ADMINISTRATIVE PROCEEDING
FILE NO. 3-6182

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
DEAN W. CLUFF	:

INITIAL DECISION

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Washington, D.C.
April 20, 1984

Irving Schiller
Administrative Law Judge

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APPEARANCES:

Bobby C. Lawyer, Associate Regional Administrator and Julie K. Lutz of the San Francisco Branch Office, for the Division of Enforcement.

Dean W. Cluff, pro se at hearings.
Ann Flower Cummings, on brief.

BEFORE:

Irving Schiller
Administrative Law Judge

This public proceeding was initiated by an Order of the Commission dated September 23, 1982 (Order), pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act) to determine whether Dean W. Cluff (Cluff) wilfully violated provisions of the Securities Act of 1933 (Securities Act), the Exchange Act and a Rule thereunder and what, if any, remedial action would be appropriate in the public interest.

The Order, in essence, charges that during the period from approximately July 1977 to April 1980, Cluff wilfully violated Sections 5(a) and (c) and Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by offering and selling unregistered joint venture agreements relating to transactions in stock options by means of untrue statements and omissions to state material facts concerning the joint venture agreements and by employing devices, schemes, and artifices to defraud in connection with money obtained from investors and engaged in transactions, acts and practices and courses of business which would and did operate as a fraud and deceit upon purchasers of the joint venture agreements.

After appropriate notice, hearings were held in January and May 1983, and the record closed on May 5, 1983. In July 1983, after the Division filed its post-hearing documents,

at the request of Cluff, the hearings were reopened and concluded in September 1983. Proposed findings of fact, conclusions of law and briefs were filed by the Division of Enforcement (Division) and a brief by respondent Cluff. Cluff appeared pro se throughout the hearings, except for the hearing on May 5, 1983.

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of the witnesses. Preponderance of the evidence is the standard of proof applied.

The Respondent

Respondent Cluff is and has been registered with the Commission as a broker-dealer since July 1977. He was vice president of the Pacific Stock Exchange (PSE) from approximately April 1975 to June 1977. In July 1977 respondent became a sole proprietor market maker[1/] on the PSE's option floor in San Francisco. He sold his PSE membership in 1980.

The Stock Options Investment Program

In the spring of 1977 Cluff approached Dr. C., an oral surgeon he met through his church, and told him he was a

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1/ An options market maker is a broker-dealer, who trades for his own account on the options floor. A market maker holds himself open to buy and sell, or make markets in, particular options.

market maker on the PSE and had a plan for investing in the stock options market whereby he would invest funds furnished by Dr. C. jointly with money of his own, in put and call options through his (Cluff's) account on the Stock Option Exchange. During the course of the next several weeks Cluff told Dr. C. that he would be "playing out-of-the money puts and calls," that Dr. C. would "always make profits ranging between 50 to 100 percent per year," that as a trader on the option floor Cluff had "a command of the situation so that there was very little chance of losing money," that there "would not be commissions taken out of the profits," that the investment was a "sure thing" and that the risks were "very minimal". Dr. C. testified that although Cluff told him about investing in out-of-the-money options he never really understood the manner in which such investments were to be made by Cluff, and the words "meant nothing" to him. On July 21, 1977 Dr. C. gave Cluff $30,000 to invest in accordance with the plan he had outlined. On October 1, 1977 Dr. C. gave Cluff $10,000 to invest and in March 1978 he invested an additional $182,000 making a total investment during the period of $224,000.

In October and early November 1977 Cluff approached Dr. B., a podiatrist friend of Dr. C., and made representations about his stock options plan similar to those he made to Dr. C. In

his testimony Dr. B. stated that Cluff told him that the plan presented the opportunity of approximately 50 percent per year return on the original investment, that Cluff was on the floor of the Exchange so that no fees or commissions would be paid for buying or selling the options and that the down side risks were "very, very minimal because of the opportunity for spread and split, so that if one or two things went down, you at least had the others that would stabilize it". On November 7, 1977 Dr. B. gave Cluff $36,000 to invest in accordance with the plan Cluff had outlined.

The investments by both doctors in Cluff's investment plan were structured as a series of loans to Cluff. For each of the investments Cluff executed a separate note. Each of the notes specifically states that Cluff agreed to pay "the greater of 10% per annum or 50% of the annual profits realized from the funds for trading in listed options contracts" by Cluff.

Beginning with the period ended August 31, 1977 (one month after Dr. C. made his initial investment) Cluff began furnishing Dr. C. with month-end summary statements reflecting the results of his trading in options. Each of such statements reflected trading profits in varying amounts. Cluff furnished

Dr. B. similar month-end summaries of his trading results. Some of these statements depicted profits which, if annualized, would result in returns of over 50% per year. Such statements were provided to the doctors through March 1978. None of the reported profits were actually distributed to either doctor but were shown in the summary statements as increases in equity of the investments. Each of the doctors believed that the purported profits were being reinvested under the stock options plan. The record discloses and respondent does not dispute that, contrary to the representations portraying continuous profits in the summary statements, Cluff, in fact, consistently sustained losses in his trading account on PSE.[2/]

On April 20, 1978 Cluff wrote to both doctors that he had "lost everything", that all the funds in his account were totally depleted, that he was out of business and there was a deficit in his account due to his clearing firm. He suggested that to remain in the market and try to repay his debts he would require additional new funds. Thereafter, Cluff met with both doctors, explained that he realized how he had lost their money and stated that he was now able to

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2/ The documentary evidence reveals that for each of the quarters ended October 1977,January and April 1978, Cluff sustained losses totalling approximately $209,800.

protect himself against such losses in the future. Cluff further stated that his plan was to expand his operations onto the Chicago Board of Options Exchange (CBOE) where, he said, there were many more options to trade and the potential profits would be greater. Cluff also told them such an operation required additional capital and asked them to introduce him to prospective investors. If new capital was thus obtained, Cluff agreed that he would share any future profits he obtained from his trading in stock options and pay them back for their losses. Following those discussions both doctors introduced Cluff to several of their friends mentioning to them that Cluff had reported profits from trading in stock options. These acquaintances were told to communicate with Cluff for specific information concerning the stock options program. At least one or two meetings were held with prospective investors. One such meeting was held in June 1978 at the home of Dr. B., at which between ten and twenty prospective investors were present. Cluff told the prospects that he was a former vice-president of the PSE and was a market maker on the floor of the Exchange. He stated further that the only strategy he would use was to invest in out-of-the-money options, that he

had a proven track record as an options trader and had generated profits of about 14 per cent per quarter on his strategy for Dr. C. and Dr. B. and that since he was on the floor of the Exchange he would not have to pay commission on his purchases and sales. Cluff also informed the prospects that his aim was to raise capital of about half a million dollars and wanted a minimum investment of $10,000. The deal as explained by Cluff was to be structured as "joint ventures" in which the investors would receive the initial six percent of any quarterly profits after which profits "would be split down the middle."

One of the investors testified he attended several meetings where Cluff explained his stock option program and at one such meeting Cluff stated that any investment would be "protected" since Cluff "would invest half of the money going in, that he intended to get a bond to protect the investors and that there would be no way that investors would be able to lose their money" nor would his "base capital be in jeopardy."

Several other investors testified that, prior to or at the time they made their investments, Cluff made representations to them either personally or at metings where several investors were present, regarding his stock options program. In essence, they testified that Cluff made the same or similar representations

concerning his stock options plan as those noted above. For example, one of the investors testified Cluff told him that his plan envisaged that the investor "would provide the money and that would be my only involvement, the investment capital. He (Cluff) would then be responsible for the capital, to invest as he saw appropriate and fit, based on his qualifications to do so. . . ."

The record reflects that between June 1978 and April 1980 at least twenty six investors in California and Utah entered into separate "Joint Venture Agreeents" (agreements) with Cluff. These agreements were on forms prepared by Cluff on which he inserted the investor's name, date of agreement and amount of the investment. Each agreement stated in substance that profits would be distributed quarterly on the basis of 45% of gross profit to the investor and 55% of such profits to Cluff, that an accounting would be made at the end of January, April, July and October, that Cluff would "use his best efforts and judgment in selecting, establishing and concluding various trading strategies that provide a reasonable opportunity for profit," that Cluff would assume all costs and that he would establish and maintain proper and adequate books of account.

The documentary evidence reveals that Cluff obtained in excess of $1,268,000 from 26 investors who entered into the agreements for the purpose of investing in his stock option plan. Of this amount Cluff admits he deposited only about $1 million in a checking account maintained in his name at the Security Pacific National Bank (Pacific Bank).[3/]

Cluff's Operations of his Stock Options Program

As soon as Cluff began entering into the agreements with investors in 1978 he arranged, at about the same time, to commence trading operations on the CBOE through Western Options, Inc., a Utah Corporation. Western Options was a registered broker-dealer which Cluff and George Haymond (Haymond) formed to purchase a seat on the CBOE. They purchased such a seat in December 1974 and Western Options began trading as a market maker in 1975. During the period Cluff was vice-president of the PSE, he was inactive in the

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3/ Though the evidence shows that all of the investors funds were not deposited in Cluff's account at the Pacific Bank. Cluff urges that some of such funds may have been put directly into his market-marker account at the PSE or his trading account at the CBOE. However, since the documentary evidence does not clearly identify which funds in such accounts came from any particular investor, Cluff's contention is not supported by a preponderance of the evidence and is rejected.

affairs of Western Options. Haymond testified that in 1978 he and Cluff entered into an arrangement whereby Cluff would furnish capital to the corporation and Western Options would trade in options contracts through a nominee trader. Under the agreement Cluff would be entitled to any profits and be liable for any losses resulting from the options trading Cluff financed in the account. Under the arrangement Haymond was free to continue his own trading in the account utilizing his capital. In March 1978 Cluff hired Michael Gumble (Gumble) as a nominee trader for Western Options. Gumble effected transactions on the floor of the Exchange on Cluff's behalf in accordance with daily trading instructions given him by Cluff. In addition, Cluff in his daily conversations with Gumble, provided him with the trading strategies which Cluff wanted Gumble to follow.

The Western Options account on the CBOE was cleared by Goldberg Securities (Goldberg) which also acted as the clearing firm for Cluff's sole proprietor account on the PSE.[4/] Gumble testified that at the time he was hired by Cluff to act

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4/ A clearing firm basically handles all of the back office functions for its market-maker customers and is paid a commission on each transaction or contract its customers enter into. In addition, it guarantees a settlement of a market-marker's trades to the Options Clearing Corporation and compiles records relating to such market-maker's options trading.

as nominee of Western Options on the CBOE, he maintained an account in his own name at the CBOE and that Goldberg also acted as clearing agent for his account. Gumble continued trading for his own account from March to July 1978. On July 11, 1978 Cluff wired funds to Goldberg which it credited to the Western Options account and Gumble began his options trading on behalf of Western Options in accordance with the daily instructions he received from Cluff. The funds Cluff continued to send to Goldberg from time to time represented money received from investors who entered into the agreements with Cluff. As noted earlier of the approximately 1.2 million dollars raised by Cluff from investors he deposited about 1 million dollars in his Pacific Bank account. From this account Cluff forwarded approximately $716,000 to Goldberg which credited the funds to Cluff's trading accounts.

From July 1978, when Gumble started trading for Western Options on the CBOE, until December 1979 when Gumble terminated his relationship with Cluff, the daily and monthly records of Gumble's trading were prepared by Goldberg and were kept in Gumble's name. These records included the transactions of the three accounts for which Gumble acted as nominee, to wit: the trades Gumble effected on behalf of and in accordance with Cluff's

instructions; the transactions effected by Gumble for Haymond with Haymond's capital; and the transactions effected by Gumble for his individual account with his own capital.[5/] The records themselves do not identify which transactions were effected on behalf of Cluff and which transactions belonged to Haymond. The Goldberg records were sent or given to Cluff who would review them and circle the trades which belonged to Haymond and forward the papers on which Haymond's transactions appeared to Haymond. It is evident that the funds which Cluff used for his investors' transactions through Western Options were commingled with funds contributed by Haymond as well as funds in the account which belonged to Gumble.

In July 1979 Cluff was determined to expand his operations by trading options on the Midwest Stock Exchange (Midwest). He arranged for Western Options to lease a seat on the Midwest and hired Charles Conner (Conner) to act as nominee on that Exchange. The arrangements Cluff made with Conner were similar to those he had made with Gumble. Cluff gave instructions to Conner daily with respect to the securities he wanted to trade and Conner would execute the

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5/ Gumble's trades for his individual account were listed under a separate subaccount number.

orders. Cluff also told Conner of the strategies he wanted to employ.

In August of 1979 Cluff arranged for Western Options to lease a second seat on the CBOE. Conner became the nominee for Western Options on the CBOE. Thereafter, Conner traded on both Exchanges as a nominee for Western Options. Conner testified that Cluff's strategies included for the most part selling naked options and that he conducted a majority of such trades for both accounts. When Conner was unable to effect the trades he would give them to floor brokers to execute on behalf of both accounts. Cluff knew that floor brokers were executing trades at Conner's request and knew they were being paid from both accounts. Conner also testified that for acting as nominee for Western Options he was paid a salary by Cluff. Starting in November 1978 and until April 1980 Conner received fifteen checks from Cluff totalling $12,570.[6/]

6/ All such checks were drawn on Cluff's account at the Pacific Bank in which account he had deposited money received from the investors in his Stock Option Program. Conner testified that at the time he terminated his association with Western Options, he was owed about $10,000 in back salary. Cluff told Conner that the reason he did not pay the salary for several months was because he did not have the money.

Cluff's Stock Options Program and Operations

The record amply demonstrates that Cluff's modus operandi of his stock options program was to trade primarily in uncovered out-of-the money options. The strategies employed by Cluff, particularly with respect to the sale of uncovered options,involved a high degree of risk and the risk was magnified when the options related to volatile stocks which the evidence shows were the types of securities usually selected by Cluff. Reference was made earlier herein to the disastrous results of Cluff's strategy in his options trading for Dr. C. and Dr. B. which, between July 1977 and April 1978, resulted in the complete loss of their investments. Despite Cluff's representations to both doctors that he had learned from that experience and would in the future know how to employ his strategy to avoid losses, it is evident that at the time he raised the 1.2 million dollars, starting in July 1978, from the 26 investors, he represented to such investors that he could and would produce profits ranging up to fifty percent of their investments. However, the record establishes that his persistence in following his strategy, of trading in uncovered options of volatile stocks, was equally as disastrous as his prior experience, since the investments of all such investors completely vanished.

This is not to indicate that every option transaction resulted in a loss. The evidence shows that from the quarterly period ended October 31, 1977, to the quarter period ended April 1980, Cluff sustained losses in his trading on the PSE in ten of the eleven quarters and he sustained losses in his trading through Western Options on the Midwest and CBOE in six of the nine quarters from approximately April 1978 through April 1980.

Cluff's continued adherence to his strategies is established by the testimony of Gumble, Conner, and an official of Goldberg who supervised Cluff's trading accounts on the CBOE. They testified, in essence, that periodically they talked to Cluff about the naked options type of trading he was engaging in, which the Goldberg official characterized, as ". . . speculative, more speculative trading strategies than other strategies that are available in the market place ..." Each of them suggested to Cluff a less risky strategy and told him on several occasions that the high degree of risk was such that Cluff would have to supply additional capital or liquidate his positions in order to reduce the level of risk in the account. The manager of Goldberg's San Francisco office who had responsibility for reviewing the risks in Cluff's account testified he also discussed with Cluff on a number of occasions the volatility of the type of naked options he was trading on the PSE

and when the manager felt the risks exceeded the equity in the account he too told Cluff to reduce his risky position or deposit more money in the account. It is apparent from the many conversations between Cluff and the Goldberg supervisors and between Cluff and Gumble and Conner that Cluff did not alter his basic strategy of essentially trading risky naked options, but that in order to continue such trading he would either reduce his position to some extent or come up with additional deposits in his account. The documentary evidence discloses that of the $1.2 million Cluff received from investors, approximately $175,000 was obtained from investors between November 1979 and January 1980, of which Cluff deposited in excess of $99,000 into the Conner accounts at the CBOE and deposited about $12,500 in the PSE account. Such evidence also reveals that in December 1979 and January 1980 the majority of Cluff's trade on the CBOE were in uncovered options relating to Teledyne and IBM. In January Cluff traded uncovered options relating primarily to Teledyne. Both such securities were characterized by Gumble and Conner as volatile stocks during that period of time and such trading was considered as speculative, carrying with it a high degree of risk. Conner testified that in the latter part of January 1980 trading was stopped in the Western

Options account at the CBOE because of lack of capital. As noted, Cluff's obstinate refusal to change his strategy resulted in the loss of the investors' funds.[7/]

However, the substantial losses Cluff incurred in January 1980, which wiped out the investors funds, did not deter him from continuing to make the same extravagant representations he previously made about his options program and obtaining additional funds from investors for such program. From February 1, 1980 to and including May 1, Cluff raised approximately $158,600. During the period he deposited about $4,500 in his Conner account at the CBOE and about $32,300 in his PSE account. Cluff's trading of uncovered options in both accounts resulted in the loss of the $158,600.[8/]

7/ Though the record shows that the trading in the Western Options account at the CBOE ceased in January 1980, Haymond testified that in November 1979 he received a telephone call from Cluff who told him "We are out of business. We don't have any capital left" Cluff suggests in his brief that Haymond may be confused about the call being made in November and hypothesizes the call was made in January. Cluff's suggestion is contrary to the evidence and is rejected. Haymond's testimony as to the telephone call and his testimony that he personally lost $150,000 in November because Cluff made some bad moves is unrefuted and is accepted. It is apparent from the record that although Cluff told Haymond that they had no capital left he, nevertheless,continued trading at the CBOE with funds he deposited in Conner's account between November 1979 and January 1980, as noted earlier.

8/ The documentary evidence reflecting the trading during this period shows that no transactions were effected in the Conner account during March or April 1980 and no transactions effected in Cluff's PSE account during May 1980. In April 1980 Cluff deposited about $32,000 in his PSE account and, as noted, this money too was lost by the end of the month.

Cluff's Representation to Investors Concerning his Options Trading and his Distribution of Profits

As noted earlier, Cluff commenced his options program in the spring of 1977 when he started talking to Dr. C. about playing out-of-the-money puts and calls on the Option Exchange and made the representations concerning the profitability of his plans. On July 21, 1977 Cluff received Dr. C's initial investment of $30,000 in accordance with the plan Cluff outlined. For the period ended August 31, 1977 Cluff furnished Dr. C. with the first "Equity Summary" depicting that the "Annualized Returns" based on his performance was equal to 31.8%. Monthly thereafter, until March 1978 Cluff sent Dr. C. "equity" reports each reflecting profitable trading. After Cluff made representations to Dr. B. that his options plan would be profitable Dr. B. invested $30,000 in November 1977. Cluff also furnished Dr. B. with monthly statements, from December 1977 until March 1978, each of which showed a profit earned on the investment.

All of the foregoing monthly statements were false. Indicative of Cluff's intentions to demonstrate his ability to generate profits in trading stock options is the fact that when he sent Dr. C. the first three monthly "equity" reports showing profits each month to the end of October 1977, the evidence establishes that for the quarter ended October 31,

1977 Cluff's trading losses amounted to $26,272. The evidence further establishes that for the next two quarterly periods ended January 31, 1978 and April 28, 1978 Cluff continued to sustain losses in his trading account which for the six months period totalled $183,536. During the entire period from July 1977 until near the end of April 1978 Cluff never informed either doctor that he had incurred any losses in his options trading. On or about April 23, 1978 the doctors received a letter from Cluff telling them that notwithstanding Cluff's representations to them when they made their investments, namely that "there was very little risk involved", all of their money "is gone."[9/]

Commencing with each quarterly period following an investors entry into the stock options program to the period ended January 31, 1980 Cluff sent reports each quarter to each of the investors, showing the amount each investor had given Cluff to invest in accordance with his joint venture agreement and the "profits" purportedly earned on such investment. In addition, each investor received a check from Cluff representing

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9/ In March 1978 , when Cluff knew that Dr. C's prior investment of $40,000 was lost, Cluff accepted an additional $182,000 from him to invest in his options program without disclosing to Dr. C. that his previous investments had already been lost.

"profits" made during the quarter.[10/]

Of utmost significance is the fact that Cluff never reported or told investors that he suffered losses notwithstanding the fact that he sustained losses in all his trading accounts in seven of the ten quarterly periods involved.[11/] Each of the investors who testified stated that during the entire period whenever they talked to Cluff they were always told that the options program was doing well or it was "going great." By letter dated April 30, 1980, Cluff told investors that the quarterly report due April 30th, "has been delayed for a few days . . . as a result of some poor planning and scheduling on my own part." On May 5, 1980 Cluff, for the first time, wrote to investors advising them ". . . that there will be no payout this quarter because of recent

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10/ All such checks were drawn on the Pacific Bank account in which Cluff had comingled the investors funds.

11/ An analysis of such evidence shows that only in the quarter ended October 31, 1978, did Cluff have a net profit in all his trading accounts. In the quarters ended April and July 1979, though Cluff sustained losses in his PSE trading account, the profits in his CBOE account exceeded such losses. In addition, the evidence shows that though he had a profit in the CBOE account for the July 1979 quarter such profit dropped about $103,000 from the preceding quarter.

trading losses." He also stated he had "not yet computed the exact loss but will have an accounting completed soon and will advise you in writing within ten (10) days." No such accounting was made. Over the course of the next several months the investors who testified stated they spoke to Cluff on a number of occasions about their investments and learned in the summer of 1980 that their entire investments in the joint venture had been lost.[12/] In the fall of 1980 Cluff held several meetings with groups of investors, constantly promising them an accounting. Cluff never produced any accounting to the investors. It was

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12/ One of the investors testified that he had given Cluff $40,000 in April 1980 after Cluff assured him the program was "in good shape" and the investor would continue to receive dividend checks as in the past." After receiving the May 5 letter the investor spoke to Cluff on the telephone on five occasions between May 7 and May 29, 1980 in a futile attempt to find out what happened. On May 30, 1980 Cluff came to the investors office and "finally admitted that the whole thing was lost", Cluff then told him he was flying to Los Angeles to pick up $1,000,000 that was due him and make good to the investors. Another investor witness testified that Cluff told him in late May or early June 1980 that everything was good and that Cluff was getting a loan from an Arab concern for over $1,000,000, for services rendered, and would pay back the investors. There is no evidence that any of this ever happened. Their testimony is unrefuted and credited.

at these meetings that the investors learned for the first time that Cluff concealed from them that his options trading had been conducted through Western Options.

Willfull Violations of the Anti-Fund Provisions of The Securities Acts

The record supports the finding that Cluff, as charged in the Order, willfully violated the anti-fraud provisions of the securities acts in that in connection with his offer and sale, both of the notes issued to Dr. C. and Dr. B. and the joint venture agreements with investors, he made false and misleading statements and omitted to state material facts and engaged in acts, practices and a course of business which operated as a fraud and deceit upon investors. Commencing in the summer of 1977 Cluff represented to Dr. C. that he (Cluff) had an investment method for playing out-of-the-money puts and calls in the options market that would assure that Dr. C's capital would be returned safely with "profits"; that Dr. C. would realize a 50-100 percent annualized profit, maybe a lesser or greater amount but there would always be "profits"; that Cluff's program was "a sure thing"; that Cluff had command of the options situation and knew

exactly what was going on and could make his moves timely; that no commission would be taken out of the profits and that there was very little chance of actually losing money. Dr. C. had no prior knowledge of stock options and testified that when Cluff said he would trade puts and calls the words meant nothing to him. He also testified that Cluff did not explain how he would operate in order to produce the profits.

Cluff made similar representations to Dr. B. In his letter of April 20, 1978 Cluff, in essence, admitted the essential misrepresentation of the safety of the doctors' investments. Cluff wrote "When you advanced money to me for this business, I told you there was very little risk involved,." (Underscoring supplied) Despite his calamitous experience with both doctors, Cluff continued to lure investors into signing the joint venture agreements by making representations to them that, for the most part, were identical to those he originally made to Dr. C. namely; they would realize 40-55 percent per year; that the investment was "safe"; that the risk associated with his options program was "negligible"; and that under no circumstances could they lose the principal amount of the funds they placed in the joint venture.[13/] In addition, each of the agreements provided

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13/ The testimony of the investors concerning Cluff's representations is unrefuted and is credited.

that Cluff would "Establish and maintain proper and adequate books of account in support of their joint venture," that all accounting for this joint venture shall be made on a quarterly basis . . . . " and that he would "distribute profits and/or losses" as described in the formula in the agreements.

It is significant in connection with the foregoing representations that Cluff failed to inform the investors that his immediate past experience of trading in option contracts for Dr. C. and Dr. B. resulted in a complete loss. Moreover, the evidence depicts that shortly after such loss and namely between June 19, 1978, when Cluff received money from the first investor to sign the joint venture agreement, and July 21, 1978, Cluff received $117,500 from eight investors and concealed from them that he was continuously losing money which, by the end of the July 31, 1978 quarter, totalled about $209,808. Perhaps the most egregious incidents of omissions by Cluff to disclose material facts, took place during the period November 1, 1979 until the end of April 1980, when the evidence shows Cluff accepted in excess of $329,000 from investors knowing full well his options contract program was collapsing and

again concealed from these investors that he was experiencing substantial losses. In addition, Cluff failed to inform investors that his trading on the CBOE was being conducted through Western Options. He also omitted telling them that their funds were commingled with those of Western Options. Cluff in outlining his options plan told investors that no commission would have to be paid by them but never told investors that the trading on the CBOE was carried on by two traders he hired who, in turn, utilized the services of floor brokers on the exchange to execute many trades. The traders testified that the floor brokers were paid a commission for the trades they executed, which payments were charged against the Western Options Trading accounts.[14/]

There was no basis originally for Cluff to represent that his trading in options contracts would produce profits of 40-55 percent per year, nor was there any basis for Cluff to assure that trading in options was a safe investment. Moreover, based on Cluff's trading experience with Dr. C. and Dr. B., such representation to investors thereafter was false and fraudulent. It is well settled that predictions

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14/ However, it is true that Cluff did not charge any costs to investors for trading he personally executed. The evidence does not delineate which transactions were executed by floor brokers nor does it reflect the percentage of trades the floor brokers executed.

made as to price increases in speculative securities within a short time, without reasonable basis, are inherently fraudulent and cannot be justified.[15/] Similiarly, predictions that profits, in the magnitude of 40-55 percent, on an investment in out-of-the-money uncovered options with a high degree of risk would be realized, without any reasonable basis for such predictions, are equally inherently fraudulent and unjustified. Certainly Cluff knew, after his disastrous experience with options trading for Dr. C. and Dr. B., that the strategy he was using to trade uncovered options was highly speculative. There was no reasonable basis for Cluff to predict and represent that profits would be realized as a result of his strategy. In making such false representation of material facts and omitting to state material facts Cluff willfully violated the anti-fraud provisions of the securities acts.

The quarterly reports Cluff furnished investors depicting "profits" earned on their investments, particularly during the period the record shows he was sustaining losses, were false. In light of all of the foregoing, Cluff is found to have engaged in acts, practices and a course of business which operated as a fraud and deceit upon investors. There is no proof in the

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15/ See e.g. Norman Pollisky et al. 43 SEC 852,855(1968).

record that Cluff, as required by his joint venture agreements, maintained any books of account in support of the agreements or that he furnished quarterly accounting to investors. The meager reports he sent or gave investors showing only the amount invested and the purported profits did not constitute an accounting. The investors who testified stated that after May 1980, when Cluff wrote them that he had sustained losses, they had a number of meetings with Cluff and asked to see his books and records. Cluff never produced any books of account nor did he ever furnish them with an accounting of their losses, in willful violation of the anti-fraud provisions of the securities acts.

Willfullness in the context of the Exchange Act and Rules thereunder requires proof only that the person charged acted intentionally in the sense that he was aware of what he is doing. Tager v. SEC 344 F.2d 5,8, (2d. Cir. 1965). See also Arthur Lipper Corporation v. SEC 547 F2d 171 (2d Cir. 1976) cert. denied, 434 U.S. 1009. There can be little doubt that, based on the findings made earlier, Cluff acted intentionally and certainly was aware of what he was doing.

The Courts have held that under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 17(a)(1) of the Securities Act, proof of scienter is required. As used in those acts scienter refer's to one's knowledge, not

to one's purpose. See e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1979). Knowledge means awareness of the underlying facts, not the labels that the law places on the facts . . . . a knowledge of what one is doing and the consequences of those actions suffices. SEC v. Falstaff Brewing Corp., 629 F.2d 62,77 (D.C. Cir.), cert. denied sub nom., Kalmanovitz v. SEC, 449 U.S. 1012 (1980). In Aaron v. SEC 446 U.S. 680, 690 (1980) the Supreme Court held that proof of scienter is established by "knowing or intentional conduct" (emphasis supplied). The Courts have repeatedly emphasized that scienter does not require a purpose, motive or "plan to deceive" under Section 10(b). Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 45 (2d Cir. 1978), cert. denied, 439 U.S. 1039 (1978); Nelson v. Serwold, 576 F.2d 1332 (9th Cir.), cert denied 439 U.S. 970 (1978). The record in the instant case warrants the finding that Cluff acted with the necessary scienter. It was found above that Cluff made false representations to investors and failed to disclose material information to investors. He certainly knew when he sent them reports of profits that such information was false and made with intent to deceive them into believing the trading in stock options was successfull. That he acted with the requisite

scienter is amply demonstrated in the record.[16]

Willfull Violation of Section 5(a) and (c) of The Securities Act

Cluff is charged with willfull violations of the registration requirements of Sections 5(a) and (c) of the Securities Act which, in essence, as applicable here, make it unlawful to offer and sell any security unless a registration statement has been filed and is in effect with the Commission, unless an exemption is available. The record establishes, and Cluff does not dispute, that no registration statement was filed or in effect with respect to the joint venture agreements.[17] The issue to be resolved is whether the joint venture agreements were "securities" within the contemplation of Section 5 and whether any exemption was available.

Section 2(1) of the Securities Act, as pertinent here, defines a security to mean, among other things, any note, evidence of indebtedness, or investment contract.[18]

16/ It is noted however, that scienter is not necessary to establish violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

17/ Cluff does not dispute the use of the jurisdictional means within the contemplation of Section 5.

18/ Section 3(a)(10)of the Exchange Act sets forth substantially the same definition of a security.

The criteria for determining whether a particular document constitutes an investment contract within the meaning of Section 5, as enunciated by the Supreme Court is:

> "Whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946)

The Ninth Circuit also considered the same issue and defined the term common enterprise. It held that the test for a security is:

> ". . . . whether the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." SEC v. Glen W. Turner Enterprises, 474 F.2d 476,482 (9th Cir.), cert. denied, 414 U.S. 821 (1973).

The Court defined a common enterprise to be:

> "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties" SEC v. Glen W. Turner, supra, at 482, n. 7. 19/

19/ See also SEC v. Koscot Interplanetary, Inc., 497 F.2d 473,478 (5th Cir. 1974).

In the instant case the joint venture agreements, between Cluff and the investors, fall squarely within the tests laid down by Howey and Glen W. Turner, supra. The agreements involve an investment of money in a common enterprise, to wit, one in which the fortunes of the investors are interwoven and the profits were to come solely from and were dependent upon the managerial efforts and success of Cluff. The investors who testified all stated that under the stock options plan outlined to them Cluff assumed complete management of their investments and had complete discretion in selecting the transactions in which their funds were to be invested. Their testimony is supported by the agreements which provided that the investors would accept the recommendations of Cluff as to "Positions to be established." However, they testified Cluff never made any recommendations to them, nor were they advised or consulted as to positions to be established or specific options contracts he traded or when transactions were, in fact, made. It is concluded that the joint venture agreements are investment contracts and, within the meaning of the Securities Act, constitute securities. Accordingly, it is found that Cluff's failure to register such securities was in violation of Section 5(a) and (c) of the Securities Act. It is also found that the violation was willfull within the meaning of Section 15(b) of the Exchange Act. Cluff

urges that a willful violation of the registration requirements can only be proved where there is evidence that he was aware that registration was mandatory. The argument has no merit and is rejected. A finding of willfulness requires merely proof that the person charged acted intentionally in the sense that he was aware of what he is doing. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts. Tager v. SEC, supra.[20/]

Cluff contends that the joint venture agreements appear to be a private offering, exempt from the registration requirements. In support of his argument Cluff urges that the offering was small, the offerees were sophisticated, and had previous investment experience. The argument is rejected. It is well settled that the burden of proving entitlement to an exemption from the general policy of the Securities Act requiring registration rests with the person claiming the exemption. SEC v. Ralston Purina Co., 346 U.S. 119 (1953); SEC v. Culpepper, 270 F.2d 241,246 (C.A. 2, 1959); Pennaluma & Co., v. SEC 410 F.2d 861,865 (C.A. 9, 1969) cert. denied 396 U.S. 1007 (1970). And the terms of

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20/ See also 2 Loss, Securities Regulation 1309(1961) "A broker-dealer willfully violates §5 of the Securities Act . . . when he voluntarily offers securities which he knows are unregistered.

an exemption must be strictly construed against the person claiming its benefit. United States v. Custer Channel-Wing Corp., 376 F.2d 675,678 (C.A. 4), cert. denied, 389 U.S. 850 (1967). In the Ralston Purina case, supra, the Supreme Court stated that the focus of inquiry should be on the need of the offerees to be furnished with information thought necessary to informed investment decision and to have access to the kind of information which registration would disclose. The Court also held that the number of offerees does not itself determine the availability of the exemption, id. at p 125.

Cluff's argument that the investors were sophisticated and had previous investment experience is not supported by the record. Though some of the investors testified they had other investments prior to entering into the joint venture agreements, all of them testified they had no prior experience with options contracts. In this sense they were not sophisticated in so far as options were concerned, had no experience in such contracts and knew nothing about options contracts. It is exactly this type of investor who needs the protection a registration statement affords. Not only did the investors lack even the basic information concerning stock options contracts, they were never provided either prior to their investment or thereafter

with any financial or other information concerning the types of options contracts which Cluff intended to trade. SEC v. Murphy 626 F.2d 633,647 (9th Cir. 1980); Hill York Corp. v. American International Franchises Inc.; 448 F.2d 680,690-91, (5th Cir. 1971). It is found that the investors did not have access to the relevant information which a registration statement would have disclosed. Cluff failed to sustain the burden of proof that any exemption from the registration requirements was available.

Other Matter

During the course of the hearing certain documents offered by the Division were received in evidence for a limited purpose. Decision was reserved to consider whether such documents should be received for all purposes. The Division, in its brief, renewed its request that the documents be received for all purposes. The testimony of the Division's handwriting expert has been reviewed and consideration given to such testimony in light of the provisions of Rule 14 of the Commission's Rules of Practice and Rule 901 of the Federal Rules of Evidence. It is concluded that the documents in question were sufficiently authenticated by the expert who based his opinion on specimens of Cluff's handwriting. The record thus supports the finding

that the documents in question are admissable and are accordingly received in evidence for all purposes. 21/

Public Interest

The remaining question to be resolved is whether it is in the public interest to impose sanctions upon Cluff. The details of Cluff's willful violations of the anti-fraud provisions of the securities acts and registration requirements of the Securities Act have been discussed above and need not be repeated hereunder. A perusal of the record suggests a review of several aspects of Cluff's conduct, in connection with the manner in which he operated his stock options program, to ascertain whether any sanction is waranted.

Beginning in June 1978 Cluff induced investors to enter into the joint venture agreements by assuring them that their capital would always be protected and safe and that, based on the strategies he would use to trade stock options, profits would be realized on their investments. Either no explanation was given to investors of the inherent risks involved in trading uncovered puts and calls or they were told that the risk was minimal.

21/ Cluff in his brief raised no objection to the Division's renewed request that the documents be received in evidence.

Such conduct, especially in light of Cluff's immediate past experience of sustaining losses in trading uncovered stock options for the two dctors mentioned earlier herein, is fraudulent and deceitful. In the ensuing several months Cluff continued to inveigle investors into his stock options program while he was sustaining losses of investors funds already committed to his program. He steadfastly omitted telling new investors either the high degree of risk involved or that he had suffered losses in each quarter ended October 31, 1977 through July 1978.[22/]

Cluff's conduct became even more egregious by reason of the fact that during that entire period he furnished investors with quarterly reports, each of which depicted profits purportedly earned on the investors' funds. Similarly, the record shows Cluff furnished investors with such reports during 1979 and for the quarter ended January 31, 1980 when his own trading on the PSE continued to show losses.[23/] Perhaps the most aggravating

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22/ For the period ended October 31, 1978 Cluff's operations showed a profit.

23/ The record does reflect that for the quarters ended April 30 and July 31, 1979 the Western Options account at the CBOE had profits which were, of course, offset to the extent Cluff sustained trading losses on the PSE.

conduct by Cluff occurred in April 1980 when Cluff deceived three investors into investing $97,000 in his options program at a time his account had been closed at the CBOE without disclosing to them the disastrous results of his prior trading.

In evaluating whether a sanction is called for, consideration is also given to the fact that during the period July 1978 to September 1980 the documentary evidence discloses that Cluff drew about 43 checks to cash, about 33 checks to pay what appears to be his personal expenses, such as, to various credit card companies, a life insurance company and the California Department of Motor Vehicles, and other checks to his other bank accounts. All of these checks were drawn on his account at the Pacific Bank in which he had deposited funds of the investors. All these withdrawals by Cluff totalled $237,228 and remain unexplained in the record. In addition, the documentary evidence reveals that in April and July 1979 Cluff received at least $257,000 from Haymond drawn on the Western Options account. Haymond testified that the reason he issued the checks to Cluff was that Cluff requested the money. Consideration is also given to Cluff's failure to maintain books of account reflecting the investment of each of the investors and the profits or losses therein, as required in the joint

venture agreements.

Cluff urges in his brief that he did not intend to defraud anyone and that he "was engaged in a desperate endeavor to save the options trading investments." The argument is specious and is rejected. Cluff never told any investor that he was seeking funds "to save the options trading investments." Quite the contrary is true. He consistently told investors, until the April quarterly report was due, that his options program was going "great", or words of similar import, and that profits were constantly being made. Even in April 1980 he told the investors the report was being "delayed" but would be forthcoming shortly. However, no report was ever issued.

The record is overwhelming that Cluff's operations of his stock options program were fraudulent and that such operations constituted a scheme and course of business which operated as a fraud and deceit upon investors. The defrauded investors placed faith and trust in Cluff and believed his representations concerning the safety of their capital as well as the representation that substantial profits would be generated. When such investors received the false reports that profits were made on their investments, many of them gave Cluff additional funds to add to what they believed was a successful operation. Such reports served to

reinforce their belief that the representations made by Cluff were true. In fact, rather than profits, the record demonstrates the investors were incurring losses. Cluff's conduct not only manifested a lack of candor in his dealings with investors but a grevious breach of his obligation and duty as a broker dealer to deal fairly and honestly with such persons.

All of the violations found were determined to be willfull. Under the securities acts willfullness means the intentional commission of the acts constituting the violation. The record amply supports the finding that Cluff intended to do precisely the acts which caused the violations. Cluff's claim that he did not intend to defraud is refuted by the evidence in the record. What Cluff told investors and the manner in which he traded in stock options, as detailed above, clearly demonstrates he acted deliberately and knowingly and thus willfully. See Arthur Lipper Corp. v. SEC, supra. It is concluded that it is in the public interest to impose a sanction on Cluff.

Having concluded a sanction is warranted the nature of such sanction must also be determined. It is well settled that administrative proceedings under the Exchange Act are not brought for the purpose of punishing a respondent but are remedial in nature.[24/] A decision in such proceedings must weigh the effect

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24/ See Abbett, Sommer & Co., Inc., 44 SEC 104 114 n.23 (1969); see also Fleming v. Nestor, 363 U.S. 603,613-614 (1960); DeVeau v. Braisted, 363 U.S. 144,160 (1960).

upon the standards of conduct in the securities business. If they are to be remedial, any sanction must have a deterrent effect not only on the respondent but on others in the securities industry who may otherwise be tempted to engage in similar misconduct. Thomas A. Sartan, Sr., 19 SEC Docket 562,567-8 (1980). The callous disregard manifested by Cluff of the effect of his conduct upon investors regarding the representations he made to them and his equally callous disregard of the effect of his conduct regarding the false reports to investors concerning profits, mandates that he be barred from the securities industry.[25/]

IT IS ORDERED that the registration of Dean W. Cluff as a broker-dealer is hereby revoked.

IT IS FURTHER ORDERED that Dean W. Cluff is hereby barred from association with any broker-dealer.

The Order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice, 17 CFR 201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party that has not within fifteen (15) days after service of this

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25/ Respondent's request for oral argument is denied.

initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to review 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.[26/]

Irving Schiller
Administrative Law Judge

Washington, D.C.
April 20, 1984

26/ All proposed findings, conclusions and supporting arguments of the parties have been considered. To the extent that the proposed findings and conclusions 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 determination of the material issues presented. To the extent that the testimony of witnesses is not in accordance with the findings herein, it is not credited.