(Securities Act Release No. 5161)

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2079

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

July 5, 1971

In the Matter of AUGION-UNIPOLAR CORPORATION 12 Leda Lane Guilderland, New York (2-32923) Securities Act of 1933 - Section 8(d)	FINDINGS, OPINION AND STOP ORDER

STOP ORDER PROCEEDINGS

Material Deficiencies in Registration Statement

Failure to Cooperate

Where registration statement under Securities Act of 1933 was materially deficient in describing intended use of proceeds of offering and certain inventions on which issuer's business was dependent, failed to disclose possibility of adverse claim to inventions and that issuer's licensee did not have financial capacity to honor potential contractual commitments, and contained financial statement not complying with Regulation S-X, and where issuer failed to cooperate in examination pursuant to Section 8(d), held, Commission would not consider issuer's post-effective amendments, and stop order issued.

Practice and Procedure

Issuer's contentions that Section 8(e) examination can be conducted only after institution of stop-order proceedings, that issuer cooperated in examination to extent permissible without infringement of privilege against self-incrimination, that Commission was estopped from bringing proceedings because registration statement was prepared in accordance with its staff's advice at pre-filing conference, that hearing examiner's decision was not in proper form and examiner was biased, and that Section 8(c) required Commission to declare post-effective amendments effective and dismiss proceedings, rejected.

APPEARANCES:

Thomas N. Holloway, L. Keith Blackwell, and Alois Lubiejewski, for the Division of Corporation Finance of the Commission.

Walter F. Wessendorf, Jr., for Augion-Unipolar Corporation.

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Following hearings in this stop-order proceeding pursuant to Section 8(d) of the Securities Act of 1933 ("Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that a registration statement filed on May 2, 1969 by Augion-Unipolar Corporation ("registrant") was materially deficient in various respects and that a stop order should issue suspending its effectiveness. We granted registrant's petition for review, and registrant and our Division of Corporation Finance ("Division") filed briefs. On the basis of an independent review of the record, we reach the same conclusion as the hearing examiner.

Registrant was organized in February 1969 to engage in research and development with respect to, among other things, "unipolar-ion" devices. It has done no business, has no plant, research facilities, services or products, and uses office space provided in his residence without charge by its president, Walter F. Wessendorf, Jr., who is also registrant's counsel, a director, a promoter and a controlling stockholder. The registration statement, which became effective by lapse of time on May 21, 1969, relates to a proposed public offering of 1,000,000 shares of registrant's $.01 par value common stock at $10.00 per share, to be made through registrant's executive officers and directors to residents of the State of New York. 1/

Deficiencies in Registration Statement

(a) Use of Proceeds

The registration statement estimates that, if all the securities covered thereby are sold, registrant will receive net proceeds of $9,210,000. Of that amount, the registration statement states that it is proposed to spend over a four-year period an aggregate of $7,200,000 ($1,800,000 each year) for "Research and Development" in five categories listed in order of priority, and a total of $2,000,000 ($500,000 each year) for "General Administration." It is further stated that if the offering is undersubscribed, funds will be used for some research in the five categories in their order of priority although the funds may be used "in altered proportions", but that, if insufficient funds are raised to conduct any research and development, registrant will simply pay officers' salaries and allow itself to become bankrupt.

The description of the intended use of the proceeds of the offering is materially deficient. The Act provides, with exceptions not relevant here, that a registration statement must set forth "the specific purposes in detail and the approximate amounts to be devoted to such purposes, so far as determinable, for which the security to be offered is to supply funds." 2/ The generalities supplied in the registration statement give an investor no clear idea of the specific uses to which the proceeds will be put within each category or over-all, 3/

1/ Registrant filed post-effective amendments on June 12 and August 14, 1969, which have not been declared effective pursuant to Section 8(c). Registrant states that it has not offered or sold any of the securities covered by the registration statement.

2/ Section 7 and Schedule A(13) of the Act.

3/ See Lewis American Airways, Inc., 1 S.E.C. 330, 344 (1936).

despite the fact that registrant, which is seeking to obtain $10,000,000 from the investing public, has no functioning existence at the present time. For example, no information is supplied as to the charges which each category of the proposed budget will bear for start-up costs before research and development can begin. Nor does registrant disclose on what basis it will determine the "altered proportions" in which it may allocate the proceeds in the event of undersubscription, 4/ or the minimum amount of funds it considers necessary to embark upon its program rather than allowing itself to become bankrupt, or the maximum period of time during which the offering is to be continued in order to establish its success or failure to raise such minimum amount. 5/ Registrant's assertions that it lacks expertise and will be operating "in the field of the unknown and esoteric" do not justify its failure to supply any meaningful information as to its intended use of the proceeds as required by the disclosure standards of the Act. 6/

(b) Organization and Business

1. The registration statement recites that registrant owns the rights to five inventions invented solely or jointly by Paul B. Fredrickson, registrant's vice-president, treasurer, and executive director of research, and that its business "is and will be materially dependent" upon obtaining patent protection for such inventions, improvements thereon, and for other "in-house" inventions and discoveries. It is further stated that, since 1963, Fredrickson has been employed as a nuclear physicist by another firm. No disclosure is made, however, of Fredrickson's agreement with that employer, executed in 1963, which requires Fredrickson to inform it of and assist it in obtaining patents on inventions and discoveries made by him individually or jointly with others while an employee which relate directly or indirectly to the work or products of the employer or companies in which it may have a substantial interest, and provides that such inventions and discoveries shall be and remain the property of the employer whether patented or not. While at least one of the inventions listed in the registration statement appears to have been specifically exempted from Fredrickson's agreement as pre-dating his employment, the possibility that the employer may assert rights to some of the inventions upon which registrant's business is said to be dependent, and the existence of the agreement on which this possibility is based, are obviously material facts which should have been disclosed to potential investors. Registrant's failure to do so rendered the registration statement materially misleading.

4/ Cf. Central Oils Incorporated, 39 S.E.C. 349, 350 (1959).

5/ See Texas Glass Manufacturing Corp., 38 S.E.C. 630, 635 (1958).

6/ Registrant further contends that the information it furnished with respect to its intended use of the proceeds of the offering is consistent with that appearing in recent registration statements of other companies. The adequacy of those other registration statements, of course, is not before us in this proceeding, but even if we were to assume that those registration statements contained deficiencies similar to those we have found here, we would not be precluded thereby from taking action in the present instance. See F.C.C. v. WOKO, Inc., 329 U.S. 223, 227-8 (1946); Maxwell Company v. N.L.R.B., 414 F.2d 477, 479 (C.A. 6, 1969); Fotochrome, Inc., Securities Exchange Act Release No. 7985, p. 3 (October 24, 1966).

2. The registration statement is also materially deficient with respect to its discussion of certain license agreements entered into by registrant. Those agreements are cited as sources of potential multi-million dollar payments to registrant provided that within four years it successfully develops certain patent protected anti-pollutant devices, and provided further that the licensee then gives its approval. No disclosure is made, however, that the licensee does not have the financial capacity to make the payments called for by the agreements, that it does not believe it will be able by itself to generate such funds in the future, and that it has no arrangement or plan for raising the moneys from other sources. Without such disclosure, an investor would clearly be misled as to the potential value of the agreements to registrant. 7/

Registrant argues that it was required to disclose only bilateral executory contracts and that those at issue here are "unilateral" agreements not requiring disclosure, and that, in any event, the contracts are not material since the licensee is not bound thereunder to give its approval, which is a condition precedent to its incurring any obligations to registrant. Disclosure is required, however, of all material contracts of whatever type which are not made in the ordinary course of business and are to be executed in whole or in part at or after the filing of the registration statement. 8/ We have defined a material contract as "one concerning which an average prudent investor ought reasonably to be informed before purchasing the registered security." 9/ The contracts in question appear plainly material, but, even assuming they were not, once registrant chose to describe them in the registration statement it was obligated to do so in a manner that would not mislead potential investors.

3. The registration statement is also materially deficient with respect to the descriptions of the inventions claimed by registrant, two of which are described in technical terms incomprehensible to the average investor. Registrant points to the fact that the patent for one of those inventions is attached as an exhibit to the registration statement, and asserts that the other was necessarily described in technical terms since it is "in the field of the unknown and esoteric." However, these factors cannot excuse registrant's failure to make meaningful disclosure.

(c) Financial Statement

Article 5A of Regulation S-X, 10/ which is applicable to the financial statement filed as part of the registration statement, provides, with exceptions not relevant here, that in the case of intangible property 11/ and unrecovered promotional and development costs, 12/ dollar amounts are to be extended only for cash transactions. The

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7/ See Brandy-Wine Brewing Company, 1 S.E.C. 123, 134 (1935).

8/ Schedule A(24) of the Act.

9/ Winnebago Distilling Company, 6 S.E.C. 926, 934 (1940).

10/ Regulation S-X governs the form and content of financial statements filed with us.

11/ Rule 5A-02(13)(a).

12/ Rule 5A-02(14).

balance sheet contained in the registration statement lists assets totalling $55,000, of which $35,000 is attributed to "Property" and $10,000 to "Organization Expense". The $35,000 represents the value placed by registrant on intangible property consisting of four inventions which were acquired in exchange for 3,500,000 shares of registrant's stock; the $10,000 is based on Wessendorf's bill for legal services in organizing registrant, which registrant paid by issuing him 1,000,000 shares. Since both items were paid for by issuing shares of registrant's stock, the balance sheet in showing dollar amounts for these items was not prepared in the form required by the Regulation, and was materially misleading. 13/

Failure to Cooperate

Section 8(e) of the Act empowers this Commission to make an examination in any case in order to determine whether a stop order should issue, and provides that if the issuer fails to cooperate "such conduct shall be proper ground for the issuance of a stop order." The examiner found that in a private examination pursuant to Section 8(e) conducted prior to the institution of this stop-order proceeding under Section 8(d), registrant failed to cooperate in that (1) registrant's president, Wessendorf, claiming his privilege against self-incrimination, refused to answer a question by a staff member duly designated to conduct the examination as to whether Wessendorf were willing, either by subpoena or voluntarily, to produce registrant's corporate books and records for examination, and (2) registrant did not respond to a duly served subpoena duces tecum which required it to appear on June 5, 1969, by its president, Wessendorf, for the purpose of testifying and producing certain specified corporate books and records.

Registrant argues that no examination can be conducted pursuant to Section 8(e) of the Act prior to the formal institution of a stop-order proceeding under Section 8(d), and so the examination conducted in this case was illegal; that, in any event, registrant cooperated in the investigation to the extent permissible without infringement of the privilege against self-incrimination; and that our staff agreed that registrant would not have to honor the subpoena duces tecum for June 5, 1969 if Wessendorf agreed to testify on May 27, 1969.

There is no merit to these contentions. Nothing in the language of Sections 8(d) and (e) or in the legislative history of the Act supports the construction urged by registrant. On the contrary, there would be little logic or common sense in requiring the institution of formal stop-order proceedings before an examination order could issue under Section 8(e) "to determine whether a stop order should issue," especially since examinations are generally conducted privately. It has been our normal practice over the years to authorize examinations pursuant to Section 8(e) prior to the institution of stop-order proceedings under Section 8(d), 14/ although a Section 8(e) examination is not, of course, a prerequisite to the institution of such stop-order proceedings. 15/ Since the privilege against self-incrimination is not available to a corporation, Wessendorf's claim of the privilege does not excuse registrant's failure to produce its books and records or otherwise

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13/ See Strategic Minerals Corporation of America, 39 S.E.C. 798, 805 (1960).

14/ See 1 Loss, Securities Regulation, 274-5 (2d ed. 1961).

15/ Breeze Corporations, Inc., 3 S.E.C. 709, 713-15 (1938).

cooperate. 16/ Finally, the examiner concluded that the testimony of Wessendorf and another of registrant's officers that Division counsel had excused registrant from compliance with the June 5 subpoena could not be credited. We find nothing in the record to move us to a different conclusion. 17/ Accordingly, we affirm the examiner's findings of a failure to cooperate.

Other Matters

Registrant argues that we are estopped from bringing this proceeding because the registration statement was prepared in accordance with "the recommendations and advice" given to Wessendorf by our staff at a pre-filing conference. However, not only may the doctrine of estoppel not be invoked against the Government acting in a sovereign capacity to protect the public interest, 18/ but the record does not show any basis for a claim of estoppel. Staff members gave Wessendorf no reason to believe that their comments, with respect to a draft prospectus which they had never seen before, were definitive, or that a filing by registrant in accordance with Wessendorf's interpretation of their views would satisfy applicable requirements.

Registrant further contends that the hearing examiner's initial decision did not comply with Rule 16(a) of our Rules of Practice because he failed to rule on each proposed finding of fact and conclusion of law, 19/ that the decision was also deficient because the examiner did not label his findings and conclusions as such, and that in various respects the examiner was biased and prejudiced. These contentions also lack merit. An examiner's decision may be in narrative form and need not specifically show his ruling on each proposed finding and conclusion as long as such rulings are in some way indicated. 20/ The examiner's decision, which included the statement that all proposed findings and conclusions had been considered and had been accepted to the extent they were consistent with such decision, was sufficiently explicit to enable the bases for his action to be ascertained.

16/ See Campbell Painting Corp. v. Reed, 392 U.S. 286, 288-89 (1968); United States v. White, 322 U.S. 694, 698, 699 (1944).

17/ Not only did members of our staff give testimony contrary to that of registrant's officers but, as the examiner noted, the transcript of Wessendorf's testimony of May 27, in exchange for which registrant asserts it was excused from compliance with the subpoena, reveals that Wessendorf refused to answer the staff's question whether he intended to honor the June 5 subpoena and particularly the demand for the production of the corporate books, a circumstance hardly consistent with the claim that registrant had been excused from responding to that subpoena. As the examiner found, the record is clear that staff members were "deeply interested" in examining registrant's records, that such records were never made available, and that it is incredible to believe that staff counsel abandoned efforts to examine such records.

18/ Richard N. Cea, Securities Exchange Act Release No. 8662, p. 11 (August 6, 1969) and cases there cited in note 18.

19/ Rule 16(a) provides, in relevant part, "An initial decision shall include: findings and conclusions, with the reasons or bases therefor, upon all the material issues of fact, law or discretion presented on the record."

20/ Norman Pollisky, Securities Exchange Act Release No. 8381, p. 10 (August 13, 1968).

In support of its claim that the examiner was prejudiced, registrant contends that the examiner ignored an instance of our staff's "tampering" with a witness during the hearings, and asserts that the examiner was a respondent, along with this Commission, in two interlocutory applications to the Court of Appeals made by registrant in connection with this proceeding. 21/ These arguments are entirely lacking in substance. During the hearings, Wessendorf, appearing as attorney for registrant, requested the hearing examiner to "admonish all persons present not to engage in any facial expressions" with respect to the answers being given by the witness then testifying. The examiner stated that he had not observed "any such signalling" but nevertheless warned those present as Wessendorf had requested. Not only did Wessendorf fail to file an affidavit with the examiner seeking his disqualification because of this incident, in accordance with Rule 11(c) of our Rules of Practice, but he specifically stated to the examiner on the record that "there was no reason at this time for us to charge any bias on your part." As to registrant's naming of the examiner as a respondent in its interlocutory applications, which were dismissed by the Court, what we said, in denying its prior similar motion to disqualify this Commission, is equally applicable with respect to the examiner. As we there indicated, it would be anomalous indeed if by registrant's own abortive legal actions it could disqualify the hearing examiner from performing his statutory functions in the instant remedial proceedings. 22/

Conclusions

We have found material deficiencies in the registration statement as well as a failure to cooperate on the part of registrant. Registrant contends, however, that no stop order should issue, arguing that since the Division has not raised any question with respect to registrant's post-effective amendments and registrant has not sold any of its registered securities to public investors, Section 8(c) of the Act makes it mandatory that we declare those amendments effective and thereupon dismiss these proceedings. We cannot agree.

Under Section 8(c) of the Act we are required to permit an amendment filed after the effective date of a registration statement to become effective only if such amendment upon its face appears not to be incomplete or inaccurate in any material respect and then only when such action is consistent with the public interest and the protection of investors. Whether such an amendment should be considered by us after stop-order proceedings have been instituted is a matter for the exercise of our discretion in the light of those provisions and the requirements of an orderly procedure. 23/ We think that consideration of the post-effective amendments as an alternative to the issuance of a stop order would be inappropriate here. As noted above, registrant and its officers

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21/ Civil Actions Nos. 34071 and 35615, filed in the United States Court of Appeals for the Second Circuit on September 22, 1969 and November 17, 1970, respectively. The Court dismissed both applications.

22/ See Augion-Unipolar Corporation, Securities Act Release No. 5113, p. 3 (November 18, 1970).

23/ See T.I.S. Management Corporation, 3 S.E.C. 174, 181-3 (1938); Doctor Dolittle Animal Fairs, Inc., Securities Act Release No. 5062, p. 3 (April 24, 1970).

failed to make its books and records available for examination, and, indeed, its officers, asserting their privilege against self-incrimination, refused to answer questions put to them in the examination. Even if we could assume that registrant's post-effective amendments were fully curative of the designated deficiencies in the registration statement, the information which registrant and its officers refused to furnish might have disclosed further material deficiencies. 24/ Under the circumstances, consideration of registrant's post-effective amendments at this time would be inconsistent with the public interest and the protection of investors.

In view of the foregoing a stop order should issue suspending the effectiveness of the registration statement. 25/

Accordingly, IT IS ORDERED that the effectiveness of the registration statement filed by Augion-Unipolar Corporation be, and it hereby is, suspended.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG), Chairman CASEY not participating.

Theodore L. Humes
Associate Secretary

24/ The examiner found that while registrant's amendments cured some of the deficiencies, they did not correct others or raised additional questions, and, in some respects, the record did not contain sufficient information to enable him to determine whether the amendments were curative or not.

25/ We have considered all exceptions to the hearing examiner's rulings, including those set forth in a "supplemental petition for review" filed after we had granted review of the examiner's initial decision and briefs had been filed. Such exceptions are overruled to the extent that they are inconsistent with our decision herein and sustained to the extent that they are in accord.