

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
STIERGA & COMPANY, INC.
(8-13052)
STIERGA MANAGEMENT & RESEARCH
COMPANY, INC.
(801-4169)
DONALD L. STIERGA

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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Ralph Hunter Tracy
Administrative Law Judge

April 3, 1973
Washington, D. C.

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2971

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(8-13052) :
SIEREGA MANAGEMENT & RESEARCH : INITIAL DECISION
COMPANY, INC. :
(801-4169) :
DONALD L. SIEREGA :

APPEARANCES: Leslie L. Ogg and Juliette Coleen Ward for the
Division of Enforcement.

Donald L. Sierega pro se and for Sierega & Company
and Sierega Management & Research Company.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

THE PROCEEDINGS

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These proceedings were instituted pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(d) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") to determine whether the above-named respondents 2/ committed various charged violations of these acts 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 charged respondents 3/ with violations of the anti-fraud provisions of the federal securities laws, for engaging in excessive trading in portfolio securities held by a registered investment company, Olympus Fund, Inc. ("Fund"), and with violations of Section 17(a)(3) of the Investment Company Act for failing to repay Fund for expenses which Fund had paid in excess of one percent of the average quarterly net assets. Further, the order charged respondents with violations of Section 37 of the Investment Company Act for converting assets of Fund to their own use and benefit.

Respondents have not been represented by counsel throughout these proceedings. Donald L. Sieroga ("Sieroga") appeared pro se and on behalf

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- 1/ The proceedings were initiated by Commission order for private proceedings dated April 13, 1971, but at the request of respondents were made public by order of June 15, 1971.
- 2/ The order also sets forth charges against Frank J. Mosler whose case has been determined by the Commission as reflected in Exchange Act Release No. 9651, dated June 27, 1972, and no findings as to him are made herein.
- 3/ On May 28, 1970, the U.S. District Court, Central District of California, entered a consent injunction against Sieroga & Co., and appointed a receiver to liquidate it. On October 23, 1970 the Commission suspended Sieroga & Co. for 30 days. SEA Rel. No. 9009.

of Sierega & Company ("Registrant") and Sierega Management & Research Company ("Adviser") at the hearing. Proposed findings of fact and conclusions of law and supporting briefs were filed by the Division only.

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

Registrant was incorporated in California on November 14, 1966, and has been registered as a broker-dealer pursuant to Section 15(b) of the Exchange Act, and as an investment advisor pursuant to Section 203(d) of the Advisers Act, since December 9, 1966. Registrant is a member of the National Association of Securities Dealers ("NASD") with offices at 1901 Avenue of the Stars, Los Angeles, California.

Olympus Fund ("Fund") was organized as an open-end nondiversified investment company on November 30, 1967, as a California corporation and became registered with the Commission on May 3, 1968. A registration statement covering its securities became effective on August 6, 1968.

Sierega Management & Research Company ("Adviser") was incorporated in California on April 25, 1968, and furnished investment advisory and other services to Fund pursuant to an advisory contract. However, Commission files disclose no record of its having been registered pursuant to Section 203(d) of the Advisers Act.

Donald L. Sierega, who has been an officer, director and principal of the foregoing entities, has been engaged in the securities business

since June 1961, when he graduated from San Fernando State College, Northridge, California. He became a registered representative in April 1962 while at Bateman Eichler & Co. He joined William O'Neill & Co. in February 1964 and remained there until October 1966 when he left to form Sierega & Co. While at O'Neill he became vice-president of O'Neill & Co., the O'Neill Fund, and O'Neill Management Co.

Violations of the Anti-Fraud Provisions Under the Exchange Act

The order for proceedings alleges that from on or about August 1968 to on or about May 1970, Sierega & Co., Adviser, and Sierega willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and (2) of the Advisers Act by causing Fund to engage in transactions involving multiple trading in the same security and by switching from one security to another. These trades were excessive in size and frequency in view of Fund's financial resources and investment objectives and, also, were contrary to Fund's stated investment policy.

Fund's registration statement became effective on August 6, 1968, and was amended once, on April 1, 1969. In its prospectus, under Investment Objectives and Policy, it is stated:

"Management of the Fund will seek capital appreciation and will take risks which it believes are consistent with this goal. * * *In seeking to obtain capital appreciation, the Fund expects to trade to a substantial degree in securities for the short term, i.e., the Fund will be engaged essentially in trading operations based on short-term market considerations as distinct from long-term investment based upon fundamental valuation of securities. Since the Fund will be trading in securities for the short term, the annual portfolio turnover rate may generally be expected to be greater than 100%. A rate of turnover of 100% would occur, e.g., if all of the stocks in the Fund's portfolio were replaced in a period of

one year. A 100% turnover rate is substantially greater than that of most other investment companies, including those which emphasize as a basic policy capital appreciation."

The foregoing statement was false and misleading in that Adviser and Sierrega caused Fund's portfolio to be turned over 1126% in 1968, 1283% in 1969 and 1483% in 1970. In 1968, Fund purchased and sold 115 separate issues, 22 of them more than once; in 1969, Fund purchased and sold 310 separate issues, 40 of them more than once, 25 more than twice, and 15 at least six times; in the six month-period ending May 31, 1970, Fund purchased and sold 42 separate issues, 12 of them more than once and two of these issues at least four times. During the entire period, the average holding time for each issue was less than 30 days, with some issues being bought and sold on the same day. Accordingly, in its slightly more than two years of operations, during which time its net asset value never exceeded \$1,100,000, Fund paid out \$277,245 in brokerage commissions. A substantial portion of the commissions derived from the excessive portfolio transactions was used by respondents to continue the operations of Sierrega & Co.

The amount of commissions paid by Fund for brokerage transactions was exorbitant in view of Fund's financial resources. The net assets of Fund increased from \$134,000 to \$727,823 between April 30, 1968 and November 30, 1968, during which period Fund paid \$60,263 in commissions. By the end of the fiscal year 1969, Fund's net assets had increased to \$1,098,827, but during that year Fund had expended \$191,500 on brokerage commissions. By May 28, 1970, Fund's net assets had declined to \$562,000 with Fund paying \$35,482 in commissions. The net asset value per share on November 30, 1968, was \$12.91, on November 30, 1969, it was \$7.88, and by May 31, 1970, it had declined to \$5.56.

Fund's prospectus states that it intended to place the primary portion of portfolio transactions with its affiliate, Sierega & Co., and most of such transactions were so placed. The commissions generated from the transactions were necessary to the continued operations of Sierega & Co., which operated at a deficit at all times during the existence of Fund. During 1968, Sierega & Co. showed a loss of approximately \$2,630. In 1968, Fund's brokerage commissions paid to Sierega & Co. amounted to \$56,900 or 8.2% of its income. During 1969, Sierega & Co. showed a loss of approximately \$247,000. In that year, Fund's brokerage contributed \$149,800 or 13.5% of the income of Sierega & Co. In the short period ending on May 28, 1970, the date a receiver was appointed to take over the operation of the insolvent Sierega & Co., the company booked losses in excess of \$400,000 and Fund's contribution to its income was shown to be \$17,598 or 2.8%. However, a review of the financial statement of Sierega & Co. for April 30, 1970, shows that cash provided by Fund's brokerage commissions, for the short period, played a more significant role than the percent of income would indicate. Approximately one fourth of the income shown as of that date was from journal entries, setting up principal profits and receivables for anticipated reciprocal business. Further, the report filed by the receiver indicates that substantial discrepancies existed in the books and records as of that date. By engaging in the above described practices, respondents caused Fund to execute excessive portfolio transactions for their benefit and thus willfully violated Fund's stated investment objective.

In Hecht v. Harris, Upham & Co., 283 F. Supp. 417 at 432 (U.S.D.C. Cal. 1968) the court said:

The courts have also held in private damage suits that

excessive trading, churning, disproportionate to the size and character of the account and primarily for the purpose of creating commissions rather than on behalf of the customer, constitutes a fraud within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5.

There is no simple formula for determining what is excessive.^{4/}

The central question of fact for determination is whether the volume and frequency of transactions considered in light of the nature of the account and the situation, needs and objectives of the customer, have been so "excessive" as to indicate a purpose of the broker to derive profit for himself while disregarding the interest of the customer.^{5/}

Fund's investment policy was capital growth and its turnover ratio was stated to be greater than 100%. Accordingly, it should be compared with funds generally having the same disclosure.^{6/} Also, as the court pointed out in Lutz, a high turnover is not an inevitable consequence of a stated investment policy, but it may be the inevitable consequence of the actual investment operations of the fund.

For the 10-year period, from 1960 through 1969, registered investment companies had an average turnover rate of 57 percent. Institutional Investor Study Report, Summary Vol. p. 22 (1971).

In 1969, funds which engaged in a high volume of trading and which had investment objectives similar to those of Fund, still only had an

^{4/} Norris v. Hirshberg, 21 SEC 865, 894, (1946).

^{5/} Hecht v. Harris, Upham & Co., supra at 433. See, e.g., Looper Company, 38 SEC 294, 301 (1958). 14 NYLF 315 (1968).

^{6/} Lutz v. Boas, 39 Del. Ch. 585, 171 A. 2d 381, 393 (1961).

average turnover in their portfolio of approximately 130%. See, e.g.,
13 Fundscope, April 1970, pp. 75-99.^{7/}

As previously stated the turnover of Fund's portfolio was 1126% in 1968, 1283% in 1969 and 1483% in 1970. Thus, churning would be present here under any conceivable set of investment policies and objectives. Even though Fund could be described primarily as a trading fund, such enormous and excessive trading to the benefit of affiliated persons was contrary to representations as to the investment policies in the Fund's prospectus, as well as the nature and financial condition of Fund. Hecht v. Harris, Upham & Co., supra at 432.

The commissions generated by such an excessive turnover rate were for the benefit of Sierega who had a substantial investment in Sierega & Co.

Respondents were under a fiduciary duty to manage Fund in the best interests of shareholders.^{8/} An investor in a registered investment company trusts that a professional money manager will deal with him fairly. He assumes that the investment adviser is obligated to be trustworthy due to his position. Further, he assumes that the information presented in the prospectus is complete and accurate, and that the investment adviser will adhere to the policies stated therein. Respondents caused Fund to engage in an excessive number of transactions. Such

^{7/} Olympus failed to supply information for inclusion in Fundscope Guide.

^{8/} Brown v. Bullock, 194 F. Supp. 207, 234 (D.N.Y. 1961).

activity is in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Richard N. Cea, Securities Exchange Act Release No. 8662, p. 9 (1969); E. H. Rollins & Sons Incorporated, 18 SEC 347, 382 (1945); R. H. Johnson & Company, 36 SEC 467, 487 (1955), aff'd 231 F 2d 523 (D.C. Cir. 1956); J. Logan & Co., 41 SEC 88, 98-99 (1962). Likewise, in Lutz v. Boas, supra at 393, the Court found that where the investment adviser had caused the fund to engage in excessive trading, the excessive trading violated the Exchange Act and further, that it violated general equitable principles because the trading was contrary to the representations appearing in the prospectus.

It was more than a violation of general equitable principles to engage in trading practices contrary to Fund's investment policy outlined in its prospectus. It also violated the anti-fraud provisions of the Exchange Act.

Upon consideration of all the circumstances, as discussed herein, it is found that Sierega & Co., Adviser and Sierega, willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and (2) of the Advisers Act, as alleged in the order for proceedings.

Violation of Section 17(a)(3) of the Investment Company Act

The order for proceedings alleges that during the period from on or about November 30, 1969 to on or about May 1970, Adviser, an affiliated person of a registered investment company, acting as principal, willfully

violated Section 17(a)(3)^{9/} of the Investment Company Act, and Section 206(1) and (2) of the Advisers Act, and that Sierega & Co. and Sierega willfully aided and abetted such violation by borrowing money or other property from Fund, which Adviser was obligated to repay to Fund and which was not repaid.

Fund's prospectus states that its expenses shall not exceed 1% of the average of its quarterly net assets. Any excess expenses were charged against Adviser as reimbursed expenses due to Fund. The record discloses that Fund had paid expenses in an amount of \$30,179 in excess of the stated 1% of the average of its quarterly net assets. On June 8, 1970, when a new management company took over, Fund had a receivable for these excess expenses which it had paid, due from Adviser, for \$30,179. This receivable was written off as uncollectible in November 1970.

The management contract created an obligation on the part of Adviser to repay the expenses in excess of 1% of the average net assets. Respondents' failure to settle this obligation had the practical effect^{10/} of a borrowing, with the Fund extending a non-interest bearing loan to

^{9/} Section 17(a) provides, in pertinent part, that:

"It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company . . . or any affiliated person of such a person, promoter, or principal underwriter, acting as principal - to borrow money or other property from such registered company or from any company controlled by such registered company . . ."

^{10/} Investment companies which fail to make prompt settlement on sales of fund shares effectively extend non-interest bearing loans, Investment Company Act Release No. 6366 (March 5, 1971).

Adviser. Accordingly, respondents' failure to repay the excess expenses was a violation of Section 17(a)(3), which prohibits an 11/ affiliated person of a registered investment company from borrowing money from such registered company.

Violation of Section 37 of the Investment Company Act

The order for proceedings alleges that Adviser, Sierega & Co., and Sierega, individually and jointly and together with others, unlawfully and willfully, directly and indirectly, converted the assets of Fund to their own use and benefit in violation of Section 37 of the Investment Company Act.

Willful conversion, as used in Section 37 of the Investment Company Act, covers more territory than larceny and embezzlement. Brown v. Bullock, supra at 419. As used in the Act, it includes the misuse or abuse of property as well as its use in an unauthorized manner. Tanzer v. Huffines, 314 F. Supp. 189, 194 (D.C. Del 1970). Viewed in this context the deriving of monies by causing Fund to engage in excessive portfolio transactions is just such a misuse and abuse of property as the Act intended to prevent.

Further, the retention of monies due Fund constitutes a conversion. With respect to Adviser's obligation to pay all Fund's expenses over 1% of Fund's average net assets, the books of Adviser show that money to

11/ Section 2(a)(3)(E) defines an affiliated person of another person: "if such other person is an investment company, any investment adviser thereof . . ."

repay Fund for the amount due as of November, 1969, had been put into Adviser through an advance from Sierega & Co. in April, 1970. However, this money was never repaid to Fund. Sierega testified that he could not recall the transaction or account for the money. The total obligation was subsequently written off as uncollectible by Fund's new management. (See p. 9 supra).

Here the monies were not repaid when they became due and owing to Fund, nor could they be accounted for later. The monies which should have been paid over to Fund were used to continue the operations of Sierega & Co. and were never repaid. By retaining the monies for their own use, respondents violated the provisions of Section 37 of the Investment Company Act.

Public Interest

Sierega testified in his own behalf during the course of the hearing and admitted that the turn-over rate for Fund was excessive and that registrant owed monies to Fund. However, he stated that he felt that the question of excessive turnover was one of disclosure and that he had relied on an attorney and an associate to see that the proper terminology as to the rate of turn-over was used in the prospectus. Further, the rate of turnover of 1126% and 1283% for the fiscal years 1968 and 1969, respectively, was shown on Form N1R filed with the Commission.

Sierega was at all times a director and either president or Chairman of the Board of Fund, Advisor and Sierega & Co. He testified that he developed the management philosophy of Sierega & Co. and that he was aware of the obligation of Adviser to Fund. However, he asserts that the

then president of Sierega & Co. and two people in the back office, all unnamed, were actually responsible for the failure to see that the obligation was discharged.

Respondents willfull ^{12/} violations of the Exchange Act, the Investment Company Act and the Advisers Act require the application of sanctions which cannot be evaded by Sierega's attempting to shift the responsibility for his conduct to others. ^{13/} The nature and extent of the violations found herein and the fact that they were committed by a principal of a registered broker-dealer and investment adviser demonstrates a contempt and disregard for the federal securities laws which cannot be overlooked when considering appropriate sanctions.

In view of all of the circumstances it is concluded that the extent and character of the violations is such that the public interest requires revocation of Sierega & Company's registration as a broker-dealer and as an investment adviser; that Donald L. Sierega be barred from being associated with a broker-dealer; ^{14/} and that the sanctions prescribed by Section 9(b) of the Investment Company Act be imposed upon Sierega Management & Research Company, Inc., and Donald L. Sierega, as more specifically delineated in the following Order.

12/ It is well established that a finding of willfulness does not require an intent to violate the law and that it is sufficient that a respondent intentionally engaged in conduct which constituted a violation. Tager v. Securities & Exchange Commission, 344 F. 2d 5, 8 (C.A. 2, 1965); Dunhill Securities Corporation, Exch. Act Rel. No. 9066, p. 4 (Jan. 26, 1971).

13/ In the Matter of J. Vander Moere & Co., Exch. Act Rel. No. 7393, p. 2 (1964).

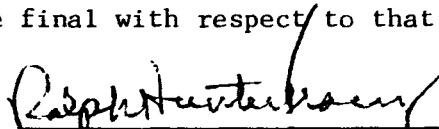
14/ It should be noted that a bar order does not preclude the person barred from making such application to the Commission in the future as may be warranted by the then-existing facts. Fink v. SEC, (C.A. 2, 1969), 417 F 2d 1058, 1060; Vanasco v. SEC, (C.A. 2d, 1968) 395 F. 2d 349, 353.

ORDER

Accordingly, IT IS ORDERED that the registration as a broker-dealer and as an investment adviser of Sierega & Company, Inc. is revoked and the company is expelled from membership in the National Association of Securities Dealers, Inc.; that Sierega Management & Research Company, Inc. is unconditionally, permanently prohibited from being an investment adviser of a registered investment company or an affiliated person of such investment adviser; and that Donald L. Sierega is barred from association with any broker-dealer and is permanently prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or principal underwriter for a registered investment company or affiliated person of such investment adviser.

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), 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(f), unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.^{15/}



Ralph Hunter Tracy
Administrative Law Judge

April 3, 1973
Washington, D.C.

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