ADMINISTRATIVE PROCEEDING
FILE NO. 3-5007

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

FAI INVESTMENT ANALYSTS, INC.
(8-14658)
FINANCIAL ANALYSTS, INC.
RICHARD F. BRIDGES

INITIAL DECISION

Washington, D.C.
March 24, 1977

Ralph Hunter Tracy
Administrative Law Judge

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APPEARANCES: Joseph L. Grant and Hugh F. Culverhouse, Jr., of the Atlanta Regional Office for the Division of Enforcement

Christopher J. Valianos of Valianos, Joh & Homer, for the respondents.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by Commission order (Order) of April 7, 1976, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act), to determine whether the above-named respondents committed various charged violations of the Securities Act of 1933 (Securities Act) and the Exchange Act and regulations thereunder, as alleged by the Division of Enforcement (Division), and the remedial action, if any, that might be appropriate in the public interest.

The Order alleges, in substance, that the respondents wilfully violated and/or wilfully aided and abetted violations of Section 17(a) of the Securities Act and Sections 10(b), 15(c), 15(c)(2) and 17(a) of the Exchange Act and Rules 10b-5, 10b-9, 15c3-1, 15c2-4 and 17a-3(a), thereunder.

Respondents were represented by counsel throughout the proceeding. Proposed findings of fact and conclusions of law and supporting briefs were filed on behalf of all parties.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

FINDINGS OF FACT AND LAW

Respondents

FAI Investment Analysts, Inc., (FAI or Registrant), a Georgia corporation, has been registered with the Commission as

a broker-dealer pursuant to Section 15(b) of the Exchange Act since April 29, 1969. It is, also, a member of the National Association of Securities Dealers, Inc., (NASD) and has offices at 2480 Windy Hill Road, Marietta, Georgia, a suburb of Atlanta.

Financial Analysts, Inc. (Financial) is a Georgia corporation with offices at the same address as FAI which is a wholly owned subsidiary of Financial.

Richard F. Bridges (Bridges) has a B.S. degree from Georgia Tech and has been engaged in insurance, investment and mutual fund businesses since 1959. Since 1973, he has been the president, a director and majority shareholder of Financial. He is the president and a director of FAI and has held such positions since June, 1972, except for the period from October 18, 1973 to March 18, 1974, when he was a director only of FAI.

Introduction

Although FAI has been registered as a broker-dealer since 1969, it has not engaged in the usual buying or selling of securities for customers either as a market maker or a retailer. Rather it has engaged in putting together limited partnerships in which Bridges is the general partner and the individual investors are the limited partners. In one of the amendments to its Form BD, it is stated that its principal activities are selling oil and gas interests and tax shelter programs including cattle, movies, Federal housing, national farming and real estate syndications.

Each of the offerings involved in this proceeding is for the production of a moving picture. In each offering a specific number of limited partnership units are offered on a best efforts all or none or minimum number basis with the statement that if a minimum number of units have not been sold by a specific date all funds will be returned without interest and the partnership will be dissolved. All offerings are private placements and none of the securities have been registered with this Commission. The offerings are made, also, in reliance on an exemption from registration in the Georgia Securities Act of 1973.

The offerings are aimed at a sophisticated type of investor and a letter of suitability and investment intent is obtained from each investor. Among other things, the investor must affirm that he, or she, has taxable income subject to income tax at a rate of 50% or more and have a net worth of not less than $50,000 or have a net worth of $175,000 or more. The investor must understand that the proposed investment is recommended only for those in a position to benefit from the special tax treatment presently given such investors under Federal tax laws. In other words, the offerings are directed to those individuals seeking "tax shelters."

Violations of Sections 10(b) and 15(c)(2) of the Exchange Act and Rules 10b-9 and 15c2-4 Thereunder.

Respondents are charged with violating and or aiding and abetting violations of Sections 10(b) and 15(c)(2) of the Exchange

Act and Rules 10b-9 and 15c2-4, respectively, thereunder in connection with the offering of units in three limited partnerships each of which was organized for the production and distribution of a motion picture. The partnerships were the O.W. Production Company (O.W.), the D.N. Company (D.N.) and the Mulberry Company (Mulberry), in each of which Bridges was the general partner and the investors were the limited partners.

With respect to the alleged violations under Section 10(b) and Rule 10b-9, [1/] respondents are charged with making representations to the effect that the securities of O.W., D.N. and Mulberry were being offered and sold on the basis that a minimum number of units would be sold by a specified date or the investors' funds would be returned, when, in fact the minimum number of units were not sold by the specified date and the investors' funds were not promptly returned.

1/ Rule 10b-9. Prohibited Representations in Connection With Certain Offerings.

(a) It shall constitute a "manipulative or deceptive device or contrivance," as used in "Section 10(b) of the Act, for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation:

> (1) to the effect that the security is being offered on an "all or none" basis, unless the security is part of an offering or distribution being made on the condition that all or a specified amount of the consideration paid for such security will be promptly refunded to the purchaser unless (A) all of the securities being offered are sold at a specified price within a specified time, and (B) the total amount due to the seller is received by him by a specified date... (Emphasis Supplied) (Exchange Act Release No. 6905, October 3, 1962).

With respect to the alleged violations under Section 15(c)(2) and Rule 15c2-4,[2/] respondents are charged with failing to properly segregate or escrow funds received from investors in the O.W., D.N., and Mulberry offerings until the "all or none" or "part or none" contingency had been met.

The facts herein are not seriously disputed. The parties submitted a stipulation of facts at the commencement of the proceedings and the respondents objected to only 10 of the Division's 87 proposed findings of fact at the conclusion. Therefore, issues to be resolved arise from the interpretation of the statutes and rules, which respondents are charged with violating, and their

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2/ Rule 15c2-4. Transmission or Maintenance of Payments Received in Connection With Underwriting.

(a) It shall constitute a "fraudulent, deceptive, or manipulative act or practice" as used in Section 15(c)(2) of the Act, for any broker or dealer participating in any distribution of securities, other than a firm commitment, to accept any part of the sale price of any security being distributed unless:

* * *

(2) If the distribution is being made on an "all-or-none" basis, or on any other basis which contemplates that payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs, (A) the money or other consideration received is promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interests therein, until the appropriate event or contingency has occurred, and then the funds are promptly transmitted or returned to the persons entitled thereto, or (B) all such funds are promptly transmitted to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred. (Emphasis supplied) (Exchange Act Release No. 6737, Feb. 21, 1962).

application to the facts, which are summarized as follows.

The D.N. Company

The D.N. Company was organized in October, 1974, as a New York limited partnership for the purpose of purchasing and exploiting a movie entitled "Dead of Night". The Private Placement Memorandum (Memorandum) states that it is a best efforts all or none offering of 20 units by FAI to a limited group of sophisticated investors at a price of $11,700 per unit and that unless all units are sold for an aggregate of $234,000 all sales will be cancelled and the money returned to the prospective investors. The subscription price for each unit is payable: cash $4,500 and balance by 8% Notes due: $3,000 December 1, 1974; $2,100 April 1, and June 1, 1975. The units will not be registered with the Securities and Exchange Commission or any similar state agency.

While the Memorandum does not state a date by which all 20 units must be sold or the sales cancelled, it does state that a payment of $55,000 on the purchase of the movie is required by October 31, 1974. Consequently, all 20 limited partnership units were required to be sold by October 31, 1974. The investors log for the D.N. Company, maintained by FAI, shows that only 10 units had been sold by October 31, and the 20th was not sold until November 18, 1974. However, the sales of limited partnership units in the D.N. Company were not cancelled and the monies not returned to investors.

An escrow account for holding funds received from investors in the D.N. units was not established and $96,650 of the funds was disbursed prior to October 31, 1974. Of this amount, $75,000 was paid to Night Walk Ltd., the seller of the movie, $15,000 was used to purchase a saving certificate from the Cobb Bank & Trust company of Smyrna, Georgia (Cobb Bank), and $2,000 was paid to FAI as commissions.

The Mulberry Company

The Mulberry Company (Mulberry) was organized on November 7, 1974, as a Georgia limited partnership for the purpose of providing services, including financing, in the production of motion picture films. The offering Memorandum states that forty units will be offered on a best efforts part or none basis to a select and limited group of sophisticated individuals at a price of $12,833.33 per unit with $9,500 to be paid in cash upon subscription. The Memorandum states that a minimum of 20 units must be sold before partnership activities can begin, that the funds will be placed in a special account and that if a minimum of 20 units have not been purchased by December 6, 1974, all funds will be returned with interest earned and the partnership dissolved. A subsequent Memorandum states that the funds will be placed in an escrow account and if a minimum of 20 units have not been purchased by December 16, 1974, all funds will be returned and the partnership dissolved.

Only 3 units had been sold by December 6, 1974, and only 10 had been sold by December 16, 1974. However, the sales of limited partnership units in Mulberry were not cancelled and the monies not returned to investors.

On November 19, 1974, Mulberry, through Bridges, entered into an escrow agreement with the Cobb Bank whereby the bank would act as an escrow agent and hold all funds from the sale of units, and if payment for 20 units, aggregating $190,000 in cash, checks or drafts, was not received by 3:00 P.M., December 16, 1974, the bank would return the proceeds to the investors. This agreement was amended on December 9, 1974, to state that "any reference to $190,000 in cash, drafts, checks, etc. is hereby amended to include irrevocable letters of credit."

On or about December 19, 1974, Bridges caused the Cobb Bank, as escrow agent, to transfer $152,000 of investors' funds, the entire amount then on deposit in the escrow account, from the escrow account to the Mulberry account. In order to accomplish this, Bridges personally guaranteed the payment of an additional $38,000 to meet the required minimum of $190,000. As of December 19, 1974, the records of FAI and Mulberry show that only 12 units had been sold, while the $152,000 on deposit would represent proceeds from 16 units. Although the minimum number of units had not been sold, the escrow was "broken" by the bank and the $152,000 transferred to the Mulberry account. On December 19, 1974, Mulberry disbursed $52,000 including $2,000 to FAI for commissions.

The O.W. Production Company

The O.W. Production Company (O.W.) was formed in December 1974, as a New York limited partnership to produce a motion picture entitled "It's Our World Too." The offering Memorandum states that 40 units will be offered to a limited group of sophisticated investors on a best efforts basis at a price of $23,000 per unit with a $5,000 downpayment and the balance in 7 1/2% Notes for $5,000 each, due on April 15, June 15 and September 15, 1975 and $3,000 due on February 15, 1976. A minimum of 20 units must be sold before partnership activities can commence, the funds will be placed in escrow and if a minimum of 20 units have not been purchased by December 30, 1974, all funds will be returned without interest and the partnership will dissolve.

Although the Memorandum discloses that a limited partnership interest (LPI) can be purchased for $5000 down the escrow agreement dated December 16, 1974, the same date as the Memorandum, states that an LPI is payable $8,000 cash on subscription and non-interest bearing notes of $15,000, $6,000 due March 15 and June 15, 1975, and $3,000 due February 15, 1976. According to FAI and O.W. records, investors were required to pay $8,000 at time of subscribing for an LPI.

As of December 30, 1974, 16.75 LPI's had been sold. As of December 31, 1974, the books and records of FAI disclosed sales totalling 27 1/4 LPI's. However, on the same date, $152,000 had been deposited in O.W.'s general account at the Cobb Bank,

representing payment for 19.0625 units with one investor making an initial payment of $2,500 while the others were required to pay $8,000 on each unit.

On December 16, 1974, O.W., through Bridges, entered into an escrow agreement with the Cobb Bank in which it would act as escrow agent and hold all funds from the sale of LPI's and if 20 units had not been subscribed by December 31, 1974, all funds would be returned to subscribers. On December 27, 1974, escrow funds in the amount of $126,000 representing payment for 15.75 units, were transferred to the general checking account of O.W. On December 30, 1974, O.W. paid FAI $10,614.19, of which $10,000 was for commissions. The O.W. Production Company was not dissovlved and investors' funds were not returned.

Respondents advance three principal arguments as to why they should not be held in violation of Sections 10(b), 15(c)(2) and Rules 10b-9 and 15c2-4 thereunder: (1) their conduct was not unlawful in 1974 because of an ambiguity in Rule 10b-9; (2) lack of scienter; and (3) representations were not material to the investors.

(1) Respondents contend that Rule 10b-9, which was adopted by the Commission on October 3, 1962 (Exchange Act Release No. 6905) was ambiguous until the Commission issued a "welcome clarification" on July 11, 1975 (Exchange Act Release No. 11532). Rule 10b-9 is set forth at the beginning of this section in footnote 1, on page 4. The specific portion objected to as ambiguous is contained in the following excerpt:

(a)(1)(A) all of the securities being offered are sold at a specified price within a specified time, and

(B) the total amount due to the seller is received by him by a specified date ... (Emphasis supplied).

Respondents claim that it is not clear whether "sold" requires the seller to have received the purchase price by the same specified date by which he had to sell the security. Release 34-11532, issued on July 10, 1975, stated, in part:

> "It has come to the Commission's attention that certain practices and procedures have been used by issuers, underwriters, and broker-dealers, and accepted by their counsel, in connection with best efforts "all or none" offerings of securities which are not in conformity with certain of the antifraud provisions of the Securities Exchange Act of 1934 . . . In many instances, the issuer, underwriter or other persons . . . have created the misleading appearance of a successful sale of the specified minimum number of securities in order to fulfill the prerequisites to receipt of the proceeds. . . ."

In the respondents' words, "The Commission then went on to the crux of the problem created by the ambiguous language in Rule 10b-9 and stated:

> "Thus, under Rule 10b-9, an offering may not be considered 'sold' for purposes of the representation 'all or none' unless all the securities required to be placed are sold in bona fide transactions and are fully paid for. It is clearly contrary to the intent and purpose of the rule to declare an offering all sold, for the purpose of the 'all or none' or 'part or none' condition, on the basis of indication of interest ..." (Emphasis supplied).

Thus, respondents conclude, it is stretching the limits of fairness and due process to allege that they clearly acted unlawfully and with intent in 1974, when the law was not clarified until 1975.

It should be noted that Release No. 11532 was not issued as a clarification or with respect to Rule 10b-9, alone. It was issued for the reasons stated in the introduction quoted on page 11, above, and encompassed both Rules 10b-9 and 15c2-4. Moreover, the "clarification" discovered by respondents in 1975 was clearly set forth in Exchange Act Release No. 6864, dated July 30, 1962, entitled Proposal to Adopt Rule 10b-9, wherein it is stated:

> The proposed rule would make it unlawful to represent that a security is offered or sold on "all-or-none" basis unless the offering is made on the condition that unless a definite number of units of the security are sold at a specified price within a specified time and the total amount due is received by the seller the amount due to the purchaser will be promptly refunded to him. (Emphasis supplied).
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> * * *
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> It has come to the attention of the Commission that some persons distributing securities have been representing that securities are being offered on an "all-or-none" basis when, because of ambiguities in the contractual arrangement, it is not clear whether the conditions have been met if the underwriter finds persons who agree to purchase all of the securities within the specified time, but he is unsuccessful in collecting payment for all of the securities. It is the purpose of the proposed rule to prohibit any person from making any representation to the effect that the security is being offered on an "all-or-none" basis unless it is clear that the amount due to the purchaser is to be refunded to him unless all of the securities being offered are sold and the seller receives the total amount due to him in connection with the distribution. (Emphasis supplied).

In addition, the "clarification" referred to by respondents was clearly articulated in 1965 in a book dealing with brokers and dealers. 3/

3/ Ezra Weiss, Registration and Regulation of Brokers and Dealers, 119 (1965).

As a practical matter the rule can only be interpreted as requiring actual payment for the securities at the time of sale as it would be impossible to return funds if they have not been collected. Moreover, Bridges interpretation that payment must be made prior to considering a "sale" bona fide is evidenced by his "guaranteeing" the payment of 4 additional units of Mulberry prior to December 19, 1974, in order to break escrow.

(2) In the second place, respondents contend that they did not wilfully violate Section 10(b) and 15(c)(2) and Rules 10b-5 and 15c2-4 thereunder. In making the decision to break escrow in the two instances of O.W. and Mulberry (D.N. was not escrowed but placed in a separate account) they relied on a combination of reservation lists and information gathered from their Monday morning sales meetings in determining the number of sales they had made. Thus, in each case, respondents claim,they had reasonable cause to believe that the minimum number of securities had been sold by the specified dated because the prospective purchasers listed on the reservation lists subsequently became actual purchasers.

The offerings for O.W., D.N., and Mulberry were made by 6 licensed FAI salesmen, including Bridges, in the states of Georgia, Alabama, South Carolina, Florida and Tennessee. The clients were well-to-do doctors, lawyers, and businessmen, largely from small towns. Bridges and each salesman had his own customers, some of whom testified that they depended on the salesman for investment advice. When these various tax shelter offerings came out, the salesman would determine the interest his client might have in it and would then reserve a subscription to one or more units. The record, kept by Claude Horton, vice president of FAI listed the names of persons supplied by the salesmen and was

known as the reservation list. The names were either phoned in or brought to the regular weekly Monday sales meeting in Bridges' office. Bridges testified that he required the salesmen to have all documents signed and the check in hand for the down payment before a sale was considered final. However, in many cases a name would appear on the reservation list but no sale was ever consummated.

One of the salesmen testified in regards to an investor: "Each year, he pretty much, I think, depends upon me to give him tax relief through investments ... He's bought almost everything I've recommended to him, including D.N. and Mulberry." The same salesman went on to say, "that the rules were, you have to have the documents and check in hand, a check number, that type of thing."

Respondents argue that in addition to the existence of reasonable cause upon which they based their belief that the minimum number of units had been sold, they also had to face the fact that a return of investors' funds during the latter stages of the offering period would have an adverse affect on their investors' tax planning benefits. In this respect, the first relevant factor is that once escrow is broken, it takes at least 10 business days before an investor is sent his funds by the escrow agent. Thus in the case of O.W., the investors would not

have received back their funds until the middle January of the following year, in the case of D.N. Company, the middle of November 1974, and in the case of Mulberry, the last few days of December 1974. Respondents state that the testimony of 4 investor witnesses in these three programs shows beyond doubt that they would have been adversely affected by the return of the funds. One investor in D.N. Company, who had the longest period of time in which to choose an alternative tax shelter investment, testified as follows while being questioned by Division's counsel:

"Q. Yet they were under an obligation by this to return it if they didn't sell it right?"

"A. Of course, at this time of the year it was in my interest for them to go ahead with the investment." (Emphasis supplied).

Thus, it is argued, the fact that respondents, relying on the reservation sheets, had reasonable cause to believe that the minimum number of units had been sold by the specified dates, plus the fact that a return of investors monies would have caused adverse affects on the investors, shows a marked absence of the element of scienter now required in general by Ernst & Ernst v. Hochfelder, 96 S. Ct. 1375 (1976) and as required specifically in actions by the Commission by Securities and Exchange Commission v. Bausch & Lomb, CCH Fed. Sec. L. Rep. §95, 722 (S.D.N.Y. 1976).

Respondents reliance on the reservation lists is misplaced. The investor logs, bank statements, and similar records clearly support the fact that Respondents had not met the terms they themselves imposed in connection with the offerings in question. That the reservation lists were nothing more than indications of interest is illustrated by the fact that all of them indicate at the top that the names inserted or a portion thereof were "protected until . . ." a specified date. Many names were placed on the lists although a check had not been received and many were placed on the lists and subsequently crossed out. Bridges testified that in the Mulberry offering the reservation list on December 16, 1974 showed 16 units sold and that he had commitments for 8 1/4 other units.[4/] However, the FAI investor log showed only 10 sold. The conclusion is inescapable that the reservation lists were no more than indications of interest which might or might not result in sales.

Respondents assert that they refrained from returning monies to investors because of the "adverse affect" such refunds would have on the investors. However, this "adverse affect" as testified to by individual investors concerned the payment of additional taxes rather than any change in the investment. All of the investors who testified stated that their reason for investing was twofold,

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4/ The attorney engaged to assist in this offering testified that he made it clear to Bridges that before he broke escrow all of the units specified in the offering Memorandum had to be sold. With respect to D.N., Bridges testified that: "We never contested that the 20th sale didn't come in. We never contested the fact that there were 19 sales and not 20 sales."

first as a tax shelter and second to realize long-term future income. Their immediate concern was to avoid paying out 50% or more of their income in federal and state taxes. Accordingly, the "adverse affect" referred to simply means that any money returned by FAI would have to be reported on their tax returns for the year ending December 31st and taxed at a higher rate than they would pay under a tax shelter program.

(3) Respondents' third contention is that none of the investors who were called as witnesses with respect to the three programs (O.W., D.N. and Mulberry) considered the representation as to the return of investors' money as material. In fact, the critical date in the minds of all the investors was December 31st, because of its income tax planning implications. Respondents contend that there was no showing of "substantial likelihood" that investors considered a return of funds important. (Citing TSC Industries v. Northway, Inc., 96 S.Ct. 2126 (1976).

In the TSC Industries case the court was considering an omission to state material facts in a proxy statement pursuant to Rule 14a-9. In the present case, it is not an omission that is being considered but a requirement under Rule 10b-9 which defines the unlawful conduct. Materiality is included within the rule and there is no need to view other factors. Either the rule is complied with or it is violated. Under the facts in this proceeding, involving primarily a misrepresentation, positive proof or reliance is not necessary.[5/]

5/ Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1971).

It is found that Respondents willfully violated Sections 10(b) and 15(c)(2) of the Exchange Act and Rules 10b-9 and 15c2-4 thereunder. The argument that Respondents advance on the question of "willfullness" of the violations is rejected. Whether Ernst & Ernst v. Hochfelder [6/] is applicable to administrative proceedings instituted by the Commission so that scienter is required before a violation may be found to be "willfull" need not be determined here. Respondents not only knew what they were doing in the sense of consciousness of the acts that formed the violative course of conduct, but it is concluded that they knew that their actions entailed a deception within the meaning of Hochfelder, supra.

Anti-Fraud Provisions

The Order charges that FAI, Bridges and Financial willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, the so-called anti-fraud provisions, in the selling and offering to sell the limited partnership interests offered by FAI. [7/] Specifically, Respondents are

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6/ 425 U.S. 185 (1976).

7/ Section 17(a) makes it unlawful for any person "in the offer and 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" to do any of the following:

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

Section 10(b) makes it unlawful, in connection with the purchase or sale of any security to use or employ, "any manipulative or deceptive device or (continued)

charged with making untrue statements or omitting to state material facts concerning: (1) the use of proceeds from the D.N. Company offering, (2) that Atlanta Company offering funds were used to repay advances made by Financial, and (3) that such funds were being used in the operations of Financial and FAI.

The D.N. Company

On October 15, 1974, when only 13 of the 20 units in the D.N. all-or-none offering had been sold, Bridges used $15,000 of the proceeds to purchase a 30-day savings certificate from the Cobb Bank in the name of D.N. On the same day Bridges arranged a $15,000, 30-day loan from Cobb Bank to Financial. On October 21, 1974, Bridges assigned the certificate to the Cobb Bank as collateral on the Financial loan. This use of funds prior to completion of the offering was not disclosed to investors or FAI salesmen nor was the offering memorandum amended. Accordingly, this use of proceeds prior to the completion of the offering made it impossible to return investors' funds and rendered false and misleading the statement in the Memorandum that such funds would be returned if the all-or-none offering was not successful.

Any use of the proceeds prior to the sale of all the units was a material fact which a reasonable investor might consider

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7/ (continued)
contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 promulgated thereunder, extends, in effect and with a few language changes, the provisions of 17(a) relating to the sales of securities to both the purchase or sale thereof.

important in making an investment decision.[8/] Particularly, where, as here, a refund of his money had been offered as an inducement if the entire offering was not sold.

The Atlanta Company

The Atlanta Company was a New York limited partnership organized to purchase an original motion picture, "The Klansman" and to also acquire other feature-length motion pictures. The general partners were Bridges and Howard Effron. The offering was made on a "best efforts" basis on November 16, 1973, to a limited number of qualified investors at $30,000 per unit with a minimum of 2 units to an investor. Each investor was to pay 40% of his investment on signing and was to deliver 2 notes, each for 30% of his investment, with interest at 7%.

On November 21, 1973, before the first Atlanta Company unit had been sold, Financial made a pre-production advance to Movie People, Inc. (Movie People) the producer of "The Klansman." By December 3, 1973, Financial had advanced $150,000 to Movie People and Atlanta Company had transferred $150,000 to Financial. The offering memorandum did not disclose the indebtedness of Atlanta to Financial nor were prospective investors informed of this fact. In June 1974, Bridges was called to a meeting in New York and told by the producer of "The Klansman" that unless additional funds of about $250,000 were immediately forthcoming there

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8/ Affiliated Ute Citizens v. United States, 406 U.S. 128, 153 (1971).

would be no completed picture. As part of the additional financing a $100,000 loan, personally guaranteed by Bridges and Effron, was obtained from the Chase Manhattan Bank to Financial on June 21, 1974. The loan was not made directly to the Atlanta Company because it had no assets. The $100,000 was used to pay $12,437 interest owed by Movie People to Chase Manhattan, $33,000 to Effron for advances he had made on behalf of the Atlanta Company, and $48,000 to Movie People.

From June 21, 1974 to October 14, 1974, 6 investors purchased Atlanta Company units and received the offering Memorandum and additional sales literature. However, no disclosure was made in any of the material furnished prospective investors of the June 21, 1974, loan or the circumstance surrounding it. By the end of 1975, Atlanta Company owed Financial a balance of $48,000 on the loan.

With respect to the Atlanta Company, respondents aver that all funds raised from investors were used as stated in the prospectus, i.e., for production costs after payment of offering expenses and that it was clearly disclosed that Atlanta Company investors would be contributing $1,980,000 which would be used for production costs (after paying offering expenses of $60,000), that the film budget was for $4,000,000 with the balance of financing to come from "distribution advances, loans, other investors." Moreover, the $100,000 loan to Financial was not material because

it was not an obligation of the Atlanta Company and would, therefore, have no effect on the investors.

The existence of the June 21, 1974, loan, the necessity for it, the circumstances surrounding it, and the partnership's (Atlanta's) subsequent obligation for it were all material factors which should have been disclosed to investors. The fact that without additional funds "The Klansman" would not be completed which would result in the failure of the partnership is just the type of information that the anti-fraud provisions of the federal securities laws demand be disclosed. It is the type of material information that could hardly help but be important to a reasonable investor in arriving at an investment decision.[9/]

Respondents again urge that by virtue of the Hochfelder decision (supra) it is necessary for the Division to establish an intent to defraud, a "scienter", on their part, not merely negligent conduct.

Reliance upon the Hochfelder case is inappropriate. That case dealt with a civil action for damages against a firm of accountants based upon alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. In concluding that the plaintiff had to prove scienter the Supreme Court pointed out that the language of Section 10(b) used as a basis, "manipulative or

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9/ Investors Management Co., Inc., 44 S.E.C. 633, 642 (1971); Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1969).

deceptive device or contrivance," would extend to any rule promulgated thereunder by the Commission, i.e., 10b-5. It held that these terms connote intentional or willful conduct rather than merely negligent conduct.

In this proceeding violation of Section 17(a) of the Securities Act is also charged. This section, as quoted above (supra, p. 18) makes it unlawful to offer to sell securities through the making of any untrue statement of a material fact or any omission to state a material fact, independent of the existence of a device, scheme, or artifice to defraud. Therefore, the rationale of Hochfelder is inapplicable. All that has to be shown herein to make Respondents' misrepresentations and omissions "willfull" is that they did the acts complained of in connection with the sale of units of D.N. and Atlanta, even though they may not have had an intent to defraud.[10/]

It is found that Respondents willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Net Capital Violation

The Order alleges that from on or about November 7, 1974 to April 7, 1976, (the date of the Order) FAI willfully violated and Bridges and Financial willfully aided and abetted violations of

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10/ Tager v. S.E.C., 344 F.2d 5, 8 (1965); Gilligan, Will & Co. v. S.E.C., 267 F.2d 461, 468, cert. den., 361 U.S. 896; Hughes v. S.E.C., 174 F.2d 969, 977 (1949).

Section 15(c) of the Exchange Act and Rule 15c3-1 thereunder in that FAI failed to maintain a minimum net capital of $25,000.

On June 14, 1972, the Commission announced the adoption of amendments to Rule 15c3-1 [11/] which raised, with certain exceptions, the minimum net capital requirement of brokers and dealers to $25,000. If certain conditions are met the dealer may be entitled to maintain a net capital of $5,000. One of these conditions, which is the one claimed by Respondents herein, is set forth as follows:

> 15c3-1
>
> (a)(2) Notwithstanding the provisions of subparagraph (a)(1) hereof, a broker or dealer shall have and maintain net capital of not less than $5,000 if he does not hold funds or securities for, or owe money or securities to, customers and does not carry accounts of, or for, customers, . . . and he conducts his business in accordance with one or more of the following conditions and does not engage in any other securities activities.
>
> (ii) He participates, as broker or dealer, in underwritings on a "best efforts" or "all or none" basis in accordance with the provisions of 15c2-4(b)(2) and he promptly forwards to an independent escrow agent customers' checks, drafts, notes or other evidences of indebtedness received in connection therewith which shall be made payable to such escrow agent; (Emphasis supplied).

Respondents admit that with respect to the D.N. offering they did not establish an escrow account for holding investors funds as required by Rule 15c3-1 and were, therefore, in violation.

11/ Exchange Act Release No. 9633.

As to the Mulberry and O.W. offerings it has been found that escrow was prematurely broken and that Respondents were in violation of Rule 15c2-4 (supra, p. 18). Accordingly, Respondents would not come within the provisions of Rule 15c3-1 and would not be qualified to have a $5,000 net capital but would be required to maintain a $25,000 net capital minimum.

The dates at which FAI's net capital was required to be $25,000 and the additional capital necessary to bring it into compliance on those dates is shown in the following table:

	8/31/74	9/30/74	10/31/74	1/31/75	5/31/75
Amount required	$14,511.93	$14,783.83	$14,477.85	$14,347.00	$13,342.17

The net capital rule has been called "one of the most important weapons in the Commission's arsenal to protect investors."[12/] By requiring that brokers maintain specific levels of liquid assets, the rule operates to assure confidence and safety to the investing public. It is not relevant here whether actual injuries or losses were suffered by anyone.[13/] Respondents were under an obligation to know whether the financial condition of FAI satisfied all applicable requirements of the net capital rule and, if registrant was not in compliance, to refrain from effecting transactions in securities.[14/]

12/ Blaise D'Antoni & Associates, Inc. v. S.E.C. 289 F.2d 276, 277 (C.A. 5, 1961), rehearing denied, 290 F.2d 688 (1961).

13/ Hughes v. S.E.C., 174 F.2d 969, 974 (C.A.D.C. 1949).

14/ Securities Planners Associates, Inc., Exchange Act Release No. 9836 (1972); Herman M. Solomon, 44 S.E.C. 910, 912 (1972).

It is found that FAI, willfully aided and abetted by Bridges and Financial, willfully violated the net capital provisions of Section 15(c) of the Exchange Act and Rule 15c3-1 thereunder.

Bookkeeping Violations

The record establishes that during the period from November 16, 1973, to April 7, 1976, FAI aided and abetted by Bridges and Financial violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by failing to maintain and to keep accurate and current certain required books and records.[15/]

As previously found and discussed at some length, Respondents broke escrow in the O.W. and Mulberry offerings prior to meeting the minimum offering level. In addition, in both offerings, Respondents did not sell the minimum number or units by the stated ending date. Accordingly, FAI was liable to investors as it was obligated to return their funds in accordance with the terms of the private placement memorandum. Also, in the D.N. offering, FAI, instead of escrowing investors' funds, used a separate account. By using a separate account FAI held funds for customers and was liable to those customers until the terms of that offering were complied with.

15/ Section 17(a) of the Exchange Act, as pertinent here, requires brokers and dealers to make and keep current such books and records as the the Commission may prescribe as necessary and appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records which must be maintained and kept current.

From August 31, 1974 to May 31, 1975, no liability to investors was reflected on FAI's trial banances. More specifically, from October 15, 1974 to November 18, 1974, when the last unit was sold, the books and records of FAI did not disclose any liability to investors in the D.N. offering for funds held in the separate account. Likewise the books and records of FAI disclosed no liability to investors in the Mulberry and O.W. offerings.

Concomitant with its failure to reflect the above liabilities, FAI failed to increase its aggregate indebtedness by the amount of these liabilities and, consequently, failed to correctly compute its net capital.

The Commission has repeatedly stressed the importance in the regulatory scheme for strict compliance with the requirement that books and records be kept current and in proper form.[16/] The requirement that records be kept embodies the requirement that such records be true and correct.[17/] Compliance with the rule relating to maintenance of books and records is regarded as an "unqualified statutory mandate" dictated by a broker-dealer's obligation to investors to conduct its business on a sound basis.[18/]

Public Interest

The evidence herein fully supports the conclusion that

16/ Olds & Company, 37 S.E.C. 23, 26 (1956); Pennaluna & Company, 43 S.E.C. 298, 312 (1967).

17/ Lowell Neibhur & Co., Inc., 18 S.E.C. 471, 475 (1945).

18/ Billings Associates, Inc., 43 S.E.C. 641, 649 (1967).

Respondents not only knowingly violated the securities laws but that they had no intention of complying unless it was convenient to do so. During his testimony Bridges admitted that he did not completely comply. In describing his philosophy regarding investors Bridges stated, "Well,if you're referring to the recission aspect of it, our general philosophy has been in the past -- that one of the mistakes that I made is taking a less than serious approach to the letter of the law as it pertains to State and Federal regulations, of taking the overriding -- consideration of what is best for investors. What's best for the investors is best for everybody, even if it doesn't comply with the letter of the law."

The breaking of escrow, as much as anything, is evidence of Respondents' intention not to return investors' monies. Respondents had entered into contracts with movie producers which required payment before the refund dates stated in the offering memorandums and, therefore, it was necessary to break escrow to make those payments. In every offering described herein neither the number of units were sold in accordance with the disclosures as required by 10b-9, nor were the corresponding escrow accounts established or maintained as required by 15c2-4. This in turn lead to the violations of the net capital and bookkeeping rules. The intent not to comply with the securities laws is implicit in such conduct. Once having made the decison to utilize the provisions of Rules 10b-9 and 15c2-4 the Respondents were bound to

abide by them and failure to do so brought them squarely within the scienter definition enunciated in Hochfelder.

On March 26, 1975, the Commissioner of Securities for the State of Georgia, by consent, suspended the registration of FAI Investment Analysts for 4 weeks from March 26, 1975. It was found that registrant had willfully violated Sections 3 and 4 of the Georgia Securities Act of 1957, by employing salesmen who were not licensed under the Georgia Securities Act. No finding was made of having engaged in any fraudulent practices in violation of Section 11(b) of the Georgia Securities Act.

On July 22, 1976, the NASD censured Bridges and suspended the membership of FAI Financial Analysts, Inc. and the registration of Bridges for 3 days by accepting an offer of settlement. The sanctions were imposed for violation of the NASD's Rules of Fair Practice in permitting a salesman to engage in the securities business without registering him with the NASD as a registered representative.

In view of all the circumstances, it is concluded that the extent and character of the violations requires that Respondents be excluded from the securities business for a period of time to allow them to decide that if they are to reenter and continue in the type of business described herein, they then must abide by the statutes and regulations governing such activity. In this connection it is noted that Respondents entire business activity takes place during the last 3 months of the calendar year. Therefore

it is believed necessary in the public interest to suspend the registration as a broker-dealer of FAI Investment Analysts, Inc. for one year and to suspend Richard R. Bridges and Financial Analysts, Inc. from associating with any broker or dealer for the same period.

ORDER

Accordingly, IT IS ORDERED that the registration as a broker-dealer of FAI Investment Analysts, Inc., is suspended for one year; and that Richard F. Bridges and Financial Analysts, Inc., and each of them, is suspended from association with a broker-dealer for one year.

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

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review

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19/ All proposed findings and conclusions submitted by the parties, and the contentions made by them, have been considered. To to the extent such proposals and contentions are consistent with this initial decison they are accepted.

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.[19/]

Ralph Hunter Tracy
Administrative Law Judge

Washington, D.C.
March 24, 1977