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UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

In the Matter Of
Capital Funds, Inc. Corner U. S. Highway 64 and Pine Street Muldrow, Oklahoma
File No. 8-10968

See USCA Decision in file (Ctrl)

RECOMMENDED DECISION

Private Proceedings

Sidney Ullman
Hearing Examiner

Washington, D. C.
September 19, 1963

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SECURITIES AND EXCHANGE COMMISSION

In the Matter of Capital Funds, Inc. Corner U. S. Highway 64 and Pine Street Muldrow, Oklahoma File No. 8-10968	RECOMMENDED DECISION (Private Proceedings)

BEFORE: Sidney Ullman, Hearing Examiner

APPEARANCES: Frank Milwee, Jr., Norman W. Reed, James D. Bennett, Esqs., of the Fort Worth Regional Office, for the Division of Trading and Exchanges.

Thomas Harper, Esq., Post Office Box 297, Fort Smith, Arkansas, for Capital Funds, Inc.

I. NATURE OF PROCEEDINGS

By an order dated October 24, 1962, the Commission instituted private proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), to determine (1) whether the application of Capital Funds, Inc. ("Capital" or "respondent") for registration as a broker-dealer should be denied, (2) whether, pending final determination of the question of denial, the effective date of Capital's registration should be postponed, and (3) whether, within the meaning of Section 15A(b)(4) of the Exchange Act, Erma Gatlin and Austin Gatlin, or either of them are causes of any order of denial which might be entered against Capital.[1/] Previously, on August 28 and

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1/ Section 15(b) of the Exchange Act provides in pertinent part:

> "The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to. . .any broker or dealer if it finds that such denial. . .is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has willfully made or caused to be made in any application for registration pursuant to this subsection. . .any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact;. . .or (B) has willfully violated any provision of the Securities Act of 1933, as amended, or of this title, or of any rule or regulation thereunder. Pending final determination whether any such registration shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days. . ."

Under Section 15A(b)(4) of the Exchange Act, in the absence of the Commission's approval or direction, no broker or dealer may be admitted to or continued in membership in a national securities association if he is subject to a Commission order denying registration pursuant to Section 15, or if any officer or director of or person controlling such broker or dealer, was, by his conduct while employed by or acting for a broker or dealer, a cause of any order denying registration to such broker or dealer which is in effect.

September 25, 1962, at the request of Capital the Commission had ordered that the effective date of its registration as a broker-dealer be postponed to October 26, 1962. The Commission's order of October 24, 1962, instituting these proceedings, directed that the effective date of registration be postponed until November 9, 1962 and that a private hearing be held on November 1, 1962 on the question whether the effective date of the registration should be postponed until final determination of the question of denial.

Thereafter, on October 29, 1962, in accordance with a stipulation and agreement of Capital, the Commission ordered that the effective date of registration be postponed pending final determination of the question of denial; cancelled the hearing scheduled for November 1, 1962 on the question of postponement of the effective date of Capital's registration; and ordered that the hearing on the question of denial of registration be postponed until further order of the Commission.

By an order dated January 10, 1963, the Commission, at the request of the Division of Trading and Exchanges ("Division"), amended the order of October 24, 1962 instituting these proceedings, by adding further allegations of violations in addition to those contained in the original order.

By order of February 4, 1963, the Commission directed that a hearing on the question of the denial of registration be held before the undersigned on March 12, 1963, at Fort Smith, Arkansas. The hearing was commenced on that date and after a recess was concluded on April 11, 1963.

Both the Division and respondent were represented by counsel throughout the hearing. Proposed findings of fact, conclusions of law and briefs in support thereof were submitted by both parties, and the Division submitted supplemental findings, conclusions and brief as well as a reply brief.

The Division's proposed findings, conclusions and brief accurately set forth a statement of the nature of these proceedings and this statement has been adopted herein almost verbatim. Counsel for the respondent, in his proposed findings, conclusions and brief concurs substantially with these factual statements but disagrees, as indicated, infra, with many of the conclusions drawn therefrom by the Division and with the relevancy to these proceedings of a portion of the facts.

During the course of the hearing, counsel for Capital offered to withdraw the application for registration or consent to its denial, but agreement could not be reached with the Division on the terms of withdrawal or denial. No action thereon was taken by the Hearing Examiner, nor could it be,under the limitation of Rule 11(e) of the Commission's Rules of Practice.[2/] In its brief in support of proposed findings and conclusions Capital again requests that these proceedings be terminated by withdrawal of the registration application, but the Division opposes this request in its supplemental and reply briefs.

2/ Rule 11(e) provides in part:

> "All applications, motions and objections made during the course of the hearing shall be made to and decided by the hearing officer, except that where his ruling would dispose of the proceeding in whole or in part, it shall be made in his recommended decision submitted after the conclusion of the hearing."

Broadly speaking, the issues raised by the Commission's order of October 24, 1962 as amended on January 10, 1963 are whether Capital or its officers and directors, Austin Gatlin and Erma Gatlin, or any of them, willfully violated the Exchange Act or the Securities Act of 1933 ("Securities Act") or rules thereunder in offering or selling the common stock of Lawton Loan and Investment Corporation ("Lawton"), of Peoples Loan and Investment Co., Inc. ("Peoples"), or of Anchorage Mortgage Corporation ("Anchorage");[3/] whether Capital, which was

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3/ Section 5(a) and 5(c) of the Securities Act provide, in pertinent part:

> "(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly -
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> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.
>
> (c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security. . . . "

admittedly not registered with the Commission under the Exchange Act as a broker-dealer, violated that Act by conducting an interstate business as a broker-dealer;[4/] whether the filing by Capital of its application for registration was in violation of the Exchange Act and a rule thereunder, because of errors or misstatements therein;[5/] whether the failure of Capital to correct these errors or misstatements was likewise a violation of the Exchange Act and the rules

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4/ Section 15(a) of the Exchange Act provides:

> "(a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section."

5/ Section 15(b) of the Exchange Act provides in pertinent part:

> "(b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors." See also the portion of Section 15(b) quoted in footnote 1.

Rule 15b-1 provides:

> "An application for registration of a broker or a dealer, pursuant to section 15(b), shall be filed on Form BD in accordance with the instructions contained therein."

thereunder;[6] whether Erma Gatlin and Austin Gatlin willfully violated Section 17(a) of the Securities Act[7] and Section 10(b) of the Exchange Act and a rule thereunder[8] by making false and misleading statements

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6/ See footnote 5, supra. Rule 15b-2 provides, in pertinent part:

"(b) If the information contained in any application for registration of a broker or a dealer, . . . is or becomes inaccurate for any reason, such broker or dealer shall promptly file an amendment on Form BD correcting such information;"

7/ Section 17(a) of the Securities Act provides:

"(a) 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 the 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.

8/ Section 10(b) of the Exchange Act provides:

"Section 10. It shall be unlawful for any person, directly or indirectly by use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -

(a) . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or 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."

(Cont'd. on p. 8)

concerning the earnings and financial condition of Anchorage and employing fraudulent, manipulative or deceptive devices in the offer and sale of its securities. In addition, the Division urges that evidence adduced at the hearing with regard to sporadic interstate transactions in Peoples stock and two other securities 9/ reflects violations of Section 15(b) of the Exchange Act. The ultimate questions in the proceeding, as stated above, are whether it is in the public interest to deny registration to Capital, and, if so, whether Erma Gatlin or Austin Gatlin are causes of any such order which may be made.

8/ (Cont'd. from p. 7)

Rule 10b-5 provides:

> "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 securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud.
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security."

9/ Commonwealth Loan and Investment Company, of Lebanon, Missouri, and Queen City Loan and Investment Company, of Springfield, Missouri.

Based upon his examination of the record in these proceedings and his observation of the witnesses, the Hearing Examiner makes the following findings of fact and conclusions of law.

II. FINDINGS OF FACT

Background of Capital: Activity in Oklahoma.

1. Capital was incorporated under the laws of the State of Oklahoma on March 20, 1961, with offices at Tulsa. It became registered as a broker-dealer in Oklahoma on April 4, 1961. Its office was thereafter moved to or established at Lawton, Oklahoma, and thereafter, on or about August 15, 1961, at Muldrow, Oklahoma, and Fort Smith, Arkansas.

2. At or about the time Capital became registered in Oklahoma as a broker-dealer, i.e., April 4, 1961, it contracted to act as underwriter, under a best efforts undertaking, of a public offering of 100,000 shares of class B non-voting common stock to be offered publicly by Lawton, at the offering price of $2 per share or a total of $200,000, with an underwriting commission of $.40 per share. The offering was to be limited to residents of Oklahoma. The underwriting agreement was for a period of six months, from on or about April 19, 1961 until its expiration in late October 1961. At the expiration of the underwriting agreement Capital had sold 31,780 shares of this offering.

3. At all times during the above offering of Lawton stock, Austin Gatlin and Erma Gatlin were officers and directors of Capital; controlled, managed and directed all of its business, operations and activities; and employed, obtained licenses for and directed salesmen in connection with the offering.

The Peoples Offering

4. On January 15, 1962, Capital received from the Secretary of State of Arkansas a Certificate of Authority to do business in Arkansas as a foreign corporation. On March 1, 1962, Capital obtained a license as an Arkansas securities dealer.

5. Since January 15, 1962 Capital has been and to the date of the hearing has continued to be authorized to do business in both Oklahoma and Arkansas, and since March 1, 1962 it has been registered and licensed as a securities broker-dealer concurrently in both Oklahoma and Arkansas.

6. On or about January 1, 1962, Capital contracted with Peoples, of Fort Smith, Arkansas, to act as underwriter, under a best efforts undertaking, for a public offering of securities by Peoples, consisting of 10,000 shares of class A common stock, carrying one vote per share, and 50,000 shares of class C common stock, non-voting, in units of one class A share and five class C shares, at the price of $5 per share, or a total of $300,000, with underwriting commission of $.60 per share. The offering was limited to residents of Arkansas.

7. Capital commenced the public distribution of the Peoples offering in the Spring of 1962 and the offering was completed in December 1962.

8. At all times during this offering of the Peoples stock, Austin Gatlin and Erma Gatlin were officers and directors of Capital and controlled, managed and directed all of its business, operations and activities.

9. Through their control of Capital and, in turn, through Capital's ownership of 20% of Peoples stock, Austin Gatlin and Erma Gatlin own a controlling interest in Peoples. Capital and Peoples share office facilities in Fort Smith, Arkansas. Austin Gatlin is being paid a salary by Peoples at the rate of $12,000 per year.

10. Capital is not, nor has it been, registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act. Nor has Austin Gatlin or Erma Gatlin ever been so registered.

11. No registration statement or notification pursuant to Regulation A has been filed with the Commission as to any of the securities of Peoples.

12. Kenneth L. Edwards, a resident of Arkansas, was hired by Austin Gatlin on behalf of Capital and Peoples as a salesman in January 1962. Since that time Edwards has been engaged, among other activities, in buying and selling common stock of Peoples under an arrangement which paid him a salary plus 2½% commission on the securities sold.

13. Edwards testified that Peoples stock, both class A and class C, was sold for cash as well as on the installment plan, at $5 per share, commencing in the Spring of 1962 and continuing until December 1962.

14. The purchaser of Peoples stock would execute a subscription form in triplicate, with the original form being retained by Capital, the second being given to the purchaser, and the third being retained by the salesman. The subscription form contained the following representation:

> "The purchaser hereby represents that he is a Bona Fide Resident of Arkansas and that he is acquiring these securities for investment purposes and not with a view to resale or further distribution."

15. The checks of purchasers of Peoples stock were made payable to either Capital or Peoples, and in the case of installment sales the purchaser would execute a promissory note payable to Peoples for the balance due.

16. When an installment purchase was made, the subscription form and the stock certificate were put into the purchaser's folder to await payment of the full price before delivery of the certificate. The stock certificates, when deliverable, were generally transmitted through the mails.

17. The availability of the stock for purchase was advertised by radio and television as well as in newspaper advertisements.

18. In July 1962, Mr. E. C. Addison, of Heavener, Oklahoma, discussed with Austin Gatlin at the offices of Capital and Peoples in Fort Smith, Arkansas, the purchase by Addison of Peoples' stock, after Addison had seen or heard advertisements for the sale of the stock on television or radio. He was advised by Mr. Gatlin, who knew Addison to be a resident in Oklahoma, that no stock was then available for purchase.

19. On September 13, 1962, Addison called again at the offices of Capital and Peoples in Fort Smith and was sold, by Mr. Gatlin, 200 shares of Peoples at $5 per share. He delivered a check in the amount of $100 payable to Peoples, dated September 13, 1962, and drawn on the account of Addison Investment Company in the State National Bank, Heavener, Oklahoma. He executed no subscription agreement for the purchase of the stock, but probably signed a promissory note for the balance due in the amount of $900. Subsequently, Addison paid an additional $200 of the purchase price by a check payable to Peoples drawn by Addison Investment Company on its account in the State

National Bank, Heavener, Oklahoma, and he subsequently paid an additional $100 by a check drawn by him in favor of Peoples, on his account in the First National Bank, Heavener, Oklahoma. All of these checks were endorsed by Peoples and paid by the respective banks of deposit.

20. On July 2, 1962, at the offices of Capital and Peoples in Fort Smith, Arkansas, William B. Robinson, a resident of Heavener, Oklahoma, bought 133 shares of class A common stock of Peoples and 667 shares of its class C common stock, making a total of 800 shares, for the sum of $4,000, making payments in that amount by withdrawal from his deposit account with Peoples and deduction of that amount from his passbook.

21. This purchase followed by approximately one week a visit to Robinson at Heavener, Oklahoma by Edwards. At the time of this visit Edwards was ostensibly trying to find a person named "Morton", and he advised Robinson that he had some shares of Peoples, which he owned personally, and which he could sell to Robinson.

22. At the time of the purchase by Robinson, Edwards and Austin Gatlin knew that Robinson was a resident of Oklahoma.

23. A few days after Robinson's purchase, the stock certificates were delivered to him at Heavener, Oklahoma,by Edwards. One certificate was for 133 shares of class A stock and bore No. 86; the other certificate was for 667 shares of class C stock and bore No. 106.

24. It is contended by the respondent that the sales of Peoples' stock to Addison and Robinson were not a part of the offering described above,

but constituted, rather, resales of stock purchased by Edwards, an Arkansas resident, as a part of the original offering and thereafter resold by him to Addison and Robinson.

25. Edwards testified that sometime in the middle of June 1962, he had executed a subscription form for the purchase of 1,000 shares of Peoples stock at $5 per share; that thereafter he realized he could not pay for the stock and so advised Mr. Gatlin, who agreed that Edwards might sell this stock. It is contended that although Edwards paid no cash for the 1,000 shares, he executed a promissory note in payment therefor, and that the payment of $4,000 by Robinson, by withdrawal of that sum from his deposit account, together with the $100 payment made by Addison and the latter's promissory note for $900,constituted payment of Edwards' obligation for the 1,000 shares. Testimony along these general lines was also given by Austin Gatlin and, as indicated below, by Erma Gatlin.

26. The Examiner rejects the testimony that Edwards, in June 1962 or at any other time, executed a bona fide subscription for the purchase of 1,000 shares of Peoples stock and became the owner of such shares. He concludes that the sales to Addison and Robinson were part of the Peoples offering on which Capital was the underwriter on a best efforts basis. The evidence in support of this conclusion is convincing.

27. Respondent was unable to produce the subscription form allegedly signed by Edwards in June 1962, and this inability casts some doubt on the respondent's contentions. In addition, the subscription form executed by Robinson for 800 shares of Peoples stock is an extremely enlightening document. This form contains the representation of residence in Arkansas,

and was signed by William B. Robinson as purchaser, on July 2, 1962. However, the signature of William B. Robinson subsequently was crossed out by Mrs. Gatlin. She wrote in its place the name "Ken Edwards". Edwards did sign the subscription form, as purchaser, but he did execute it for Capital Funds, Inc. as "agent or broker-dealer" at the time of the execution by Robinson. The words "file" and "Kenneth Edwards" were also written on the form by Mrs. Gatlin, "so that he [Edwards] would have a record for his income tax." And on the margin of the form, in Mr. Gatlin's handwriting, is the following notation:

> "This stock is repurchassed (sic) stock and not issue beng offerd (sic) as regular issue."

Mrs. Gatlin testified that she struck Robinson's name as purchaser and inserted Edwards' name in its place "Because Mr. Robinson did not buy any stock from us.", and she pointed to this notation as authority for this action.

28. No satisfactory testimony or explanation was given by Edwards, or by either Erma or Austin Gatlin, in support of the contention that this sale to Robinson constituted a secondary transfer of stock which had become the property of Kenneth Edwards rather than the sale of stock which was part of the offering. It is noted, of course, that the offering was not completed until December 1962.

29. Further refutation of the factual contention of respondent is made by numbers appearing in the stock certificate book of Peoples with regard to this stock purchase by Robinson, but it belabors the point to detail the

inability of the above witnesses to explain the fact that the numbers on the stock certificates ostensibly issued to Edwards in June on the basis of the subscription allegedly executed by him in June were higher than those on the certificates issued to Robinson in July. Suffice it to say that Mrs. Gatlin, who was in charge of the records of Peoples, was unable to explain the discrepancy although she was a party to the transaction.

30. One further aspect of this situation should be noted. Edwards' testimony regarding the subscription form signed by Robinson as purchaser (and by himself on behalf of Capital as agent or broker-dealer for Peoples), enforces the conclusion that changes in the form were made by Mrs. Gatlin to support the incredible position that Robinson was in fact purchasing stock that had been subscribed for and was owned by Edwards rather than stock which was part of the offering. Edwards was uncertain regarding the details of his alleged subscription for the stock. In addition, he testified that he received from Capital a 2½% commission for the sale of the stock to Robinson, but on being asked to explain why he received commission for selling his own stock he changed his testimony and denied that he had received commission for the sale. From all of the above it is entirely clear that the offering, sale and delivery of Peoples stock by Capital as underwriter was not restricted to residents of Arkansas.

31. Respondent's brief urges that Peoples stock was sold only to Arkansas residents, suggesting the availability of the intrastate

exemption of Section 3(a)(11) of the Securities Act, pertaining to ". . . an issue offered and sold only to persons resident within a single state. . .". This suggestion, of course, has been rejected by the Examiner.[10/] In any event, respondent further contends, no violation of Sections 5(a) or 5(c) of the Securities Act would result from the sale or delivery of Peoples stock to residents of Oklahoma, inasmuch as the stock was an exempted security within the meaning of Section 3(a)(2) of that Act because of the status of Peoples as a banking institution. Section 3(a)(2) exempts, among other securities,

> "any security issued or guaranteed by any national bank, or by any banking institution organized under the laws of any State or Territory or the District of Columbia, the business of which is substantially confined to banking and is supervised by the State or Territorial banking commission or similar official;".

32. The Prospectus issued by Peoples indicates that it was registered in 1940 with the State Bank Department as an industrial loan company and has continued to operate as such; that it is authorized to issue and does issue deposit certificates, and that it is under the supervision of the Securities Division of the State Bank Department.

10/ Under the above findings it is unnecessary to consider whether by reason of a purchase by Edwards, as alleged, he could have obtained title to the 1,000 shares, or the factual question whether the stock had come to rest as property of a resident investor before the alleged resale by Edwards. See Securities Act Release No. 4434 (1961), subject, "Section 3(a)(11) Exemption for Local Offerings", indicating that even if Edwards had subscribed for the shares, since it is nevertheless clear that not only did he not retain them for investment but also that he never received the shares, the Section 3(a)(11) exemption would not be available.

No reason was given for not cancelling the alleged sale to Edwards when he concluded he would be unable to pay for the shares. To permit a device such as was used here to become a subterfuge for sales to non-residents would, of course, frustrate the limitations of the Act.

The Prospectus also states that:

> "The general business conducted by the Company is, the loan of money on first and second mortgages secured by real and personal property, the purchase of existing notes at discounts ranging from 10 per cent,upwards, of the face value thereof on both real and personal property. The loan business is very competitive."

33. Title 67 of the Arkansas Statutes of 1947 is entitled "Banks and Other Financial Institutions", and this title or name, as well as the various chapters and the text itself of Title 67, indicates that the Legislature recognized a basic distinction between the banks, on the one hand, (treated in Chapters 1 - 7 of the Title), and "other financial institutions" such as building and loan associations (treated in Chapter 8),credit unions (treated in Chapter 9) and industrial loan institutions such as Peoples (treated in Chapter 10).[11/]

34. Section 67-112 of these statutes reads, in part:

> "Whenever the word 'bank' appears in this Act, it shall be deemed to apply alike to any incorporated bank, trust company, or savings bank, . . . and also to any partnership or individual transacting a banking business."

Of course, Peoples does not fall into any of the above categories. Moreover, under Section 67-701 Peoples is prohibited from using, or from making any reference in its name or otherwise, to the words "bank",

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11/ Other types of financial institutions such as loan brokers, and investment companies and security dealers, have been treated in subsequent chapters of Title 67, further illustrating the distinctions made by the Legislature between banks and "other financial institutions."

. . . "banking", . . . "trust company", "or any other word or phrase which tends to induce the belief that the party using it is authorized to engage in the business of a bank, trust company, savings bank or building and loan association. . . ."

35. Conversely, in Section 67 - 1001 the term "Industrial Loan Institution" is construed to mean

> "any corporation . . . engaged in lending money to be paid in weekly, monthly, or other periodical installments or principal sums as a business; provided, however, that this definition shall not be construed to include building and loan associations, or commercial banks or savings banks, or trust companies, or credit unions . . ."

and Section 67-1003 provides, in part, as to industrial loan institutions:

> "All such institutions operating under the provisions of this Act shall so distinguish their operations and so qualify them as to not perform any of the functions of a Commercial Bank, Savings Bank or Trust Company, outside of the specific authority provided for their operation under this Act."

Thus, it is entirely clear that under the Arkansas statutes Peoples is not a bank, but is one of the "other financial institutions" treated in Title 67.

36. Nor does Peoples fall within the category of "banking institution" as the term is used in the Section 3(a)(2) of the Securities Act. The legislative history of this section is not especially enlightening on the Congressional intent in the use of this term. However, it is clear from an examination of Section 3 that the term was intended to be and must be confined to the commonly accepted banking institutions,

i.e., commercial banks, savings banks and perhaps trust companies.[12] This conclusion is demonstrated by the fact that in Section 3(a)(5), Congress provided for the exemption from the requirement of registration of

> "Any security issued by a building and loan association, homestead association, savings and loan association or similar institution, substantially all the business of which is confined to the making of loans to members. . ."

If the associations designated in Section 3(a)(5) were not intended to be distinguished from banking institutions, the limitation with regard to loans to members would be pointless and the distinction between Sections 3(a)(2) and 3(a)(5) would be meaningless. It is apparent that while Peoples might be a "similar institution" under Section 3(a)(5), it is not a banking institution within the meaning of Section 3(a)(2).[13]

12/ As to trust companies, see London National Bank of Leesburg v. Continental Trust Co., 180 S.E. 548 (Va., 1935): "In concrete terms, one is a bank and one is a trust company . . . The fact that a trust company is permitted by its charter to exercise some of the functions of a bank does not constitute it a banking institution". Cf., however, 1 Loss, Securities Regulations 566 (2d ed., 1961): "The exemption for banks raises no particular problems otherwise. Presumably it does not apply to small loan or finance companies, or investment banking firms, or bank holding companies, however supervised. Since Section 3(a)(2) does not specifically mention trust companies, perhaps as good a test as any of the question whether a particular trust company is a 'banking institution' is whether it is so supervised by the state banking authorities."

13/ Cf. United States Trust Co. of N. Y. v. Brady, 20 Barb. 122 (1855), where the Supreme Court stated, regarding the plaintiff:

> "It is not a corporation created for banking purposes, within the meaning of section 4, of article 8, of the constitution. Banking is there used in its then and still familiar and popular sense, that business which might be carried on by banking associations under the law to authorize the business of banking, passed April 18, 1838. The law has been amended. . .and the meaning of the word had thus become fixed by legislative usage also."

(Inasmuch as Peoples does not confine its loan business to its members, it was not contended by respondent that Peoples stock is exempt under Section 3(a)(5) of the Act.)

37. It follows, from the fact that Peoples is not a banking institution within Section 3(a)(2), that we need not consider whether, within the meaning of that Section, its business is "substantially confined to banking and is supervised by the state. . .banking commission or similar official" as respondent contends.[14/] The burden of proving a claimed exemption from the requirements of the Securities Act is on the claimant. S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); Gilligan, Will & Co. v. S.E.C., 267 F. 2d 461 (C.A. 2, 1959). Respondent has clearly failed to sustain the burden of establishing the claimed exemption under Section 3(a)(2).

38. It follows from the above and from the non-availability of the exemption in Section 3(a)(11) of the Securities Act,[15/] that the acts of Capital and of Austin Gatlin and Erma Gatlin in offering, selling and effecting delivery of the unregistered Peoples stock to residents of Oklahoma were in violation of Sections 5(a) and 5(c) of the Securities Act. These acts were knowingly and intentionally performed and they constitute willful violations within the meaning of Section 15(b) of the

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14/ As suggested above, the differences between the business of banks in Arkansas and the business of industrial loan institutions are in fact substantial and extreme.

15/ A single sale to a non-resident will destroy this exemption with respect to the entire issue. Universal Service Corporation, Inc., 37 S.E.C. 559, 563-564 (1957); Associated Investors Securities, Inc., Securities Exchange Act Release No. 6859 (1962); Edsco Manufacturing Co., Securities Act Release No. 4413 (1961).

Exchange Act. Cf. Hughes v. S.E.C., 174 F. 2d 967, 977 (C.A.D.C., 1949); Robert Dermott French, 36 S.E.C. 603, 605 (1955).

39. The Division urges that inasmuch as Capital was not registered with the Commission as a broker-dealer under Section 15(b) of the Exchange Act, its conduct of an interstate business and use of the mails and other instruments of interstate commerce to effect purchases and sales of securities violated Section 15(a) of that Act. (See footnote 4, page 6, supra.) Respondent contends that upon completion of the Lawton offering in Oklahoma, it ceased doing business in Oklahoma and that its subsequent offering of Peoples stock was exclusively intrastate business conducted only in Arkansas and therefore not violative of Section 15(a). Neither respondent nor the Division has cited pertinent law which would resolve the question whether an Oklahoma corporation can conduct business as a securities dealer in Arkansas or, indeed, in fifty different states, without conducting an interstate business, provided no business activity is conducted concurrently in two different states. The issue becomes moot, however, by reason of the findings made above with regard to the sales of Peoples stock in Oklahoma at a time when Capital was ostensibly selling the stock to Arkansas residents only, for they indicate that Capital, in fact, was conducting an interstate business. Additionally, Mr. Gatlin testified that after the completion of the Lawton offering in Oklahoma, Capital arranged to sell the Peoples stock in Arkansas, and he continued as follows:

> "We were finished in Oklahoma. We had no further interest there except that we had this Oklahoma corporation and we opened an office in Muldrow, Oklahoma, and still maintain an office in Muldrow to make loans. They are in the loan business." Tr. 230.

Thus it appears that Capital continued to do business in Oklahoma, albeit not as a securities dealer, while it was engaged in selling Peoples stock in Arkansas. One further type of activity, the sporadic securities transactions mentioned above, indicates that Capital engaged in an interstate business contrary to the contention made in its brief. Mr. Gatlin testified that Capital owned stock in Commonwealth Loan and Investment Company, of Lebanon, Missouri, and in Queen City Loan and Investment Company, of Springfield, Missouri, and that on behalf of Capital he sold to Frank Blosser, a resident of Springfield, Missouri, the controlling interests in the stocks of these respective companies. He also testified, as did another witness, to secondary transactions in the stock of Peoples, including the purchase of shares from a resident of Texas and the sale and delivery of part of these shares to residents of Oklahoma.[16/]

The Application for Registration

40. Capital's application for registration as a broker-dealer pursuant to Section 15(b) of the Exchange Act and Rule 15b-1 thereunder was filed with the Commission on Form BD on July 30, 1962 in duplicate, as required by the General Instructions on the Form. The Form BD was dated July 23, 1962, and was signed on behalf of Capital by Austin Gatlin,

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16/ Respondent's brief urges that:

> "There are other sales dealt with, [than those to Addison and Robinson], but the record clearly shows that these were not original issues of stock but were repurchases of stock by Capital for investment."

Of course, this contention does not negate the fact that the transactions were interstate transactions. Moreover, the suggestion that such transactions should be considered as investment activity separate and apart from the conduct of a brokerage business as such must be rejected. See Chester R. Koza & Co., 39 S.E.C. 950 (1960).

Secretary-Treasurer, and the Supplement and Financial Statements reflecting Capital's condition as of June 30, 1962, attached to and constituting a part of said application, were dated July 23, 1962, and were signed on behalf of Capital by Erma S. Gatlin, Vice President. The order for proceeding charges, in effect, that Item 3(b) of the Form BD improperly lists John Littlejohn as a director of Capital, and also that Item 3(c) improperly lists him as owner of 10% or more of the equity securities of Capital. At the hearing it developed that John Littlejohn had sold all of his shares of Capital stock on June 29, 1962, and he had ceased to be a director of the corporation on April 28, 1962. Accordingly, it appeared that the Form BD application was admittedly incorrect in these material respects when signed on July 23 and when filed on July 30. Nor was any amendment filed by Capital to the Form BD application correcting the alleged errors, all in apparent violation of Section 15(b) of the Exchange Act and the rules thereunder.

41. Mrs. Gatlin testified that the application was prepared by Capital's attorney, Joe Greggs, who had previously obtained the information in connection with his preparation of Capital's offering circular and a prior Form BD for Capital which had never become effective. Respondent took the position that inasmuch as the information furnished to its attorney was correct at the time it was furnished, no willful violation of Section 15(b) of the Exchange Act and of the rules thereunder was proved.

42. However, the Commission has uniformly held that those who seek the benefits of registration as broker-dealers cannot avoid the concurrent

responsibilities, and they are responsible for errors in their applications.[17/]

43. Strangely, during the preparation of this recommended decision the undersigned examined the original Form BD retained in the files of the Commission at its Washington, D. C., Headquarters, and noted that John Littlejohn's name had been lined out as a director of the applicant prior to the filing.[18/] Apparently, the name had not also been lined out on the duplicate original form which was transmitted by the Washington Headquarters to the Fort Worth Regional Office of the Commission subsequent to the filing of the duplicate original forms. Apparently also, the form transmitted to Fort Worth was used in the preparation of the order for proceedings and was the form examined by Mrs. Gatlin as a witness when she admitted that Littlejohn was listed therein as a director.

17/ The Whitehall Corporation, 38 S.E.C. 259, 270 (1958); Peoples Securities Company, 39 S.E.C. 641 (1960), wherein, at page 645, the Commission said:

> "Respondents urge that any inaccuracies in the application and amendments were inadvertent rather than intentional and were due to error on the part of the attorney who prepared them. However, a finding of willfullness within the meaning of Section 15(b) of the Exchange Act does not require a finding of intention to violate the law; nor is reliance upon counsel sufficient to negative the existence of willfullness. It was incumbent upon Peoples, through the principal officer who executed the application and amendments, to verify the information contained therein, and Peoples' failure to carry out its responsibilities in this respect rendered willfull its making of false and misleading statements in the application and amendments, and its violation of Section 15(b) and Rule 15b-2 thereunder."
>
> Cf. II Loss, op. cit. supra, 1302, to the effect that it is no defense that an application was prepared by an attorney and that the registrant signed it without discussing or reading it, and quoting from Securities Exchange Corporation, 2 S.E.C. 760 (1937), to the effect that otherwise ". . .the representation by an applicant that 'all statements and representations herein are true to the best of registrant's knowledge and belief' would be meaningless."

18/ This file, of course, is part of the record in the proceeding.

44. Under the circumstances, the Examiner is loathe to find any error in Item 3(b) of the Form BD, it appearing that through inadvertence his name was not lined out on one of the two forms filed with the Commission.

45. There remains, however, the misstatement regarding Littlejohn as the beneficial owner of 10% or more of the stock of Capital, as asserted in response to Item 3(c), and the failure to correct this error, all in technical violation of the Act and rules thereunder. The failure to remove Littlejohn's name from Item 3(c), although it was removed from Item 3(b), would seem to have resulted from the fact that he disposed of his stock two months after he had ceased to be a director. The misstatement seems clearly the result of inadvertence or negligence on the part of the persons executing the Form BD, but as indicated above the decisions hold such error to be a willful violation of the Act by Capital, aided and abetted by the two persons who executed the documents. Cf. Peoples Securities Company, footnote 17, page 25, supra.

The Public Offering of Anchorage Mortgage Corporation, Cocoa Beach, Florida

46. From March 1957 to August 1958, Erma Shuler Gatlin was a partner in the broker-dealer firm of Justice and Shuler, a partnership securities dealer in Cocoa Beach, Florida, composed of Erma Gatlin (then Erma Shuler) and Thurman Justice, an attorney. In 1957 Justice and Shuler acted as underwriter of a public offering of 100,000 shares of class B common stock issued by Anchorage

at $2 per share, with commission of 40¢ per share to the underwriter. The stock was ostensibly for sale only to residents of Florida. At the time of the offering Erma Gatlin was Secretary-Treasurer and also a director of Anchorage, and Austin Gatlin was general manager of the company.

47. In connection with its public offering, Anchorage issued two Prospectuses: one was dated June 1, 1957, and contained a statement of the financial condition of the issuer as of May 23, 1957; the other was dated August 19, 1957, and contained a balance sheet of the company as of July 31, 1957.

48. In or about June 1957, Mrs. David Wright, then a resident of Merritt Island, Florida, discussed with Austin Gatlin the purchase of Anchorage common stock. In one of several conversations Mrs. Wright advised Mr. Gatlin that she and her husband wanted to buy some of the stock and that her brother-in-law, who lived in Baton Rouge, Louisiana, also wanted to buy some. As to a purchase by her brother-in-law, she testified that Mr. Gatlin stated that ". . . it would not be possible for him to buy it directly, but that there would be nothing to prevent us from purchasing the stock in our name and later transferring it to him."

49. Mr. Gatlin gave Mrs. Wright a copy of the Prospectus dated June 1, 1957, and in late June or early July she delivered to the

office of Justice and Shuler two subscription forms, one for 100 shares of Anchorage stock and the other for 25 shares, in line with prior conversations with Mr. Gatlin. She paid for 100 shares by her check dated July 3, 1957, in the amount of $200, and for the 25 shares by her check dated July 9, 1957, in the amount of $50. The checks were payable to Anchorage and were indorsed for the corporation by Erma Shuler. Mrs. Wright was issued two certificates in her name, one for 100 shares of Anchorage class B stock and the other for 25 shares.

50. Two or three months following the purchases, Mrs. Wright visited the Gatlin residence in Cocoa Beach. In the presence of Mr. Gatlin, Mrs. Gatlin reissued a certificate for the 25 shares in the name of Mrs. Wright's brother-in-law, Martin Wright. Martin Wright reimbursed his sister-in-law for the shares and the certificate was either transmitted to him by mail by Mrs. Wright or delivered to him by her personally on a trip from Cocoa Beach to Baton Rouge, Louisiana.

51. No registration statement or notification pursuant to Regulation A was filed with the Commission as to any of the securities of Anchorage. The mails were used in connection with the public offering and the sale of the stock, and the transactions in Anchorage stock as well as all transactions in the other securities described herein were accomplished in the over-the-counter market.

52. The record indicates that the financial statements contained in each of the two Prospectuses used in the public offering of the Anchorage stock were false and misleading. The balance sheet of July 31, 1957, contained in the Prospectus of August 19, 1957, erroneously reflected transactions which did not occur until August 1957. Several items which should properly have been shown as unearned income were, in fact, reflected as earned surplus. The total of these items plus unearned service charges improperly reflected according to the record, resulted in a net profit of $17,458.66¢ being reflected instead of a loss of $2,269.61. Similarly, the statement as of May 23, 1957, included in the Prospectus of June 1, 1957, overstated by approximately $12,000 an item titled "Cash on hand and in bank" and understated by the same amount the "Notes receivable". Additional discrepancies of a less serious nature existed in this financial statement. The total assets of Anchorage were approximately $250,000.

53. Counsel for the respondent objected to all testimony relating to the Anchorage stock as irrelevant to the proceeding, but his objections were overruled. Thereafter, Erma and Austin Gatlin, as witnesses for the Division, were questioned on direct examination concerning the Anchorage offering but refused, on advice of counsel, to answer any questions in this area. At the request of the Division,

the witnesses were directed by the Examiner to answer the questions, but they persisted in their refusals.[19/] Accordingly, they failed to deny under oath any of the testimony of other Division witnesses or to refute the documentary evidence relating to the Anchorage offering. The Hearing Examiner deems such failure to be a factor of substantial significance warranting the inference that their testimony in response to the questions in this area would have been adverse.[20/]

Public Interest

54. The order for proceedings alleged and the Division proved, particularly as a matter of public interest, a refusal by Erma Gatlin to comply with a subpoena duces tecum issued by the Commission on October 4, 1962, pursuant to a formal order of investigation of Capital. The subpoena required the production for examination, by an officer of the Commission, of stockholder records of Peoples which were relevant and material to the proceeding.[21/] Respondent's brief

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19/ The Hearing was recessed pending a decision by the Division whether to seek an order of the United States District Court compelling the respective witnesses to answer the questions. The Division concluded that it was not necessary or expedient to obtain such order and no such effort was made.

20/ N. Sims Organ & Co., Inc., Securities Act Release No. 6495, (1961); N. Sims & Co., Inc., et al. v. SEC, 293 F. 2nd 78 (C.A. 2, 1961). In its brief in support of its findings and conclusions respondent reiterates its contention made at the Hearing that this evidence is irrelevant to the proceedings inasmuch as the acts of Mr. and Mrs. Gatlin were known to the Commission shortly after they occurred in 1957 and the Commission took no action in regard thereto. The suggestion of estoppel or similar argument was rejected by the Examiner.

21/ Section 21(b) of the Exchange Act, relating to investigations by the Commission, empowers any designated officer to compel the attendance of witnesses and the production of books and records.

urges that the subpoenaed material was withheld on advice of prior counsel for Capital, but that on subsequent advice of counsel this position was abandoned and the desired information was made available. Standing alone, the refusal, even on advice of counsel as asserted, would have some significance on the issue of public interest. But when considered in conjunction with the several violations by Capital of the securities acts and rules thereunder, and particularly in light of the action of Mrs. Gatlin in altering the subscription form executed by Robinson for the purchase of Peoples stock, it seems especially significant that the records were not made available to the Commission's officer at the time production was required by the subpoena. Even if records were not tampered with prior to ultimate production of the desired information, this is by no means an answer to the charge that the initial refusal reflects adversely on an applicant for broker-dealer registration, as a matter of public interest. However, the seriousness of the charge is somewhat mitigated by what the Examiner finds to have been a true concern of Mrs. Gatlin that delivery of a list of Peoples' depositors might have caused apprehension among them and created a "run" on the institution.

55. More importantly, on the matter of public interest, is evidence in the record indicating that Mrs. Gatlin had written to the Fort Worth Regional Office of the Commission on behalf of Capital on May 16, 1961, requesting information, instructions and

forms with regard to proper qualification "for a company organized in one state and desiring to sell stock in another state", and that she received a reply calling attention to the various statutes and rules and regulations thereunder indicating the need for registration of broker-dealers in interstate commerce. In addition, the record indicates that Mr. Bennett, an attorney on the staff of the Fort Worth Regional Office, advised her of his view that Capital was in violation of Section 15 of the Exchange Act in selling unregistered Peoples stock, but that Capital thereafter continued its distribution of the offering until its completion in December 1962.

56. The refusal to testify as to the Anchorage transactions is also viewed as a matter of importance in the public interest.

Erma Gatlin and Austin Gatlin as Causes

57. It would be utterly wasteful of time and energy to treat at length with the question whether Erma Gatlin and Austin Gatlin are causes of any order of denial of registration that may be made, so completely were they in control of Capital and its activities, and so thoroughly was each of them connected with and responsible for substantially all of the violations of the statutes and rules indicated above.

III. CONCLUSIONS OF LAW

On the basis of the foregoing findings and the entire record in the proceedings, the Examiner makes the following conclusions of law:

1. That Capital, Austin Gatlin and Erma Gatlin willfully violated, and Austin Gatlin and Erma Gatlin caused Capital to violate, Section 15(a) of the Exchange Act, in that it engaged in the business of buying and selling non-exempted securities as a broker-dealer otherwise than on a national securities exchange and not in an exclusively intrastate business, and in connection therewith made use of the mails and the means and instrumentalities of interstate commerce to effect transactions in and to induce the purchase and sale of such securities without being registered as a broker or dealer with the Commission pursuant to Section 15(b) of the Exchange Act.

2. That Capital, Austin Gatlin and Erma Gatlin willfully violated, and Austin Gatlin and Erma Gatlin caused Capital to violate, Section 15(b) of the Exchange Act and Rules 15b-1 and 15b-2 thereunder in making a statement in Capital's application for registration as a broker and dealer, which was false and misleading at the time and in the light of the circumstances under which it was made, and in failing to file an amendment correcting such statement.

3. That Capital, Austin Gatlin and Erma Gatlin willfully violated, and Austin Gatlin and Erma Gatlin caused Capital to violate, Sections 5(a) and 5(c) of the Securities Act in offering, selling and delivering

after sale common stock of Peoples to non-residents of Arkansas and common stock of Anchorage to a non-resident of Florida.

4. That Austin Gatlin and Erma Gatlin willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in the sale of common stock of Anchorage.

5. That pursuant to Section 15(b) of the Exchange Act it is in the public interest to deny registration to Capital as a broker-dealer.

6. That within the meaning of Section 15A(b)(4) of the Exchange Act Austin Gatlin and Erma Gatlin are each a cause of any order which may be issued denying registration to Capital as a broker-dealer.

IV. RECOMMENDATIONS

In view of the above findings of fact and particularly the conclusions of law numbered 1, 3, 4, 5 and 6, it is the opinion of the Examiner that the request for withdrawal of Capital's application for registration as a broker-dealer should not be granted, and that it is in the public interest that said application for registration be denied and that Erma Gatlin and Austin Gatlin be found to be causes of the denial. It is recommended that the Commission issue an appropriate order giving effect to the foregoing.[22/]

Respectfully submitted,

Sidney Ullman
Hearing Examiner

Washington, D.C.
September 19, 1963

22/ To the extent that the proposed findings and conclusions submitted to the Examiner are in accord with the foregoing they are sustained, and to the extent that they are inconsistent therewith they are rejected.