

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
FIRST STATE FINANCIAL, INC. :
(801-22847) :
:

INITIAL DECISION.....

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February 8, 1985
Washington, D.C.

David J. Markun
Administrative Law Judge

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In the Matter of :
FIRST STATE FINANCIAL, INC. : INITIAL DECISION
(801-22847) :
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APPEARANCES: T. Christopher Browne and Katheryn Millwee,
Esqs., Fort Worth, Texas, for the Division
of Enforcement.

Sidney I. Shupack, president and chairman
of the board of First State Financial, Inc.,
appeared for Respondent at the hearing. A
brief on behalf of Respondent was submitted
by Donald R. Bradford, Esq., Blackstock,
Joyce Pollard & Montgomery, Tulsa, Oklahoma.

BEFORE: David J. Markun
Administrative Law Judge

I. THE PROCEEDING

This matter involves the November 16, 1984 application of First State Financial, Inc. ("First State" or "Respondent") to register as an investment adviser pursuant to Section 203(c)(1) of the Investment Advisers Act of 1940.

On December 20, 1984 the Commission issued an Order for Public Proceedings and Notice of Hearing ("Order") pursuant to Section 203(c)(2) of the Investment Advisers Act of 1940. The purpose of the Order is to determine whether the application of First State for registration as an investment adviser should be denied, granted or granted "contingent upon a subsequent showing by respondent that no person associated with respondent is subject to a statutory disqualification unless the Commission has consented to such association pursuant to Rule 29 of the Commission's Rules of Practice."

An evidentiary hearing was held in Fort Worth, Texas on January 9, 1985. Applicant chose to be represented by its president and board chairman, Mr. Sidney I. Shupack ("Shupack") at the hearing, instead of by legal counsel. However, counsel for Respondent, who had represented First State when it filed its application and an earlier related application, did file a five-page post-hearing brief in letter form. The briefs of the parties were filed simul-

taneously because of the shortened time schedules governing the disposition of this application.

Shupack testified at the hearing on behalf of First State and was cross examined by Division counsel. No other witnesses were called by either party, but both parties introduced exhibits.

The findings and conclusions herein are based upon the record and upon observation of the demeanor of the witness.

II. FINDINGS OF FACT AND LAW

A. The Respondent; Background of Application.

First State, an Oklahoma corporation, is a broker-dealer registered with the Commission.

From February 1972 until January 8, 1979, First State was also an investment adviser registered with the Commission. On January 8, 1979 First State's registration as an investment adviser was revoked by order of the Commission and has remained revoked since that time.

In that revocation order the Commission found that First State wilfully violated and wilfully aided and abetted violations of Section 206 of the Investment Advisers Act of 1940, Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 17(a) and 20(a) of the Investment Company Act of 1940

and that First State wilfully aided and abetted violations of Sections 10(f), 13(a)(3), 15(c) and 17(f) of the Investment Company Act.

Shupack is President of First State and Chairman of its Board of Directors. He has been the principal owner of First State since its inception and currently owns 23% of its stock, making him the largest shareholder. Shupack is, of course, "a person associated with" First State.

On January 8, 1979, Shupack was barred by order of the Commission from being associated with an investment adviser. He has been barred from being so associated since that time.

In that bar order, the Commission found that Shupack wilfully violated and wilfully aided and abetted violations of Section 206 of the Investment Advisers Act, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 20(a) of the Investment Company Act and Rules 20a-1 and 20a-2 thereunder, and that Shupack wilfully aided and abetted violations of Sections 10(f), 13(a)(3), 15(c), 17(a) and 17(f) of the Investment Company Act.

Mr. Jack Warren ("Warren") has been the vice President and Secretary and a director of First State since 1975. On January 8, 1979, the Commission found that Warren wilfully violated and wilfully aided and

abetted violations of Section 20(a) of the Investment Company Act and Rules 20a-1 and 20a-2 thereunder, and wilfully aided and abetted violations of Section 206 of the Investment Advisers Act, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 10(f), 13(a)(3), 15(c), 17(a) and 17(f) of the Investment Company Act. Warren is a person associated with First State, where he is in charge of compliance.

On October 24, 1984 Shupack sought to file with the Commission, pursuant to Rule 29 of the Commission's Rules of Practice, 17 C.F.R. §201.29, a request ("Rule 29 Request") to modify the Commission's order barring him from being associated with an investment adviser. Since Rule 29 contemplates association only with a registered entity, and since First State, with whom Shupack sought the Commission's consent to associate is not an entity registered as an investment adviser, the Commission's Secretary on December 21, 1984, returned Shupack's Rule 29 application to Shupack's attorney "without prejudice to its resubmission at an appropriate time."

In its answer filed in this proceeding, First State amended its Form ADV application to request (1) that its activity as an investment adviser be contingent upon Shupack's first receiving authority to be associated

with Respondent as an investment adviser and (2) that its activity as an investment adviser be limited to the activity described in the application and in Shupack's October 24, 1984, Rule 29 request, relevant portions of which were attached to and incorporated by reference as part of First State's answer.

In essence, the limitations upon investment advisory activities of First State, were it allowed to function as an investment adviser, as set forth in Respondent's answer and the incorporated Shupack Rule 29 request, would be the following:

(1) First State would not be involved in any way with any investment company.

(2) No customer securities or funds would be held by First State.

(3) The nature of advisory services and fees would be as described in the application.

In addition, Shupack, in his testimony on January 9th at the hearing herein, indicated he would be amenable to having the registration conditioned upon a prohibition of the purchase by advisory clients of (1) securities underwritten by First State and (2) securities in which First State makes a market.

The application describes the clients to whom it would generally be seeking to render investment advisory

services as follows, in response to question #2 on its ADV form:

"Clients are generally past middle age who have substantial funds and who are seeking only high quality issues with a reasonable safety of principle, fair yield and some appreciation."

The application describes the investment strategy First State intends to pursue as follows:

"For the clients described in question 2 above, the investment strategy is almost exclusively long term using high quality common stocks and short - 2 to 4 years - municipal bonds. For other clients the applicant will handle but does not encourage short sales, margin transactions and option transactions and seldom provides an opinion for this type of activity."

In his testimony at the hearing herein, Shupack testified that the essential reason for Respondent's seeking registration as an investment adviser is that First State is presently, as a broker-dealer, offering investment advice to many of its "Safe Money Management" customers but is unable to charge them for that advice except through broker's commissions, and that fees and other charges authorized to be charged by an investment adviser would provide a more practical basis for charging for such services, particularly in the case of those customers whose transactions are so infrequent that they generate little or nothing by way of broker's commissions.

B. Division's Grounds for Opposing Application for Registration Contingent Upon Satisfactory Rule 29 Request(s).

The Division opposes the application of First State, even on a contingent basis, i.e. contingent upon a successful Rule 29 request by Shupack, and, presumably by Warren, if the latter is to continue to be with First State, ^{*/} on a number of grounds.

Firstly, the Division urges that the Commission should consider, among other factors, the seriousness of the violations leading up to the sanctions entered in 1979, and other facts indicating a reasonable likelihood of future violations, in determining whether to exclude a registrant from the advisory business. Steadman v. Securities and Exchange Commission, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). The activities resulting in the 1979 sanctions were, indeed, egregious, consisting of serious violations of the antifraud provisions.

Secondly, the Division notes that, as established by the record herein, on five separate occasions since First State's registration as an investment adviser was revoked, the NASD has sanctioned First State as a broker-dealer. While the violations involved were not individually or in

^{*/} Shupack in his testimony described Warren as semi-retired or as in process of taking early retirement, and it may be contemplated that Warren would sever association with First State.

the aggregate sufficient to prompt initiation of any action against First State or its officers by the Commission, they are certainly relevant on the question of whether First State's application for contingent registration as an investment adviser should be granted. They are not just "technical violations", as Shupack characterized them.

Thirdly, the Division notes, as the record establishes, that Shupack's Rule 29 request, which, as already noted, has been incorporated into First State's instant application, incorrectly represented, in a statement signed by both Shupack and Warren, that:

"2. Financial and Shupack have compiled a disciplinary-free record during the preceding two years. Correspondence relating to NASD audits for the past two years are [sic] attached and with minor exceptions demonstrate complete compliance with broker-dealer regulations".

That statement was untrue, since the last of the NASD sanctions, issued on May 13, 1983, fell within the "past two years". Respondent First State never bothered to correct that untrue information. At the very least, this indicates a sloppiness, carelessness, and indifference on the part of First State's top management that does not speak well for the firm's attitude towards compliance procedures generally.

The Division also argues that Respondent's current financial condition militates against granting a contingent

registration. First State, with a net worth of \$200,000, has lost about \$300,000 in the last year. Its investment securities consist entirely of 24,000 shares in a single entity, a bank holding company, the value of which shares has been written down recently from \$35 to \$28 per share.

The Division advances other arguments as well in opposition to conditional registration that will not be mentioned or discussed herein in light of the conclusion reached, and the basis therefor.

C. Conclusion.

In the interest of avoiding even an appearance of lack of due process in the Commission's respective procedures for considering investment-adviser applications and Rule 29 requests, as involved here, it is concluded that the most appropriate action is to grant First State's application for registration as an investment adviser on a contingent basis and subject to various restrictions and limitations in the event the contingency should eventuate. The reaching of this conclusion should not be taken as an expression of any view or attitude towards the merits of any Rule 29 request that may hereafter be filed, a matter clearly not within my jurisdiction under the Order herein.

III. ORDER

Accordingly, IT IS ORDERED as follows, pursuant to Section 203(c)(2) of the Investment Advisers Act:

(1) Respondent First State Financial, Inc.'s application for registration as an investment adviser is hereby granted contingent upon a subsequent showing by Respondent that no person associated with Respondent is subject to a statutory disqualification other than a person as to whom the Commission has consented to such association pursuant to 17 C.F.R. §201.29 of the Commission's Rules of Practice, and subject to the limitations and restrictions expressed in paragraph (2) next below.

(2) The contingent registration of Respondent granted herein shall be subject, if the contingency should be met, to the limitations and restrictions upon the Respondent undertaken in Respondent's Form ADV application for registration and at the hearing herein (see p. 6 above) and to any limitations and restrictions that necessarily follow as a result of limitations and restrictions in any consent that may be given by the Commission in acting on any relevant request under 17 C.F.R. §201.29.

(3) The attention of the parties is directed to the concluding page of the Order initiating this proceeding, the pertinent lettered paragraphs of which provide as follows:

"(c) The Initial Decision of the Administrative Law Judge, in accordance with Rule 16 of the Commission's Rules of Practice, 17 C.F.R. 201.16, shall be filed on or before February 12, 1985.

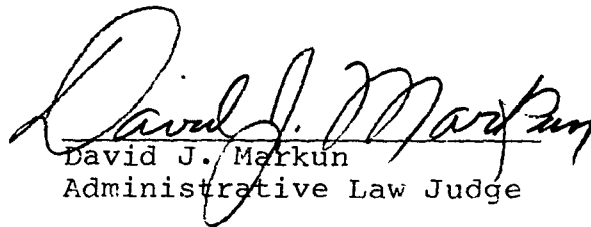
(d) Any party desiring to file a Petition for Review of the Initial Decision, in accordance with Rule 17 of the Commission's Rules of Practice, 17 C.F.R. 201.17, shall file said Petition for Review on or before February 15, 1985;

(e) In the event a Petition for Review is filed, petitioner must file its brief with the Commission on or before February 19, 1985;

(f) Any party seeking to file a reply brief to petitioner's brief must file on or before February 26, 1985;

(g) The Commission will enter its final decision on or before March 15, 1985; and

(h) The provisions of Rule 22(j) of the Commission's Rules of Practice, 17 C.F.R. 201.22(j), will apply to all parties required to be served, in accordance with the Commission's Rules of Practice, 17 C.F.R. 201.23." **/


David J. Markun
Administrative Law Judge

Washington, D.C.
February 8, 1985

**/ All proposed findings, conclusions, and supporting arguments of the parties have been considered. To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the findings, conclusions and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determinations of the material issues presented. To the extent that the testimony of the witness is not in accord with the findings herein it is not credited.