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F.3d 993, 1000 (5th Cir. 1995),* where the court found that contractual language similar to that found in Defendants' contract precluded a finding of fiduciary duty. Gateway is distinguishable. The contract in Gateway specifically stated that "each party shall act as an independent contractor and not as an agent for, partner of, joint venturer with the other party. The parties create no other relationship outside of that contemplated by the terms of the subcontract." *Id. at 1000* (emphasis

added). Further, the Fifth Circuit found, based on the relationship of the parties and the unambiguous language of the contract, "the parties intended no formal relationship which would impose fiduciary duties on MCI." Id. A close examination of the contract between the DOA and Defendants indicates that ambiguities exist, and that the contract could have created a fiduciary relationship despite the above language. Under the "Standard Terms and Conditions" portion of the contract, the contract states that "each party will act in its individual capacity and not as an agent, employee, partner, joint venturer, or associate of the other." (Rauscher Mot. Ex. A at 26.) However, "Part Two" of the contract, specifically discusses Rauscher's duties as financial adviser, states that Rauscher will "provide advice and assistance in all aspects of the lease purchase process." Id. at 13.

Defendants further argue that in addition to the contract, the confirmation forms they sent to the DOA also establish that Defendants were not acting as the DOA's agents but as principals on their own account. n10 Defendants cite *Press v. Chemical Inv. Serv. Corp., 988 F. Supp. 375, 382 (S.D.N.Y. 1997)* as allegedly controlling. Press involved a one time transaction where Mr. Press bought a U.S. Treasury bill worth roughly $100,000 from Chemical Investment Securities. *Id. at 378.* Further, the confirmation form sent by the defendant, the only contract between the parties, specifically stated that it was acting as principal. *Id. at 379.* In addition, the court found that Press had pleaded no facts and made only conclusory allegations to support the claim that the defendants were acting as his agent. *Id. at 381.* Based on those facts, the court concluded that when a confirmation form clearly establishes that no fiduciary relationship exists, a court may reject a party's conclusory allegations that such a relationship exists. n11 *Id. at 382.* In the instant case, Plaintiff has alleged facts to support its allegation that a fiduciary duty exists based on the contract. In addition to the contract, the parties had an ongoing business relationship which may have required Defendants to disclose, prior to the closing of the deal, that they were acting as principal in the sale of the securities. Because of the significant factual differences between Press and the instant case, this Court is not persuaded that Press controls the instant case. Assuming that the contract did not create a fiduciary relationship, contractual language does not preclude a finding that the parties' relationship gave rise to a confidential or fiduciary relationship. See *Gateway, 64 F.3d at 1000* (finding that even though the contract did not create a fiduciary duty, the relationship between the parties could create such a duty).

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n10 Plaintiff did not refer to the confirmation forms in its complaint. Generally, a district court may not consider any material beyond the pleadings in a Rule 12(b)(6) motion. *Hal Roach Studios, Inc. v. Richard Feiner & Co., 896 F.2d 1542, 1555 n.19 (9th Cir. 1990).* The Ninth Circuit has held that "a document is not 'outside' the complaint, only when "the complaint specifically refers to the document and if its authenticity is not questioned." *Branch v. Tunnell, 14 F.3d 449, 454 (9th Cir. 1994),* cert. denied, *512 U.S. 1219, 114 S. Ct. 2704, 129 L. Ed. 2d 832 (1994).* When matters outside the pleadings are presented to and not excluded by the court, a Rule 12(b)(6) motion is treated as one for summary judgment and disposed of as provided in Rule 56. This Court declines to convert this motion into a motion for summery judgment. *Cortec Indus. Inc. v. Sum Holding L.P., 949 F.2d 42 (2d Cir. 1991)* does not persuade this Court to consider the confirmation forms in this motion. In Cortec, the court held that "where plaintiff has actual notice of all the information in the movant's papers and has relied upon these documents in framing the complaint the necessity of translating a Rule 12(b)(6) motion into one under Rule 56 is largely dissipated." *Id. at 48.* In this case, Plaintiff did not rely on the confirmation forms to frame its Complaint. Further, in Cortec the plaintiff alleged that misrepresentations had been made in the forms, and then did not attach those forms to the complaint. Here, Plaintiff is not relying on the confirmation forms.

n11 In addition to the reasons listed above the court in The Press also noted that "Press has commenced at least one other very similar securities class action in this District . . . alleging violations of Section 10b-10 and 10b-5, and state common law in connection with the sharing of certain fees between introducing and clerking brokers without disclosure to, or consent of, investors. Press's complaint in that case was

dismissed in its entirety." *988 F. Supp. at 384.* It appears the court in Press may have been influenced by the plaintiff's unwarranted persistence in litigating meritless claims.

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Plaintiff alleges that Defendants' relationship gave rise to a fiduciary relationship that imposed duties on Defendants both during the issuance of the bonds and the sale of the securities. Plaintiff alleges that as DOA's financial adviser in connection with the 1992B COPs offering, Defendants assumed substantial responsibility for structuring the offering, preparing the necessary documentation, and advising the DOA regarding the allocation and investment of issue proceeds. (Compl. P 18.) Plaintiff alleges that only Rauscher had access to information concerning the prices it paid for the securities and the profit it reaped. Id. P 21. Plaintiff contends that Defendants derived substantial benefits from its relationship with the DOA. Id. P 22. Plaintiff alleges that Defendants made $707,037 on the sale of the treasury securities, in addition to their $71,856 adviser fee, and that Feltham personally made over $100,000 on the deal. Id. Plaintiff further contends that Defendants knew, or should have known, that the DOA personnel responsible for the 1992B COPs offering were inexperienced with advance refunding transactions and relied heavily on their advice. Id. P 31. As a result of their contractual duties, and the reliance of the DOA on Defendants, Plaintiff contends that Defendants had a fiduciary duty to provide the DOA with complete information and unbiased advice and assistance in all aspects of the 1992 COPs offering including the purchase of the escrow securities. Id. P 4. Plaintiff has clearly pled enough facts to satisfy the state and federal standards for determining the existence of a fiduciary relationship.

Defendants argue that even if they had a fiduciary relationship with the DOA during the 1992B COPs offering, that fiduciary duty did not extend to the separate and independent transaction of providing the DOA with the United States Treasury securities for its escrow account. Defendants contend that they made it obvious to the DOA that they were not acting as a fiduciary in the sale of the securities by disclosing on the confirmation forms that they were acting as a "dealer" in "an arm's length transaction." (Rauscher Mot. at 18.) In essence, Defendants argue that they had no duty to disclose their markup on the sale of the Treasury securities to the DOA because it was a completely independent transaction from the DOA's 1992B COPs offering. Defendants contend that because they had no duty to disclose during the second transaction, *United States v. Cochran, 109 F.3d 660 (10th Cir. 1997)* controls. In Cochran, the Tenth Circuit found that the absence of a "duty to disclose" was dispositive in a case involving fraud in a municipal securities transaction. *Id. at 667.*

Defendants' reliance on Cochran is misplaced because the facts of Cochran are distinguishable from those in the instant case. n12 First, Cochran was not acting as an investment advisor to his client, but merely as a underwriter for the bond offering. *Id. at 662.* Second, Cochran's client understood that underwriting the bond offering was a separate transaction from defendant's work brokering the guaranteed investment contract. *Id. at 666.* Third, the bond offering had already closed before the defendant brokered the guaranteed investment contract. Id. Fourth, the plaintiffs did not rely upon the defendant to advise or evaluate the guaranteed investment contract. Id. Finally, the plaintiffs admitted that Mr. Cochran did not have a fiduciary duty with them during the second transaction of negotiating the guaranteed investment contract. Id. In the instant case, Plaintiff has alleged that Defendants recommended that the DOA issue bonds in order to buy securities, they helped the DOA in all aspects of their bond offering, and, finally, they sold the DOA, after locking out all competitors, the securities at an undisclosed markup.

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n12 The defendant, Mr. Cochran, was the head of an underwriting firm that participated in a bond offering for the Oklahoma City Airport Trust Authority. *Cochran, 109 F.3d at 662.* In addition to acting as underwriter for the offering, the defendant also brokered a collateralized guaranteed investment contract. Id. The defendant received an undisclosed fee of $489,241.09 for his work in the second transaction. Id.

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Whether these were indeed two separate and distinct transactions, and whether Defendants had a fiduciary duty during the sale of the securities are both questions of fact that cannot be resolved in a motion to dismiss. Further, even if Defendants are correct in asserting that their fiduciary relationship did not extend to the sale of the securities, the existence of a fiduciary relationship during the bond offering may have required them to disclose the markup information to the DOA when they notified the DOA that they would be providing the securities. See *Rhoads, 700 P.2d at 845* (holding "where a relation of trust and confidence exists between two parties so that one of them places peculiar reliance in the trustworthiness of another, the latter is under a duty to make a full and truthful disclosure of all material facts and is liable for misrepresentation or concealment").

Finally, Defendants argue that the SEC and Municipal Securities Rulemaking Board ("MSRB") rules and regulations determine whether a duty to disclose existed. Defendants contend that under SEC and MSRB rules they had no statutory or regulatory duty to disclose information to the DOA regarding the markups. Defendants argue that they had no duty to disclose the markup under Rule 10b-10 because Rule 10b-10 does not apply to the sale of equity securities. (Rauscher Mot. at 14.) Defendants further contend that they had no duty to disclose the markup under MSRB Rule G-23, because Rule G-23 only imposes disclosure requirements on financial advisers when they purchase securities from their clients, not when they sell securities to their clients. Id. Defendants assert that in 1992, MSRB Rule G-23 did not even suggest that a financial adviser was required to make any specific disclosures when selling securities to an issuer. (Rauscher Reply at 10.) Defendants further contend that the absence of a full disclosure requirement in MSRB Rule G-23 can only be premised on the MSRB's view that no fiduciary relationship exists between a financial adviser and an issuer. Id. at 11. Defendants further assert that MSRB Rule G-23 establishes that an issuer and financial advisor may act as principals in relation to each other in transactions associated with an issuance so long as the financial adviser discloses its status as principal. Id.

Plaintiff does not contend that Defendants did not comply with these rules. Further, even if Defendants did comply fully with MSRB and SEC Rules, courts have held that "a broker-dealer's compliance with the disclosure requirements of Rule 10b-10 does not, as a matter of law, shield it from possible liability under Rule 10b-5." *Ettinger v. Merrill Lynch, Pierce, Fenner & Smith, Inc, 835 F.2d 1031, 1036 (3d Cir. 1987)* (emphasis added).

C. Plaintiff's Omission Claim Based on Excessive Markups

Plaintiff asserts that Defendants had a duty to disclose the markups because the markups were excessive. Plaintiff contends that the undisclosed markups charged by Defendants were excessive (1) in light of the circumstances surrounding the sale, and (2) because they were not reasonably related to prevailing market prices. (Compl. P 1.) Plaintiff alleges that Defendants had a duty to disclose the markups because the prices they charged were excessive in light of: (1) the existence of a fiduciary relationship; (2) the fact that Rauscher never considered or approached any other firm about providing the securities through competitive bid or negotiation; (3) the fact that Defendants assigned themselves the job of selling the securities despite an offer by the Office of the Treasurer of the State of Arizona to supply the securities; and (4) the fact that Defendants did not disclose, until after the deal had closed, that they would purchase the securities as principal for their own account. Id. P 18. Plaintiff also alleges that Defendants had a duty to disclose the markups because they knew, or should have known, that the prices were excessive because they were not reasonably related to prevailing market prices. Id. Plaintiff alleges that Defendants made an undisclosed profit of $707,037 on the sale of their securities to the DOA. Id. Plaintiff further alleges that Defendants sold the DOA thirteen different securities with markups ranging from .0236% to .7333%, with the average markup for the entire deal being .55%. Id. P 20. Finally, Plaintiff asserts that the average markup charged by dealers-brokers in sales of Treasury securities comparable to those at issue in the instant case range from zero to 2/32 (or .06%). n13 (Resp. at 28.)

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n13 Plaintiff suggested leave to amend its Complaint to include this allegation. Plaintiff's request will be granted because the particularity will assist in moving the litigation forward.

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Defendants, once again, contend that Plaintiff's complaint has not met the particularity requirements of Rule 9(b). Defendants contend that under the holding of *Christidis v. First Pennsylvania Mortgage Trust, 717 F.2d 96, 100 (3d Cir. 1983)* and *Glenfed, 42 F.3d at 1549,* Plaintiff must show how Defendants' actions were inconsistent with reasonable practices. Defendants would be correct if Plaintiff was asserting that a fraudulent statement about the markup had been made, Plaintiff, however, is asserting that Defendants made no statement about the markup at all. In Christidis and Glenfed, the courts addressed statements made by banks in which they estimated loan loss reserves. In both cases, the plaintiffs were alleging that statements concerning loan loss reserves were fraudulent because they were different from later statements made by the bank that contained revised loan loss figures. See *Christidis, 717 F.2d at 98; Glenfed, 42 F.3d at 1543.* In Glenfed, the court held "both the valuation of assets and the setting of loan loss reserves are based on flexible accounting concepts . . . plaintiff must set forth facts demonstrating why the difference between the earlier and the later statements is not merely the difference between two permissible judgements, but rather the result of falsehood." *42 F.3d at 1549.* In Christidis, the court held that estimates of loan loss reserves "could be fraudulent only if, when they were established, the responsible parties knew or should have known that they were derived in a manner inconsistent with reasonable accounting practices. What those practices were and how they were departed from is nowhere set forth." *717 F.2d at 99.* Because Plaintiff is asserting an omission claim, those cases do not apply. Taking all these allegations as true, and drawing all inferences in favor of Plaintiff, Plaintiff has clearly met the requirements of Rule 9(b).

Plaintiff must first establish that Defendants had an affirmative duty to disclose the markup. There can be no question that broker-dealers have an obligation under federal securities laws to disclose markups that may be deemed excessive. See *SEC v. Feminella, 947 F. Supp. 722, 729 (S.D.N.Y. 1996).* This duty arises because there is an implied representation by broker-dealers when they hang out their shingle to do business that they are charging their customers securities prices that are reasonably related to the prices charged in an open and competitive market. See *Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943).* Broker-dealers that do not disclose that they are charging excessive markups are committing fraud. See *SEC v. First Jersey, 101 F.3d 1450, 1469 (2d Cir. 1996).* Thus, Defendants had a duty to disclose their markup only if it was excessive. Defendants contend that Plaintiff cannot establish a duty to disclose because the markup they charged was not excessive as a matter of law.

Plaintiff contends that the reasonableness of a markup can be determined only on the basis of the individual facts of each case. Plaintiff contends that case law has held that in order to determine whether a markup is excessive, a fact finder must assess all the relevant facts and circumstances of the transaction including: (1) the industry practice regarding the range of appropriate markups on a security in comparable transactions; (2) the availability of the security; (3) the total amount of money involved in the transaction; (4) the nature of the broker-dealer's business and the pattern of its markups; (5) the unit price of the security; (6) the nature of the services that the brokerage firm provides to the customer; and (7) the extent to which the broker-dealer was at risk in the transaction. See *Feminella, 947 F. Supp. at 729.* Plaintiff contends that because the determination of excessiveness depends so heavily on an extensive factual inquiry, it cannot be resolved on a motion to dismiss. In support, Plaintiff cites to Feminella where the court held:

Given the fact-specific nature of the inquiry, it is clear that there is no single, fixed definition of what constitutes an excessive markup for all transactions. Rather, the fact finder must determine whether, under all the circumstances of the transaction, the price charged for the security was reasonably related to the prevailing market price. This determination cannot reasonably be made upon a motion to dismiss. Id.

The complex nature of a securities transaction generally makes it impossible in a motion to dismiss for a court to find that a markup is or is not excessive as a matter of law. This Court, however, rejects Plaintiff's position that excessiveness can never be determined in a motion to dismiss. As Defendants correctly point out in their motion, the SEC's position is contrary to the case law which has held that some markups are

either so excessive, or so minimal, that they do not need to be heard by a fact-finder at trial. See *Press, 988 F. Supp. at 385* (holding that as a matter of law that a markup of 1/6 of one percent was not excessive); *Grandon, 147 F.3d 184, 1998 U.S. App. LEXIS 13027, 1998 WL 321695,* at *9 (holding that "we anticipate that in some cases a trial court, as a matter of law, properly may conclude that a plaintiff has failed to state a claim that the markups were excessive"). While this Court agrees that it can determine whether markups are excessive as a matter of law, it is unable to rule that the markups charged by Defendants on these motions to dismiss were not excessive as a matter of law.

Defendants basically assert that a safe harbor exists in securities law that allows for markups of 5% or below. (Rauscher Mot. at 8.) Defendants contend that, in addition to the general 5% markup policy that the National Association of Securities Dealers (the "NASD") has created for debt securities, the SEC has also provided specific guidance for broker-dealers of zero-coupon bonds. n14 Id. at 9. Defendants contend that in the Zero-Coupon Release, the SEC recognized that the industry practice was to charge markups of up to 3.5%. Id. Defendants further contend that while the SEC recognized that markups of one percent could be excessive, the clear implication of the Release was that a markup of less than one percent on the purchase price was not excessive. Id. Defendants contend that because their average markup of .55% was at the low end of the range of markups allowed under the NASD's 5% policy and the guidelines for zero-coupon securities, their markups were not excessive as a matter of law.

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n14 Zero-coupon securities are debt securities that do not pay interest to the holder periodically prior to maturity. *Zero-Coupon Securities Release, No. 34-24368, 1987 WL 133877,* at *15576 (Apr. 29, 1987). The majority of the securities Defendants sold to the DOA were zero-coupon securities.

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Defendants assert that courts have recognized that the 5% policy and the guidelines in the Zero-Coupon Release clearly foreclose this Court from finding that the .55% markup they charged in this case is excessive. Id. at 9-10. In support, Defendants rely heavily on the holding in Press. In Press, the plaintiff asserted that the defendant had charged an excessive undisclosed markup of 1/6 of one percent on a six-month Treasury bill in violation of Rule 10b-5. *988 F. Supp. at 385.* In making its decision, the court relied heavily on the Zero-Coupon Release. Id. In reaching its decision that the markup was not excessive, the court stated that "simply put, the markup is indisputably at the extreme low end of what the SEC considers to be acceptable. . . . More specifically, no authority of which this court has been advised involves a markup even remotely as small as 1/6 of a percent markup at issue in this case." *Id. at 385-86.* In the court's opinion "'excessiveness' appears not to become a consideration in debt-security cases until markups reach the three to three and one-half percent range." *Id. at 386.* Finally, Defendants contend that Plaintiff cannot, just as the plaintiff in Press could not, cite to any authority that has held that a markup under the 3.5% threshold set in the Zero-Coupon Release is excessive. n15 (Rauscher Mot. at 10.)

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n15 In support of their position, Defendants cite to *Banca Cremi, 132 F.3d 1017 at 1037* (holding that markups of 1.78% to 5.25% were not excessive); *Bank of Lexington, 959 F.2d 606 at 614* (holding that a 5.02% markup on zero-coupon bonds was not excessive); *In Re Investment Planning, Inc., 51 S.E.C. 592, 1993 SEC LEXIS 1897, 1993 WL 289728,* at *2 (July 28, 1993) (holding that markups on municipal bonds between 4 and 5.99% were excessive); and *In Re Lehman Bros., Inc., 62 S.E.C. 2195, 1996 SEC LEXIS 2453, 1996 WL 519914,* at *5 (Sept. 12, 1996) (holding that markups of 3.5 to 4.7% were excessive).

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Defendants' argument is that the NASD and the SEC guidelines have produced a safe harbor, such that a court can rule, without taking into consideration the circumstances surrounding the deal, that a markup was not excessive simply because it fell below a certain percentage is not supported by the case law. While neither the SEC nor the MSRB has adopted a numerical standard for excessiveness, "the SEC has consistently held, that in sales of equities, undisclosed markups of more than 10% above the prevailing

market price violate securities law." *Bank of Lexington, 959 F.2d at 606.* The Commission has also "consistently . . . taken the position that mark-ups on debt securities . . . generally are expected to be lower than mark-ups on equity securities." Id.; see also *SEC v. Charles A. Morris & Assoc., Inc., 386 F. Supp. 1327, 1334 (W.D. Tenn. 1973).* The NASD has taken the position that a markup on securities in excess of 5% is generally excessive. See *Lehl v. SEC, 90 F.3d 1483, 1487 (10th Cir. 1996).* While the SEC and NASD have been willing to set a ceiling for markups, they have refused to set a floor, below which a markup can never be found excessive. The NASD has consistently stated, and courts have consistently held, that the five percent policy is not a rule, but merely a guideline. See *Samuel B. Franklin & Co. v. SEC, 290 F.2d 719, 725 (9th Cir. 1961); Lehl, 90 F.3d at 1487; Bank of Lexington, 959 F.2d at 613.* In Lehl, the Court explained that:

The NASD cautioned . . . that the 5% policy 'is a guide--not a rule'; that a mark-up pattern of 5% or even less may be considered unfair or unreasonable; and that in the case of certain low-priced securities, such as those selling below $10.00, a somewhat higher percentage may sometimes be justified.

90 F.3d at 1488 n.4. In other words, excessiveness depends on the circumstances surrounding the deal as well as the percentage charged. For this reason, the SEC has held that markups below five percent can be excessive. See *In Re Investment Planning, Inc., 1993 WL 289728,* at *2 (holding that markups on municipal bonds between 4 and 5.99% were excessive); and *In Re Lehman Bros., Inc., 1996 WL 519914,* at *5 (holding that markups of 3.5 to 4.7% were excessive). The SEC's Zero-Coupon Release did not eliminate the need for a court to examine a markup in light of the circumstances surrounding a transaction; it merely lowered the ceiling for acceptable markups on debt securities. n16 *1987 WL 133877,* at *15576. While Defendants correctly note that the markups they charged were towards the low end of the range listed in the Zero Coupon Release, that fact alone does not mean that their markups were not excessive. The Zero Coupon Release simply indicates that the industry practice in 1992 was to charge markups from 3 1/2 percent to 1/32 of one percent, depending on maturity, order size, and availability. Id. In other words, under some circumstances, markups as high as 3 1/2% may not be excessive, but under other circumstances markups above 1/32 of one percent may be excessive. Defendants' argument that the Zero Coupon Release clearly implied that markups below one percent could not be excessive is not persuasive. The relevant portion of the Release states:

> the commission has become aware of the practice of a number of broker-dealers of charging a percentage mark-up based on the face amount of a zero-coupon security for all maturities, a pricing practice often employed in the market for conventional coupon bonds. Although this percentage may be as low as 1% of the face amount, such pricing can result in a mark-up that is excessive relative to the prevailing market price because zero-coupon bonds trade at a deep discount.

Id. at *15577 (emphasis added). There is no support in the Release for Defendants' argument that the SEC was setting one percent as a safe harbor. In fact, when the Release is read in its entirety, the exact opposite conclusion is reached. The SEC warned that a markup on zero-coupon bonds as low as one percent could be excessive because there was a practice among some brokers of charging a one percent markup. Id. There is simply no indication in the Release that the SEC was definitively stating that a markup below one percent could not also be excessive.

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n16 In 1988, the SEC issued its Zero-Coupon Release in which it recognized that "as a general matter, common industry practice regarding mark-ups is to charge a mark-up over the prevailing inter-dealer market price of between 1/32% and 3 1/2% for conventional or 'straight' Treasuries depending on maturity, order size, and availability." *1997 WL 133877,* at *15576.

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Defendants' argument that Press controls this case is also not persuasive. Press involved a one time transaction in which Mr. Press bought a "straight" U.S. Treasury bill worth roughly $100, 000 from

Chemical Investment Securities. 988 F. Supp. at 378. The defendant charged a markup of 1/6 of 1% on the transaction. Id. The confirmation form sent by the defendant, the only contract between the parties, specifically stated that it was acting as principal. Id. Finally, the court found that "Press provided no authority for his contention that 'the industry spread' for such a markup is five times less than what the defendants charged." Id. In the instant case, Plaintiff alleges that a fiduciary duty and other circumstances surrounding the deal exist to make the markup excessive. Further, the majority of the securities sold to the DOA were zero-coupon bonds, not "straight" treasuries. In the Zero-Coupon release, the SEC warned broker-dealers that markups as low as 1% could be excessive on zero coupon securities, but made no such warning for straight treasuries. n17 *1987 WL 133877,* at *15577. Finally, the SEC has alleged that the markups typically charged for the refunding transactions at issue here range from zero to 2/32 of one percent (.06%). (Resp. at 28.)

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n17 In the Zero-Coupon Release, the SEC stated that "it is expected . . that percentage mark-ups on zero-coupon securities, as with other debt securities, usually will be smaller than those on equity securities." *1987 WL 133877,* at *15577. The SEC also stated that markups as low as one percent on zero-coupon bonds could be excessive because "they trade at a deep discount." Id.

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In none of the cases cited by Defendants did a court rule that the markup was not excessive simply because the percentage charged was under the 5% guideline, or the guidelines of the Zero-Coupon Release. In Press, the court recognized that "the determination as to whether a given markup is or is not excessive depends on a range of factors." Id. In Banca Cremi, the Fourth Circuit Court of Appeals rejected the fraud claim not because the markup was not excessive, but because "a disclosed markup would not have mattered." Id. at 1037. Finally, in Bank of Lexington, the Sixth Circuit Court of Appeals upheld the district court's finding that the markups were not excessive because "the bank had failed to cite any evidence, besides the markup percentage, that Vining-Sparks had charged the bank an unfair price." *959 F.2d at 613.*

Defendants are incorrect in stating that the SEC cannot cite to any authority that has held that a markup of less 3 1/2 percent may be excessive. The Commission held *In Re Lehman Brothers, Inc., 1996 WL 519914,* at *6, that markups ranging from 3.5% to 4.7% were excessive. Significantly, the Commission further held that of the approximately $1,390,000 of markups that Lehman Brothers had charged on the $38.5 million securities sale, "at least $1 million" of that was excessive. Id. The markup the SEC considered appropriate under the circumstances of the case turns out to be approximately 1.01%. Defendants contend that markup was still twice the average markup they charged the DOA. The "at least" language, however, indicates that the SEC was only offering an estimate, and that the proper markup in the case could have been much lower than one percent. Further, even if Plaintiff could not cite to a case where a court found that a markup of less than 3.5% was excessive, that does not mean that Defendants' markup was not excessive.

While Defendants' arguments raise questions concerning Plaintiff's ultimate ability to prove its omissions claim, they do not persuade this Court to rule as a matter of law that Plaintiff cannot prove that the markups were excessive under the circumstances surrounding the transaction or because they were above the prevailing market price, or both.

Defendants contend that even if the markups were excessive, they did not have fair notice in 1992 that markups of less than one percent could be excessive. Defendants contend that as late as 1993, the SEC recognized that its markup decisions had failed to give notice to the industry that markups of less than five percent were excessive. Defendants cite to *In Re First Honolulu Securities, Inc., 51 S.E.C. 695, 1993 WL 380039,* at *4 (Sept. 21, 1993), where the SEC held that "under all the circumstances before us here, however, it may not have been clear to applicants in 1990 that mark-ups on municipal securities of over four percent usually are unfair." Defendants further contend that in *Platsis v. E.F. Hutton & Co., 946 F.2d 38, 41 (6th Cir. 1991)* and *Banca Cremi, 132 F.3d 1017 at 1037,* courts have reached the same conclusion

as the SEC in First Honolulu, that broker-dealers did not have notice that markups below five percent could be excessive.

Defendants contend that the lack of notice makes it impossible for Plaintiff to establish that Defendants acted with scienter. n18 In *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976),* the Supreme Court defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud." The Ninth Circuit Court of Appeals has held that in addition to knowing or intentional misconduct, recklessness may satisfy the element of scienter in a civil action for damages under Rule 10b-5. See *Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990).* The Ninth Circuit has held that:

Reckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

Id. (quoting *Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977),* cert denied, *434 U.S. 875, 54 L. Ed. 2d 155, 98 S. Ct. 224, 98 S. Ct. 225 (1977)).* Defendants contend that the most precise markup guidance available in June of 1992 was the SEC's Zero-Coupon Release and the NASD's 5% policy. (Rauscher Mot. at 12.) Defendants assert that because no guidance in 1992 even suggested that a markup of less than 1 percent could be fraudulent, their markups of .0266 to .73 of one percent could not have been excessive. Defendants contend that if they had no notice that their markups were excessive, then under no circumstance could their actions have been an extreme departure from the prevailing standards necessary to find scienter. Defendants also assert that the retroactive application of a new standard violates due process. Defendants contend that even if the SEC now considers markups in excess of .06 of one percent to be excessive, no one in the industry was on notice in 1992 that such standards would be applied rather than those in the Zero-Coupon Release. (Rauscher Reply at 7.)

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n18 See supra note 7.

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Once again, Defendants' arguments raise questions of fact. At trial, or the summary judgement stage, Defendants may be able to argue that there was no industry practice of charging less than a one percent markup, that the industry had no notice that markups of less than one percent could be excessive, and that they did not have the necessary mental state to satisfy the scienter requirement; but, in this motion, those arguments are not well-taken. The cases cited by Defendants do no more than raise material issues of fact, they do not settle the issue. Plaintiff alleges that the industry practice was to charge between zero and 2/32 of one percent markup on transactions comparable to those at issue in this case. (Resp. at 28.) Plaintiff further alleges that the markups changed by Defendants ranged from .02 of one percent to .77 of one percent. (Compl. P 20.) These allegations, taken as true, could potentially allow a reasonable trier of fact to find that scienter existed.

Defendants' due process claim must also fail because Plaintiff asserts that in 1992 the industry standard was to charge between zero and 2/32 of one percent for transactions like the one in question. (Resp. at 28.) A new standard is not being applied retroactively; Plaintiff is asserting that the same standard has existed all along. If this standard did exist as Plaintiff alleges, then people within the industry obviously knew that the SEC could sue those broker-dealers who charged in excess of that standard, even if the SEC was not actively pursuing claims against those broker-dealers in 1992.

Finally, Defendants' argument that its markup practice was in line with industry practices, and therefore, it could not have violated the law was rejected by the court in *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, 135 F.3d 266, 273-74 (3d Cir. 1996).* In that case, the Third Circuit Court of Appeals held:

In concluding as we do, we are not unmindful of the fact, deemed determinative by the district court, that execution of customer orders at the NBBO was a practice 'widely, if not almost universally followed' in the securities industry . . . . Under the district court's logic, a Section 10(b) defendant would be entitled to summary judgement even if it were her regular practice to knowingly violate the duty of best execution, so long as she could identify a sufficient number of other broker-dealers engaged in the same wrongful conduct to be able to argue in good faith that the underlying duty was 'ambiguous.' We cannot accept an analysis that would produce such a result. Even a universal industry practice may still be fraudulent.

Id. Accordingly, this Court finds that Plaintiff has met its burden under Rule 12 for its omission claim based on excessive markups.

D. Plaintiff's Claims Under the Investment Advisers Act of 1940

Plaintiff has alleged in all three of its claims that in addition to violating the Securities Act of 1933 and the Securities Exchange Act of 1934, Defendants also violated the Investment Advisers Act of 1940 ("the Act"), *15 U.S.C. § 80b-6.* Defendants contend that all three of Plaintiff's claims brought under the Act fail to state a claim that is actionable under the Act.

Defendants contend that the only basis for Plaintiff's allegations is the fact that Defendants are registered as investment advisers under the Act. (Rauscher Mot. at 28.) Defendants assert that registration as an investment adviser does not alone bring all of a broker-dealer's actions within the scope of the Act. Id. Accordingly, Defendants contend that the Act does not apply to the transactions at issue in this case for several reasons. First, Defendants assert that the Act's definition of an investment adviser specifically excludes those who provide advice with respect to debt obligations of, or guaranteed by, the United States. Id. Defendants argue that because the Complaint alleges that the securities they provided to the DOA were Treasury securities of the United States, they are not a financial adviser under the Act. Id. Second, Defendants contend that Plaintiff's allegation that they acted as an investment adviser in the sale of the securities is contrary to the other allegations in the Complaint, the terms of the contract, and the information contained in the confirmation forms. Defendants argue that these documents establish that Defendants were acting as a broker-dealer. Third, Defendants assert that even if the statutory exclusion did not apply, there is no authority for the proposition that a financial consultant who assists in the structuring and issuance of municipal bonds is subject to the Act. Id. Defendants further contend that in *Dominion Resources, Inc., SEC No-Action Letter, 1985 WL 54428,* at *6 (Aug. 24, 1985) and *The Knight Group, SEC No-Action Letter, 1991 WL 251302,* at *2-*3 (Nov. 13, 1991), the SEC held that firms that provide ancillary investment advice to state and local governments in the course of providing assistance in the issuance of bonds are not subject to the requirements of the Act. Id. Defendants assert that any advice they gave concerning a forward supply contract, or a guaranteed investment contract (GIC), or both, was ancillary advice regarding the "investment of temporarily idle proceeds of an issue" and, as such, is not "investment advice" subject to the Act. See *The Knight Group, 1991 WL 251302,* at 2-3. Finally, Defendants assert that a prerequisite of the Act is that there must be a charge for the investment advice, and in this case Defendants did not charge or receive compensation for their advice. (Rauscher Mot. at 29-30.)

Defendants' allegation that the only basis for Plaintiff's claims is the fact that Defendants are registered as investment advisers under the Act is incorrect. Plaintiff alleges that Defendants acted as an investment adviser, within the meaning of the Act, because in connection with the 1992B COPs offering, Defendants received a fee for their advice to the DOA concerning the availability of investing in, purchasing, or selling securities. (Compl. P 23.) Plaintiff alleges that in addition to selling the escrow securities to the DOA, Defendants advised the DOA to structure the defeasance escrow to include a forward supply contract. Id. Plaintiff also alleges that Defendants received a separate fee for acting as co-broker in the procurement and sale of a GIC. Id. Plaintiff has demonstrated in its allegations that it has relied upon more than the mere fact that Defendants are a registered financial adviser to assert their claims under the Act.

Defendants, however, are correct in stating that registration as an investment adviser under the Act does not alone bring all of a broker-dealer's actionParty Fees i scope of the Act. In order to face liability under the Act, a defendant must first meet the Act's definition of an investment adviser. The Act defines an investment adviser as:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities . . . .

15 U.S.C. § 80b-2(11). Plaintiff has alleged that Defendants, for compensation, advised them as to the advisability of investing in United States Treasury securities, a forward supply contract, and a GIC. (Compl. P 23.) Plaintiff has alleged enough facts to support its allegation that Defendants are an investment adviser under the Act. The only remaining question is whether Defendants meet one of the exclusions to this definition that has been created by SEC regulations or the Act itself.

Defendants are correct when they state that the Act's definition of investment adviser excludes those who provide advice with respect to debt obligations of the United States. The Act states that the definition of investment adviser excludes "any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct of indirect interest . . . ." *15 U.S.C. § 80b-2*(11)(E). The SEC, however, has consistently stated that this exception does not apply when an individual, in addition to providing advice on United States securities, gives advise on any other security that is not a United States' security. In *J.Y. Bery Arbitrage Mgmt., Inc, SEC No-Action Letter, 1989 WL 246531,* at *3 (Oct. 18, 1989), the SEC stated "you should note that if you provide advice as to any security other than a government security as provided in Section 202(a)(11)(E), you may not rely on this exception." See also *Securities Counselors of Iowa, Inc., SEC No-Action Letter, 1989 WL 246135,* at *5 (June 29, 1989). In this case, Plaintiff has alleged that in addition to advising the DOA to buy United States Treasuries, Defendants also advised them to invest in a forward supply contract and a GIC. (Compl. P 23.) Both the forward supply contract and the GIC are separate debt securities, and neither was issued or insured by the United States. Accordingly, Defendants do not come under the government securities exception.

Defendants' argument that it was clear from the contract and the confirmation forms that they were acting as a broker-dealer, and not a financial adviser, in the sale of the securities has already been found unpersuasive. Even assuming that Defendants were acting as a broker-dealer in the sale, the Act only excludes broker-dealers from the definition of an investment adviser when the "performance of such services (financial advising) is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." *15 U.S.C. § 80b-2*(11) (C). Plaintiff has alleged that Defendants' advice was not incidental to, but central to the 1992B COPs offering. (Compl. P 14.) Plaintiff alleges that Defendants' advice included recommending which securities should comprise the escrow, that the escrow include a supply contract, what price the DOA should pay for the escrow securities, the amount of money the DOA should accept for the forward supply contract, and whether the reserve fund should be invested in a GIC. Even assuming that Defendants were acting as broker-dealer, the broker-dealer exclusion is inapplicable because based on these allegations, this Court cannot find that advice given was "solely incidental" to Defendants' broker-dealer business.

Defendants' argument that The Knight Group and Dominion Resources, Inc. No-Action Letters control this case is unpersuasive. Defendants seem to assert that these letters have established that a financial consultant who advises on municipal issues is never subject to the Act. This interpretation of the letters is unpersuasive. Neither letter states that financial advisers that provide advice to municipal issues are exempt from the Act. The Dominion Resources, Inc. letter comes the closest to supporting Defendants' position and it merely states that "the division of Investment Management ("IM") has asked us to inform you that, in general, IM does not interpret Section 202(a)(11) of the Investment Advisers Act of 1940 to

apply to persons that advise issuers on how to structure their financing." *1985 WL 54428,* at *6. The "in general" language clearly indicates that there is no rule that municipal finance advisers do not meet the definition of financial adviser under the Act. The letters simply held that the SEC would not take action against individuals that gave investment advice at the request of the issuer concerning idle proceeds from the offering. See *The Knight Group, 1991 WL 251302,* at *2 (stating that the SEC stated they would not seek action against the Knight Group if the advice was "requested by the issuer" and limited to "recommendations about investment of temporarily idle proceeds of an issuer pending their project use"); *Dominion Resources, Inc., 1985 WL 54428,* at *6 (stating that the SEC stated they would not take action against Dominion if they advised "without compensation and as an accommodation to the issued" and only made "recommendations about the investment of temporarily idle proceeds of an issue"). Defendants contend that any advice they gave concerning a forward supply contract, or a GIC, or both, concerning idle proceeds is contrary to the facts alleged by Plaintiff. As Plaintiff correctly points out, the whole purpose of issuing 1992B COPs was to raise proceeds which were sufficient, if properly invested, to defease the 1988 COPs and achieve savings for the State. Defendants' role was to insure that the proceeds of the offering were, in fact, properly invested. Plaintiff has alleged that Defendants recommended the various securities investments. Plaintiff has also alleged that Defendants charged a fee for their advice. Finally, Plaintiff has alleged that there were no idle proceeds to give advice on because the plan from the beginning was to invest the proceeds from the offering in United States Treasury securities, a GIC, and a forward supply contract. Based on the facts alleged by Plaintiff, Defendants cannot rely on The Knight Group and Dominion Resources, Inc., No-Action letters.

Finally, Defendants' allegation that they received no compensation for their advice is contrary to the facts alleged in the Complaint. Plaintiff alleges that Defendants received $71,840 as a financial advisory fee, over $700,000 for selling the escrow securities, and additional and separate compensation for its work in the procurement and sale of the GIC. (Compl. PP 13, 22, 23.) While some of Defendants' arguments appear to raise questions of fact, they do not prove Plaintiff cannot, as a matter of law, prove its claims under the Act.

Accordingly,

IT IS ORDERED that Plaintiff's Motion for leave to amend its Complaint to include allegations concerning the industry standard of markups is granted. Plaintiff has thirty days to file an Amended Complaint.

IT IS FURTHER ORDERED that Defendant James R. Feltham's Motion to Dismiss (Doc. # 9) is denied.

IT IS FURTHER ORDERED that Defendants Rauscher Pierce Refsnes, Inc.'s and Dain Rauscher Inc.'s Motion to Dismiss (Doc. # 11) is denied.

DATED this 24 day of AUGUST, 1998.

THE HONORABLE ROSLYN O. SILVER

UNITED STATES DISTRICT JUDGE

Securities and Exchange Commission v. Robert M. Cochran, Michael B. Garrett and Randall W. Nelson, Civ. Action No. 95-1477T (W.D. Okla.), Litigation Release No. 14644 (September 20, 1995) consolidated with Securities and Exchange Commission v. James V. Pannone and Sakura Global Capital, Inc., Civ. Action No. CIV98-146L (W.D. Okla.), Litigation Release No. 15630 (January 29, 1998) (complaint); Securities and Exchange Commission v. Robert M. Cochran, Randall W. Nelson, James V. Pannone, Steven Strauss, and Sakura Global Capital, Inc., (Order granting in part and denying in part motions for summary judgment of defendants)(January 28, 1999); Litigation Release No. 16063 (February 17, 1999) (settled final orders).

See "THE UNDERWRITER" section.

Administrative Proceedings - Commission Decisions

In re Boettcher and Company, Exchange Act Release No. 8393, A.P. File No. 3-544 (August 30, 1968).

See "THE UNDERWRITER" section.

Commission Orders - Settled Administrative Proceedings

In re Lazard Freres & Co. LLC, Securities Act Release No. 7671, Exchange Act Release No. 41318, A.P. File No. 3-9880 (April 21, 1999).

See "THE FINANCIAL ADVISOR" section.

In re John E. Thorn Jr., and Thorn Welch & Co., Inc., Securities Act Release No. 7663, Exchange Act Release No. 41233, A.P. File Nos. 3-8400 and 3-9860 (March 31, 1999).

See "THE UNDERWRITER" section.

In re Eugene J. Yelverton, Jr., Securities Act Release No. 7662, Exchange Act Release No. 41232, A.P. File No. 3-9859 (March 31, 1999).

See "THE UNDERWRITER" section.

In re Kidder, Peabody & Co. Inc., Exchange Act Release No. 41224, A.P. File No. 3-9857 (March 30, 1999).

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that a public cease-and-desist proceeding be, and hereby is, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether Kidder, Peabody & Co. Incorporated ("Kidder") violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

II.

In anticipation of the institution of this proceeding, Kidder has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of this proceeding and any other proceedings brought by or on behalf of the Commission or in which the Commission is a party, and without admitting or denying the findings contained herein, except that Respondent admits the jurisdiction of the Commission over it and over the subject matter of this proceeding, Kidder consents to the issuance of this Order Instituting Public Proceeding, Making Findings and Imposing a Cease-and-Desist Order and Disgorgement ("Order") and to the entry of the findings and the imposition of the relief set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds the following: n1

- - - - - - - - - - - - - - - - - -FOOTNOTES- - - - - - - - - - - - - - - - - -

n1 The findings herein are made pursuant to Respondent's Offer and are not binding on anyone other than Respondent Kidder.

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A. Respondent

Kidder, Peabody & Co. Incorporated was, at all relevant times, a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act. Kidder withdrew its registration by filing a Form BDW, which was effective January 1996.

B Other Relevant Entity

Tampa, Florida ("Tampa" or "City") is the largest municipality in the State of Florida. At all relevant times, the City was empowered to issue bonds and invest the bond proceeds in accordance with applicable laws and regulations.

C. Facts

This matter involves material misrepresentations by Kidder in connection with the purchase of an Escrow Reinvestment Agreement ("Agreement"); whereby Kidder was able to purchase the Agreement at less than fair market value. Kidder's purchase of the Agreement at less than fair market value had the effect of reducing--or "burning"--the yield on that Agreement, a form of "yield burning."

In December 1993, Kidder was the winning bidder for the right to enter into an Agreement awarded by the City. Kidder also had been responsible, along with another broker-dealer (referred to here as "BD-1"), for soliciting bids on the Agreement from others. During the bidding, an individual affiliated with BD-1 ("Registered Person") engaged in misconduct that caused two bidders (one of which was affiliated with the Registered Person), to submit artificially low bids. Kidder won the Agreement with a bid of $1.319 million, more than $3.0 million below what Kidder then believed the Agreement was worth.

In connection with the award of the Agreement, Kidder and BD-1 made certain representations to the City regarding the bidding process and the value of the Agreement. Kidder either knew or recklessly disregarded that these representations were false. In subsequent purchases and sales of securities under the Agreement, Kidder and BD-1 realized profits of nearly $3.5 million.

1. The City's Series 1991 Advance Refunding Bonds

In April 1991, the City issued its tax-exempt $138,610,000 Utilities Tax and Special Revenue Refunding Bonds, Series 1991 (the "Series 1991 Bonds"). The Series 1991 Bonds were advance refunding bonds, meaning that the City intended to use the proceeds to repay previously-issued bonds when those bonds became due and payable. Because the previously-issued bonds were not then due and payable, the City set up an escrow account to hold the proceeds from the Series 1991 Bonds.

The proceeds from the Series 1991 Bonds were invested in various federal government securities, which were chosen in amounts and for durations such that they matured as near as possible to the time the City would actually need the proceeds to repay the previously-issued bonds. However, in several instances, the federal government securities matured prior to the time the City actually needed the funds. These gaps, referred to as "float periods", ranged from 45 to 228 days.

Pursuant to certain provisions of the Internal Revenue Code ("IRC"), a municipal issuer of tax-exempt advance refunding bonds may invest the bond proceeds so long as the issuer does not earn an overall return on the proceeds materially higher than the yield on the underlying tax-exempt bonds. See *26 U.S.C. § 148.* These provisions are generally referred to as the "IRC arbitrage provisions." An issuer must either structure the escrow in compliance with these provisions or run the risk that the Internal Revenue Service will declare interest on the advance refunding bonds taxable. Id.

As originally structured, the overall yield to the City was below the maximum it could earn. Thus, an opportunity existed for the City to earn additional investment income if the City could find a proper vehicle through which to invest proceeds from the Series 1991 Bonds during some or all of the float periods in the escrow, so long as that additional income did not cause the overall yield on the escrow to exceed the maximum, which was 6.892697%.

2. The Proposal by Kidder and BD-1 to Restructure the Escrow for the Series 1991 Bonds

In late 1992, Kidder and BD-1 proposed that the City restructure the escrow for the Series 1991 Bonds. Kidder's primary representative in this matter was a then Senior Vice President in Kidder's Tampa office (the "Former Senior Vice President"). In his dealings with the City, the Registered Person presented himself as a representative of BD-1. Neither Kidder nor the Registered Person ever disclosed to the City that the Registered Person was also affiliated with a second broker-dealer (referred to here as "BD-2"). n2

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n2 Kidder's relationship with the Registered Person was memorialized in a four-page agreement dated February 23, 1993. The agreement lists a number of pending escrow restructuring proposals (including the transaction with the City) and details the manner in which the parties would share any profits arising from the transactions. The Registered Person signed the agreement on behalf of BD-2.

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The proposal Kidder and BD-1 eventually presented to the City focused on seven float periods in the escrow. Under the proposal, Kidder would make an initial cash payment to the City, and Kidder would obtain the right, at the outset of each float period, to sell to the escrow a federal government security that matured on or before the end of the float period, in an amount at least equal to the amount the City needed to meet its underlying repayment obligation. Kidder would then take the proceeds from the escrow that the City paid in exchange for the federal government security, reinvest those proceeds for the duration of the float period and retain for itself any reinvestment earnings. At the end of the float period, Kidder would retain both the principal amount of the proceeds and any reinvestment earnings, and the City would retain the initial cash payment and the government security provided by Kidder, which would mature as needed to meet the City's underlying repayment obligation.

The increase in the City's overall yield on the escrow from such a transaction is determined by the amount of the initial payment: the higher the payment, the higher the City's overall yield. Thus, the size of the initial payment the City could receive was limited by the requirement that the City's overall yield on the escrow not exceed the yield on the City's underlying tax-exempt bonds.

In a proposal dated January 11, 1993, Kidder and BD-1 proposed a transaction which would result in a payment to the City of $1,367,928.33. In this proposal, Kidder and BD-1 calculated that the effect of such a payment would be to increase the City's yield on the escrow to 6.892591%, just below the yield restriction of 6.892697%.

In late 1993, the City agreed to enter into an Escrow Reinvestment Agreement. However, IRC arbitrage provisions required that any payment to the City under the Agreement represent "fair market value" for

the reinvestment rights transferred under the Agreement. 26 CFR § 1.148-5(d)(6)(iii). One of the purposes of the fair market value requirement is to ensure that investment banks and others that enter into such agreements with yield-restricted escrow accounts do not artificially depress the yield to the municipality (and thus allow the municipality to appear to be in compliance with the IRC arbitrage provisions). Id. Such practices are commonly referred to as "yield burning."

Regulations under the IRC provided a safe harbor for determining the fair market value of an investment contract such as the Agreement. Among other things, the IRC regulations required that an issuer obtain bids for any such investment contract from at least three qualified bidders (i.e., bidders with no other financial interest in the transaction) and that the contract be awarded to the highest bidder. Id.

As a result, in December 1993 the City required that Kidder and BD-1 solicit bids on the Agreement from at least three bidders not otherwise involved in the escrow restructuring, to ensure that the initial payment the City received for the Agreement represented fair market value.

3. The Rigged Bidding on the Escrow Reinvestment Agreement

As noted above, in their January 11, 1993 proposal Kidder and BD-1 determined that the maximum initial payment the City could receive for an escrow restructuring without violating IRC yield restrictions was approximately $1.37 million. However, internal Kidder documents prepared by the Former Senior Vice President prior to bidding on the Agreement in late 1993 show that Kidder believed that the present value of the Agreement was between $4.34 million and $4.8 million, far above the maximum amount the City could receive. Kidder never disclosed its present value calculations to the City.

Kidder agreed to be jointly responsible, along with BD-1, for soliciting bids on the Agreement. The bidding produced bids from three entities, in addition to a bid from Kidder itself. At least two of the non-Kidder bids, which ranged from $1,205,000 to $1,301,550, were rigged. In one instance, the Registered Person provided false information to a bidder as to the amounts available for reinvestment and the duration of the float periods under the Agreement, which caused that bidder to submit an artificially low bid. In a second instance, the Registered Person (known to the City only as a representative of BD-1) solicited an artificially low bid from BD-2, without disclosing the fact that he was affiliated with BD-2 or that BD-2 had a written agreement to share with Kidder in any profits either party realized on an escrow restructuring transaction with the City. n3 As a result, Kidder was the high bidder for the Agreement at $1.319 million, more than $3.0 million below what Kidder then believed the Agreement was worth.

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n3 Notwithstanding the fact that it agreed to be jointly responsible with BD-1 for the bidding process, Kidder took no part in preparing or distributing the bid solicitation forms, contacting potential bidders or reviewing the bids received.

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4. Misrepresentations by Kidder and BD-1 in the Representation Letter

With the bidding complete, the City awarded the Agreement to Kidder and held a closing on December 28, 1993. As part of the closing, Kidder and BD-1 each signed a letter (the "Representation Letter") which contained the following three representations, each of which was false.

The first representation was that the yield to the City on the Agreement. i.e. the initial payment to the City) was at least equal to the yields offered on similar obligations under similar agreements. This representation was false because, as internal Kidder documents show, Kidder believed the actual present value of the Agreement was at least $4.34 million, or $3.0 million more than Kidder's winning bid.

The second representation was that in soliciting the bids Kidder and BD-1 had not acted with an intent to reduce the resulting yield to the City. This representation was false because the Registered Person had obtained an artificially low bid from one bidder by providing that bidder with false information and had obtained a second artificially low bid from his affiliated company, BD-2.

The third representation was that Kidder and BD-1 had taken reasonable steps to obtain bids for the Agreement from at least three bidders not otherwise involved in the escrow restructuring. This representation was false because one of the bids the Registered Person obtained was from BD-2. Because it already had a profit-sharing agreement with Kidder concerning the transaction with the City, BD-2 was not a disinterested bidder.

The City's Special Tax Counsel drafted the Representation Letter and relied on each of these representations in rendering his opinion that entering into the Escrow Reinvestment Agreement would not jeopardize the tax-exempt status of the Series 1991 Bonds.

5. Profits to Kidder and BD-1 Resulting from the Fraudulent Escrow Reinvestment Agreement

The Agreement contemplated that Kidder would realize its profits over time; at the outset of each float period, Kidder would sell a security to the City in exchange for escrow proceeds, which Kidder would then reinvest for its own benefit. However, the Agreement included a second option which allowed Kidder to substitute securities for those in the escrow, and thus realize its profits sooner.

In February 1994, Kidder exercised this second option, which required the City to liquidate certain federal government securities then held in the escrow. The securities at issue were those which, had the City held them to maturity in the escrow, would have produced the proceeds scheduled to be available for reinvestment during each of the seven float periods covered by the Agreement. The market value of the securities the City liquidated was $142,089,275.40. Pursuant to the terms of the Agreement, Kidder then required the City to use those proceeds to purchase from Kidder a group of securities sufficient to meet the City's repayment obligations on its underlying tax-exempt bonds at the end of each of the seven float periods. The market value of the securities Kidder sold to the City was $137,494,667.37. The difference, approximately $4.6 million, was wired to Kidder by the City's escrow agent pursuant to the Agreement. Kidder also realized commissions of nearly $400,000 for the trades. Thus, the gross profits on the transaction were $4,992,072.72.

After deducting Kidder's initial payment to the City and other expenses, net profits on the transaction were $3,461,724.66. Of this amount, Kidder retained $1,676,673.08 and transferred the balance, or $1,785,051.58, to BD-1.

6. Kidder's Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

In signing the Representation Letter, Kidder made material misrepresentations of fact in connection with the sale of securities to the City, in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The first representation was that the yield i.e., the initial payment) to the City under the Agreement was at least equal to the yield on similar obligations under similar agreements. At the time it made this representation, Kidder knew that the present value of the Agreement was in excess of $4.34 million. Thus, Kidder knew that, absent the IRC-imposed restriction on the amount of the initial payment the City could receive, a willing buyer would have paid much more than Kidder's winning amount of $1.319 million for the right to enter into the Agreement. Because Kidder was aware of the significant disparity between the present value of the Agreement and the amount of its winning bid, Kidder either knew or recklessly disregarded the fact that this first representation was false.

The second representation was that the bids for the Agreement were not solicited with an intent to reduce the yield to the City. Kidder was reckless in making this representation because Kidder knew that its own winning bid was more than $3.0 million below what Kidder believed the Agreement was worth, and that

the only reason Kidder had limited the size of its bid was to limit the yield to the City on the Agreement. The fact that Kidder relied on the Registered Person to solicit bids from other parties does not change this analysis, since any such bids were lower than Kidder's winning bid.

Similarly, Kidder was reckless in disregarding the falsity of the third representation--that Kidder and BD-1 had taken reasonable steps to obtain bids from at least three bidders not otherwise involved in the escrow restructuring. Had Kidder conducted even a minimal inquiry, it would have learned that one of the bids was from BD-2, with which Kidder already had an agreement to share profits from any escrow restructuring agreement with the City. Under these circumstances, Kidder was reckless in falsely representing that it had obtained bids from at least three bidders not otherwise involved in the escrow restructuring.

IV.

On the basis of this Order and the Offer submitted by Respondent, the Commission finds that Kidder violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

V.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 21C of the Exchange Act, that Kidder:

(1) cease and desist from committing or causing any violation and any future violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

(2) disgorge, within 30 days after the date of issuance of the Commission's Order, an amount equal to Kidder's wrongful profits of $1,676,673.08 plus prejudgment interest, computed and payable as follows:

(a) if paid by Kidder on or before March 31, 1999, a total amount of $2,466,657.34;

(b) if paid by Kidder after March 31, 1999, the amount of $2,466,657.34 plus interest to be accrued at an annual rate of 7.62%, compounded daily beginning April 1, 1999; and

(3) make the monetary payment called for in the Order by United States postal money order, certified check, bank cashier's check, or bank money order payable to the United States Treasury. Such payment shall be sent by certified mail to: Mr. Charles Anderson, Group Manager-Tax Exempt Bond Group, Southeast Key District Office (EP/EO), Department of the Treasury, Internal Revenue Service, 31 Hopkins Plaza, Room 1420, Baltimore, MD 21201, with a cover letter that identifies the payment as relating to the City of Tampa, Florida Utilities Tax and Special Revenue Refunding Bonds, Series 1991, and also identifies Kidder as the Respondent in the public proceeding instituted by the Order. A copy of the cover letter and the payment instrument shall simultaneously be sent to David B. Bayless, District Administrator, San Francisco District Office, Securities and Exchange Commission, 44 Montgomery Street, Suite 1100, San Francisco, California 94104.

By the Commission.

In re O'Brien Partners, Inc., Securities Act Release No. 7594, Investment Advisers Act Release No. 1772, A.P. File No. 3-9761 (October 27, 1998).

See "THE FINANCIAL ADVISOR" section.

In re Meridian Securities, Inc., and Corestates Capital Markets, Securities Act Release No. 7525, Exchange Act Release No. 39905, A.P. File No. 3-9582 (April 23, 1998).

See “THE UNDERWRITER” section.

RELIANCE ON COUNSEL

Federal Court

SEC v. Senex Corp., 399 F. Supp. 497 (E.D. KY. 1975).

See “OBLIGATED PERSONS” section.

Administrative Law Judge Decision

In the Matter of Thorn, Alvis, Welch, Inc., John E. Thorn, Jr., and Derryl W. Peden, 61 SEC Docket 2524 (May 2, 1996).

TEXT: INITIAL DECISION

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission (Commission) initiated this proceeding on June 23, 1994, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), and Sections 15(b), 19(h), and 21C of the Securities Exchange Act of 1934 (Exchange Act). The Order Instituting Proceedings charges that, from about August 1992 through at least February 1994, the respondents willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that Thorn, Alvis, Welch, Inc. (TAW) willfully violated, and Mr. Thorn willfully aided and abetted violations of, Section 15B(c)(1) of the Exchange Act and Rule G-17 of the Municipal Securities Rulemaking Board (MSRB).

I held five days of hearing in Atlanta, Georgia, in January and February 1995 at which each side presented nine witnesses. n1 I allowed 157 exhibits into evidence: three from counsel, 87 exhibits by the Division of Enforcement (Division), and 67 by the respondents. n2

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n1 Three people testified twice. The transcript for January 2 through 5 is numbered 1 to 1002 and I will refer to it as Tr. . The transcript of February 9 is numbered 1 to 210. I will refer to it as Tr. 2/9/95 at .

n2 The Division's exhibits are referred to by number as Div. Ex. ; the respondents' exhibits are referred to by number as Resp. Ex. . Exhibits that were stipulated to by all parties are referred to by number as Counsel Ex. .

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The parties filed consecutive briefs. I received the last brief on April 28, 1995. I deny respondents' single sentence request for oral argument received in April 1995 because they gave no reason why they needed another opportunity, in addition to briefs, to present arguments to me.

Respondents

TAW, a broker-dealer with a single office in Jackson, Mississippi, has been registered with the Commission, pursuant to Section 15(b) of the Exchange Act, since 1977. TAW specializes in municipal tax-exempt securities.

Mr. Thorn has owned a 25 percent interest in TAW since it was founded. He is a director and has been president of the firm for 18 years. He has degrees from Mississippi College and New Orleans Baptist Theological Seminary. Mr. Thorn is a registered municipal securities principal. He did not take an exam but was grandfathered in when TAW joined the National Association of Securities Dealers. Tr. 51-52. In a 30-year career in the securities industry, Mr. Thorn's activities have consisted almost entirely of selling and underwriting tax-exempt securities. Tr. 53, 55-57.

The Commission entered an Order Making Findings and Imposing a Cease and Desist Order Against Derryl W. Peden on December 2, 1994. *58 SEC Docket 0505 (1995).*

Issues

Whether Respondents TAW and Mr. Thorn have willfully violated the antifraud provisions of the securities statutes, and either willfully violated or willfully aided and abetted violations of Rule G-17 of the MSRB, and Section 15B(c)(1) of the Exchange Act and, if they did so, (a) what remedial action is appropriate; (b) whether they should be ordered to cease and desist from committing or causing violations and future violations of the statute and rules thereunder; (c) whether they should be ordered to comply with the applicable laws and regulations in the future; (d) whether they should be ordered to disgorge amounts, including reasonable interest; and (e) whether civil penalties should be imposed.

Findings of Fact n3

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n3 My findings are based on the record and my observation of the witnesses' demeanor. I applied preponderance of the evidence as the applicable standard of proof. I have considered all proposed findings and conclusions and all contentions, and I accept those that are consistent with this decision.

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Reading this record is reminiscent of reading Alice in Wonderland in that things are not what they appear to be and, as Alice exclaimed, events get "Curiouser and curiouser!" n4

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n4 Lewis Carroll, Alice's Adventures in Wonderland, Chap. II.

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In the period August 1992 through October 1993, TAW was the underwriter on seven non-rated private activity urban renewal revenue bond offerings totaling almost $19.5 million by two Mississippi counties - Warren or Hinds County. n5

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n5 The term private activity bond indicates that a municipality or state government served in effect as a conduit for the private party to achieve tax-exempt financing. Tr. 635. A bond is a private activity bond if 10 percent or more of the bond issue proceeds are used for private business uses. Internal Revenue Code, *26 U.S.C. § 141.*

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Name of Project	Face Value	Date
Sherwood Garden Apartments	$ 1,375,000	August 27, 1992

Northwest Plaza Apartments	950,000	January 21, 1993
Eden Point Apartments	2,470,000	March 26, 1993
The Pines	1,865,000	April 30, 1993
Northpark Apartments	625,000	May 15, 1993
Glen Oaks Apartments	4,050,000	July 28, 1993
The Lodge Apartments	7,950,000	October 20, 1993

Counsel Ex. 1 at 1-2.

These bonds were not registered with the Commission, pursuant to the exemption in Section 3(a)(2) of the Securities Act.

The same parties participated in each of the seven offerings. As noted, TAW was the underwriter. The Mitchell Company (Mitchell) of Mobile, Alabama, was the contractor, and the project manager after development was completed. Attorney Derryl W. Peden (Attorney Peden), who at the time had been counsel on about 90 percent of the tax-exempt, multi-housing bonds issued in Mississippi, was bond counsel and underwriter's counsel in the first two issues by Warren County, and was bond counsel in the next five issues by Hinds County.

Mitchell, which specialized in real estate development, is the largest of fourteen companies and partnerships known as the Mitchell Group which was run as one business enterprise. n6 Three officers of Mitchell - Mr. Saint the president, Mr. Kelly the senior executive president, and Mr. Stefan the executive vice president - owned 70 percent of the company, and the employee stock ownership plan owned the remaining 30 percent. In the period at issue here, these persons ran Mitchell under a contract to buy the company from the Resolution Trust Corporation (RTC). Tr. 387. The Mitchell Group is not a legal entity but a term used to refer to all the companies in which at least one of the three individual owners of Mitchell - Mr. Saint, Mr. Kelly, and Mr. Stefan - owns an interest. Tr. 351-52.

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n6 The record is confusing because witnesses used the term Mitchell when they meant individual officers or employees or one of several companies.

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The material facts on all seven bond issues are sufficiently similar so that a detailed description of the first one, Sherwood Garden Apartment Project (Sherwood Garden Project, Sherwood Garden, project), is applicable to all seven situations. Counsel Ex. 1. The Sherwood Garden Project is a ninety-eight unit, garden-type apartment project, located in Vicksburg, Mississippi. Id. Mitchell learned of the property from a real estate broker in 1992. The owner, a financially distressed savings and loan association, had foreclosed on the property which was in disrepair. Local authorities would only grant a building permit on ninety-eight of the original 150 units, and required that the fifty-two units which had been flooded three times be demolished. Mitchell or Mr. Stefan and Mr. Saint took an option to buy the property. Compare Tr. 496-97; Tr. 2/9/95 at 10-14.

Each of the TAW offerings involved several legal documents. For Sherwood Garden, the legal documents are as follows:

1. The Official Statement for the bond issue dated August 27, 1992, was the disclosure document provided to prospective purchasers. Div. Ex. 1; Counsel Ex. 1 at 2.

2. The Agreement of Limited Partnership effective August 24, 1992, which created the limited partnership, Warren-Sherwood, Ltd., formed to own the Sherwood Garden Project, the subject of the bonds. n7 Div. Ex. 63C.

3. The Construction Management Contract between Warren-Sherwood, Ltd. and Mitchell dated August 23, 1992. Div. Ex. 63B.

4. The Memorandum of Agreement prepared by Attorney Peden to memorialize what occurred at the closing. Div. Ex. 63(a). n8

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n7 Paul C. Wesch, Mitchell secretary, senior vice president, and legal counsel, prepared the documents. According to Attorney Wesch, the certificate of limited partnership executed July 22, 1992, is a perfunctory but statutorily required document. Tr. 728. The partnership agreement is a non-filed instrument prepared on or after July 22, 1992, but prior to its first execution on August 21, 1992.

n8 The underwriter allowed a person with conflicting interests to sign documents for more than one party. For example, Mr. Stefan signed the construction contract between Mitchell and Warren-Sherwood, Ltd., on behalf of Warren-Sherwood, Ltd., of which he was a partial owner. Mr. Stefan was an executive vice president of Mitchell.

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Attorney Wesch acted as counsel for Warren-Sherwood, Ltd. when it was negotiating a construction contract with Mitchell, his employer. Moreover, Attorney Wesch opined on August 27, 1992, that Warren-Sherwood, Ltd., owned by some of the same people who owned his employer, had validly executed the documents regarding the bonds at issue. Resp. Ex. 84D.

Mr. Thorn signed the Memorandum of Agreement for TAW and Warren-Sherwood, Ltd. Mr. Stefan signed the same document for Mitchell and Warren-Sherwood, Ltd.

Attorney Peden, in his capacity as bond counsel, opined that the bonds were tax-exempt and, in his capacity as underwriter's counsel, prepared with Mr. Thorn the Official Statement which made this representation. n9 Tr. 69-75. TAW sold these bonds to the public as qualified tax-exempt private activity bonds, and in doing so it used the mails and other means of interstate commerce.

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n9 I reject Mr. Thorn's denial that he prepared the Official Statement with underwriter's counsel. He admits to furnishing counsel with information, reviewing and providing comments on counsel's draft, and approving the final version which was furnished to investors.

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The Official Statement for the Sherwood Garden bond issue, dated August 27, 1992, represented that:

1. Interest on the bonds is excludable from income for federal income tax purposes.

2. The bond proceeds are expected to be used primarily to provide the Issuer, Warren County, with funds to loan to the Developer to finance the acquisition, partial demolition, reconstruction, renovation, and expansion of an existing multifamily rental housing project located in an urban renewal area of the Issuer.

3. The Developer is Warren-Sherwood, Ltd., an Alabama limited partnership. The Developer's general partner is Disposition & Management, Inc., which is owned by Mitchell's President, John Saint, and Executive Vice-president, Chester J. Stefan. The Developer's limited partners include Mr. Stefan, Mr. Saint, Mr. Napper and Mr. Kelly, of Mitchell, and Mr. Thorn, Mr. Welch and Mr. Yelverton of TAW.

4. Mitchell, the Project Coordinator, General Contractor, and Property Manager, is a wholly-owned subsidiary of Altus Bank which has been placed under control of the RTC.

5. The contractor will guaranty the payment of a portion of the principal and interest on the bonds.

6. The construction contract will be a turnkey contract in the total amount of $686,000. n10

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n10 A turnkey contract is where the contractor agrees, for a set fee, to turn over to the developer a completed project that is ready to rent. Tr. 113.

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7. The source of funds are:

Bond principal	$ 1,375,000
Premium	27,500
Interest earned	3,500
Developer's contribution	95,450
Total	$ 1,501,450

8. One application of funds is a construction expenditure of $713,950.

9. The fair market value of the site is $525,000.

10. Mitchell will manage the project for an annual fee of 5 percent of gross rental income.

Div. Ex. 1.

Mitchell typically did not share ownership in renovated projects with others, i.e., engage in joint ventures. It agreed to jointly own these renovated projects with Mr. Thorn and others from TAW because TAW offered to arrange 100 percent financing, n11 which was not available from any other source, and Mr. Thorn required that he and others receive ownership in the projects. Tr. 356-57, 518-20; Tr. 2/9/95 at 16-17. As a result, certain owners and officers of TAW and Mitchell formed limited partnerships which became the owner/developer of each of the seven properties which were the subject of the bond offerings. Mr. Thorn signed the Agreement of Limited Partnership of Warren-Sherwood, Ltd. (limited partnership) on August 24, 1992. Div. Ex. 63(c).

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n11 One hundred percent financing refers to a situation where the parties - developer, owner and/or construction company - do not have to contribute additional funds over what is raised from the offering. Tr. 517-19.

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As noted, the limited partners of Warren-Sherwood, Ltd. were John B. Saint, Chester J. Stefan, Gordon K. Napper, and Donald P. Kelly, Jr., from Mitchell, and Lonnie Joe Welch, Mr. Thorn, and E. J. Yelverton, Jr., from TAW. A limited partner's share of the profits, to be paid in cash quarterly, was in the same proportion as his ownership of the partnership. Div. Ex. 63C at 1-2. The limited partners' shares ranged from a low of 9.9 percent and a high of 19.8 percent. Mr. Thorn owned 19.8 percent of the project. Div. Ex. 1 at 8; 63C. The total capital contribution to the partnership was $2,000. The general partner paid $20. The limited partners contributed in a range between $198 and $396. Div. Ex. 63C, Schedule A.

Each of the Official Statements for the seven bond offerings listed a developer's contribution as a source of funds.

Project	Developer's Contribution	Percent of Offering Proceeds
Sherwood Garden	$ 95,450	6.81
Northwest Plaza	72,500	7.48
Eden Point	144,229	5.69
The Pines	105,143	5.49
Northpark	48,144	7.50
Glen Oaks	242,450	5.99
The Lodge	404,662	5.09

Counsel Ex. 1 at 7.

The limited partnership agreement that created Warren-Sherwood, Ltd., dated August 24, 1992, directed the partnership to enter a construction contract with Mitchell for rehabilitation of the project for actual costs plus 10 percent. Tr. 729; Div. Ex. 63C at 12-13. This limited partnership agreement provided that Mitchell n12 would be paid property management fees not to exceed 5 percent of the gross collections from the project, and an incentive fee equal to 25 percent of the distributable cash for each quarter. Div. Ex. 63C at 13; Tr. 729. As I have noted, the Official Statement did not disclose that Mitchell would receive an incentive fee.

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n12 The testimony was that the payment was to Mitchell; however, the limited partnership agreement provided for payment of the management fee and the incentive fee to "the General Partnership and its Affiliates." Div. Ex. 63C at 13. The partnership's general partner was Disposition & Management, owned by Mr. Saint and Mr. Stefan.

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Also on August 24, 1992, Warren-Sherwood, Ltd. entered into a two page Construction Management Contract (construction contract) with Mitchell. Mr. Stefan signed for Warren-Sherwood, Ltd., as the executive vice president of Disposition & Management, Inc., the general partner, and Duke W. Miller signed for Mitchell as the vice president of Armay Development Corp., a general partner of Mitchell. Div. Ex. 63B. This contract provided that Mitchell would repair and rehabilitate the project for costs plus 10 percent, and that Mitchell was not responsible for cost overruns, insuring the project, plan errors, or existing code violations. Id.; Tr. 363-64, 438-48. The Official Statement did not disclose this information or that Mitchell would receive an incentive fee to manage the property of 25 percent of net revenues.

The construction contract was just one part of the overall compensation received by Mitchell and some of its officers and employees. Tr. 362-384, 451, 453, 735; Tr. 2/9/95 at 180-96; Div. Ex 113. At least thirty days before the bond closing, Mr. Stefan, representing Mitchell, and Mr. Thorn, representing TAW, agreed that the transaction would be financed 100 percent, and that Mitchell would do the work for:

1. hard construction costs plus 10 percent; Mitchell agreed on the sum of $429,855, which included the 10 percent return on hard costs, on a best efforts basis. n13 Div. Ex. 113; Tr. 390-92, 416, 435-47. Mitchell was not responsible for cost overruns, insuring the project, plan errors or code violations. n14

2. cost of the contractor's guaranty for payment of principal and interest on the bonds, i.e., $211,000 to purchase zero coupon or stripped Treasury bonds. If these securities were not needed to pay debt service over the 25 years the bonds were outstanding, they would revert to Mitchell. Div. Ex. 113; Tr. 381.

3. ownership interest in the project for certain officers and employees of Mitchell.

4. five percent of gross rents as a management fee when the project is rehabilitated.

5. twenty-five percent supplemental management fee, i.e., percentage of distributable cash as defined in the partnership agreement. Div. Ex. 63C at 2.

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n13 Attorney Peden believed the Official Statement accurately described Sherwood Garden as a turnkey project even though the construction contract provided that Mitchell would do the work for actual costs plus 10 percent. Tr. 247-49, 929-33.

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Attorney Peden maintained that Mr. Thorn and Mr. Stefan were still negotiating Mitchell's compensation when they participated in a phone call shortly before August 27, 1992, even though Mr. Stefan and Mr. Thorn agreed on Mitchell's compensation well before that conversation. Tr. 246.

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n14 Mitchell paid small cost overruns on Sherwood Garden and some of the other projects of between five and ten thousand dollars. One project, Glen Oaks, had more serious problems and Mitchell put in approximately $86,000. Tr. 438-48.

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Tr. 361-68, 383.

According to Mr. Stefan, Mitchell would not have agreed to just a construction contract for cost plus 10 percent. Mitchell viewed the various agreements as a compensation package. It expected to make a profit from each of the agreements. Tr. 453.

Mr. Stefan learned that Mitchell was expected to make a $95,450 developer's contribution when he saw a draft of the Official Statement and the Memorandum of Agreement shortly before the bond closing. Tr. 393-95, 403-05. He called Mr. Thorn and Attorney Peden and reminded them that they had consistently represented that Sherwood Garden would be financed 100 percent. Tr. 396-97. Attorney Peden and Mr. Thorn assured Mr. Stefan that Mitchell would not have to bring a check to the closing. n15

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n15 The testimony is that Mr. Stefan was able to understand Attorney Peden's explanation when it was analogized to a Builders and Sponsors Profit and Risk Allowance (BSPRA), a device reportedly used in Federal Housing Act deals by the Department of Housing and Urban Development when the contractor leaves something of value in the project. Respondents' Counterstatement of Proposed Findings of Fact and Conclusions of Law at 25. There was no BSPRA in this situation. Tr. 399, 650, 788.

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Respondents represent that Mitchell, the construction company, made the developer's contribution in all seven offerings. At the closing on August 27, 1992, Attorney Peden directed that Batesville Security Bank, trustee for the bond proceeds, disburse the following sums from the construction fund to escrow accounts of First American Title Insurance Company (First American) at Sunburst Bank: $525,000 for Warren-Sherwood, Ltd.'s. account for site purchase; $3,500 for First American's account for title insurance premium; $1,000 for the State of Mississippi for bond allocation fee; and $95,450 for Mitchell's account representing the contractor's initial draw. Counsel Ex. 1 at 7-8.

Additional disbursements from the construction fund were: $1,000 to Batesville Bank for trustee fee; $10,787 to Attorney Peden for bond counsel fee and expenses; $6,000 to Attorney Ken Harper for issuer's counsel fee; $10,263 to TAW for underwriter's fee; and $307,021 to Mitchell for the initial draw under the

construction contract. Div. Ex. 46A. Attorney Peden directed First American to wire $83,237 of the $95,450 to TAW and the remaining $12,213 to Attorney Peden's law firm to pay issuance costs in excess of 2 percent of the offering. Tr. 410-420.

Attorney Peden had TAW, Warren-Sherwood, Ltd., and Mitchell sign a Memorandum of Agreement at the closing on August 27, 1992. n16 Div. Ex. 63A. It stated that Mitchell agreed to pay miscellaneous business expenses and obligations of the owner, Warren-Sherwood, Ltd., in consideration of being awarded the construction contract of $713,950; that payment of the expenses shall be a cost of the contractor in performing under its construction contract; and that the contractor was required to pay these costs under the contract. Mr. Stefan considered the Memorandum Agreement just another closing document, and he did not notify Mitchell's attorney that he had signed such a document or that Mitchell received $95,450 and used it to pay closing costs in excess of 2 percent. Tr. 427.

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n16 Attorney Peden prepared this because Mr. Thorn wanted to document the agreement with Mitchell. Attorney Peden believed that TAW and Mitchell "were staffed with honorable men who would adhere to their word." Tr. 254-57.

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The Sherwood Garden offering raised $1,402,500. n17 Issuance costs of the offering totaled $124,500 or 8.88 percent of bond proceeds. n18 Div. Ex. 104. TAW received net underwriter's fees of $24,750. Counsel Ex. 1 at 12; Tr. 594. Attorney Peden and his law firm received $23,000 as bond counsel fees and expenses. Counsel Ex. 1 at 11; Div. Ex. 104.

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n17 Respondents and the Division stipulated that the offering proceeds totaled $1,402,500, but the disbursement sheet at closing puts the total at $1,410,693. Compare Counsel Ex. 1 at 7 with Div. Ex. 47.

n18 In the other six offerings, issuance costs as a percentage of bond offerings were as follows: Northwest Plaza, 9.44%; Eden Point, 7.63%; The Pines, 7.57%; Northpark, 9.41%; Glen Oaks, 7.99%; and The Lodge, 6.96%. Tr. 560-74.

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TAW retained $117,376 of the total underwriting fees of $350,635 it received from the seven offerings. Counsel Exhibit 1 at 15. It disbursed $116,432 to Mr. Thorn and $116,827 to another TAW principal. Id.

Attorney Peden's law firm received a total of $152,161 from the TAW offerings. Id.

Findings of Law

Antifraud Provisions of the Securities Statutes and Regulations

It is well established that broker-dealers are subject to the same high standards when underwriting and trading municipal securities as when they underwrite and trade corporate securities. *Walston & Co., Inc., 43 S.E.C. 508, 512 (1967).* As the underwriter, TAW was required: to have a reasonable basis for recommending any municipal securities and its responsibility, in fulfilling that obligation, to review in a professional manner the accuracy of the offering statements with which it is associated.

An underwriter, whether of municipal or other securities, occupies a vital position in an offering. The underwriter stands between the issuer and the public purchasers, assisting the issuer in pricing and, at times, in structuring the financing and preparing disclosure documents. Most importantly, its role is to place the offered securities with public investors. By participating in an offering, an underwriter makes an implied recommendation about the securities. Because the underwriter holds itself out as a securities professional, and especially in light of its position vis-a-vis the issuer, this recommendation itself implies

that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings.

Release Requesting Comments on SEC Proposed Rule 15c2-12, *41 SEC Docket 1402, 1411 (1988).* See *Brown, Barton & Engel, 41 S.E.C. 59 (1962); The Richmond Corporation, 41 S.E.C. 398 (1963); Amos Treat & Co., Inc., 42 S.E.C. 99 (1964).*

The expert testimony affirmed TAW's duty as the underwriter to have a reasonable basis for the truthfulness and completeness of the factual representations in the Official Statement. Tr. 803-06. This duty included undertaking a reasonable investigation of the facts behind the disclosure documents to make sure they were not misleading. Tr. 2/9/95 at 97-102.

Mr. Thorn and, through him, TAW willfully disseminated copies of the Official Statement, the disclosure document provided to prospective purchasers, which he knew or was reckless in not knowing contained material information that was false and misleading. Mr. Thorn acted with full knowledge of the facts and the responsibilities of an underwriter intending to deceive, manipulate and defraud investors. *Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980).* Alternatively, if one accepted Mr. Thorn's claim that he did not know that certain material information was false, the evidence is overwhelming that he acted with extreme recklessness, i.e., a degree of negligence that was an extreme departure from ordinary care. *SEC v. Steadman, 967 F.2d 636, 641 (D.C. Cir. 1992).*

The Official Statement for the Sherwood Garden Project, which was similar to the other six offerings, was false and misleading in material respects by representing that:

1. interest on these bonds was tax-exempt;

2. a total of $1,500,000 was coming into the transaction, Tr. 798, and the owner/developer, Warren-Sherwood, Ltd., contributed $95,450 to the project, Tr. 796-98; Tr. 2/9/95 at 102-03;

3. $713,950 would be spent on construction, Tr. 796;

4. the construction contract was for a turnkey project so that the contractor was responsible for any cost overruns, Tr. 799-801;

5. the fair market value of the property was approximately $525,000; and

6. the contractor would furnish a guaranty on the payment of interest while the bonds were outstanding.

These representations were material because a reasonable person would consider the information important in deciding whether to invest in these securities. *TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976);* accord Basic, *Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).*

1. Bonds are not tax-exempt.

Interest on these bonds is taxable because the transaction violated two provisions of the Internal Revenue Code which made them ineligible for tax-exempt status. Section 147(g) provides that "a private activity bond shall not be a qualified [tax exempt] bond if the issuance costs financed by the issue (of which such bond is a part) exceed 2 percent of the proceeds of the issue." n19 *26 U.S.C. § 147*(g). Issuance costs include the cost of lawyers, underwriters, printers, and others concerned with issuance. Tr. 637. Section 142(a) provides that "the term 'exempt facility bond' means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide" the financed facility. *26 U.S.C. § 142*(a). n20 The term "provide" means a cost chargeable to the capital account of the facility such as the purchase, construction or rehabilitation cost. Tr. 636-37, 777. Issuance costs are not costs of providing the facility within the meaning of Section 142(a). Tr. 777.

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n19 This provision was added to the Internal Revenue Code in 1986 when Congress made a policy decision that bond professionals were making too much money from their participation in tax-exempt offerings. Tr. 778.

n20 These two provisions are applied independently. If either provision is not met, interest on the bonds is not tax-exempt. Tr. 636-38.

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As noted the developer was Warren-Sherwood, Ltd. There is not one shred of evidence that the parties ever considered that Warren-Sherwood, Ltd., which had a capitalization of $2,000, would make a developer's contribution of $95,450.

To accept respondents' position, you have to accept first that it was reasonable for them to describe in the Official Statement a contribution from Mitchell, the contractor, as a developer's contribution. Attorney Peden claimed that Mitchell was the developer because by industry custom the developer can be a party who advises the owner or does the development work for the owner. Tr. 317-21. I disagree. Mitchell was not the developer in these seven offerings. The Official Statement which Attorney Peden drafted designated Warren-Sherwood, Ltd. as the owner/developer. Two experts, Attorney N. Jerold Cohen for the Division and Attorney Margaret Joslin for respondents, thought Warren-Sherwood, Ltd. to be the developer based on their reading of the Official Statement. The drafter of the limited partnership agreement, Attorney Paul C. Wesch, considered Warren-Sherwood, Ltd. to be the developer. Tr. 659-60, 727-28; Tr. 2/9/95 at 102, 162.

Even if one excused as not misleading the Official Statement's misdescription of the developer, rather than the contractor, as the source of the contribution to pay issuance cost in excess of 2 percent, n21 the evidence leaves no doubt that Mitchell agreed to do all the work in connection with Sherwood Garden for consideration which did not include the $95,450 developer's contribution. Speaking on behalf of Mitchell, Mr. Stefan's position is unequivocal. The developer's contribution of $95,450 was of no economic consequences either to Mitchell or to Mr. Stefan. Tr. 418-23. I find the evidence persuasive that Mitchell did not earn the $95,450, and did not donate its funds to pay issuance costs over 2 percent. As an accommodation to Mr. Thorn and Attorney Peden who arranged the transaction, Mr. Stefan agreed to have it appear that Mitchell was making a contribution. As long as Mitchell and Mr. Stefan received all the economic benefits they had agreed to, Mr. Stefan was willing to do or sign whatever Attorney Peden and Mr. Thorn proposed at the closing.

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n21 The evidence is unanimous that issuance costs almost always exceed 2 percent of the offering proceeds in tax-exempt offerings. The two basic ways of raising funds to pay issuance costs over 2 percent of the offering are either a contribution from the developer or owner, or a taxable bond issue (taxable tail) for the amount of the additional costs. Tr. 2/9/95 at 81-82.

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I reject the position of respondents' municipal bond expert, Attorney Theberge, n22 that:

in the hands of the contractor, once earned it is no longer proceeds from the bonds. . . . if it is a reasonable contract and the proceeds are disbursed to the contractor and they are earned, they lose their character as bond proceeds. What the contractor does with them is irrelevant for our purposes. Tr. 981.

Attorney Theberge's belief is that:

Effectively what happened here was The Mitchell Company's contract was cost plus 10% plus $95,450. That was the contract billing, and that was a reasonable contract. They then took $95,450 and gave it, in one form or another, to their employees and shareholders, who then made a contribution to pay the excess cost of issuance. That's what the transaction was. And that's really what Stefan and -- and that's what Derryl Peden gave his opinion on I think pretty clearly. That's what Stefan I think negotiated; that is, a cost plus 10% and no one paying out-of-pocket. And when they were out-of-pocket he said, "Well, I want to adjust -- adjust it to reflect that net-net, no one's out-of-pocket." So I think the adjustment of the $95,450 was clearly what Stefan -- it was consistent with what they had negotiated. Tr. 2/9/95 at 75.

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n22 Attorney Theberge is a partner in the law firm of Kutak, Rock in Washington, D.C.

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Attorney Theberge's position is unpersuasive for several reasons. He incorrectly assumed that Mitchell was donating $95,450 which it had earned and which was part of the fee it negotiated. He determined that Mitchell's compensation was reasonable believing that Mitchell's full compensation was cost plus 10 percent and $95,450. Tr. 2/9/95 at 54, 57-58, 77. He was unaware that Mitchell also received $211,571.25 to reimburse it for the contractor's guaranty it was required to post, and that these funds went to Mitchell if the project succeeded and the funds were not used. Tr. 2/9/95 at 59. He also failed to consider that Mitchell received the right to manage the project for an annual fee of 5 percent of gross rental income. n23 Div. Ex. 1 at 9. Finally, he claimed that cost plus 30 or 25 percent would have been a reasonable fee for Mitchell's services based on the testimony of others. He had no independent judgment on this issue. Tr. 2/9/95 at 58.

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n23 No expert has opined that these offerings were tax-exempt on the facts as I have found them.

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Attorney Theberge also adopted certain false theories put forward by Attorney Peden:

Mitchell lowered its fee from the reasonable level of cost plus 25 or 30 percent to cost plus 10 percent with no out-of-pocket expenses because its employees and shareholders were members of the limited partnership, Warren-Sherwood, Ltd., which owned the Sherwood Garden Project;

Mitchell earned the $95,450 for reasonable services rendered and contributed it to the project to benefit some of its employees and shareholders; and

Mitchell's contract was adjusted upward by $95,450, within fair value, to cover an out-of-pocket expense (closing costs in excess of 2 percent of the proceeds) in keeping with the agreement that Mitchell would receive cost plus 10 percent without any out-of-pocket expenses, meaning 100 percent financing.

Tr. 235, 315, 322, 896-900; Tr. 2/9/95 at 50-53, 55-56, 58, 64-67, 70-71.

It is well settled that the terms agreed to by independent parties in arms length negotiations are the best evidence of what is reasonable compensation for services rendered. Tr. 2/9/95 at 148, 187. Mitchell and TAW were independent parties, and Mitchell negotiated the best deal it could get for itself and related parties in all the agreements having to do with these projects. Mitchell bargained for and got a compensation package which did not include $95,450. Div. Ex. 113; Tr. 412-19; Tr. 2/9/95 at 159.

The fact that Attorney Peden had to explain to Mr. Stefan why the Official Statement showed a developer's contribution of $95,450 undercuts his position that Mitchell earned this money. According to Attorney Peden:

I was explaining to [Mr. Stefan] and was pointing out the fact that as project coordinator in this and for the functions that they were performing [Mitchell] were certainly entitled to reasonable compensation for this because they had done a great many very valuable things for this project. The project in no way could have gone forward without the Mitchell Company's activities.

I told him that what we are doing here is you are going to be getting funds like this, in effect a developer's type fee, and it is going to be limited, though, to an amount sufficient to offset what you are going to be contributing to pay the developer's contribution. Tr. 898.

There is no evidence that Mitchell left $95,450 on the table. I find it implausible that Mitchell had a claim for an additional $95,450 over the consideration to which it had agreed. Mr. Stefan was unaware that Mitchell was going to be asked to pay these costs prior to his conversation with Attorney Peden. He expected Mitchell would receive at the closing only $211,571.25 for the contractor's guaranty. Tr. 412. It was illogical and contrived for Mr. Thorn and Attorney Peden to inform the construction company that it had earned $95,450 more than it had bargained for, and that it would use the $95,450 to pay issuance costs, including part of their fee, which exceeded the 2 percent of bond proceeds allowed in a tax-exempt offering. Tr. 898-99.

The Peden and Theberge position - that Mitchell and TAW were still negotiating a few days before the closing and agreed on terms, including a developer's contribution, on a phone call Attorney Peden held with Mr. Stefan and Mr. Thorn shortly before the closing - is false. Mitchell and TAW had agreed on terms, and contracts were in preparation or signed, when the phone conversation occurred. Tr. 375-83, 390-92, 416, 436-46. Both the partnership agreement, which directed a cost plus construction contract, and the construction contract itself were signed on August 24, 1992, a few days before the August 27 closing.

The record is persuasive that Mr. Thorn had, from the beginning of negotiations with Mitchell, consistently represented that the project would be 100 percent financed. Therefore, he and Attorney Peden structured the offering so as not to appear to violate the Internal Revenue Code restrictions for tax-exempt offerings, and yet pay issuance costs in excess of 2 percent from bond proceeds. Tr. 357. To do this, Attorney Peden and Mr. Thorn carried out a scheme to artificially inflate Mitchell's construction contract by $95,450 for services it allegedly rendered, and directed Mitchell to contribute this amount to pay Attorney Peden and TAW for issuance costs over 2 percent of the offering. Tr. 268.

Respondents emphasize all the work Mitchell did, including that of a project coordinator, to show that Mitchell earned the $95,450. Their evidence is unpersuasive. Mr. Stefan testified the term "project coordinator" was meaningless and was used because it was on the documents from a prior transaction. Tr. 495. Someone in Mitchell's role normally incurred the cost of a property appraisal. Mitchell did not order one for Sherwood Garden, however, and it did not do a formal written feasibility study. Tr. 2/9/95 at 10-11; Tr. 495. According to Mr. Stefan, all Mitchell needed was financing because they had the property under contract, had done a walk-through inspection and had budgeted needed repairs, and had spoken with building and county officials. Tr. 355-56. The evidence is that TAW's underwriting of this project as a tax-exempt offering allowed Mitchell to recoup funds that it could not recover by other means, and provided Mr. Thorn, TAW, Mitchell, and some of their officers and employees, substantial financial benefits.

Mitchell had been looking for financing for Sherwood Garden for about two years. The Mitchell employee who located all seven projects, Mr. Griffen, testified that the Department of Housing and Urban Development had rejected Mitchell's financing proposal for Sherwood Garden. According to this Mitchell real estate broker, "Nobody was willing to do [conventional financing] because of the market at that time. And we had accumulated a good amount of cost involved in our efforts to try to do something with this complex." Tr. 2/9/95 at 12-13. According to Mr. Griffen, Mitchell recovered these costs in the reduced price it paid for the property. n24 Mr. Stefan and Mr. Saint appear to have purchased the project from the

bank which was controlled by the RTC, paid a $50,000 commission, resold it to Warren-Sherwood, Ltd. for $525,000, and each pocketed $25,000. Tr. 428-30. n25

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n24 The witness's references were to Mitchell, but the evidence is that Mr. Stefan and Mr. Saint each made a profit of $25,000 by buying the property for less than the $525,000 they charged the limited partnership.

n25 Attorney Cohen calculated Mitchell's profits on the seven offerings applying respondents' position. The summary of 10 percent of construction costs, the developer's contribution, and the cost of the contractor's guaranty, would give Mitchell a profit of $371,926, or 26.52 percent of the bond offering, on the Sherwood Garden Project. Div., Ex. 117. Similar results occurred on each of the seven offerings. Attorney Cohen characterized these results as staggering in terms of total construction costs and outlandish in terms of hard construction costs. Tr. 2/9/95 at 156.

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Respondents note that these projects are all successful in that interest is being paid on the bonds and the projects provide quality housing to low-income tenants. These facts are interesting but irrelevant to resolving the allegations in this proceeding.

As support for his position, Attorney Peden relied on the use of a developer's contribution in a 1990 tax-exempt offering by Clarksdale, Mississippi, in which another law firm served as bond counsel. The Clarksdale situation does not support the legality of the developer's contribution in these seven offerings because here the source of the contribution was bond proceeds while in Clarksdale the project owners obtained a bank loan and used it to make the developer's contribution. Tr. 925.

Because the only money available to pay the expenses of the offering was from the bond issue, n26 and because $95,450 was 6.81 percent of the offering proceeds, well above the 2 percent limit for tax-exempt offerings prescribed by Section 147(g), it follows that 95 percent of the offering was not used as required by Section 142(a) of the Internal Revenue Code. n27 Tr. 668-69.

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n26 According to one expert, when, as here, no other money is brought to the table but the bond proceeds, it immediately raises questions as to whether issuance costs above the 2 percent limit are being financed from bond proceeds. Tr. 713.

n27 This is also true for the other six offerings. Counsel Ex. 1 at 7.

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The expert opinions of Attorney N. Jerold Cohen, former chief counsel of the Internal Revenue Service, n28 and Attorney Earle R. Taylor n29 are persuasive that these bonds were not tax-exempt offerings under either a direct application of the Internal Revenue Code or application of three generally accepted and closely related tax doctrines: (a) substance-over-form; n30 (b) sham transaction; n31 and (c) step transaction. n32 Tr. 650-51, 653-59, 778-90, 807.

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n28 Attorney Cohen is a partner in the firm of Sutherland, Asbill & Brennan in Atlanta. Attorney Cohen was qualified as a tax expert. Attorney Cohen believed, with close to 100 percent certainty, that these bonds were not tax-exempt. Tr. 659. In his opinion, it is doubtful that any reasonable, competent tax counsel could find these offerings to be tax-exempt. Tr. 2/9/95 at 208.

n29 Attorney Taylor, a partner in the firm of Kilpatrick & Cody in Atlanta, is a member of the firm's public finance group. He was qualified as an expert on tax law, especially disclosure and materiality. Tr. 771-74.

n30 Attorney Taylor believed this doctrine is the one that most clearly and easily destroys the tax-exempt status of these bonds. Tr. 786.

n31 This is the most difficult of the three theories to satisfy. Tr. 651, 784.

n32 Attorneys Cohen and Taylor believe that the Memorandum of Agreement, which the parties signed at the closing, described a situation which violated Internal Revenue Code Sections 142(a) and 147(g). Tr. 649-50, 779. Attorney Taylor was adamant that it showed a non-exempt transaction because Mitchell got a contract financed with bond proceeds by agreeing to pay costs that could not be paid with bond proceeds. Tr. 784-88.

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For tax analysis purposes, the $95,450 developer's contribution, which Mitchell purportedly earned and contributed to pay issuance costs, was meaningless and should be ignored under the substance-over-form doctrine, was a sham transaction, and was meaningless because the transaction does not survive scrutiny under any of the three versions of the step transaction doctrine.

The substance-over-form doctrine is applicable where the substance of the transaction is different than the form would suggest. In such a situation, the substance of the transaction governs for tax purposes. Tr. 639-40, 780-81, 784. Accordingly, the $95,450, which Attorney Peden characterized as a developer's contribution, is meaningless and should be ignored under the substance-over-form doctrine because it was, in substance, a portion of the bond proceeds used to pay issuance costs. Tr. 653-55, 786-87.

If a transaction has no business purpose or economic substance it is a sham and will be ignored for tax purposes. Mitchell was willing and ready to execute the contract without receiving $95,450. By receiving this amount and disbursing it as Attorney Peden directed, Mitchell was simply a conduit to get funds from the bond proceeds to pay issuance costs. Tr. 645-46, 648, 710. The developer's contribution was therefore a sham transaction and bond proceeds directly financed issuance costs over 2 percent. Tr. 783-86.

Respondents' argument, that Mitchell's costs were reasonable and therefore it deserved the $95,450, is irrelevant. The fact is that Mitchell agreed to do all the work on this project for an amount that did not include the $95,450 that it received, or purportedly received, at the closing which the Official Statement designated as the developer's contribution. Tr. 648-49, 655, 788.

I agree with Attorneys Cohen and Taylor that a finding that the transaction was a sham is supported by the fact that it is unreasonable to believe that (1) the RTC, which controlled the bank that owned Mitchell, would give away funds to pay issuance costs which were the responsibility of a third party, Warren-Sherwood, Ltd.; and (2) Mitchell would donate its funds when the beneficiaries included some Mitchell owners and others who had no connection to Mitchell. n33 Tr. 649, 663, 785.

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n33 Attorney Taylor believed the entire scenario contained all types of red flags. Tr. 784-85.

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This transaction does not survive scrutiny under any of the three versions of the step transaction doctrine and is, therefore, meaningless. Under the step transaction doctrine, if the taxpayer designs the transaction to have several steps to avoid taxes, the steps are collapsed and taxability is determined from what actually occurred. Tr. 641-43, 655-59, 784, 787-88. In applying the step transaction doctrine, the closer in time the steps took place, the greater the likelihood the steps will be collapsed. Here, the steps - the transfer of bond proceeds to First American, then the transfer from First American to TAW and to Attorney Peden's law

firm - happened on the day the offering closed. From a tax perspective, this would set off red flags that there is a potential step transaction problem. Tr. 656-57. Even if Mitchell received the $95,450, and I have found that it did not, Mitchell never had the ability to keep the money, because it was always obligated to use these funds to pay the issuance costs in excess of 2 percent of the offering. Tr. 254-55, 656.

Under the interdependence test, a generally accepted version of the step transaction doctrine, if the individual steps would not have been taken but for other steps, you would collapse the steps and examine what actually happened. The tax consequences of the transaction are determined by ignoring the intermediate step or steps. Here the developer's contribution would not have been paid to Mitchell but for Mitchell's agreement to use the funds to pay the issuance costs in excess of 2 percent. The intermediate step - the payment to Mitchell - would be ignored and the $95,450 would be viewed as coming directly from bond proceeds. Tr. 642, 658-59.

Two other versions of the step transaction doctrine yield the same result. Under the most limited version, the binding commitment test, because Mitchell was committed to pay issuance costs of $95,450 at the time it received that amount, one would, for tax purposes, collapse the steps and look at the end result. The $95,450 would, therefore, be considered as coming directly from the bond proceeds to pay issuance costs in excess of 2 percent. Tr. 642-43, 657. Under the end result test, the broadest application of the doctrine, the alleged payment to Mitchell and the developer's contribution in the same amount are ignored as steps taken to make it appear, for tax purposes, that bond proceeds were not used to pay issuance costs over 2 percent. Tr. 641-42. Since the only money coming in was from the bond offering, bond proceeds are considered to have been used to pay issuance costs. Tr. 657-58.

For purposes of the above analysis, I assumed respondents were correct that Mitchell received $95,450 from the bond proceeds and disbursed it to TAW and Attorney Peden's law firm. However, this claim does not appear to be true. There is nothing to indicate that First American's function was to do more than the normal function of a title company, which is to accept that portion of the bond proceeds going to purchase the property. n34 Tr. 645. I find that Mitchell had no claim to the $95,450, and neither Mitchell nor anyone acting for it ever had custody of the $95,450. This finding is supported by the testimony of the examiners from the Commission's Division of Market Regulation. In their examination of TAW's books and records, the examiners could not reconcile the statement of receipts and disbursements at closing and the Official Statement's sources and uses of funds because the funds from the developer's contribution "were not there at the closing." Tr. 743; see also Tr. 177-78.

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n34 Mr. Stefan selected First American and testified that it was "our agent." Tr. 474-75. However, considering the variety of roles Mr. Stefan played in the transaction, I am not sure if he was referring to Mitchell, he and Mr. Saint who held an option on the property, or Warren-Sherwood, Ltd. of which he was an owner. Since Warren-Sherwood, Ltd. was the owner/developer, it is logical that First American was its agent, not the agent of the construction company.

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2. Bond proceeds totalled $1.5 million

Attorney Peden and at least two experts agreed that reasonable investors would believe that funds at the closing would total $1,501,450 based on information in the Official Statement. Div. Ex 1; Tr. 336, 798; Tr. 2/9/95 at 104. This material representation was false because the developer did not contribute $95,450 so that the offering raised $1,402,500. Counsel Ex. 1 at 7; Tr. 798-99.

3. Application of funds: construction - $713,950

The expert testimony is that an investor would interpret this representation to mean that $713,950 was spent on hard costs to improve the property. This was false material information. Tr. 796-97. The

$713,000 included only about $425,000 for construction costs including the 10 percent. n35 The rest of the funds were spent on the $211,000 to reimburse Mitchell for the cost of the contractor's guaranty, and on the $95,450 for the developer's contribution. Tr. 376-77, 392, 796.

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n35 Mitchell agreed to do the work on a best efforts basis for $429,855 which included the 10 percent return. Tr. 417-19. Mr. Yelverton, who worked with Mr. Thorn at TAW, got a construction cost figure from Mitchell of about $400,000 plus. Tr. 950. Mr. Yelverton accepted the hard costs that Mitchell gave him as true, and made no attempt to verify beyond talking to persons at Mitchell. Tr. 950-53.

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4. The project was a turnkey project

There is no dispute that Mr. Thorn lied and caused Attorney Peden to believe that the construction contract for Sherwood Garden would be a turnkey contract. Mr. Thorn received a draft of the Official Statement, which stated that the project was a turnkey project, and discussed its contents with Attorney Peden and Mr. Stefan in a phone conversation a few days before August 27. TAW and Mr. Thorn issued an Official Statement which Mr. Thorn knew was materially erroneous because he knew his agreement with Mr. Stefan, the limited partnership agreement, and the construction contract which Mitchell had signed on August 24, all provided for a cost plus construction contract which absolved Mitchell from responsibility for cost overruns.

I reject Mr. Thorn's excuse that he was confused and that the misrepresentation was immaterial because Mitchell had agreed to do the construction for a sum certain. Tr. 114. The expert evidence is that the terms of the construction contract, including liability for cost overruns, are materially significant especially on an offering such as this where the funds to pay interest on the bonds will be generated solely by the cash flows from the project. n36 Tr. 800-01, 822-23.

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n36 Expert Attorney Taylor testified:

So economically there is a big difference between the contractor eating the cost overruns and the partnership eating the cost overruns. . . . To the extent the partnership has to pay cost overruns, there is less cash available to pay my bonds if I were an investor. So on that basis I say there is a material misstatement.
Tr. 800-01.

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5. Site value was $525,000

The Official Statement's Application of Funds showed $525,000 as the amount to be paid for the site purchase. Div. Ex. 63C at 11; Div. Ex. 1 at 7. Based on this representation, an investor would reasonably expect that the property was worth about one half million dollars. This was not true. It appears from the record that Mr. Stefan and Mr. Saint exercised an option and acquired the property for approximately $425,000 and resold it to Warren-Sherwood, Ltd. for $525,000. Mr. Stefan admits to negotiating a reduced price. He claimed to have paid a $25,000 commission to a real estate agent and acknowledged splitting $50,000 with Mr. Saint. Tr. 428-29; Tr. 2/9/95 at 12-14.

Mr. Stefan claimed to have told Mr. Thorn before the closing that he and Mr. Saint had purchased the site for less than $525,000. Tr. 428-29, 481-89, 525-26. Mr. Thorn's credibility is highly suspect based on the evidence in this record. Even if you accept Mr. Thorn's position that he did not know that Mr. Stefan paid less than $525,000, he did not fulfill an underwriter's obligation to assure the accuracy of this material information in the Official Statement.

Mr. Thorn devoted little time to the responsibilities of an underwriter on these offerings. Tr. 87-88. In the five months from the initial contact in April, until the August 27 closing, Mr. Stefan and Mr. Thorn only spoke five or six times for about 15 minutes each time. Tr. 358. He met with Mr. Stefan and Mr. Saint once briefly. Mr. Thorn did not verify the price Mr. Stefan actually paid for the property he resold to Warren-Sherwood, Ltd., and he failed to get an appraisal supporting the $525,000 purchase price. In 1988, the property was appraised at $1,750,000 in "as-is" condition. Tr. 2/9/95 at 11. The record does not show whether this appraisal occurred before or after 52 units had been flooded three times, and whether it considered the asbestos and other possible problems with hazardous waste caused by the required removal of the flooded units. Tr. 2/9/95 at 12.

The unrefuted expert testimony is that while the amounts are small, the fact that the property was purchased from related parties made this misrepresentation and omission material. Tr. 801-02.

6. Contractor's guaranty

The Official Statement provided that the contractor would guaranty payment of principal and interest on the bonds pursuant to a limited guaranty agreement issued by Mitchell, and that Mitchell intended to buy government zero based bonds or strips to meet this obligation. Div. Ex. 1 at iii. n37 The Official Statement did not reveal that Mitchell received the cost of the contractor's guaranty, $211,571.25, from bond proceeds. Tr. 2/9/95 at 187-93. According to Mr. Thorn, this money was part of the $713,950 described as "Construction" in the Application of Funds section of the Official Statement. Tr. 83-84; Div. Ex. 1 at 7.

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n37 Both Division experts opined that payment of $211,571.25 to Mitchell from bond proceeds for the zero interest bonds or strips violated the Internal Revenue Code provisions for a non-taxable bond offering and made the interest on these bonds taxable. Tr. 651, 779-80; Tr. 2/9/95 at 154-55. I sustained objections to this testimony because the Order Instituting Proceedings did not challenge the legitimacy of this use of bond proceeds.

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Attorney Cohen's opinion that the Official Statement permitted Mitchell to get out of its obligation to provide a guaranty by buying the strips and depositing them with the trustee is unrefuted on this record. This is not clear from the document. Tr. 2/9/95 at 187-93.

Q. But isn't part of what the contractor's being paid, the $713,000, for providing this guarantee?

A. No, there's no guarantee. The minute this transaction closed there's no guarantee, Mr. Russ. The minute the transaction closed, the strips are purchased, they're deposited, there's no further guarantee. Contractor never had a guarantee.

Tr. 2/9/95 at 192.

The expert's position is affirmed by evidence that Mr. Yelverton at TAW told Attorney Peden that Mitchell would find it difficult to furnish the guaranty because it was under RTC control, and Attorney Peden indicated he was willing for Mitchell to do the work without a bond. Tr. 953.

Municipal Securities Rulemaking Board Rule G-17 and Exchange Act Section 15B(c)(1)

On these facts, TAW violated Municipal Securities Rulemaking Board (MSRB) Rule G-17, which specifies that a broker-dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice, and Section 15B(c)(1) of the Exchange Act, which prohibits a broker-dealer from using the mails or any means of interstate commerce to effect any transaction which violates an

MSRB rule. The MSRB has interpreted Rule G-17 as prohibiting conduct which violates the antifraud provisions of the securities statutes. MSRB Manual (CCH) at 4864, 4867.

Mr. Thorn willfully aided and abetted TAW's violations because there were independent or primary securities law violations, he knew that his activities were part of an overall activity that was illegal, and he knowingly gave substantial assistance in effecting the primary violations. *Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1009 (11th Cir. 1985); IIT, an International Investment Trust v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980).*

Respondents' Arguments

Respondents argue: (1) reliance on advice of counsel is an absolute defense to securities fraud charges; (2) the Internal Revenue Service has exclusive jurisdiction on the tax-exempt status of the offerings; and (3) Attorney Peden's tax analysis was correct.

Reliance on counsel's advice is not an absolute defense, and a person asserting reliance on counsel as a defense must show that he/she: (1) made a complete disclosure to counsel; (2) sought and received advice that the proposed conduct was legal; and (3) relied on that advice in good faith. *Markowski v. SEC, 34 F.3d 99, 105 (2d Cir. 1994); SEC v. Goldfield Deep Mines Co. of Nevada, 758 F.2d 459, 467 (9th Cir. 1985);* SEC v. Mechoir, [1992-1993 Transfer Binder] *Fed Sec. L. Rep. (CCH) P 97,356 at 95,838* (D. Utah, Jan. 14, 1993). This defense is inapplicable to Mr. Thorn because he lied and withheld several pieces of material information from underwriter's counsel.

Mr. Thorn did not tell Attorney Peden that Mitchell had agreed to do all the work for compensation which did not include the $95,450; that Mitchell and Warren-Sherwood, Ltd. had entered a cost plus 10 percent construction contract before the Sherwood Garden offering closed on August 27; and that Mitchell would receive a 25 percent incentive fee for managing the property. Because he lied to counsel and withheld material information from him, and because he knew that information he distributed to investors was false and misleading, Mr. Thorn did not act in good faith in reliance on counsel's advice.

Mr. Thorn claimed he directed Attorney Peden to structure a tax-exempt offering and then merely followed his instructions. According to Mr. Thorn,

I said Derryl, are we going to do a taxable tail for this excess of two percent, or are we just going to put in the cash like we did in Clarksdale, which we went to the bank and borrowed the money and put it in. It was paid from the contractor's profits. He said well, let me get back to you. I don't remember exactly.

He got back to me. He said John, you're working with [the] Mitchell Company, which are honorable people. He said they're going to be entitled to certain fees at the closing. They can take these fees, and what we're going to do is we're going to make these fees where they are going to exceed what we need in order to help make the project better because they were really entitled to more money. There's no doubt about that. Tr. 85.

Contrary to his testimony given under oath, Mr. Thorn was not a naive client depending on legal counsel for advice in a difficult legal area in which he was unfamiliar. He is a college graduate with many years of specialized experience in this subject matter. In addition, there is testimony from Attorney Peden that perhaps Mr. Thorn was the one who came up with the structure for the seven offerings. Tr. 268. The evidence is persuasive that Mr. Thorn willingly and willfully participated as underwriter in these seven bond offerings and his participation was part of a scheme to defraud public investors. Mr. Thorn's college and theological education and his thirty years experience specializing in tax-exempt securities caused him to know that the material information he provided to the public was false, and that he omitted to disclose material information which was necessary to make statements he made not misleading.

There are many points in the record where Mr. Thorn lied or where he could not remember information. n38 For example, Mr. Thorn lied in the investigative phase of this proceeding when he stated he was unaware that the bond's tax-exempt status depended on compliance with the 2 percent rule. Tr. 77-79. Contrary to his assertions, the evidence is persuasive that Mr. Thorn knew that: (1) issuance costs paid from the bond proceeds could not exceed 2 percent for the bonds to be tax-exempt; (2) Mitchell agreed to compensation that did not include $95,450; (3) the owner/developer would not be contributing funds; and (4) the Official Statement falsely represented that the developer was contributing funds to pay issuance costs over 2 percent. Tr. 76. Mr. Thorn assured Mitchell that the deal would be 100 percent financed and thus acquired for himself and others an equity interest in the projects.

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n38 According to Mr. Stefan and Mr. Griffen, Mr. Thorn consistently stated that the deal would be 100 percent financed. Tr. 357. Mr. Thorn denied ever telling Mr. Stefan that the transaction would be financed 100 percent. Tr. 133-35, 144-45, 162. Mr. Thorn's position is that the offering was not 100 percent financed. Tr. 141-43.

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Mr. Thorn did not recall that the Official Statements represented that all but the last project were turnkey projects. Tr. 164. After the Commission began its investigation, Mr. Thorn tried to understand how the developer's contribution was handled at the closings. Tr. 165.

I reject respondents' defense that the Internal Revenue Service has exclusive jurisdiction in this area. n39 I denied the same argument on October 12, 1994, when respondents advanced it as an affirmative defense. *Ruling On Motion to Strike Affirmative Defenses, 57 SEC Docket 2421 (1994).*

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n39 It is obvious that I deny respondents' defense that Attorney Peden's tax analysis was correct.

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I find that TAW and Mr. Thorn willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and that TAW willfully violated, and Mr. Thorn willfully aided and abetted violations of, Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17, by offering and selling the seven private activity bond offerings described herein to the public using Offering Statements that were false and misleading in material respects.

Sanctions

Bar and Revocation

I find that revoking TAW's broker-dealer registration and barring Mr. Thorn from association with any broker or dealer and from dealing in municipal securities are necessary to protect public investors.

As a substantial equity owner, firm president, and registered municipal securities principal, Mr. Thorn controlled TAW's involvement in these seven offerings. I therefore impute his knowledge and actions to TAW. *SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1097 n.18 (2d Cir. 1972).* n40

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n40 See also *Gotham Securities Corp., 46 S.E.C. 723, 727 n.19 (1976).*

Mr. Thorn is a tax professional, with 30 years of specialization in tax-exempt offerings, who knew all the material facts. Acting with a high level of scienter, he committed egregious violations of the securities statutes and regulations. The illegalities were not isolated events but occurred in seven bond offerings during a 15 month period that totaled almost $19.5 million. The likelihood of future violations is high

since the respondents do not acknowledge any wrongdoing or give any assurance that the violations will not reoccur. *Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979),* aff'd, *450 U.S. 91 (1981).*

In addition to the Steadman criteria, other factors that persuade me that this sanction is necessary are Mr. Thorn's lack of candor, TAW's abysmal failure to carry out its underwriter's due diligence responsibilities, and the fact that TAW's primary concern was the personal financial benefit of persons in the firm with no concern for their responsibilities as securities professionals.

Mr. Thorn's due diligence activities on the Sherwood Garden offering consisted of coordinating and talking with the construction company, n41 visiting the project, checking on the need for rental units by talking to people, and checking on rents in the area. Tr. 58-59, 71. Personally, Mr. Thorn only made sure the figures on the closing sheet added up. He let others check that disbursements occurred as represented. n42 Tr. 161-62.

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n41 Mr. Thorn thought Mitchell was responsible for construction cost overruns even though the construction contract provided otherwise. Tr. 115.

n42 In his investigative testimony, Mr. Thorn said he made sure that disbursements were done according to the Sources and Applications of Funds in the Official Statement. Tr. 148-50.

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Mr. Yelverton, a TAW owner and director, acted in Mr. Thorn's absence. In doing due diligence on Sherwood Gardens, Mr. Yelverton relied on Mitchell for rental information and vacancy rates because "that is their business, and you have to rely on them for that." Tr. 949. Mr. Yelverton only read that part of the partnership agreement for Warren-Sherwood, Ltd. to make sure TAW got its agreed percentage. Tr. 954. TAW did not have a copy of the construction contract in its file. Tr. 956-57. Mr. Yelverton described the underwriter's responsibilities at the closing, "All I was assured of is that out of the closing we received the compensation that was coming to us. At that point I was satisfied." Tr. 969.

Disgorgement

Sections 8A of the Securities Act and 21C of the Exchange Act authorize the Commission to order an accounting and disgorgement, including reasonable interest, in cease and desist proceedings when, as here, respondents have violated the securities statutes and regulations. Disgorgement is an equitable remedy "uniquely suited to redress or cancel unfairness and promote investor confidence in securities transactions." *SEC v. World Gambling Corp., 555 F.Supp. 930, 934 (S.D.N.Y. 1983).* The deterrent effect of the Commission's enforcement efforts will be diminished if securities violators were not required to disgorge their illicit profits. *Manor Nursing Centers, 458 F.2d at 1104.*

The rationale cited in the above cases is applicable to this situation. I find, therefore, that TAW and Mr. Thorn should disgorge the net underwriting fee they received on these seven offerings, plus pre-judgment interest; TAW received $117,376 and $116,827, and Mr. Thorn received $116,432. Counsel Ex. 1 at 15. I find further that Mr. Thorn should disgorge his equity interest in the seven partnerships that own the housing projects that were the subject of the offerings. n43 Counsel Ex. 1. Disgorgement wrests ill-gotten gains from the hands of the wrongdoer, and is meant to prevent the wrongdoer from enriching himself by his wrongs. *SEC v. Huffman, 996 F.2d 800, 802 (5th Cir. 1993).*

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n43 The Division's position would allow Mr. Thorn to retain what he acquired by fraud. Division's Post-Hearing Brief at 31-32, n.32.

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Civil Penalty

Section 21B of the Exchange Act provides for three tiers of monetary penalties in an administrative action where the respondents have willfully violated the securities statutes, regulations thereunder, or MSRB rules, and the penalty is in the public interest. The statute does not specify characteristics for the first tier. Tier two is applicable where the violations "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." Tier three is applicable where, in addition to the characteristics present at tier two, the violations caused substantial losses or the risk of such, or substantial pecuniary gain to the person who committed the violations. n44

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n44 The Division has recommended the application of penalties at the second tier of $50,000 against Mr. Thorn and $250,000 against TAW. Post Hearing Brief at 32; Reply Brief at 22.

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I find it in the public interest to assess civil penalties at the highest level, $100,000 against Mr. Thorn and $500,000 against TAW. Mr. Thorn's unblemished record in the securities industry is outweighed by the following considerations:

(1) his actions involved fraud, deceit, and deliberate or reckless disregard of the applicable laws and regulations;

(2) his actions caused him to be unjustly enriched by partial ownership of seven housing projects which are valuable as real estate investments and as operating businesses:

Property	Mr. Thorn's Ownership Interest	Property Acquisition Cost Before Rehab	Record Citation
Sherwood Gardens	19.8%	$ 525,000	Counsel Ex. 1
Northwest Plaza	13.2	315,000	Div. Ex.46 at 11
Eden Point	19.8	1,400,000	Div. Ex 70
The Pines	13.2	1,100,000	Div. Ex. 88 at 11-12
Northpark	19.8	670,000	Div. Ex. 82 at 12
Glen Oaks	14.9	2,030,000	Div. Ex. 39 at 11
The Lodge	19.8	1,100,000	Div. Ex. 66 at 11;

(3) his actions could cause financial harm to persons who purchased these bonds relying on the false representation that the interest was tax-exempt; and

(4) the securities industry presents many opportunities for fraud so that these strong penalties are necessary to deter others.

Cease and desist

A cease and desist order is applicable when, as here, the respondents violated the statutes and regulations. n45

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n45 The Order Instituting Proceedings raises the possibility of an order requiring future compliance or steps to effect future compliance. In view of the other sanctions that I have ordered, it does not seem necessary.

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Order

Pursuant to Section 8A of the Securities Act, and Sections 15(b), 19(h), and 21C of the Exchange Act,

I ORDER that the broker-dealer registration of Thorn, Welch & Co., Inc., n46 be, and it hereby is, revoked, and that John E. Thorn, Jr., be, and he hereby is, barred from association with any broker or dealer and from dealing in municipal securities; n47

I FURTHER ORDER that Thorn, Welch & Co., Inc., disgorge $234,203, and that Mr. Thorn disgorge $116,432 and his equity interest in the seven limited partnerships that own the seven projects which were the subject of these bond offerings, plus prejudgment interest from November 1, 1993 through the last day of the month preceding which payment is made at the rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, compounded quarterly. n48 A copy of the letter transmitting the payment should be sent to the Atlanta District Office, Division of Enforcement, Securities and Exchange Commission.

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n46 The firm has changed its name to Thorn, Welch & Co., Inc.

n47 The Division recommended that I bar Mr. Thorn from association with any investment adviser, investment company, and municipal securities dealer. I deny this request because the sections of the statutes which are the basis for this proceeding do not, in my opinion, provide for such broad sanctions. This issue is before the Commission.

n48 I have used November 1, 1993, the first day of the month following the closing of the last bond offering at issue as the date to begin assessing interest. Payment should be made by certified check payable to the Securities and Exchange Commission, bearing on its face the caption John E. Thorn and Thorn, Alvis, Welch, Inc., Administrative Proceeding No. 3-8400. The check should be sent to the Office of the Comptroller, Room 2067, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, on the first day after this decision becomes final.

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If and when the respondents pay any or all of the disgorgement amount and interest, the parties shall submit to the Office of Administrative Law Judges, within 60 days, a plan for the administration and distribution of those funds.

I FURTHER ORDER that Mr. Thorn and Thorn, Welch & Co., Inc. pay penalties of $100,000 and $500,000, respectively. n49

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n49 Payment should be made in accordance with procedures outlined in n.48.

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I FURTHER ORDER that John E. Thorn, Jr. and Thorn, Welch & Co., Inc., cease and desist from committing or causing any present or future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and that Thorn, Welch & Co., Inc. cease and desist from committing or causing, and Mr. Thorn cease and desist from aiding and abetting, any present or future violations of Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice, 17 C.F.R. § 201.17 (1995). 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 15 days after service of the initial decision upon that party, unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to a party. If a party timely files a petition for review, or the Commission acts to review as to a party, the initial decision shall not become final as to that party.

Washington, D.C.

May 2, 1996