ADMINISTRATIVE PROCEEDING
FILE NO. 3-7091

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)
	)
J. BAKER TUTTLE CORP.	)
TUTTLE & CO.	)
JASON BAKER TUTTLE, SR.	)
	)

INITIAL DECISION

Washington, D.C.
December 21, 1990

Brenda P. Murray
Administrative Law Judge

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APPEARANCES: C. Gladwyn Goins, Denise M. O'Brien, Douglas G. Ward and Ronald E. Wood of the San Francisco Branch Office for the Securities and Exchange Commission, Division of Enforcement.

J. Baker Tuttle Corp., Tuttle & Co. and Jason Baker Tuttle, Sr., pro se.

BEFORE: Brenda P. Murray, Administrative Law Judge

BACKGROUND

The Securities and Exchange Commission (Commission) initiated this administrative proceeding on June 27, 1989, pursuant to Sections 203(e) and (f) of the Investment Advisers Act of 1940 (Advisers Act). In response to the Order for Public Proceedings, I conducted hearings in San Francisco on August 29, 1989 - September 1, 1989, at which I heard testimony from twenty witnesses and received into evidence approximately 100 exhibits. I received the final brief on December 12, 1989.

In a related development, in a decision issued January 8, 1990, I denied an application by J.B.T. Management, Inc. d/b/a Tuttle Inc. for registration as an investment adviser, and suspended Jason Baker Tuttle, Sr. (Mr. Tuttle, Sr.) and Jason Baker Tuttle, Jr. from association with any investment adviser for a period of six months. That decision became final by operation of law and the six month suspensions took effect at the close of business on February 5, 1990. J.B.T. Management, Inc. d/b/a Tuttle Inc., Investment Advisers Act Release No. 1218 (January 22, 1990), 45 SEC Docket 788.

RESPONDENTS

In 1980 Mr. Tuttle, Sr. and Mr. Steve Noroian formed the investment adviser firm of Tuttle - Noroian, Inc. The firm's investment adviser registration became effective on April 1, 1980. Mr. Tuttle, Sr. bought out Mr. Noroian's interest and changed the firm's name to The J. Baker Tuttle Corp. in March 1986. Between 1986 and 1988, Mr. Tuttle, Sr., formerly of San Francisco now of

Palm Beach, Florida, was president, chairman, and sole shareholder of The J. Baker Tuttle Corp. and Tuttle & Company, Inc., two registered investment adviser firms.1/ Both firms were located in San Francisco, California, and used the mails and instrumentalities of interstate commerce to conduct business with clients in several states. The corporate status of the several investment advisor firms controlled by Mr. Tuttle, Sr. cannot be determined from the evidence of record. See Division's Reply Brief 2, 5-6, responding to the new materials which respondents attached to their brief.

Mr. Tuttle, Sr. was the only one of the 14 employees of The J. Baker Tuttle Corp. familiar with the terms and requirements of the Advisers Act. Mr. Tuttle, Sr. prepared all the ADV forms (Application for Registration as an Investment Adviser) for The J. Baker Tuttle Corp. and Tuttle & Co. The Commission received ADV forms filed by The J. Baker Tuttle Corp. on May 29, 1986, September 17, 1986, and March 23, 1987. These filings represented that The J. Baker Tuttle Corp. had 258 discretionary accounts with an aggregate value of $150 million and 9 non-discretionary accounts with an aggregate value of five million. The Division contends the firm had about 91 clients and $56.6 million under

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1/ Mr. Tuttle, Sr. is also the sole owner, president, and chairman of Tuthill, Ltd. International, an investment adviser whose registration became effective on June 4, 1987. The firm allegedly did not do any business. (Tr. 858-60) The ADV forms for Tuthill, Ltd. International and Tuttle & Co. contain almost identical information for each firm. (Compare Division Exhibits 15 and 17)

discretionary management. (Division Exhibit 2)

Mr. Tuttle, Sr. and his wife filed for Chapter 11 reorganization under the federal bankruptcy code, 11 U.S.C. §1101 (1986) on March 20, 1987, and The J. Baker Tuttle Corp. filed for Chapter 11 reorganization four days later. In a memorandum dated March 30, 1987, The J. Baker Tuttle Corp. notified its clients that the company was relocating and moving to "New Corporate Headquarters", that the new property was "owned and not rented", and that this change would free up the company to devote its future revenues and capital to an "expanded research staff and capability". (underlining appears in original) The notice also stated that "In order to terminate the previous lease arrangement we were advised to and did file for reorganization under chapter eleven of the United States bankruptcy code." (Division Exhibit 28) In May 1987, Mr. Tuttle, Sr. sent the Commission's San Francisco office an ADV form for The J. Baker Tuttle Corp. which he indicated was its latest filing but this form, which disclosed that applicant had filed a bankruptcy petition, was never filed with the Commission in Washington, DC.

The J. Baker Tuttle Corp. ceased doing business on July 17, 1987, when it petitioned to have its bankruptcy filing converted to a Chapter 7 liquidation, 11 U. S. C. §701 (1986). In anticipation of this event, Mr. Tuttle, Sr. filed a Form ADV on behalf of Tuttle & Co. so that he could stay in business after the demise of The J. Baker Tuttle Corp. (Tr. 838) Tuttle & Co's. investment adviser registration became effective on June 26, 1987.

Mr. Tuttle, Sr. told the clients of The J. Baker Tuttle Corp. in June 1987, that he had created Tuttle & Co. to manage accounts over five million dollars, however, Tuttle & Co. was willing to handle the accounts of The J. Baker Tuttle Corp's clients whatever their size. Tuttle & Co. had approximately 29 clients with 42 accounts. Most of the clients of Tuttle & Co. had been clients of The J. Baker Tuttle Corp. Tuttle & Co. charged an additional $2,500 "set-up charge" when these clients transferred their accounts to the new firm. (Tr. 397-98) The Commission received ADV forms from Tuttle & Company on May 13, 1987, and July 21, 1987. Tuttle & Co. ceased doing business in November 1987, and filed for liquidation under Chapter 7 of the federal bankruptcy code in January 1988.

A member of the Commission's San Francisco staff examined the books and records of The J. Baker Tuttle Corp. in February-March 1986, and in April-July 1987, and Tuttle & Co. in November-December 1987, and in May-June 1989. On several occasions, Mr. Tuttle, Sr. indicated to Commission personnel in San Francisco that he had remedied the deficiencies they had brought to his attention, and that he intended to operate the firms "in a manner that adheres strictly to the requirements and spirit of the SEC regulations." (Division Exhibits 20-26, 31, 32; Tr. 81-83, 131-33)

FINDINGS

My findings and conclusions are based on the record and my observation of the demeanor of the witnesses. The applicable

standard of proof is preponderance of the evidence.

Initially, I find that Mr. Tuttle, Sr., the president, chairman, and sole shareholder of both corporate respondents, exercised tight managerial control over these investment advisers and these firms are accountable for the actions of their responsible officers. A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977), cert. denied, 434 U.S. 969 (1977)

The thrust of the Advisers Act is disclosure to the public of material information about investment advisers so that the public can make an informed decision. The Commission relies on the Form ADV as its primary method of gathering this information for public inspection and dissemination. The courts have held that the Form ADV is a basic and vital element in the regulation of investment advisers, and that it is essential that the information required by the form be kept current and accurate. Jesse Rosenblum, 47 S.E.C. 1065, 1067 (1984), aff'd, 760 F.2d 260 (3d Cir. 1985); Marketlines, Inc. v. SEC, 384 F.2d 264, 267 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968); Justin Federman Stone, 41 S.E.C. 717, 723 (1963)

Section 207

Section 207 of the Advisers Act prohibits any person from willfully making any untrue statement of a material fact in any registration application or report filed with the Commission pursuant to Sections 203 or 204, or to omit to state in any such application or report any material fact which is required to be stated therein.

In the Order for Public Proceedings the Commission set for hearing allegations that since May 1986, The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. willfully violated Section 207 in that they filed ADV forms which contained untrue statements of material fact concerning, among other things, The J. Baker Tuttle Corp.'s practices with respect to advisory fees and billing. 2/

On brief, the Division argues that The J. Baker Tuttle Corp. and Tuttle & Co. violated Section 207 and Mr. Tuttle, Sr., aided and abetted those violations. (R. Brief, 3) I make no findings on whether or not Tuttle & Co. violated Section 207 since the Commission in its Order for Public Proceedings did not allege Tuttle & Co. committed these violations, and a respondent is entitled to adequate notice of the charges which can bear on the issue of sanctions. Jaffee & Co. v. SEC, 446 F.2d 387, 392-94 (2nd

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2/ In its brief, the Division also alleged that The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. willfully violated Section 207 because they filed ADV forms which falsely stated that (1) the adviser had registrations pending in 19 states, (2) it was a California corporation, and (3) it managed 258 discretionary accounts with an aggregate market value of $150,000,000 and nine discretionary accounts with an aggregate market value of $5,000,000. Respondents did not challenge the Division's position perhaps because they appeared pro se. I will not consider these allegations since the Order for Public Proceedings does not mention them. The term "among other things" used in connection with specific allegations is defined restrictively in Commission practice and it does not include matters beyond those specified. Sterling Securities Co., 37 S.E.C. 825, 827 (1957) Consideration of the additional charges raised by the Division violates this precedent and the due process requirement that a person alleged to have acted in violation of the statute should be informed of the nature of the charge in order to have ample opportunity to present an appropriate defense to the case presented by the Division. Michael J. Meehan, 1 S.E.C. 238, 240 (1935), Russell Maguire & Co., Inc., 10 S.E.C. 353 (1940), Charles M. Weber, 35 S.E.C. 79 (1953), Murray Securities Corp., 37 S.E.C. 780 (1957), Sterling Securities Co., 37 S.E.C. 825 (1957), and Morris J. Reiter, 39 S.E.C. 484 (1959)

Cir. 1971)

Advisory fees and billing practices

The ADV form, Part 1, Item 15 asks "Does applicant require prepayment of fees of more than $500 per client and more than 6 months in advance?" and Part II, Item 14 requires that registrant submit a balance sheet for the most recent fiscal year if it "requires prepayment of more than $500 in fees per client and 6 months or more in advance". Rule 204-1(b)(2) specifies that the balance sheet shall be filed within 90 days of the end of the adviser's fiscal year.

The J. Baker Tuttle Corp. answered no to Items 15 and 14 and wrote that a balance sheet was "not required" on all its ADV forms. On each ADV form it indicated that fees were payable quarterly in arrears. (Statement appears on Schedule F, a continuation sheet for Part II)

I find that The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. willfully violated Section 207 by the false answers they supplied in all The J. Baker Tuttle Corp. ADV forms with respect to advisory fees and billing practices - the answer to Item 15 of Part I, Item 14 of Part II, and Schedule F. I find that these respondents acted willfully because the evidence is overwhelming that the billing information on the ADV forms was false and that the president, chairman and sole shareholder of the investment adviser knew the answers were false when he filed them.

I make these findings because the unequivocal testimony, supported by written documents, from clients and employees of The

J. Baker Tuttle Corp. and the Commission's compliance examiner who reviewed the firm's records is that during its entire existence the firm billed clients more than six months in advance for management fees well in excess of $500. The parties stipulated that the majority of The J. Baker Tuttle Corp.'s clients, who were clients prior to July 1986, were required to prepay management fees of $500 or more, one year in advance. (Division Exhibit 2, Stipulation 13) Other evidence is that each month from May 1986, through March 1987, almost half and some months more than half of the firm's clients paid more than $500 six months or more in advance. (Tr. 74-75, 83-84, 302, 354, 387, 401-02, 435-38, 593, 675-80, 720-21, 791-99, 804, 807; Division Exhibit 33, Division Exhibit 63, at 10-15, Division Exhibit 64 at 37, 57-59, 76-79)

The fact that the ADV form requires information about an adviser's billing practices indicates that the information is material. See SEC v. First City Fin. Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989); SEC v. Savoy Indus., 587 F.2d 1149, 1165 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979) and S.E.C. v. Levy, 706 F. Supp. 61, 72 (D.D.C. 1989) Another basis for a finding of materiality is that there is a substantial likelihood that a reasonable person could consider it important in selecting an investment adviser that respondent's billing practice was to require payment of management fees more than six months in advance of when the service was completed. See Basic Inc. v. Levinson, 108 S. Ct. 978, 983 (1988). Still another reason why the omitted information concerning billing advisory fees is material in this

situation is because if The J. Baker Tuttle Corp. had answered the questions honestly, it would have had to supply a balance sheet as part of its ADV filing. Finally, this information is material because it informs the Commission's Division of Investment Management of where high risk situations exist so that it can design a suitable inspection and compliance program for investment advisers. (Tr. 40-41)

Mr. Tuttle, Sr. gives assorted reasons why he gave incorrect answers - he was intimidated by the Commission's staff, he believed the question referred to billing practices for only new clients, that he intended to change his billing practices to reflect his answers within 90 days, and that he did not understand the nature of the ADV form. Mr. Tuttle's excuses are unbelievable and often contradict his prior statements. For example, in a letter to the Commission dated May 23, 1986, Mr. Tuttle, Sr. stated that as of April 28, 1986, all clients were being billed on a quarterly basis after services were performed. "No client is billed in advance for management services." (Division Exhibit 20) He made similar representations on June 25, 1986, and September 5, 1986. (Division Exhibits 22 and 24) Mr. Tuttle, Sr. testified that his statements meant that the firm did not bill new clients in advance for service, but that the firm billed old clients in advance until June 30, 1987.

The meaning Mr. Tuttle, Sr. gives to the questions on the ADV form and his answers are implausible from a college graduate with close to 25 years experience in the securities industry who was

the founder and owner of several investment adviser firms and who had about ten years experience preparing ADV forms. However, even if you accept by some wild stretch of the imagination that Mr. Tuttle believed the form only required information about billing practices for new clients, The J. Baker Tuttle Corp. did not bill either new clients or old clients the way Mr. Tuttle says they did. Contrary to Mr. Tuttle's representations, The J. Baker Tuttle Corp. did not bill all new clients after service had been performed, and did not stop billing old clients in advance as they renewed their contracts in the period June 1986 to June 1987. In a fifteen month period from May 1986 through July 1987, The J. Baker Tuttle Corp. submitted 231 bills to clients, 216 were for fees payable in advance and four of these were to new clients. (Division Exhibit 33) Witnesses testified that on June 3, 1986, The J. Baker Tuttle Corp. billed a new client $602,000 for management fees in advance. On March 25, 1987, The J. Baker Tuttle Corp. billed two clients who had been with it and Tuttle-Noroian since 1982 for amounts greater than $500 for services to be rendered in future periods.

The J. Baker Tuttle Corp. paid between $30,000 to $50,000 monthly for Mr. Tuttle, Sr.'s salary, his personal and business expenses, and for four real estate mortgages on three properties held in his name. In 1986, the firm paid him between $360,000 and $370,000 in wages. (Division Exhibit 64, at 63-69) The cash disbursement ledger of the corporation shows payments of $439,421.68 to Mr. and Mrs. Tuttle, Sr. in the period January

1986, through July 17, 1987. (Division Exhibit 48)

In early 1986, the Commission began an examination of the books and records of the investment adviser firm of Tuttle - Noroian, Inc., the predecessor firm to The J. Baker Tuttle Corp. in response to a complaint from a member of the public. This examination resulted in a "deficiency letter" to Mr. Tuttle, Sr. as Chairman of Tuttle - Noroian, Inc. from the Chief, Branch of Regulation in the Commission's San Francisco office stating that the investment adviser should immediately engage a qualified independent public accountant for an audit of its balance sheet for the fiscal year ended February 28, 1986, since it had been collecting prepaid fees in excess of $500 per client since 1982. In March 1986, after the firm changed its name to The J. Baker Tuttle Corp., Mr. Tuttle, Sr. informed the San Francisco office that The J. Baker Tuttle Corp. had ceased as of April 30, 1986, requiring clients to pay management fees in advance and that it now billed quarterly in arrears. Respondent retained an accountant in March or April 1986, to prepare a balance sheet. The accountant testified that he was unable to prepare financial statements for the firm because the books of The J. Baker Tuttle Corp. listed a $231,250 loan by J. H. Tuttle & Sons to an affiliated company owned by Mr. Tuttle, Sr. as an asset and that Mr. Tuttle, Sr. would not or could not explain the current status of this asset. (Tr. 616-21)

I conclude that Mr. Tuttle, Sr. willfully gave false answers on the ADV forms he prepared for The J. Baker Tuttle Corp. because

accountants were unwilling to provide audited balance sheets for The J. Baker Tuttle Corp. without additional information from Mr. Tuttle, Sr., and he wanted the firm from which he was receiving substantial income to continue operating as long as possible.

Section 206

Section 206 states that:

> it shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly -
>
> (1) to employ any device, scheme, or artifice to defraud...
> (2) to engage in any ... practice, or course of business which operates as a fraud or deceit ...;
>
> . . .
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

In the Order for Proceedings the Division alleges that The J. Baker Tuttle Corp., Tuttle & Co., and Mr. Tuttle, Sr. willfully violated Sections 206(1), (2), and (4), in that, among other things, they accepted prepaid fees while not disclosing that the investment advisers were insolvent, and that The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. willfully violated these provisions because they failed to provide pro rata refunds of advance fees to clients who cancelled their investment advisory service agreements.

I will not make any findings as to whether Mr. Tuttle, Sr. personally violated Section 206 because the section only regulates the conduct of investment advisers. I will, however, consider the lesser charge of whether or not he aided and abetted the alleged violations. There is no question of procedural due process since

the Order for Public Proceedings put Mr. Tuttle, Sr. on notice that this proceeding would consider allegations that he willfully violated Section 206.

The J. Baker Tuttle Corp. aggressively sought new clients after it and Mr. Tuttle, Sr. filed under the bankruptcy statute. It sent out over three times as many advance billings in March 1987, the month the filings occurred, than it had sent out in any of the prior ten months. (Division Exhibit 33) Mr. Tuttle, Sr.'s efforts on behalf of The J. Baker Tuttle Corp. to collect prepaid fees from clients after March 24, 1987, are particularly egregious since he believed at that time that there was only a very slim chance that the firm would emerge from the Chapter 11 reorganization. (Division Exhibit 63, 13)

There is no dispute that the bankruptcy filings occurred because both the firm and Mr. Tuttle, Sr. were insolvent as that term is used in a bankruptcy sense, i. e., liabilities exceeding assets. J. F. Weston & E. F. Brigham, Managerial Finance, 675 (7th ed. 1981) The J. Baker Tuttle Corp. did not disclose either its bankruptcy filing or that of Mr. Tuttle, Sr. when it solicited new clients or renewed the contracts of existing clients. To prevent clients and potential clients from learning of his insolvency and that of the firm, Mr. Tuttle, Sr. did not inform the employees of The J. Baker Tuttle Corp. of the filings, and, after they found out, he instructed that they not tell clients or brokers. The firm worked with brokers on behalf of the clients and brokers were a source of customer referrals. In addition, Mr. Tuttle, Sr.

misrepresented why the firm filed for bankruptcy and made false assertions about the company's relocation to owned quarters and growth plans in the memorandum he sent to clients on March 30, 1987.

I find that The J. Baker Tuttle Corp. willfully violated Sections 206(1), (2), and (4) from March 20, 1987 through July 17, 1987, by soliciting and accepting prepaid fees while not informing its clients and prospective clients that it and its sole shareholder, chairman, and president were insolvent. Investment advisers are fiduciaries and the courts have imposed on them an affirmative duty of utmost good faith, and full and fair disclosure of all material facts. SEC v. Capital Gains Research Bureau, 375 U.S. 180, 194 (1963) The Commission has consistently held that a failure by a broker-dealer to disclose the material fact of insolvency or inability to meet obligations as they become due constitutes fraud. Intersearch Technology, Inc., (1974-75 Transfer Binder) Fed. Sec. L. Rep. (CCH) ¶ 80,139, at 85,188 (1975), Investment Advisers Act Release No. 457 (April 30, 1975), 6 SEC Docket 817. Investment advisers should be held to no less a standard.

I find that Tuttle & Co. willfully violated Sections 206(1), (2), and (4) by soliciting and accepting prepaid fees while not disclosing that it was insolvent in the period August 13, 1987 until it ceased doing business in October/November 1987. I reach this conclusion because for all but a few days of this period the firm's liabilities exceeded its assets (accrual basis) and its

accounts payable exceeded its cash balances (cash basis). (Division Exhibit 57) This evidence is unrefuted on this record. The fact that on July 21, 1987, Tuttle & Co. did not file the balance sheet prepared by a outside accountant as part of its ADV filing but changed the accountant's submission in material respects to make the firm look stronger financially confirms that Mr. Tuttle, Sr. knew the firm was in financial difficulty and submitted fraudulent information to hide this fact. (Division Exhibit 75)

The preponderance of the evidence is that these investment advisers violated the anti-fraud provisions of Section 206 by soliciting and accepting prepaid fees for their investment adviser services without disclosing to clients and potential clients that they were insolvent, and that Mr. Tuttle, Sr. willfully aided and abetted these violations because it was through his activities that the violations occurred and he knew or should have known that these activities violated the Advisors Act. The fact that the firm's president knowingly participated in an illegal scheme amply supports a finding that he willfully aided and abetted in the firm's violation. A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977), cert. denied, 434 U. S. 969 (1977) In summary, through the actions of Mr. Tuttle, Sr., The J. Baker Tuttle Corp. and Tuttle & Co. employed devices, schemes or artifices to defraud, they engaged in practices and a course of business which operated as a fraud or deceit, and they engaged in fraudulent, deceptive

actions.3/

I also find that from May 1986 to July 1987, The J. Baker Tuttle Corp. willfully violated Section 206 because it did not return prepaid fees to clients when the clients canceled their contracts before the end of the period, and that Mr. Tuttle, Sr. willfully aided and abetted in these violations. Several witnesses testified that The J. Baker Tuttle Corp. did not return a portion of their prepaid fees when they cancelled before the end of the period, and that they paid those fees in response to solicitations by the investment adviser which did not disclose material information about the firm and/or the firm took other fraudulent actions. For example, none of the witnesses knew when they prepaid for investment management service by The J. Baker Tuttle Corp. that the investment adviser and Mr. Tuttle, Sr. had filed under the bankruptcy code because of insolvency and that the firm was not the strong, growing business described in Mr. Tuttle's letter to clients on March 30, 1987. In addition, Mr. Tuttle, Sr. terminated the agreement with the Schmanski family who had prepaid management fees of almost $30,000 after the Schmanskis learned that Mr. Tuttle, Sr. had lied and the firm did not have a bond manager handling their $700,000 bond portfolio.

3/ The Division's reliance on Rule 206(4)-4 which defines a fraudulent, deceptive, or manipulative act, practice, or course of business as a failure to disclose to clients or potential clients material facts with respect to a financial condition that is reasonably likely to impair the adviser's ability to meet contractual commitments to clients would appear to be misplaced. The Order for Public Proceedings does not mention the rule and it became effective on December 1, 1987, after both corporate respondents ceased doing business.

In each of the situations described by the public witnesses, The J. Baker Tuttle Corp. violated Section 206 in not making pro rata refunds to its former clients because it acted fraudulently and withheld material information about the financial status of the firm and Mr. Tuttle, Sr. when it solicited and accepted prepaid management fees, it enticed people to prepay for service by giving a discount when there was little likelihood that the firm would remain a going concern for the period of the contract, it misrepresented that the firm had a bond manager, or it refused to refund moneys paid to it in error.

Beyond the factual situations just recited, the Division alleges that The J. Baker Tuttle Corp. acted fraudulently by failing to make pro rata refunds to all clients who canceled their prepaid agreements. In advancing this position, the Division adopts the policy expressed by the Commission's Division of Investment Management since at least 1978, that the failure to refund prepaid fees to a client who cancels is a per se violation of Section 206 because it is inconsistent with an investment adviser's fiduciary obligations to deal fairly and honestly with, and in the best interests of, its clients. The Division witness who examined the firm's records estimated that prepaid clients who canceled will receive little if anything of the $356,146.30 owed to them. (Tr. 129-30)

Resolution of this issue requires scrutiny of an investment adviser's fiduciary relationship with its clients. The question is whether the practice should be considered fraudulent because it

puts an investment adviser in a situation where it could take undue advantage of its clients or put its own interests ahead of theirs. As noted in SEC v. Capital Gains Research Bureau, 375 U.S. 180, 195 (1963), Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but flexibly to effectuate its remedial purposes. Investment adviser contracts are personal service contracts that is they depend on the existence of a personal relationship between the parties, and if a client, for whatever reason, loses faith in the skill and abilities of the investment adviser managing his or her investments then the contract is of little value to the client. See Lowe v. SEC, 105 S. Ct. 2557, 2568, 2572 (1985) Recognizing the personal nature of these contracts, a client should not be put in a position where it is impossible to end the relationship without suffering a financial loss. Also, permitting investment advisers to keep the entire prepaid fee in the event of cancellation places a strain on the fiduciary relationship because it diminishes the incentive for advisers to act to further their client's interests since inaction or doing the bare minimum better serves their interests where their fees are assured. As the Supreme Court noted in Capital Gains Research, supra, at 200, "The Investment Advisers Act of 1940 was 'directed not only at dishonor, but also at conduct that tempts dishonor.' U.S. v. Mississippi Generating Co., 364 U.S. 520, 549."

The Commission's San Francisco office informed Mr. Tuttle, Sr. in May or June 1986, that it considered the firm's non-refundable

prepaid fee policy as inconsistent with an advisor's fiduciary obligations and possibly a violation of Section 206. Mr. Tuttle, Sr. represented that clients would receive refunds, however, he did not fulfill those commitments, in fact his lavish spending was the reason the firm was unable to refund much of the funds it owed to clients. (Division Exhibits 20 and 64 at 63-66,; Tr. 274-80)

For all these reasons, I find that The J. Baker Tuttle Corp. willfully violated Section 206 because from May 1986 to July 1987, it knowingly acted fraudulently by failing to make pro rata refunds of prepaid fees to clients who canceled their contracts before the end of the period, and that Mr. Tuttle, Sr. willfully aided and abetted these violations because he knew or should have known that these activities were illegal and through his actions and control of the firm's activities he substantially assisted in the commission of the violations.

Section 204 and Rules Thereunder

Section 204 of the Advisers Act requires investment advisers to make and keep records for prescribed periods, to furnish copies of records, to disseminate such reports as the Commission may prescribe, and to make records available for Commission inspection.

Section 204 and Rule 204-1

Rule 204-1 requires that investment adviser registrants file a complete Form ADV, and Rule 204-1(b) requires that advisers promptly amend their Form ADV if their answers to specific Items of Part 1 become inaccurate for any reason or if their answers to any Items of Part II become inaccurate in a material manner. An

adviser shall amend its ADV form for all other changes. Rule 204-1(b)(2) requires submission of a balance sheet as required by Item 14 of Part II of the Form ADV within 90 days of the end of the adviser's fiscal year.

The Order for Proceedings alleges that (1) from May 1986 to July 1987, The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. willfully violated Section 204 and Rule 204-1 by failing to amend Forms ADV to disclose that the firm accepted more than $500 in fees per client six or more months in advance, and failing to file audited balance sheets, and that (2) since July 1987, Tuttle & Co. and Mr. Tuttle, Sr. willfully violated these provisions by failing to amend promptly the Form ADV to disclose that the firm abruptly ceased doing business in November 1987. 4/

I find that The J. Baker Tuttle Corp. willfully violated Section 204 and Rule 204-1 because it billed and received payment from half or more than half of its clients of fees greater than $500 at least six months before it provided service, yet all its ADV forms indicate that it did not do so, and it did not amend the forms to correct the erroneous information. Mr. Tuttle, Sr. willfully aided and abetted these violations because he knew or should have known of these requirements and his actions contributed

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4/ On brief the Division alleged that The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. violated Section 207 because the investment adviser failed to file amended ADV forms disclosing the investment adviser's precarious financial condition and the bankruptcy filings of both parties. These omissions appear to go to violations of Section 204 rather than Section 207, but in any event I have not considered them because the Order for Public Proceedings does not contain these allegations.

substantially to the violations.

Since it billed clients $500 or more six months in advance, The J. Baker Tuttle Corp. was required to submit a balance sheet within 90 days of the end of its fiscal year. The Commission's San Francisco office reminded Mr. Tuttle, Sr. of this requirement in letters dated June 13, 1986, and August 7, 1986. (Division Exhibits 21 and 23) The balance sheet requirement is important because, unlike broker-dealers, registered investment advisers do not have minimum capital requirements. Thus clients are put at risk when people pay investment advisers in advance for their services. By disclosing the adviser's financial condition, the balance sheet provides the public a limited measure of protection. The J. Baker Tuttle Corp. willfully violated Section 204 and Rule 204-1 by not filing a balance sheet when it was required to do so, and Mr. Tuttle, Sr. willfully aided and abetted in these violation for the reason stated in the prior finding.

I find that since July 1987, Tuttle & Co. willfully violated Section 204 and Rule 204-1, and Mr. Tuttle, Sr. willfully aided and abetted these violations because when the investment adviser ceased doing business in November 1987 and Mr. Tuttle, Sr. moved to Chicago, it did not promptly file an amended ADV form showing a change in address, phone number, and business hours. (Item 2 of Part I) Mr. Tuttle, Sr. admitted that Tuttle & Co. did not notify the Commission it had ceased doing business. (Tr. 762-3) One witness testified his stockbroker called Tuttle & Co. in November 1987, and was told Mr. Tuttle, Sr. was in Europe with his family

for the month. When he called back in December, the phone number was no longer operative. The witness then wrote to Tuttle & Co. terminating service and the letter was returned marked "Moved Left No Address". (Division Exhibit 83)

Section 204 and Rule 204-2

Rules 204-2(a), (b), (c), and (d) describe the books and records which investment advisers must maintain in a true, accurate and current format. Rule 204-2(e)(1) specifies that the required books and records shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made. Rule 204-2(f) provides that before discontinuing business an investment adviser shall arrange for and be responsible for the preservation of books and records which it was required to preserve and maintain, and shall notify the Commission in writing, at its principal office, Washington, DC, of the exact address where such books and records will be maintained for the period specified.

The Order for Proceedings alleges that from May 1986 to July 1987, The J. Baker Tuttle Corp. and Mr. Tuttle, Sr. willfully violated Section 204 and Rule 204-2 in that they failed to (1) keep true, accurate, and current books and records, (2) arrange for the preservation of the books and records of The J. Baker Tuttle Corp., and (3) notify the Commission in writing of the firm's address after it ceased operations and where the firm's books and records were maintained. The Order alleges further that Tuttle & Co. and Mr. Tuttle, Sr. violated these same provisions in

that since July 1987 they failed (1) to arrange for the preservation of the books and records of Tuttle & Co. and (2) to notify the Commission in writing of the address where the firm's books and records were maintained after it ceased operations.

Numerous witnesses, including Mr. Tuttle, Sr., testified that The J. Baker Tuttle Corp. did not keep true, accurate and current books and records. (Tr. 88-89, 162, 207-17, 320, 517-22, 535-48, 595-9, 606-7, 621, 727-8, 741-3, 753-4, 914; Division Exhibit 21 at 11-12, Division Exhibits 86-88) Respondents do not take issue with the examination by the Commission's San Francisco office which concluded that: cash disbursement and receipt journals were incomplete and inaccurate, a check book was missing for one of four bank accounts, almost all copies of client invoices sent prior to June 1986, were missing and only some bills were found for after this date, trial balances prepared from the firm's general ledger for the period March 1 through October 31, 1986 did not balance, and there were no records to show that the firm had delivered or offered to deliver the written disclosure statements required by Rule 204-3.

I reject as unpersuasive Mr. Tuttle, Sr.'s claim that he was not responsible for the condition of the firm's books and records because he had delegated responsibility for the firm's day-to-day operations. Mr. Tuttle, Sr. admits he had ultimate responsibility for the books and records as the firm's president, owner, and compliance officer. (Tr. 756) The evidence is that he exercised tight control over the firm's operations, and that he was aware

that the firm's books and records were in disarray. (Tr. 273, 521-23)

The evidence is persuasive that The J. Baker Tuttle Corp. and Tuttle & Co. did not arrange to maintain and preserve their books and records for a period of five years from the end of the fiscal year in which they recorded their last entry, and that after they ceased operations they did not notify the Commission in writing of the firms' address and where the firms' books and records were maintained. Mr. Tuttle, Sr. is wrong that respondents did not violate either the statute or the rules because the Commission's San Francisco office was able to learn the location of the books and records from the trustee in bankruptcy. The fact that the San Francisco office was able to gather information does not change the fact that respondents did not discharge their regulatory responsibilities. The attestation from the Commission's Secretary that neither investment adviser made a filing informing the Commission's principal office in writing of where their books and records would be maintained pursuant to Rule 204-2(f) is conclusive evidence that neither firm made the required filing. (Exhibits 52 and 53)

I find that The J. Baker Tuttle Corp. and Tuttle & Co. willfully violated Section 204 and Rule 204-2, and that Mr. Tuttle, Sr. willfully aided and abetted those violations because Mr. Tuttle, Sr. acted for respondents and he knew or should have known what the law and regulations required and he did not comply with them.

Public Interest

The Division recommends that the Commission revoke the investment adviser registrations of The J. Baker Tuttle Corp. and Tuttle & Co., and bar Mr. Tuttle, Sr. from acting as or associating with any investment adviser, broker, dealer, investment company, or municipal securities dealer pursuant to Section 203(e) and (f). The Division cites Intersearch Technology, Inc. (1974-75 Transfer Binder) Fed. Sec. L. Rep. (CCH), ¶ 80,139 (1975), Investment Advisers Act Release No. 457 (April 30, 1975), 6 SEC Docket 817; Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Marketlines, Inc. v. SEC, 384 F.2d 264 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968), and Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979), aff'd, 450 U.S. 91 (1981).

Mr. Tuttle, Sr. believes he did nothing wrong and acted at all times in good faith, and the regulators are engaged in a witch-hunt.

I find that the Commission should revoke the investment adviser registrations of The J. Baker Tuttle Corp. and Tuttle & Co. and bar Mr. Jason Baker Tuttle, Sr. from being associated with any investment adviser. I reach this conclusion because the violations were blatant, they were serious, they occurred over an extended time period, the responsible individual, Mr. Tuttle, Sr., knew or should have know that his activities violated the statute and regulations, he attempted to mislead the investigators with false claims that respondents were taking corrective actions, and there is a high probability that Mr. Tuttle, Sr. will repeat the

violations since he continues to believe his actions were lawful and his testimony demonstrated disdain for the investment adviser regulations. Additional support for this last point is the fact that in a separate proceeding based on actions which occurred after those at issue here, the Commission suspended Mr. Tuttle, Sr. from association with any investment adviser for a period of six months commencing February 5, 1990. J.B.T. Management, Inc. d/b/a Tuttle Inc., Investment Advisers Act Release No. 1218 (January 22, 1990), 45 SEC Docket 788. Finally, the case law cited by the Division supports this sanction.

There are no mitigating circumstances.

Order

Based on the findings and conclusion contained in this decision, IT IS ORDERED that the investment adviser registrations of The J. Baker Tuttle Corp. and Tuttle & Co. are revoked and Mr. Jason Baker Tuttle, Sr. is barred from being associated with any investment adviser.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice. Pursuant to that rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within fifteen days after service of the initial decision upon him or her, unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to a party. If a party timely files a petition for review, or the Commission acts

to review as to a party, the initial decision shall not become final as to that party.

Brenda P. Murray
Administrative Law Judge

Washington, DC
December 21, 1990