ADMINISTRATIVE PROCEEDING
FILE NO. 3-4492

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FILED
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SECURITIES & EXCHANGE COMMISSION

In the Matter of

ROALD GEORGE GREGERSEN
RICHARD LEE CHATHAM
(GREGERSEN & CO., INC.)

U.S. SECURITIES & EXCHANGE COMMISSION
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INITIAL DECISION

Washington, D.C.
June 26, 1975

Max O. Regensteiner
Administrative Law Judge

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In the Matter of ROALD GEORGE GREGERSEN RICHARD LEE CHATHAM (GREGERSEN & CO., INC.)	INITIAL DECISION

APPEARANCES: John E. Jones and Gregory L. Guilford, of the Commission's Denver Regional Office, for the Division of Enforcement

James N. Barber, of Meredith, Barber & Day for Roald George Gregersen and Richard Lee Chatham */

BEFORE: Max O. Regensteiner, Administrative Law Judge

*/ Respondent Gregersen was represented during the hearings by Thomas N. Crowther, of Parsons, Kruse & Crowther, who withdrew before the submission of post-hearing documents.

In these public proceedings instituted by the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), the issues for consideration are whether Roald George Gregersen and Richard Lee Chatham engaged in misconduct as alleged by the Division of Enforcement and, if so, what if any remedial action is appropriate in the public interest.[1/]

During periods here relevant both Gregersen and Chatham (sometimes referred to herein as "respondents") were associated in principal capacities with Gregersen & Co., Inc. ("registrant"), which was then a registered broker-dealer with its principal place of business in Salt Lake City.[2/] The Division's charges against them relate for the most part to three major areas of alleged misconduct: (1) alleged violations by the registrant of the Commission's net capital rule over a period of several months in 1973; (2) registrant's participation as underwriter in an offering of stock of Fabri-Glas, Inc. pursuant to a purported Regulation A exemption from registration under the Securities Act of 1933; and (3) its participation in transactions in the unregistered common stock of Silver Exploration, Inc. ("SEI"). Respondents are also charged with a failure reasonably to supervise others with a view to preventing violations.

1/ The order instituting the proceedings named various other respondents, including Gregersen & Co., Inc., formerly a registered broker-dealer, but the proceedings as to all but two of them (whose settlement offers are still pending before the Commission) have been disposed of on the basis of settlement offers submitted by them, or, in the case of Gregersen & Co., on the basis of its default. Even though the findings herein of necessity make reference to certain of the former respondents, such findings are binding only on Gregersen and Chatham.

2/ Registrant withdrew its registration effective February 15, 1974.

Following extended hearings, the parties filed proposed findings and conclusions and supporting briefs, and the Division filed a reply to respondents' proposals and a reply brief.

The findings and conclusions herein are based on the record and on observation of the witnesses' demeanor. Preponderance of the evidence is the standard of proof applied.

The Respondents

Gregersen was president and a director of registrant from the time it first became registered in May 1970 until October 1972.[3/] In that month Chatham succeeded him as president and Gregersen assumed the positions of chairman of the board and chief executive officer. When Chatham resigned in April 1973, Gregersen added the title of president to his others. Until May 1971, Gregersen also owned substantially all of registrant's common stock. Effective May 1, 1971, he transferred his ownership interest to Suite 500 Corporation, a wholly-owned subsidiary of MIC Investment Corporation. Gregersen was an officer of both those corporations and a shareholder of MIC. The record does not show the extent of his interest in that corporation, however.

Chatham first became associated with registrant in August 1972, following employment as an examiner by the National Association of Securities Dealers ("NASD") for over two years. His original position with registrant was operations officer. In that capacity, he had responsibility

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3/ Registrant was originally registered under the name First Utah Underwriting Corporation. Its name was changed to Gregersen & Co., Inc. in September 1970.

for compliance with net capital and other regulatory requirements. In October 1972, Chatham became president and a director, and he served in those positions until his resignation in April 1973. It is undisputed, however, that even after his resignation he continued to be involved to some degree in registrant's affairs. According to Chatham, such subsequent association was merely as a consultant to registrant and Gregersen with respect to the firm's net capital situation and compliance with the net capital rule and he had nothing to do with registrant's day-to-day operations. The Division, on the other hand, while not disputing the "consultant" characterization, asserts that Chatham remained active on a day-to-day basis at least through October 1973 in the areas of registrant's financing, compliance with net capital requirements and maintenance of books and records and exercised executive and supervisory duties in those areas. The nature of Chatham's association with registrant during the period after April 1973 will be further discussed in subsequent sections of this decision.

Net Capital Violations

The order for proceedings alleges that during the period from on or about April 30 to on or about August 9, 1973, registrant, willfully

aided and abetted by Gregersen and Chatham, willfully violated Section 15(c)(3) of the Exchange Act and Rule 15c3-1[4/] thereunder ("the net capital rule"), in that it effected over-the-counter securities transactions when its "aggregate indebtedness" exceeded 2,000 per cent of its "net capital" and it did not have and maintain the required minimum net capital.

In support of this allegation, the Division, among other things, introduced into evidence detailed staff computations of registrant's net capital at various dates.[5/] According to those computations, which are summarized in the tabulation below, registrant had an adjusted net capital deficit on each of those dates and had net capital deficiencies under the rule ranging from $27,793 to $328,628. Respondents, on the other hand, contend that registrant at all times had sufficient net capital.

4/ 17 CFR 240.15c3-1.

5/ No objection was raised by respondents to the introduction of a schedule reflecting an August 20, 1973 computation even though that date is somewhat beyond the last-mentioned date in the order for proceedings. The inclusive dates there stated are in any event phrased in approximate terms.

Dates (All in 1973)	Adjusted Net Capital (Deficit)*	Aggregate Indebtedness*	Required Net Capital*	Net Capital Deficiency*
April 30	($ 10,591)	$344,033	$ 17,202	$ 27,793
May 24	(113,101)	427,232	21,361	134,462
May 31	(47,956)	347,107	17,355	65,311
June 21	(197,381)	403,194	20,160	217,541
June 29	(170,950)	541,400	27,070	198,020
July 31	(303,585)	500,846	25,042	328,628
August 20	(13,964)	63,683	15,000**	28,964

*/ Amounts rounded off to nearest dollar.

**/ Minimum net capital required.

As the table indicates, the net capital rule contains two measures for the amount of net capital which a broker-dealer subject to the rule must maintain: First, his "aggregate indebtedness" may not exceed 2,000 per cent of his "net capital," as those terms are defined in the rule. Stated another way, for each $1 of aggregate indebtedness, he must have at least $.05 of net capital or $1.05 of assets after appropriate adjustments. Secondly, he must have and maintain a specified minimum amount of net capital, wholly apart from the extent of his indebtedness. During the period here under consideration, that minimum amount was $5,000 until July 31, 1973 and $15,000 thereafter.[6/] It is evident from the figures in the table that on each of the dates in question with the exception of August 20, registrant,

6/ Effective July 31, 1974, the minimum was raised to $25,000.

according to the Division's calculations, required net capital far in excess of the minimum requirement in order to carry its aggregate indebtedness. Moreover, if those calculations are correct, registrant on each of those dates had a net capital deficit and was therefore not in compliance with either prong of the requirement.

Registrant's own net capital computations, which are part of the record, showed it to be in compliance with requirements. In some cases these computations are too sketchy to permit a precise determination of differences between them and the staff computations. It appears, however, that registrant consistently excluded from aggregate indebtedness its indebtedness to its principal creditor, the Zions First National Bank ("the bank"), and included in net capital certain assets which the staff excluded.

As defined in the rule,[7/] "aggregate indebtedness" consists of the broker-dealer's total money liabilities, less certain excluded items. Among the liabilities excluded is indebtedness "adequately collateralized, as hereinafter defined, by securities or spot commodities owned by the broker or dealer."[8/] Indebtedness is deemed to be adequately collateralized "when the difference between the amount of the indebtedness and the market value of the collateral is sufficient to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community."[9/] "Net capital" is defined as the broker-dealer's net worth, with certain adjustments designed at least in part

7/ Paragraph (c)(1).

8/ Paragpaph (c)(1)(i).

9/ Paragraph (c)(6).

to exclude illiquid assets.[10/] One of those adjustments requires the deduction of fixed assets and assets "which cannot be readily converted into cash (less any indebtedness secured thereby).[11/]" (Emphasis added).

Respondents now concede that the staff was correct in not excluding the indebtedness to the bank from aggregate indebtedness[12/] and in treating certain assets as not readily convertible into cash. They contend vigorously, however, that deductions from net capital for those assets should have been decreased by amounts borrowed from the bank on them, and that, had this been done, registrant would still have been in compliance with the rule on each of the dates in question.[13/]

An analysis of the evidence regarding registrant's relationship and transactions with the bank clearly demonstrates that respondents' contention is without merit and that their concessions are consistent with conclusions compelled by the record.

10/ Paragraph (c)(2).

11/ Paragraph (c)(2)(ii).

12/ Their brief (p. 8) states that "registrant" is now "willing to admit" that its previous position was incorrect because "it has developed in retrospect" that the loans were not "inadequately collateralized."

13/ Respondents' proposed findings and brief do not, however, address themselves to the computation as of August 20, by which time registrant's indebtedness to the bank had been eliminated. The differences in the computations for that date result almost entirely from the staff's exclusion from net capital of securities for which there existed no regular or independent trading market. See also note 19, *infra*.

The record shows that during the period under consideration, registrant, through Gregersen and Chatham, had a special relationship with one Milo Paskett, at that time a branch manager and second vice-president of the bank. Under the bank's rules, Paskett had authority to grant loans not exceeding $25,000 per borrower without prior approval of the loan committee. Loans in larger amounts were required to be submitted to the committee for prior approval, and even loans within Paskett's lending limitation had to be submitted for subsequent review and approval. For reasons which must be left to speculation, Paskett, on his own authority and without disclosure to the loan committee, extended loans to registrant which according to registrant's records had reached more than $415,000 by July 31, 1973. Paskett's superiors did not discover these loans until 1974. The loans were not only unauthorized, but their terms were wholly out of line with the bank's normal lending policies. Thus, a bank vice president who is manager of its loan department testified that it was bank policy, on broker-dealer loans, to require that the loan be secured by marketable collateral which normally would have to be delivered to the bank; normally not to lend an amount exceeding two-thirds of the market value of listed or over-the-counter securities of established issuers; and generally not to accept as collateral securities traded only in the local over-the-counter market. Paskett, however, extended bank loans to registrant on collateral which for the most part was not of a quality generally acceptable to the bank and permitted registrant for much of the period under consideration to retain possession of securities which purportedly secured the loans.

Paskett testified that in early 1973 he and Gregersen, who had personally borrowed money from the bank and was having difficulty in making repayment, discussed the possibility of the bank's extending a line of credit to registrant with a view to enabling Gregersen to earn income with which to repay his personal indebtedness. Before this plan could be implemented through regular channels, it was overtaken by events. An overdraft developed in registrant's checking account with the bank which eventually reached about $100,000, and Gregersen indicated to Paskett that if registrant's checks "bounced" it would soon be out of business. As a result, Paskett granted registrant a $100,000 line of credit to cover the overdraft. On April 30, 1973, registrant and Gregersen executed a note for $100,000. The bank's records pertaining to this note include a "general pledge agreement" executed by registrant in November 1972 and an accommodation pledge agreement by an organization named The Travel House, Inc., dated April 19, 1973. According to Paskett, the collateral pledged to secure the $100,000 indebtedness consisted of drafts presented for collection through the bank, which were covered by the terms of the general pledge agreement, and a "due bill" by a broker-dealer to deliver securities registered in Travel House's name to the bank. Such securities, with a value of about $50,000, were in fact delivered to the bank after two to three months. But these securities were subsequently used to secure a loan to Travel House itself. Paskett further testified that it was also the intent that securities in registrant's trading account "would be pledged" to secure the loan.

On June 23, the April 30 note, which had by then matured, was renewed and a new general pledge agreement was executed in connection therewith Two days earlier, registrant had obtained an additional $100,000 loan. And on July 23 it signed a note for a further loan of $135,000.[14/] In connection with that loan, which Paskett testified again covered an overdraft, registrant executed a security agreement giving the bank a security interest in the "leasehold improvements" in registrant's offices and all furniture and fixtures on those premises. As of July 23, registrant's indebtedness to the bank, according to the bank's loan records, was thus $335,000. For reasons not wholly clear, but apparently because of additional overdrafts, registrant's records at all pertinent dates except for April 30 reflected a substantially higher indebtedness to the bank than the loan balance.

On August 14, 1973, the loan balance of $335,000 was transferred to Suite 500 Corporation, registrant's parent. The notes to the bank executed by Suite 500 for that amount have never been paid. It appears that as part of this transaction registrant's fixed assets and investment account were transferred to Suite 500.

During the period between June 14 and June 22, 1973, NASD and Commission staff examiners spent several days in registrant's offices, for the most part looking into its net capital situation. Their concern was focused at that time on the net capital position as of May 24 and 31. Joseph Coogan, a staff examiner, testified that he commenced an inspection on June 21; that he was very much concerned with the indebtedness to the

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14/ Of the proceeds of that loan, however, $25,000 went to capitalize a new brokerage firm by the name of Gregersen, Boynton & Company, Inc., located at the same address as registrant.

bank which appeared on registrant's May 31 balance sheet in the amount of $193,633; and that Chatham informed him that this was an open line of credit "in which the other assets, the marketable securities of the firm were pledged against the loan" and that registrant had retained possession of the securities but would turn them over to the bank upon request. Coogan and Frank N. Black, his fellow staff examiner, could find nothing in registrant's records pertaining to collateralization of the bank loan. In response to their request on June 21 for documentation regarding such collateralization, Chatham on the following day furnished them with three documents, as described below:

1. A letter dated June 4 from the bank to registrant, signed by Paskett, referring to an attached Exhibit A as a list of assets pledged to the bank as of May 31, 1973 to secure loans totalling $193,633 (Div. Exh. 7). The letter states that the stocks pledged "are held by you and you may make substitutions from time to time as may be mutually agreeable. You have also agreed to deliver the securities if we demand that you do so." Exhibit A lists items to which a total valuation of $206,965 is ascribed. The list includes a number of securities having a total stated value of $73,225; certain fixed assets and receivables, at book value, totalling $81,387; and an item entitled "savings" for $52,353, which in fact represented the "thrift certificate" described below. [15/] The securities listed were all unlisted securities, a number of which were either not quoted at all in the "sheets" published by the National Quotation Bureau

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15/ See note 19 and page 27 , infra.

or were not quoted by any dealer other than registrant (i.e., had no independent market). Exhibit A further stated that the bank also held as collateral an item "underwriting receivable," which in fact consisted of unsold shares of Fabri-Glas stock.[16/]

2. The second of the items furnished to the staff examiners on June 22 was another letter from Paskett to registrant, dated June 21 (Div. Exh. 8). It refers to an attached Schedule A as a list of assets pledged to the bank as of that date to secure loans totalling $259,000 and states that any other stocks held in registrant's possession for its own account should be delivered to the bank on demand. Schedule A purports to list collateral "held by" the bank, with a total value of $291,245. It includes various securities with a total stated value of $155,953, some of them over-the-counter securities not quoted in the sheets or with no independent market; the "underwriting receivables" which was described as "stock not yet collected for on Fabri-Glas 22,826 shares at $2.00" and listed at $45,652; and an item entitled "C.D." listed at $50,000 which in fact represented the "thrift certificate." In addition, the schedule lists a group of items collectively identified as "other collateral at bank," identified by registrant's ledger account numbers, to which a value of $86,426 was attributed. By reference to registrant's June 21 balance sheet, it appears that these items included various receivables, fixed assets, and an item "other assets," comprising prepaid expenses, organization costs and registrant's

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16/ See pages 37-38, *infra*.

membership in the Intermountain Stock Exchange. All assets included under "other collateral" were assigned the book value appearing on the balance sheet.

3. The third document (Div. Exh. 9) is a copy of a letter from registrant to Paskett, also dated June 21, 1973, which states that it would serve to confirm that registrant "has agreed to deliver" to the bank specified securities to be held as collateral on the outstanding loan of $100,000 dated June 21. The same securities, in the same numbers of shares, are among those listed on Schedule A to Exhibit 8.

It was brought out at the hearings that it was Chatham who determined the contents of the letter portions of Exhibits 7 and 8 and that the collateral lists which are part of Exhibits 7-9, including the valuations attributed to the assets listed on the schedules in Exhibits 7 and 8, were prepared not by Paskett or other bank officials, but by or at the direction of Chatham. Paskett testified, with respect to those two exhibits, that Chatham told him registrant was being examined for net capital compliance and would be aided if it could satisfy the examiners concerning "the value of the assets in relationship to the loan."

Shortly after his visit to registrant's office when he obtained Exhibits 7-9, Coogan sought additional information concerning the bank loans. He caused a letter to be written from the Denver Regional Office to the bank, addressed to Paskett's attention, seeking further information concerning the collateral for the loans as of April 30, May 24 and 31, and June 21. Among other things, the letter requested submission of

copies of pledge agreements, notes and collateral schedules and specification of loan values assigned to each of the assets reflected in Exhibits 7-9. The record shows that the letter was received by Paskett's branch. Not surprisingly, the Denver office received no response. 17/

Included in material furnished by registrant to Black in August 1973, pertaining to its net capital position as of June 29, was a "daily transaction report" for that date which reflects a collateral account for stock held at the bank. There is no indication in the record when that account was established. However, the report reflects the delivery to the bank on June 22 of the securities shown on Schedule A of Exhibit 8 (the June 21 letter from Paskett to registrant). Paskett's testimony, on the other hand, indicates that the securities were not delivered until some months later.

It is apparent from what has been said that the record provides no basis for finding that the bank loans were "adequately collateralized" by securities owned by the registrant. Indeed, the record shows that registrant lacked the assets needed to adequately collateralize loans of the magnitude involved here and was able to obtain the loans only because it found a benefactor in Paskett.

17/ During a June 14, 1973 inspection of registrant by NASD examiners, in the course of which they raised questions about the bona fides of the bank loan, the examiners suggested in a meeting with Gregersen, Chatham and others that "maybe we should go over and talk to the bank ourselves to determine whether or not the bank would verify that that loan as stated to us did in fact exist." (Tr. 257). At that point Gregersen threatened that he would "see them in court" if they "interfered" with the loan. The upshot was that they did not contact the bank.

Even accepting the values which registrant attributed to the securities which were assertedly pledged to the bank, such values at no time approached the amount of the indebtedness. The definition of "adequately collateralized" contemplates an excess of market value of collateral over the amount of the indebtedness. Indeed, it contemplates a sufficient excess "to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community." As the bank's vice president and loan manager testified, in the normal couse of events the bank would not have made loans in the amounts specified on Exhibits 7 and 8 on the basis of the collateral listed on the attached schedules. 18/

As noted, however, respondents now rest their defense on that provision of the net capital rule which permits the inclusion in net capital of assets not readily convertible into cash to the extent any indebtedness is secured by such assets. Conceding and, indeed, urging now that certain assets of registrant which the staff examiners deducted from net capital were assets which could not be "readily converted into cash," respondents assert that when registrant realized that it could not claim such assets for net capital purposes, "it went to the bank, borrowed money, and pledged all of these assets as collateral. See

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18/ Those exhibits, as noted, pertain to indebtedness and collateral on May 31 and June 21. At April 30, when the indebtedness was $100,000, the only securities pledged were securities not owned by registrant, with the possible exception of an unspecified amount of drafts presented for collection through the bank. The general pledge agreement by its terms covered only collateral in the bank's possession. With respect to the May 24, June 29 and July 31 computations, it is equally clear that the indebtedness was not adequately collateralized. By August 20, the indebtedness had been eliminated.

Division's Exhibits 7, 8 and 9." (Brief, p. 4).[19/] Accordingly, respondents argue, the amounts of the loans must be added back into net capital.

19/ During the hearings, respondents strongly contested the Division's characterization of certain assets in question as assets which could not be "readily converted into cash." Since they now concede this point only a brief discussion pertaining to those assets is necessary.

The controversy during the hearings centered on two items or types of items, the thrift certificate and certain proprietary securities. Registrant's balance sheets dated April 30, May 24 and 31 and June 21, 1973 all reflected a $50,000 asset entitled "certificate of deposit." In fact, the item was not a certificate of deposit, but a "time savings thrift certificate" issued to Fabri-Glas by Sentry Thrift Corporation and assigned or loaned to registrant. The staff examiners, who apparently did not see the document, assuming that a bank certificate of deposit was involved, nevertheless excluded the item from net capital as not readily convertible into cash because it had not been demonstrated that the issuing bank would consider the net capital rule a sufficient emergency to redeem the certificate prior to maturity. In its proposed findings and brief, the Division appears to rest its case for exclusion of this item from registrant's capital on the argument that the certificate did not even belong to registrant, but was borrowed on a short-term basis from Fabri-Glas. There is no need to determine whether the certificate was an asset of registrant's, because the record warrants no finding that it could readily have been converted into cash. The certificate did not mature until April 1974. And while it was apparently negotiable, there is nothing in the record concerning the issuer and its financial condition, nor concerning the existence of any market for instruments of this nature.

The staff examiners also excluded from net capital unlisted stocks which either were not quoted at all in the sheets on the dates in question or which had no independent market. Such securities, at least presumptively, had "no ready exchange or over-the-counter market"; under Commission decisions, securities having no such market must be excluded from net capital as not readily convertible into cash. See John W. Yeaman, Inc., 42 S.E.C. 500, 504 (1964) and cases cited in note 9 of that decision. With the possible exception of one stock (Bank of Salt Lake), as to which Chatham testified there was an active local market in a specified price range, respondents presented no evidence that there was a ready market for any of the securities in question. Even if registrant's Bank of Salt Lake stock were added back to its net capital at the various computation dates at the prices at which it was carried by registrant, there would be no significant decrease in registrant's net capital deficiencies.

The theory on which respondents rely is unexceptionable. But the facts here do not fit the theory. It is true that to the extent assets which are not readily convertible into cash are accepted as bona fide collateral for indebtedness, they may be added back into net capital to the extent of the indebtedness. 20/ As a leading book on broker-dealer regulation explains, an asset which has thus been accepted as collateral

> "in a genuine transaction for cash indebtedness . . . is regarded as liquid to the extent of that indebtedness. In effect the asset has thus actually been partly converted into cash. In any event, it is regarded as having a readily realizable cash value to the extent of the indebtedness it secures. In such circumstances, therefore, only the balance of the asset above the indebtedness it secures is deducted from assets in computing net capital." 21/

The preceding discussion indicates that the arrangements between Paskett and registrant were not of a bona fide character. The record leaves grave doubt whether any assets of registrant were actually pledged to the bank prior to late June 1973 at the earliest. Even as to the later period, it is difficult to determine the extent to which the bank had a security interest in registrant's assets. Aside from those problems, however, the exception relied on by respondents presupposes a bona fide arms-length determination by the lender as to the amount of cash to be advanced on particular items of collateral. Here, there is no indication that any such determination was ever made by Paskett or the bank.

20/ See Securities Exchange Act Release No. 8024, Accounting Series Release No. 107, p. 8 (January 18, 1967).

21/ Weiss, Registration and Regulation of Brokers and Dealers, p. 59 (1965).

There was no attempt on Paskett's part to evaluate the assets listed as collateral on Exhibits 7-9. Indeed, it is evident that most of those assets were not acceptable security for any bona fide bank loan.

Registrant effected over-the-counter securities transactions throughout the period under consideration. It follows that on the dates indicated, it violated the net capital rule. I further find that Gregersen and Chatham willfully aided and abetted registrant's violations Notwithstanding his resignation as president and director of registrant in April 1973, Chatham continued to perform the functions of an official of the firm, at least in the net capital area. As before, he participated in making registrant's net capital calculations. More significantly, he and Gregersen represented registrant in its dealings with Paskett and the bank, and the record establishes that both were fully familiar with registrant's true capital situation. 22/

There is no warrant, however, for the further finding sought by the Division that respondents failed to exercise reasonable supervision with a view to preventing the net capital violations. As the Commission recently held, where findings of substantive violations are made against an individual who is an active participant in the misconduct involved, "it is unnecessary to find him responsible for a failure of supervision with respect to the same misconduct." 23/

22/ Chatham thus remained during the period following his resignation and into August 1973 a "person associated with" registrant within the definition of the quoted phrase in Section 3(a)(18) of the Exchange Act.

23/ Charles E. Marland & Co., Inc., Securities Exchange Act Release No. 11065 (October 21, 1974), 5 SEC Docket 313, 315. The fact that respondents here are found to have aided and abetted violations of the net capital rule rather than to have violated the rule (which can be violated only by a broker or dealer) does not affect the applicability of the Marland holding.

Misconduct in Connection With Fabri-Glas Offering

In July 1972, Fabri-Glas filed a notification and offering circular with the Commission for the purpose of obtaining a Regulation A [24/] exemption with respect to a public offering of 250,000 shares of its common stock at $2 per share. The shares were to be offered on a best efforts basis by registrant as underwriter. Under the terms of the offering, as set forth in the offering circular, if registrant was unable to sell a minimum of $175,000 worth of the stock (or 87,500 shares) within 120 days from the offering circular's date (January 11, 1973), all proceeds were to be returned to the investors. The issuer would receive none of the proceeds and registrant no commission. Under the terms of an escrow agreement between Fabri-Glas, registrant and a bank, registrant was required to transmit proceeds from the sale of shares to an escrow account at the bank within three business days after receipt.

That escrow agreement was designed to conform to the requirements of Rule 15c2-4 under the Exchange Act, [25/] which, as pertinent here, makes it a fraudulent practice for a broker-dealer participating in a best efforts distribution in which the issuer is to get nothing unless a specified number of shares is sold to accept money from investors unless it is promptly transmitted to a bank which has agreed in writing to hold the funds in escrow for the persons who have the beneficial interests therein "and to transmit or return such funds directly to the persons entitled thereto when

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24/ 17 CFR 230.251-263.

25/ 17 CFR 240.15c2-4.

the appropriate event or contingency has occurred."

The record shows that on April 9, 1973, $175,000 (minus a small escrow fee) was transmitted from the escrow account to Fabri-Glas. The Division asserts, however, that the required number of shares had not been sold and that there were other serious irregularities in or in connection with the offering. It contends that the Regulation A exemption was not available for the offering because of noncompliance with certain of the Regulation's terms and conditions, including the fact that the offering circular was materially misleading. 26/ It further contends that the use of that offering circular in the offer and sale of the shares was fraudulent, and that proceeds were not transmitted to the escrow account as required by Rule 15c2-4. Accordingly, the Division proposes that I find, as alleged, that Gregersen willfully aided and abetted violations by registrant of the registration provisions of Section 5 of the Securities Act 27/ and the antifraud provisions of Section 17(a) of that Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; 28/ that both Chatham and

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26/ On April 22, 1974, an order was issued permanently suspending Fabri-Glas' Regulation A exemption. Securities Act Release No. 5485, 4 SEC Docket 154. That order was entered, after Fabri-Glas and registrant had withdrawn requests for hearing, pursuant to Rule 261(b) under the Securities Act (17 CFR 230.261(b)), under which a temporary suspension order becomes permanent if no hearing is requested and none is ordered by the Commission. The findings herein are based solely on the instant record, however.

27/ No registration statement for Fabri-Glas was ever filed with the Commission.

28/ The order for proceedings did not charge Chatham with aiding and abetting those violations.

Gregersen willfully aided and abetted registrant's violations of Rule 15c2-4 as well as Rule 10b-6 [29/] (an antimanipulative provision) under the Exchange Act; and that they failed reasonably to supervise persons subject to their supervision who violated all the above provisions. [30/]

The availability of a Regulation A exemption for a securities offering depends, among other things, on compliance with the Regulation's terms and conditions. [31/] The Division's contention that the exemption was not available for the Fabri-Glas offering is based essentially on the following grounds which bear in part also on the alleged violations of the antifraud and antimanipulative provisions:

1. Sales were effected at times when they could not properly be made because waiting periods triggered by the filing of amendments to the notification and offering circular had not expired. Regulation A requires that at least 10 business days before commencement of a Regulation A offering, a specified number of copies of a notification and offering circular must be filed with the appropriate regional office of the Commission. A new 10-day waiting period begins each time an amendment to the notification (including an amended circular) is filed.

29/ 17 CFR 240.10b-6.

30/ Fabri-Glas-related matters are also involved in allegations that Gregersen and Chatham willfully aided and abetted violations of the recordkeeping and reporting provisions of Rules 17a-3 and 17a-5 under the Exchange Act (17 CFR 240.17a-3 and 17a-5) and failed reasonably to supervise with respect thereto. Those matters are discussed in a subsequent section of this decision entitled "Other Violations."

31/ See 17 CFR 230.252(a). Thus, respondents' argument that here a finding of violation of Section 5 can be predicated only on a suspension of the exemption or on a finding that registrant "as well as the issuer" violated the antifraud provisions of the securities acts is not accurate.

The waiting period may, however, be shortened by the Commission upon request; i.e, "acceleration" may be granted. 32/

In this case, Fabri-Glas filed amendments to its notification on March 21 and April 2, 1973, the latter before the waiting period triggered by the March 21 amendment had expired. The waiting period triggered by the April 2 amendment was "accelerated" to midnight, April 6. Registrant's own records show, however, that it effected a substantial number of sales of Fabri-Glas stock during the period between March 26 and April 6, when under the terms of Regulation A the offering was required to be held in abeyance. In this respect there was noncompliance with the terms and conditions of Regulation A.

2. Further, the Division asserts, funds received from customers were not promptly transmitted to the escrow account, as required by the terms of Rule 15c2-4 and the terms of the offering as set forth in the offering circular. Registrant's own records and other evidence introduced by the Division show that payments for Fabri-Glas shares were received by registrant beginning on March 26, 1973 and were deposited in registrant's account in Zions First National Bank. On April 9, 1973, $175,000 in one lump sum was deposited in the escrow account, which was maintained at another bank, in the form of a cashier's check issued by Zions Bank which debited registrant's bank account.

Respondents advance the following explanation, relying on the testimony of Chatham: Commencement of the offering was deferred until it was cleared

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32/ See 17 CFR 230.255 and 256.

by the California authorities on March 23, 1973. "At that time," some money was received for the purchase of Fabri-Glas stock. However, it was called to registrant's attention, either by its own counsel or the issuer's counsel, that an amendment to the notification had to be filed to reflect a reduction in the underwriter's commission which California had required as a condition of clearance. According to Chatham's further testimony, registrant contacted customers who had remitted funds and advised them that sales could not be consummated until the waiting period triggered by the amendment had expired and that if they desired, registrant in the interim would hold the funds as free credit balances in their accounts, "which I believe was done for a few days." (Tr. 856) After it was advised of acceleration of the amended notification to midnight, April 6 (a Friday), registrant transmitted the funds into the escrow account on April 9, the next business day. Respondents asserts that no sales of Fabri-Glas stock were completed and no confirmations issued before April 6 and that on April 9 registrant confirmed the sales and remitted the proceeds to the escrow account.

The difficulty with this scenario is that it flies in the face of registrant's own records which show that confirmations were issued at various dates between March 26 and April 9. Under the circumstances I cannot credit Chatham's uncorroborated testimony to the contrary, and I find that proceeds were not promptly transmitted to the escrow account.

3. The Division further alleges that when the escrow account was "closed" on April 9, the required minimum number of shares had not been

sold and that funds other than customers' funds were used to close the escrow. As the Division points out, registrant's own records show that as of dates in May and July 1973, only 64,674 shares for a total of $129,348 had been sold. The record further shows that an item entitled "underwriting receivables" which appeared as an asset on registrant's balance sheet from at least April 30 through July 31, 1973 consisted for the most part or wholly of 22,826 shares of Fabri-Glas stock, valued at $2 per share (the offering price). Those 22,826 shares of course represented the difference between 87,500 shares, the minimum number required to be sold, and the 64,674 shares referred to above. In early August 1973, registrant "took down" the 22,826 shares for its own account.

Respondents point to a fact reflected in the record which the Division has not discussed, namely, that as of April 9, confirmations for the sale of Fabri-Glas shares exceeding in sum the required 87,500 had been issued. The record further shows that sales of a total of about 26,000 shares to 10 customers were cancelled between April 9 and 30. Chatham testified, in this connection, that some of these transactions represented cancellations by the customers, while in other instances payment was made by checks which "bounced," compelling registrant to cancel the transactions. Respondents argue from these facts that as of April 9 registrant had a legal claim for payment against customers who had not paid or whose checks had not cleared; that even after the cancellations it had "actionable legal rights to collect" from the customers; that in legal effect the shares remained sold to such customers; and that the "intermediate use" of registrant's funds to close the escrow did not violate the provisions of Regulation A.

I cannot accept these arguments. Investors were led to believe that the offering would be aborted unless a specified minimum number of shares were purchased and paid for by public investors. Thus, registrant was not warranted in treating the offering as having reached the minimum success level until funds totalling such minimum amount had been received or in using its own funds to make up the deficiency. Respondents' argument that even though sales had been cancelled, the shares somehow remained sold to customers is simply not tenable. As it was, not only were investor funds improperly turned over to Fabri-Glas, but that company immediately issued a check to registrant for $24,500, representing commission and expense allowance on the premise that $175,000 worth of stock had been sold. That did not exhaust the immediate benefits to registrant from closing the escrow, as will be detailed below.

4. A further irregularity charged by the Division with respect to the Fabri-Glas offering, bearing on the alleged violations both of the registration and antifraud provisions, pertains to the use of the proceeds of the offering. Beginning immediately upon Fabri-Glas' receipt of those proceeds on April 9 and in the ensuing weeks, a series of transactions was effected between it and registrant whose precise nature is less than clear. What emerges clearly, however, is that Fabri-Glas funnelled a substantial portion of the proceeds back to registrant. Thus, on April 9, Fabri-Glas issued a check to registrant in the amount of $62,793. Ralph Rollins, who was Fabri-Glas' president at the time, testified that as of April 8, Fabri-Glas had substantially less than $50,000 in its bank account. Thus, the funds represented by this check were at least in large part attributable to the proceeds of the offering. Rollins

testified that the check was issued at registrant's request and upon Gregersen's representation that registrant needed the money "to finish the underwriting" and in connection with a "net capital problem." It was Rollins' understanding that these funds would be returned to Fabri-Glas. In fact, registrant made repayment in several installments between April 16 and June 28.[33/]

The nature of the above transactions is further obscured by the fact that registrant's records include a customer's account in the name of Fabri-Glas. The account record reflects several purchases by Fabri-Glas of stock of MIC Investment Corp. in March and April 1973, the reversal of those transactions in June 1973, and the deposit in the account and subsequent repayment of the $62,793. The Division, relying on Rollins' testimony, asserts that this was not in fact Fabri-Glas' account and that the purported transactions in the account did not in fact occur. Chatham, on the other hand, testified that Rollins opened a customer account for Fabri-Glas and deposited more than $60,000 in it. Rollins' testimony is to some extent refuted by two delivery tickets introduced by the Division (Exhs. 47K and L) which reflect the delivery of 20,000 shares of MIC stock to Fabri-Glas on May 31, 1973 and are signed by Rollins. The most reasonable inference to be drawn from the record in my opinion is that the Fabri-Glas customer account was used in an effort to disguise the loan to registrant and its subsequent repayment.[34/]

33/ While Rollins testified that two of the payments by registrant to Fabri-Glas represented loans to Fabri-Glas, the more reasonable inference from the evidence presented is that they were part of the repayment of the $62,793.

34/ I draw this inference in part because the transactions reflected in the account, taken at face value, make no economic sense. For example, at the time the $62,793 was credited to the account on April 9, the debit

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Another of Fabri-Glas' expenditures on April 9 out of the proceeds of the offering is also pertinent here. This was in the form of a check for $50,000 issued to Sentry Thrift Corporation in return for the "thrift certificate" to which reference has been made in connection with the discussion of net capital violations. On April 30, 1973, the certificate was assigned to registrant. According to Rollins, this transaction was also in the nature of a loan and was effected, again at Gregersen's request, for the same reasons as the loan discussed above. The certificate was returned to Fabri-Glas in June 1973.

Needless to say, the offering circular describes intended uses for the proceeds of the offering other than loans to registrant. Respondents assert that Fabri-Glas reserved the right to alter the use of the proceeds and that respondents had neither knowledge nor reason to believe that "the provisions or the offering circular concerning stockholder approval of such a change in the use of proceeds had not been fully complied with." (Proposed findings, p. 17) The argument can only be characterized as frivolous.

It follows from the above findings that (a) statements in the offering circular concerning the transmission of customers' funds to the escrow account, the closing of the escrow and the use to be made of the offering's proceeds were materially misleading, in violation of the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; (b) because the offering circular was misleading and the stock was offered during waiting periods

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34/ Continued
balance resulting from prior (purported) purchases of MIC stock was only $12,793. The next purchase transaction reflected in the account was on April 30, at a cost of only $36,002.

occasioned by amendments to the notification, the claimed Regulation A exemption was not available and the Fabri-Glas offering violated Section 5 of the Securities Act; and (c) registrant's failure to transmit promptly to the escrow account payments received for Fabri-Glas stock violated Rule 15c2-4. However, I cannot find that Rule 10b-6 was violated. That rule among other things prohibits an underwriter in a particular distribution of securities from purchasing such securities until he has completed his participation in such distribution. The Division's theory is that registrant purchased the 22,826 shares which it had failed to sell to public investors, at a time when the distribution had not been completed. Respondents argue that registrant did not in fact purchase the shares, but that if it did so, its purchase fell within the first exception of Rule 10b-6 covering, as here pertinent, "transactions in connection with the distribution effected . . . with the issuer." It appears that registrant did purchase the shares in question; such purchase, however, was from the issuer and came within the exception.

During the period when the above violations occurred, Gregersen was registrant's chief executive officer and board chairman and Chatham its president. The record shows that both men were fully cognizant of the matters discussed above and were active in connection with the underwriting. Accordingly, I find that, as charged, Gregersen willfully aided and abetted registrant's violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Sections 10(b) and 15(c)(2) of the Exchange Act and Rules 10b-5 and 15c2-4 thereunder. For the reasons

previously set forth,[35/] there is no warrant for finding additionally that Gregersen failed reasonably to supervise with respect to those violations.

As noted at the outset of this section, the allegations against Chatham are more limited. I find that, as charged, he willfully aided and abetted the violations of Rule 15c2-4. But there is in my judgment no basis for finding a supervisory failure on his part with respect to the remaining violations. Aside from the question whether failure of supervision is an appropriate finding against one who participates in or is actually aware of improprieties, which appears to be an open question at the moment,[36/] the record indicates that Gregersen, who was not subject to Chatham's supervision, was in direct charge of registrant's activities in connection with the underwriting.

Misconduct Relating to SEI Stock

The order for proceedings includes allegations that within the period from approximately August 1971 to February 1974, registrant and certain of its former officials (originally respondents herein) willfully violated (a) Section 5 of the Securities Act by offering and selling unregistered common stock of SEI and (b) Section 10(b) of the Exchange Act and Rule 10b-6 thereunder by bidding for and purchasing SEI stock while participating in the distribution of such stock. Gregersen and Chatham are not charged with those violations, or with aiding and abetting them, but with failure to

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35/ See page 18, *supra*.

36/ *Cf*. Anthony J. Amato, Securities Exchange Act Release No. 10265 (June 29, 1973), 2 SEC Docket 90, 92 and Fox Securities Company, Inc., Securities Exchange Act Release No. 10475 (November 1, 1973), 2 SEC Docket 667, 669 *with* Charles E. Marland & Co., Inc., Securities Exchange Release No. 11065 (October 21, 1974), 5 SEC Docket 313, 315.

provide reasonable supervision with a view to preventing them. In addition, Gregersen is charged with willfully aiding and abetting violations of Section 15(c)(2) of the Exchange Act and Rule 15c2-11 thereunder, 37/ during the period from about March 1972 to August 1973, in connection with registrant's submission of quotations to the National Quotation Bureau for insertion in the "sheets." Here, too, Gregersen and Chatham allegedly failed to carry out their supervisory responsibilities. 38/

Respondents do not dispute that Section 5 and Rule 10b-6 were violated as alleged. Their arguments as to those provisions are directed entirely to the charge of supervisory failure. Thus, they challenge the adequacy of the allegation because it fails to state the specific respects in which their performance was allegedly deficient. They further point out that the Division introduced no direct evidence concerning their supervisory practices and assert that the record is devoid of evidence that they were remiss in performing their supervisory duties. In addition, Chatham asserts that he had

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37/ 17 CFR 240.15c2-11.

38/ The allegation of supervisory failure, which spans all allegations of violations in the order for proceedings, also covers an allegation (Paragraph II G of the order) charging various respondents with fraudulent practices in connection with transactions in SEI stock. However, as a result of the fact that the respondents named in that paragraph either defaulted or submitted settlement offers prior to or during the hearing, the Division concededly introduced no evidence in support of three of the four subparagraphs. Acordingly, at the conclusion of the Division's case I dismissed the allegation of supervisory failure with respect to those subparagraphs (subparagraphs 2-4) of the fraud charge. The Division has sought no findings pertaining to subparagraph 1. Accordingly, the allegation of supervisory failure with respect to the misconduct alleged in that subparagraph is also dismissed.

no supervisory responsibilities following his resignation in April 1973 as president and a director.[39/]

The record shows that registrant sold substantial amounts of SEI stock as agent for a number of persons who had acquired shares directly from the issuer at around the time of its inception in 1970. Between October 1971 and December 1972, registrant sold a total of 90,000 shares for such persons in 12 transactions. Two of these persons were called as witnesses and testified that they had purchased their shares with a view to reselling them when they could realize a profit. While the other four did not testify, the record warrants the inference of a similar intent. Under Section 2(11) of the Securities Act, which defines an underwriter to include "any person who has purchased from an issuer with a view to . . . the distribution of any security," all these persons were "statutory underwriters" and registrant was a participant in underwriters' sales.[40/] Moreover, pursuant to a September 1972 subordination agreement between registrant and Stewart E. Campbell, one of the original respondents who at that time was manager of registrant's branch office in Ogden, Utah, registrant received a certificate for 50,000 shares of SEI stock directly from the issuer. It sold those shares from its trading account in June 1973. At the time of the above transactions, no registration statement under the Securities Act with respect to SEI stock was filed or in effect. As indicated, no exemption from the registration requirements has been claimed for registrant's sales referred to above and it does not appear that an

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39/ At the close of the Division's case, upon its "stipulation" that it would seek no findings against Chatham with respect to the period preceding his assumption of those positions in October 1972, I dismissed the allegation of supervisory failure to the extent it covered such period.

40/ See Quinn and Company, Inc., 44 S.E.C. 461 (1971), aff'd 452 F.2d 943 (C.A. 10, 1971), cert. denied 406 U.S. 957.

exemption was available. Those sales therefore violated Sections 5(a) and 5(c) of the Securities Act. 41/

The alleged violations of Rule 10b-6 are less clear. As pertinent here, that rule prohibits a broker-dealer or other person participating in a distribution from bidding for or purchasing any security which is the subject of such distribution until after he has completed his participation in the distribution. The Division's theory appears to be that (1) registrant was a participant in a distribution of SEI stock for the period spanning the beginning of its sales for the statutory underwriters in October 1971 through delivery of the 50,000 shares in August 1973, and (2) during that period it inserted bid quotations for SEI stock in the sheets beginning in March 1972, purchased 35,500 shares for its own account from statutory underwriters between August 1972 and April 1973, and must have purchased, at some point between September 1972 and June 1973, the 50,000 shares which were originally loaned to registrant pursuant to a subordination agreement.

There appears to be no basis, however, for finding that registrant was a participant in a distribution, within the meaning of Rule 10b-6, during the entire period indicated. At most it was such a participant and subject to the prohibitions in Rule 10b-6 each time it sold shares on behalf of one of the statutory underwriters. 42/ Registrant did not enter bids in the sheets until March 1972, by which time all but 10,000 of the 90,000 shares had been sold. The remaining 10,000 shares were sold in three transactions

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41/ The Division also introduced evidence that registrant purchased for its own account several thousand shares of SEI stock from certain of SEI's original shareholders, but presented no evidence regarding the disposition of those shares.

42/ Cf. J.H. Goddard & Co., Inc., 42 S.E.C. 638, 641 (1965); Jaffee & Company, 44 S.E.C. 285, 287 (1970), aff'd in part and reversed in part, 446 F.2d 387 (C.A. 2, 1971).

on June 13 and 14, 1972 and one transaction on December 6, 1972. On those days registrant also had bid quotations in the sheets.[43/] Thereby it violated Rule 10b-6, albeit in a somewhat technical sense. I cannot find further violations of the rule in the purchases to which the Division points since they came within the first exception to the rule for transactions among persons participating in the distribution.[44/]

Turning to the allegation of supervisory failure with respect to the above violations, I disagree with respondents' contention that such allegation is overly broad and failed to give them adequate notice of the charges against them. That allegation apprised them that they were being charged with a failure to carry out the supervisory responsibilities flowing from their top executive positions, with a view to preventing specifically alleged violations.[45/]

As respondents correctly point out, the Division introduced no evidence pertaining to supervisory practices designed to prevent violations of Section 5 or Rule 10b-6, or to the supervision actually exercised over Campbell who effected most of the transactions in question. A failure to provide

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43/ In making this finding, I have taken official notice of the sheets for the days in question.

44/ The record shows that on the same day that registrant sold the 50,000 shares, it bought 12,000 shares of SEI stock for its trading account. (Div. Ex. 77). However, in my opinion these bare facts do not in themselves warrant a finding that Rule 10b-6 was violated.

45/ Both respondents filed extensive motions for more definite statements. Neither sought further details concerning the allegation of supervisory failure.

reasonable supervision may be inferred, however, from the nature of the violations committed,[46/] on the theory that such violations would have been prevented had appropriate supervisory procedures been established and implemented. In my view, the record here, including the number of transactions involved, warrants the finding that Gregersen failed reasonably to supervise with a view to preventing the violations of Section 5 and the related Rule 10b-6 violations. Such a finding is not warranted, however, as to Chatham, whose association with registrant postdated the bulk of the improper sales and whose responsibilities as an official of registrant were in the financial rather than the sales area.

Rule 15c2-11, as pertinent here, prohibits a broker-dealer from submitting quotations for a security for publication in a quotation medium such as the sheets unless (in the case of an issuer which is neither subject to the Exchange Act's reporting requirements nor has made a recent filing under the Securities Act) he has in his records specified information, including the issuer's most recent financial statements, reasonably current in relation to the time the quotation is submitted, "which he has no reasonable basis for believing is not true and correct or reasonably current."

On or about March 15, 1972, Jasper N. Erskine (one of the original respondents), who was then an employee as well as a director of registrant, submitted an application for registrant to the National Quotation Bureau to quote

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46/ This is not, as respondents suggest, tantamount to imposing automatic and absolute responsibility on supervisors for the acts of their subordinates.

SEI stock. The only recent SEI financial statements which registrant had at that time were a December 31, 1971 balance sheet and a profit and loss statement for the calendar year 1971, both of which were unaudited and in handwritten form.[47/] The profit and loss statement was on its face inaccurate, because the sum of the itemized expenses was far below the figure for total expenses and the bottom line figure, presumably reflecting net loss for the year, did not correspond to the difference between listed income and listed total expenses. Moreover, both the balance sheet and profit and loss statement contained erasures and smudges. In the terms of the rule, Erskine and registrant had a reasonable basis for believing that these financial statements were not correct. Under those circumstances, the submission of quotations for SEI stock violated Rule 15c2-11.

I am unable to find, however, that Gregersen willfully aided and abetted the violation. The only testimony concerning submission of the application to the Quotation Bureau was Erskine's. That testimony indicates that Gregersen was not involved in the process of obtaining the financial information from SEI or preparing the application, with the possible exception of furnishing the opening quotations. But Erskine could not recall whether he discussed those quotations with Gregersen or with another official.

On the other hand, I find that Gregersen failed reasonably to supervise with a view to preventing the violations of Rule 15c2-11. The Rule, which had become effective only a few months before registrant first

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47/ Erskine caused copies to be typed for submission to the Quotation Bureau.

entered the sheets with SEI quotations, [48/] imposes a heavy burden on a broker-dealer initiating quotations for a security where current information concerning the issuer is not generally available. Under the circumstances, it was incumbent on Gregersen, as registrant's president, either to review personally the information in registrant's possession prior to the submission of quotations or at least to give appropriate instructions to Erskine. Had either course been diligently pursued, it seems likely that the violations would have been avoided.

There is, however, no basis in the record for an adverse finding as to Chatham in connection with the Rule 15c2-11 violations.

Other Violations

Several allegations in the order for proceedings remain for consideration. For the most part they are related to the three major areas of violation already discussed.

Deficiencies in Registrant's Books and Records

The order for proceedings alleges that registrant, willfully aided and abetted by Gregersen and Chatham, willfully violated the recordkeeping requirements of Section 17(a) of the Exchange Act and Rule 17a-3 [48a/] thereunder by failing to accurately make and keep current certain of its books and records.

Upon motion of respondents and others who were then respondents, I required the Division to specify the respects in which it claimed registrant's

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48/ Rule 15c2-11 became effective on December 13, 1971. See Securities Exchange Act Release No. 9310 (September 13, 1971).

48a/ 17 CFR 240.17a-3.

books and records were deficient.[49] The following findings are limited to the matters specified in the Division's response dated August 13, 1974:

1. Registrant failed to maintain proper records pertaining to the collateralization of the bank loans. As has been noted, prior to late June 1973 there was no collateral account among registrant's records. Even after that time that account did not include all the collateral which was purportedly pledged to the bank.

2. Registrant's records did not reflect the loans which Fabri-Glas made to registrant, including the large cash loan made on April 9, 1973 and the subsequent loan of the thrift certificate.

3. The Fabri-Glas customer account with registrant was not an accurate reflection of the transactions recorded therein. As has been found,[50] that account was used to disguise the misuse of proceeds of the Fabri-Glas offering.

4. Entries reflecting the purchase by registrant's customers of Fabri-Glas stock were not made in customers' accounts until April 9 and 10, 1973, even though sales were effected and payments received as early as March 26.

5. Finally, registrant's records were inaccurate in showing an asset entitled "underwriting receivables" for several months after the

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49/ Respondents have overlooked this fact in arguing that the allegations in the order for proceedings concerning books and records were not specific enough to permit a meaningful defense.

50/ Page 26, *supra*.

closing of the Fabri-Glas escrow. As has been noted, this item purported to represent amounts due from persons who had ordered Fabri-Glas stock but subsequently had cancelled their orders or had paid by checks which "bounced," whereupon registrant had cancelled the transactions. There is nothing in the record to indicate that registrant had any reason to believe that those persons intended to reinstate their orders or that registrant took any action with a view to collecting the purchase price from them. Under the circumstances, there was no basis for carrying as a receivable what in fact represented either unsold shares or shares which registrant itself had purchased.[51/]

In the respects listed, registrant violated the designated provisions. I further find that Gregersen and Chatham willfully aided and abetted those violations. Respondents' argument that registrant's comptroller had the primary responsibility for keeping the firm's records and that the firm was warranted in placing confidence in him is beside the point. The deficiencies found here, with the possible exception of item (4), reflected determinations made at the managerial level by, or with the participation or at least knowledge of, Gregersen and Chatham.

51/ In his testimony, Chatham presented a somewhat different theory regarding the nature of this "receivable" from that advanced in respondents' brief. He testified that when he was consulted by registrant concerning this item as of May 31, 1973, his thinking was that since the underwriting had not closed, either the cancellations would be replaced by new orders, or registrant would have to buy the shares after the underwriting closed. "Therefore, as far as I was concerned, it certainly was an asset." (Tr. 852) Aside from the fact that what started out as an explanation of a "receivable" ended up as a conclusion that the item was an "asset," even that conclusion seems highly questionable.

Inaccurate Financial Report

Subparagraph (a) of Rule 17a-5 52/ under Section 17(a) of the Exchange Act, as in effect during 1973, required a broker-dealer to file with the Commission (and furnish to his customers) on a quarterly basis a balance sheet (which did not have to be certified) and a net capital computation. In June 1973, registrant filed an uncertified balance sheet and net capital computation as of May 31, 1973. Registrant's report comprising these documents was inaccurate in several respects. Among other things, the "underwriting receivables" item which has been previously discussed was carried as an asset on the balance sheet and included in registrant's net capital. The indebtedness to the bank was improperly excluded from "aggregate indebtedness" in registrant's net capital computations. And there was no indication that registrant owed a substantial amount to Fabri-Glas.

Accordingly, I find that registrant violated Section 17(a) and Rule 17a-5 and that Gregersen and Chatham willfully aided and abetted that violation.

Failure to Comply With "Early Warning" Requirements

Rule 17a-11 53/ under the Exchange Act, adopted by the Commission in 1971 pursuant to Section 17(a) of that Act, among other things requires a broker-dealer to give the Commission immediate telegraphic notice if his net capital is less than that required by the net capital

52/ 17 CFR 240.17a-5.

53/ 17 CFR 240.17a-11.

rule and within 24 hours thereafter to file a report of his financial condition. Telegraphic notice is also required when a broker-dealer's records are not current. Such notice must be followed within 48 hours by a report describing corrective measures which have been and are being taken.

The order for proceedings alleges that during the period from April 30, 1973 to February 15, 1974 (the date on which registrant's broker-dealer registration terminated), registrant, willfully aided and abetted by Gregersen and Chatham, failed to comply with the above requirements. The record shows, and respondents do not dispute, that with one possible exception[54/] registrant at no time during the relevant period gave notice or filed a report under Rule 17a-11. Respondents, aside from claiming that no such action was required because registrant was in fact in compliance with net capital and recordkeeping requirements, assert that throughout the period between April 30 and August 9, 1973, there was a legitimate dispute between registrant and the Division concerning the proper method of computing registrant's net capital and that it was not until August 9 that the Division made an internal decision that registrant's position was incorrect and gave "authoritative notification" to registrant that it was in violation of the net capital rule.[55/]

54/ See note 55, infra.

55/ Respondents assert that on August 9, 1973, registrant paid its bank indebtedness; that indebtedness was assumed by Suite 500 Corporation; (continued)

In light of the circumstances which the record here presents, there is no need to determine whether a state of facts such as respondents posit might constitute a good defense to a charge of willfully violating Rule 17a-11. First of all, the record shows that as early as the beginning of July 1973, the Commission's Regional Administrator in Denver advised registrant that the recent inspection had disclosed that registrant's capital did not meet the requirements of the net capital rule in April, May and part of June 1973. (Div. Exh. 32). More significantly, however, the record now shows that the differences between registrant (and respondents) on the one hand and the staff and NASD personnel on the other were not simply in the nature of disagreements concerning the interpretation of the net capital rule. As the examiners suspected but were unable to pin down, there <u>was</u> something "fishy" about the loan arrangements

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55/ (continued)
such assets of registrant as were "disqualified" in the Division's net capital computations were transferred to Suite 500; and as a result registrant was at no time in violation of the net capital rule from August 9 on. These assertions, however, are in various respects inconsistent with what the record shows. First, as found above, registrant was again in violation of the net capital rule on August 20. Secondly, as discussed below, registrant was given "authoritative notification" of net capital violations in early July. Finally, it was on August 14 that the transfer of the loan to Suite 500 occurred. The August 9 date referred to by respondents pertains to certain other events. At an August 8 meeting in registrant's office attended by, among others, Gregersen, Chatham and staff and NASD examiners, registrant's representatives were advised that it appeared registrant's net capital was insufficient. The following day registrant sent a telegram to the Denver office referring to such advice, and stating that registrant's own records did not reflect a violation but that, in order to erase any doubt, an $85,000 cash contribution to capital had been made that morning. (Div. Exh. 34) While this matter was not further developed at the hearing, the bank's loan ledger for Suite 500 Corporation (Div. Exh. 25) reflects a loan of $65,000 to that corporation on August 9.

between registrant and the bank. The facts concerning Paskett's largesse with the bank's money and the nature of the collateral arrangements were known to respondents but not to the examiners. Thus, respondents knew or should have known throughout the period from April 30 to August 1973 that registrant's net capital was insufficient. In addition, they knew or should have known that at least during part of this period registrant's collateral records were not current.

Accordingly, I find that respondents willfully aided and abetted violations by registrant of Rule 17a-11.

Failure to Amend Registration Application

Rule 15b3-1 [56/] under the Exchange Act provides that if the information in a broker-dealer's registration application (Form BD) becomes inaccurate, he must promptly file an amendment on Form BD correcting such information. The order for proceedings alleges that during the period from about April 1971 to February 15, 1974, registrant and respondents failed promptly to file amendments disclosing certain information required to be disclosed on Schedule D of Form BD, which is an integral part of the form. A separate Schedule D must be filed, among other things, for each officer and director of the broker-dealer and for every person with similar status or functions. Under the caption "Business Background," a "complete, consecutive statement of all business experience and employment for the past ten years" must be furnished.

56/ 17 CFR 240.15b3-1.

At various times during the above period, registrant's Form BD included Schedules D for Gregersen, Chatham, Erskine, Campbell, who for certain periods was a vice-president of and director of registrant, and Richard Y. Bennion, who was also for a time a vice-president and director. It is undisputed that at times when they were associated with registrant, each of these persons was also affiliated as a director and/or in some instances as an officer with one or more of the following corporations: First Utah Underwriters, Inc.,[57/] Suite 500 Corporation and Chatham Corporation. The Commission's files show, and it is also undisputed, that registrant's Schedules D and amendments thereto did not disclose these relationships.[58/]

Respondents contend that reporting of affiliations with Suite 500 Corporation was not required, because that corporation was solely a holding company for registrant and had no business of its own and the "business experience and employment" of the common officials was thus derived solely from their association with registrant. The disclosure requirements of Schedule D appear to be broad enough to encompass the association of the various individuals with Suite 500 Corporation even had its business been as limited as claimed by respondents. But Suite

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57/ Respondents' arguments on this issue confuse the above corporation with First Utah Underwriting Corporation, which was registrant's original name.

58/ However, contrary to the Division's arguments, the amended Schedule D for Gregersen filed in April 1971 did disclose his affiliation with MIC Investment Corporation.

500's 1972 annual report to the State of Utah (part of Div. Exh. 56) shows that it was a holding company not only for registrant but for two other companies as well.

As to Chatham's association with Chatham Corporation, that corporation was organized on March 23, 1973, but according to Chatham's testimony engaged in no business activity until about mid-April, only a few days before Chatham terminated his formal association with registrant.[59/] Thus, an adverse finding in this respect seems unwarranted. There is no basis for such a finding with respect to Chatham's association with First Utah Underwriters, which was not even incorporated until May 1973.

In the other respects indicated, however, I find that registrant violated Rule 15b3-1. Gregersen willfully aided and abetted the violations. Chatham willfully aided and abetted the violation resulting from the failure to promptly report his position as president of Suite 500 Corporation.[60/]

59/ The Division did not allege that registrant's Form BD was deficient in failing to list Chatham thereafter as a person with a status or functions similar to those of an officer. I therefore do not deem it appropriate to find a continuing obligation to report Chatham's other associations.

60/ For the reasons discussed on page 18, *supra*, the allegations of supervisory failure against Gregersen and Chatham with respect to all violations found under "Other Violations" are dismissed.

Recapitulation of Findings; Public Interest

By way of recapitulation, the following findings of misconduct have been made:

1. Both Gregersen and Chatham willfully aided and abetted violations of the net capital rule as charged.

2. In connection with the Fabri-Glas offering,

a. Gregersen willfully aided and abetted violations of Sections 5(a), 5(c) and 17(a) of the Securities Act, Sections 10(b) and 15(c)(2) of the Exchange Act and Rules 10b-5 and 15c2-4 under the latter sections.

b. Chatham willfully aided and abetted violations of Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

3. In connection with transactions in SEI stock, Gregersen failed reasonably to supervise with a view to preventing violations of Section 5 of the Securities Act, Sections 10(b) and 15(c)(2) of the Exchange Act and Rules 10b-6 and 15c2-11 under the latter sections.

4. Both respondents willfully aided and abetted violations of Sections 15(b) and 17(a) of the Exchange Act and Rules 15b3-1, 17a-3, 17a-5 and 17a-11 thereunder.

The remaining issue concerns the remedial action which is appropriate in the public interest. The Division takes the position that both Gregersen and Chatham should be unqualifiedly barred from association with a broker-dealer. In so urging, it emphasizes the activities respondents

engaged in which were designed "to maintain the fiction that Registrant's net capital was sufficient" and the "zeal with which they sought to cover the failing company's condition."

The list of violations committed by each of the respondents, particularly by Gregersen, is a long one. Many of those violations were of a serious nature. For example, the Fabri-Glas offering involved a flagrant fraud, especially in connection with the closing of the escrow even though the minimum number of shares had not been paid for by public investors and the use by registrant for its own purposes of a large percentage of the offering's proceeds. As serious as those and other violations were, however, I agree with the Division's singling out of respondents' misconduct in connection with registrant's net capital problems. In that area, the culpability of the two respondents must be judged approximately equal.

The importance of the net capital provisions as a financial safeguard for the protection of investors has been repeatedly noted by the Commission and the courts. 61/ While it appears that the deficiencies here did not result in customer losses, that fact "cannot mitigate the net capital violations since the rule was designed to assure the financial responsibility of

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61/ See, e.g., Blaise D'Antoni & Associates, Inc. v. S.E.C., 289 F. 2d 276, 277, rehearing denied, 290 F. 2d 688, (C.A.5.), cert. denied 368 U.S. 899 (1961); S.E.C. v. General Securities Co., 216 F. Supp. 350, 351 (S.D.N.Y., 1963); Barraco and Company, 44 S.E.C. 539, 540-1 (1971); Fcx Securities Company, Inc., Securities Exchange Act Release No. 10475 (November 1, 1973), 2 SEC Docket 667, 669.

broker-dealers, and exposure of customers to risk of loss is itself the abuse at which the rule is aimed."[62/] Respondents permitted registrant to continue in business over a period of several months with massive net capital deficiencies. In addition, however, they sought to mislead the regulatory authorities concerning their relationship and arrangements with the bank, which were crucial to an evaluation of registrant's net capital position. There can be no question that Gregersen, an experienced businessman, and Chatham, who came to registrant with a background of compliance work for the NASD, were aware that Paskett was dispensing the bank's funds on an essentially unsecured basis. Yet in their contacts with NASD and Commission personnel they persisted in portraying the bank loans as normal secured loans and they sought to pass off documents prepared internally (Exhibits 7 and 8) as bank documentation.

Under all the circumstances, the public interest requires that respondents be excluded from the securities business.[63/]

62/ Higgs, Inc., Securities Exchange Act Release No. 10299 (July 26, 1973), 2 SEC Docket 197, 198. See also the court decisions cited in note 61, supra.

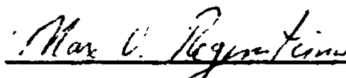
In any event, customer losses were avoided only because respondents were able to obtain the bank loans for registrant through Paskett. Respondents argue, in this connection, that the fact that registrant went out of business without any debt except that to the bank "is evidence for the proposition that the [net capital] rule, as interpreted by the Registrant, has served its purpose of protecting the investment community. It is for the Federal Reserve Board or the Congress to protect the banks." (Brief, p. 10). The suggestion that the Commission need not be concerned if a broker-dealer manages to meet obligations to its customers by in effect defrauding a lender must be rejected.

63/ All proposed findings and conclusions and briefs submitted by the parties have been considered. The parties' proposals and contentions are accepted to the extent they are consistent with this initial decision.

Accordingly, IT IS ORDERED that Roald George Gregersen and Richard Lee Chatham are hereby barred from being associated with a broker or dealer.

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, 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.



Max O. Regensteiner
Administrative Law Judge

Washington, D.C.
June 26, 1975