

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
RICHARD D. DEMAIO

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INITIAL DECISION

Washington, D.C.
August 4, 1993

Edward J. Kuhlmann
Administrative Law Judge

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APPEARANCES: Bruce M. Bettigole and James G. Mann
for the Division of Enforcement

Kenneth W. Lipman for Richard D. DeMaio

BEFORE: Edward J. Kuhlmann, Administrative Law Judge

Richard D. DeMaio was a broker, group leader, and office manager at the broker-dealer, Graystone Nash, Incorporated, in its Boca Raton, Florida branch office during April 1986 through December 1988. Graystone Nash was at the time a registered broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934 with headquarters in Bloomfield, New Jersey. The Order Instituting Public Proceedings against DeMaio alleged that he willfully violated, aided and abetted or caused violations of Sections 17(a) of the Securities Act of 1933 and 10(b) and 15(c) of the Exchange Act of 1934 and Rules 10b-5, 10b-6 and 15c1-2 thereunder. It is also alleged that DeMaio wilfully violated, aided and abetted or caused violations of Section 5 of the Securities Act. This hearing was held to determine:

- A. Whether the allegations set forth in the Order Instituting Public Proceedings are true, and if they are, to consider any defenses DeMaio may have to the allegations.
- B. What, if any, remedial action is appropriate in the public interest pursuant to Section 15(b)(6) and 21C of the Exchange Act.

The hearing was held in Fort Lauderdale, Florida on March 9 and 10, 1993. The record was closed on March 10, 1993. Following the hearing the parties filed proposed findings and briefs. The Division filed a reply on May 10, 1993.

FINDINGS OF FACT

DeMaio was a broker in Graystone's Boca Raton office from April 1986 through December 1988, except for six weeks beginning in August of 1986 when he was at another Graystone office. Tr. 299-300; Div. Ex. 1, Stipulation at ¶1. From about April 1987 to December 1988, DeMaio was one of the five managers of the Boca Raton office. The other managers were the owner of the office, Dennis Williams, Williams' nephew, Gene Foland, who had no assigned responsibilities, James R. Ricketts, Jr. and James L. Copley. In May 1988, DeMaio became the office manager, second in command after the office owner, Dennis Williams. Tr. 242, 307-08, 368. 1/

DeMaio was in charge of enforcing the "Buy-Sell Formula," under which the office was required to generate customer buy orders totalling at least 125 percent of its customer sell orders. Tr. 384. DeMaio also held sales meetings with the brokers, and

1/ DeMaio's co-managers in the Boca office, Ricketts and Copley, were also named as respondents in this proceeding. Both Ricketts and Copley consented to the entry of sanctions against them prior to the commencement of the hearing. The sanctions included a permanent bar from association with any broker, dealer, municipal securities dealer, investment adviser, or investment company under Section 15(b)(6) of the Securities Exchange Act of 1934, 15 U.S.C. §78o(b)(6), and orders, pursuant to Section 21C of the Exchange Act, that they permanently cease and desist from committing or causing any violation and committing or causing any future violation of Sections 5 and 17(a) of the Securities Act of 1933 and 10(b) and 15(c) of the Exchange Act and Rules 10b-5, 10b-6, and 15c1-2 thereunder. Div. Ex. 18 at 2-3; Ex. 19 at 2-3. As part of the settlement, Copley and Ricketts submitted sworn financial statements demonstrating an inability to pay any disgorgement amount, in consideration of which the Commission agreed to waive any disgorgement requirement. Div. Ex. 18 at 3; Div. Ex. 19 at 3.

designed special sales incentives, known as "spiffs." Tr. 368, 374-75; Div. Ex. 22. He was involved in at least some personnel matters, such as recruiting the compliance manager for the office. Tr. 203-4. When brokers quit the Boca Raton office, DeMaio routinely assigned their clients to other brokers who were staying with the office. Tr. 110-11. 2/ DeMaio was also involved in handling customer complaints for the Boca Raton office. Tr. 114-15. When Dennis Williams was absent from the Boca Raton office, as he frequently was for personal reasons or to visit his other Graystone branch offices, DeMaio was left in charge. Tr. 31, 82-83, 242, 376.

DeMaio told to his clients that because he was a manager he had access to privileged information that other brokers were not aware of. Tr. 150, 189-90, 367-68. He told James Morton, a customer of his from March 1986 until Graystone closed, that he received "privileged information" because he was in management but that he could not reveal the content of that information. Nevertheless, DeMaio did tell Morton that based on information he knew, he could say that the price of the stock in question was going to go up. Tr. 150. During the period when he was a manager in the Boca Raton office, DeMaio attended Graystone's monthly national management meetings. Tr. 78-79. He also owned part of the Graystone office in Reno, Nevada, and was involved in efforts in 1988 to open an additional office in Orlando, Florida which was

2/ It was common practice for the newly assigned brokers to falsely tell the customers that the departing broker had been fired. Tr. 110-11.

to be owned by DeMaio, Williams, Gene Foland, and Graystone broker Richard Cohen. Tr. 84, 233, 309-10, 376-78.

From April 1987 through December 1988, the period during which DeMaio served as a manager of the office, he received a 2 1/2 percent "override" on the production of the office. Tr. 83-84, 301, 369, 370-71. In 1987 and 1988, he received approximately \$430,000 from Graystone, of which approximately 65-70 percent, or \$279,500 - \$301,000, consisted of his commissions as a broker from selling house stocks to his personal clients. The remaining \$129,000 - \$150,500 was his override on the sales of house stocks by other brokers. Tr. 369-71. His income was tied directly to retail sales of the house stocks. Tr. 84. Although DeMaio also sold some mutual funds, his income from that activity was a "tiny fraction" of his overall compensation, and yielded "minimal" revenue for the office. Tr. 80-81, 371. DeMaio's emphasis was always on selling the "chop," the house stocks with the biggest commissions, not mutual funds. Tr. 151.

DeMaio was one of the top five producing brokers in Graystone's Boca Raton office. He had a number of large customer accounts. Tr. 84-85. In addition to the regular commissions paid to brokers, DeMaio earned special bonuses for selling particular combinations of house stocks to his clients, such as 1000 shares of ATC Environmental, 1500 shares of W.I.N.E., and 1500 shares of International Electronics in September 1988. Div. Ex. 20-21; Tr.

372-73. DeMaio initially denied having earned such bonuses, but recanted this testimony when confronted with documentary evidence. Id.

DeMaio represented in his Answer and Amended Answer that he was a former liquor salesman who did not understand the securities business. Answer at 3; Amended Answer at 3. But DeMaio is a college graduate who had worked at First Jersey Securities for 2 1/2 years prior to his tenure at Graystone. First Jersey was a firm which sold and made a market in penny stocks that its customers were not permitted to sell unless they bought other stocks. First Jersey also engaged in a practice called "flips," where one office would buy a particular stock for clients while another First Jersey office simultaneously recommended selling the same stock. DeMaio testified he knew of these practices while employed at First Jersey. Tr. 296-98, 326, 366-67.

Graystone's Practices in Making Initial Public Offerings and Aftermarket Trading

Graystone, from January 1, 1987 through December 31, 1988 underwrote 12 initial public offerings. Div. Ex. 1, Stipulation at 1. DeMaio either directly or indirectly had copies of the prospectuses for the offerings sent to purchasers of the units. Tr. 185-86, 196, 289, 330. The units were common stock and detached warrants which were immediately exercisable. Within days of the first sale of the stocks on the over-the-counter market, Graystone would purchase nearly all the units from the customers who had

initially purchased them. The initial customers would make substantial profits.

Graystone would remove the warrants from the units and sell the common stock to its customers at successively higher "ticks" or preset prices during the first few days the securities traded in the over-the-counter market. As the tick price increased, Graystone would make more stock available for purchase. The total amount of stock to be sold at any tick was determined by Graystone headquarters in New Jersey. Graystone headquarters also determined how much stock a branch office would be allocated at the various after market price levels. The branch office determined how much stock a particular broker would have available at any price level. Div. Ex. 1, Stipulation. Bids at other than the set tick prices would not be executed. Tr. 20.

DeMaio was involved in the initial allocations of IPO units among the brokers in the office. Tr. 32. DeMaio and the other managers of the Boca Raton office instructed the brokers that they would have to arrange for customers to resell the units to Graystone almost immediately, at a profit to be chosen by Graystone. Tr. 16-18. Brokers were told to sell units only to customers who would "play ball." Tr. 16. This meant that "when management wanted the units back we were supposed to be able to get those units back." Id. Sanctions were imposed on brokers who failed to comply. Tr. 60.

When Graystone wanted the units back, DeMaio went around the Boca Raton office with a list of the brokers who had not yet

complied, and instructed them to get their units back. Tr. 29, 87. L. Henry Aselton, a former broker in the Boca Raton office, testified as follows:

Q: Did [DeMaio] seem at all apologetic or reluctant about doing that?

A: It was more of a demand.

Q: Was he enthusiastic about it?

A: Very.

Tr. 29.

Customers were also required to buy common stock in the aftermarket after they had resold their units to Graystone. Tr. 27-28, 87-88, 90-91, 141, 380. Brokers were routinely instructed by the managers in the Boca Raton office, including DeMaio, that the clients would have to pay in advance of the offerings for both units and aftermarket common stock. Tr. 18-19, 88, 140. The advance payments, which were reflected as "credit balances" in customer accounts, far exceeded the amounts of the unit offerings. This ensured that the price of the common stock would rise substantially in the immediate aftermarket. Tr. 91. This information was available on the office's computer system. Tr. 91-92.

DeMaio was aware of the overselling of Graystone's IPOs, and used it as a marketing tool with his own customers. DeMaio told one of his customers, James Morton, that Graystone's IPOs were so successful because "they were oversold . . . Consequently, it is a shoo-in." Tr. 28, 141. As Morton testified, without

contradiction by DeMaio, DeMaio mentioned "rather horrendous values of cash which had been raised for some specific offerings." Tr. 142.

To get customers to pay for units and aftermarket common stock in advance of the offerings, the Boca Raton office gave "courtesy confirmations." Courtesy confirmations were forms, sent to customers by their brokers in advance of the actual confirmations, which reflected the transaction and the total amount due. These forms were used to get customers to send in payment in advance, so that there would be fewer cancellations of buy tickets due to failure of the clients to pay on time. When customers failed to pay for their buy tickets, Graystone's headquarters would cancel the trades and fine the brokers. DeMaio told the Boca Raton brokers that the courtesy confirmations were a good tool to bring in payments more quickly and to avoid sellouts by Graystone's headquarters. Tr. 98-101.

Clients who only wanted to buy units in the IPOs and not aftermarket common stock were derided by DeMaio and the other managers as "new issue whores," and brokers were instructed not to sell units to such customers. Tr. 27-28, 87-88, 380. DeMaio conceded that he had told his clients "in the majority of cases" that they would have to sell the units back to Graystone. Tr. 379-80. DeMaio also admitted that he had his customers send in money in advance of the offerings for both units and aftermarket stock. Tr. 381.

DeMaio and the other managers allocated to the brokers particular amounts of common stock at particular prices prior to the opening of the OTC market, sometimes with several different price levels being assigned at once. Tr. 19-20. The amount of stock assigned by DeMaio and the other managers generally increased as the preset "tick" price increased. Similarly, the commission levels set by the managers increased as the "tick" price increased. Tr. 32-33. One effect of this scheme was to encourage brokers to sell to their customers at higher prices, in order to reap higher commissions. Tr. 33.

Because the prices were known in advance, in the IPO of a stock called W.I.N.E., the brokers in the Boca Raton office wrote out the tickets for the aftermarket in advance at the various tick levels. But at the last minute Graystone headquarters changed the number of shares allocated at various tick prices. DeMaio, Richard Cohen, a broker, and Jose Gallego, the operations manager, readjusted the buy tickets that had been left by the brokers. They rewrote the tickets to reduce the amount of stock purchased by particular customers at the lowest ticks and increased the amount of stock purchased at the higher ticks. Customers had not authorized the changes. Tr. 94-96. The night before the aftermarket on W.I.N.E. was scheduled to begin, DeMaio asked Dennis Williams to give him additional shares for his customers at the lowest preset price of \$2.50. As a result, DeMaio received more of the \$2.50 stock than any other broker. Tr. 96-97. Similar

patterns were followed with the other IPO offerings of Graystone. Div. Ex. 1, Stipulation.

The Prospectuses

The prospectuses stated that units of common stock and warrants were to be offered to the public at a set price and that the underwriter's compensation consisted of a commission or discount from the offering price, expenses and long-term warrants. However, as established at the hearing, the true nature of the offerings were distributions of common stock at multiple, escalating tick prices in controlled markets. No disclosure was made of the extraordinary selling arrangements, such as repurchase of the units by Graystone, or of the huge compensation received by Graystone in distributing the common stock at the various tick prices. Div. Exs. 11(A)- 11(L).

Preliminary, or "red herring," prospectuses are intended, among other things, to warn potential investors in advance of the risks involved in a new offering. Dennis Williams discouraged the use of red herrings in the Boca Raton office. Tr. 89, 42-43. DeMaio generally did not send such prospectuses to clients, but rather told them that time was short and they had to invest immediately if they were going to get in on the house stocks. Tr. 186. DeMaio admitted that he sent out very few of these prospectuses, and that he did not ask his clients if they had received the prospectuses before getting them to send in their money. Tr. 378-79. Although he claimed that Graystone's

headquarters was supposed to send the red herrings out, he admitted knowing that this was not happening consistently. Tr. 378-79.

In the W.I.N.E. offering, rather than distribute "red herring" prospectuses, the Boca office obtained approximately 15,000 full color reprints of an extremely favorable article in Speculators Magazine concerning the offering. Dennis Williams, the owner of the office, DeMaio, and the other managers encouraged the brokers to distribute this reprint to their customers to stimulate interest in the upcoming IPO. Tr. 41-44, 97-98; Div. Ex. 7. The reprint did not mention Graystone's plan to repurchase the units and retail the common stock at artificial tick prices. DeMaio sent copies of the Speculators reprint to at least some of his clients. Tr. 193, 382-83.

Commissions and Selling Practices

The commissions which were paid on aftermarket trades in the house stocks were a minimum of 50%, and were often considerably higher. Tr. 20-22. Commissions on non-house stocks were only 2 percent. Tr. 22-23. The commissions on the house stocks were listed on internal memoranda known as "quote sheets" or "price sheets." When state and federal regulators came to inspect the Boca Raton office, DeMaio and the other managers would tell the brokers to hide their quote sheets and leave the office, particularly unlicensed brokers or those thought to be indiscreet. Tr. 47-51, 117; Div. Ex. 9.

The order tickets used by the Boca Raton office were in three parts. The copy that was given to the individual broker contained

the gross commission figure for the office but the other copies either showed no commission or only the net commission to the broker. DeMaio was aware of this practice. Tr. 118.

The quote sheets would show the brokers which house stocks had the largest commission at any particular time. The managers referred to the commissions as "chops." They would tell the brokers to follow the chops, that is, the brokers should have their customers buy the house stocks that would give the highest commission to the office and the broker. Tr. 50-51, 148, 150-51. Brokers were assessed ticket charges on all trades but they were not paid a commission on sell tickets for house stocks. They were paid commissions on sales of non-house stocks. Tr. 23, 101, 104-05.

DeMaio and the other managers devised and distributed various commission bonus programs for brokers in the Boca Raton office to encourage brokers to sell particular house stocks. In order to sell house stocks that had been in the Graystone inventory for some time, the brokers were given a bonus to sell several of these stocks to customers who were putting up money that was not already invested in Graystone stocks. Tr. 23-26, 62, 106-07; Div. Ex. 2-5. DeMaio was aware of this practice and encouraged brokers to sell these securities. Tr. 27. DeMaio and the other managers told the brokers that the house stocks could not be shorted. This was considered "playing against the house." Tr. 107. DeMaio knew that house stocks were artificially priced. Tr. 181.

DeMaio also knew that in the office he managed unlicensed brokers were permitted to act as brokers and receive commissions by using a registered broker's number. Tr. 116-17. DeMaio denied that he knew that Mary Flanagan, an unlicensed broker, was doing any trades. Tr. 305, 378. But her testimony shows that they discussed her trades. Tr. 251-52. DeMaio collected his override on the production of the unregistered brokers and he never informed regulators of their activity, although he knew it was not legal. Tr. 325.

Interference with Customers' Sales of House Stocks

While DeMaio was at Graystone, he said, customers were not always free to sell the house stocks when they wanted to do so. Tr. 319, 326. The "script" required that brokers claim that there was some good news about one of the other house stocks, and that the customer should buy that stock rather than receive any cash. Brokers would also refuse to take calls from clients trying to sell house stocks. Tr. 30-31. For one and a half months in 1987, in the Boca Raton office, in order to delay sales of house stocks, buy tickets would be submitted for execution before sell tickets. Tr. 102-04. As early as 1987, DeMaio realized that his clients would not be able to sell their house stocks, he believed that some of the house stocks were not real companies, and he wanted Graystone to get out of the penny stock business. Tr. 115-16, 119. Despite these beliefs, when brokers could not convince customers not to sell house stocks, DeMaio told his assistant manager, Vincent Beatty, to call the customers and persuade them not to sell. Tr.

385-86. On the other hand, non-house stock sales were immediately executed. Tr 104-05.

In early 1988, Graystone began a policy known as the "Buy-Sell Formula." Customer buy orders had to equal at least 125 percent of the sell orders. If the policy was not met, the sell tickets would not be executed and/or the commissions paid to the office would be reduced. Tr. 45-46. This caused problems in the Boca Raton office which had many customers who had held house stocks in their accounts for a long time and therefore were more likely to sell.

DeMaio was in charge of enforcing the Buy-Sell Formula in the Boca Raton office. Tr. 384, 226, 250-51 46. DeMaio explained that:

maintaining the formula had basically meant to go ahead and get more buys than sells and keep the buys 25 percent above the sells. And that was, you know, the basic job that I was given.

Tr. 313. Sell tickets could not be submitted to the back office for processing until DeMaio initialled the tickets. He refused to allow sell tickets to be transmitted to Graystone's headquarters for execution until he was given sufficient buy tickets to meet the formula. He delayed execution of his own customers' sell tickets for the same reason. When he did put through a sell ticket for a broker, he would ask the broker not to tell anyone that he had done so. Tr. 46-47, 214-15, 233. Privately, however, DeMaio acknowledged that it was wrong to delay sell tickets. Tr. 47, 252. DeMaio often argued with the brokers about his refusal to initial or execute their sell tickets. Tr 204-05.

The compliance manager, John Mather, warned DeMaio that he had personal legal exposure for delaying the sell tickets. Mather stated that DeMaio was required to forward all sell tickets to the New Jersey trading desk as soon as he received them from brokers. He told DeMaio that the Formula was a heinous thing, and that it was a way in which the New Jersey headquarters was manipulating the prices of the house stocks. DeMaio's only reply to Mather was that he was just doing what he was told, and that he didn't know what else he could do. Mather responded that if DeMaio and others in the Boca Raton office collectively refused to follow Graystone's illegal policies, the policies would have to be changed. Nevertheless, DeMaio continued to enforce the Buy-Sell Formula, despite these express warnings. Tr. 205-06, 225.

Graystone's New Jersey headquarters did not uniformly refuse to execute sell tickets which were forwarded by the Boca Raton office, even when the Boca Raton office failed to meet the formula. For at least two or three of the monthly pay periods, the Boca Raton office failed to carry out the formula. Tr. 109. DeMaio himself conceded during cross-examination that "there were a lot of times that the buy/sell formula was not met." Tr. 385. Richard Cohen, a broker who was called as a witness for DeMaio, testified that he was able to "pressure" Richard Adams in the New Jersey headquarters into executing his sell tickets. Tr. 229.

At the hearing, DeMaio admitted that he had known that the Buy-Sell Formula and the other restrictions on sell tickets were illegal. Tr. 324. DeMaio further admitted that he had been warned

by Mather of his personal exposure for enforcing the Formula. Tr. 398.

DeMaio's admissions at the hearing are in direct conflict with his Answer and his Amended Answer. There, DeMaio claimed as follows:

Finally, and most important, Mr. DeMaio truly believed that the policies being followed by Graystone Nash were in compliance with the law. Indeed, he was repeatedly assured by Dennis Williams that the office was being operated in a strictly lawful manner, and whenever he questioned any particular policy, Mr. DeMaio would be told that Graystone Nash's attorneys or compliance department had approved the policy being questioned.

Answer, filed on or about December 15, 1992, at 2; Amended Answer, filed on February 1, 1993, at 2-3. Mather, the Boca Raton compliance officer, testified that DeMaio never claimed at the time that he was acting legally, or that he had been told that Graystone's practices were legal. Tr. 206. Nor, Mather said, did Williams give any such assurances. Tr. 206.

DeMaio also claimed in his Answer and Amended Answer that he had "absolutely no inkling [of any] impropriety," and that if he "had possessed this knowledge, he quite simply, would not have performed any questionable act." Answer at 3; Amended Answer at 3.

At the hearing, DeMaio admitted that he believed that impeding execution of the sell tickets, using unlicensed brokers, and Williams' practice of announcing questionable and non-public information about the house stocks, were illegal. Tr. 324-25. He also said that he had told other broker's customers, but not his own, to call the New Jersey Headquarters and talk with Adams

directly and if they did not get any results they should call the SEC. Tr. 219-20, 392. But DeMaio never called the SEC himself, even though he knew it was his responsibility to do so. Tr. 388, 392.

DeMaio argued during his testimony that he was under great pressure to obey orders when he enforced Graystone's illegal policies. He testified that Dennis Williams threatened to fire him if he did not do a good job of enforcing the Buy-Sell Formula. However, DeMaio testified during the investigation on November 13, 1989 that he "never knew Mr. Williams to want to let go of anybody for any reason." Tr. 392-93.

The record also indicates that DeMaio was aware that the Boca Raton office attempted to prevent or delay customer attempts to sell off their house stocks by threatening to close the customers' accounts and send them their stock certificates through the mail. This was apparently done to force the customer to go to another brokerage firm to sell the stock. Tr. 109-10.

On redirect examination, DeMaio claimed that the Buy-Sell Formula was no longer in effect during the final months of Graystone's existence, and that sell tickets were being freely accepted. Tr. 399, 401, 402. The preponderance of DeMaio's other testimony is to the contrary. He said that clients were having extreme difficulties, "especially the last couple of months," in selling their house stocks, apparently due to the Buy-Sell Formula. Tr. 317-18. Moreover, DeMaio said that he had the same difficulty getting sell tickets executed for his clients after the Boca Raton

office closed in December 1988, when he briefly joined Graystone's Deerfield Beach office. Tr. 320. In fact, he represented that Dennis Williams' split off from Graystone in December 1988 was in part because of his disagreements with Thomas Ackerly, Graystone's President and Chairman, over the Buy-Sell Formula. Tr. 321.

Resale of Units by DeMaio's Clients

DeMaio told some of his clients that they would be required to resell to Graystone any units they purchased at a time and price that he would specify. Tr. 140-41, 172, 190. DeMaio explained to them that if they failed to sell the units back, they would not be able to buy any units in future Graystone IPOs, and that he would get "in trouble." Tr. 190-91. Morton testified that he told DeMaio "if this is such a good stock and it is such a good company with such a good story and it is going to fly, let's hold on to it." Tr. 141. DeMaio told Morton that he could not hold onto the units. Id.

Efforts to Prevent Selling of House Stocks

DeMaio would not permit his clients to sell their house stocks and take cash out of Graystone. His clients had numerous arguments with him about his failure to obey their instructions to sell house stocks. Tr. 191-92. One client, Morton, made numerous requests to him to get cash, "just to see it. Let me feel it. I'll send it back to you when we see another stock come or something. You couldn't get it." Tr. 144. Another DeMaio customer, Mike Holm, as well as Morton and Gary Katz, another customer, on behalf of Holm,

repeatedly sought to get DeMaio to cash out Holm's house stocks so that he could make a down-payment on a home; DeMaio never complied. Tr. 143-46, 172-73. DeMaio instead would convince his customers to buy other house stocks, rather than withdraw cash. Tr. 161-62, 191-92.

Occasionally, DeMaio would accept sell orders and promise to send cash. Nothing would happen for some period of time. Eventually DeMaio simply called the clients about the next Graystone house stock he wanted them to buy. Even if the clients insisted that they wanted to get their cash, DeMaio would not comply. Tr. 144-45, 173, 191-92.

When Jasbia Ahluwalia, another DeMaio customer, needed money urgently and was being particularly insistent on raising the money by selling his house stocks, DeMaio lent him \$5,000, rather than let him sell the stock. Tr. 191-92. Once when Ahluwalia called DeMaio to sell house stocks, DeMaio's assistant, Elizabeth Curcio, said that DeMaio was out of town. When he persisted, she called him back and falsely said that the stock had been sold as he requested. Tr. 192.

Efforts to Generate Buy Orders

DeMaio recommended that his clients sell their securities listed on the New York Stock Exchange and use the proceeds to buy Graystone house stocks. He derided the listed stocks as "grandmother" stocks. Tr. 138-39, 142-43. Katz repeatedly instructed DeMaio not to sell some General Electric stock which he had inherited and wanted to hold for his retirement. DeMaio

ignored these instructions and sold the stock, then used the proceeds to make unauthorized purchases of a Graystone house stock. Tr. 173-76; Div. Ex. 12-13. On November 1, 1988, DeMaio arranged with Katz to have Katz buy units in the Advanciers IPO, then resell the units to Graystone at a profit. Katz, however, told DeMaio that he did not have the money necessary to invest. DeMaio said he would lend him the money and they would share in the profits. DeMaio told Katz that he could repay him after the transaction was completed. Tr. 176-80; Div. Ex. 14-17.

DeMaio opened an account for the mother of one of his clients using the client's Florida address rather than the mother's true address in Connecticut because DeMaio was not licensed in that state. Tr. 138.

DeMaio successfully urged Ahluwalia to take out a \$100,000 line of credit on his condominium to buy house stocks, even suggesting particular lenders and explaining the process to Ahluwalia. Ahluwalia used \$40,000-\$60,000 of this line of credit to buy house stocks through DeMaio. Tr. 193-95. DeMaio promised Ahluwalia vast returns on his investments in the house stocks, as high as 300 percent or more. Tr. 192.

The Two Call Closing

DeMaio used a sales technique on his clients known as the "two call closing." DeMaio would call a customer and falsely represent that he would be attending a meeting the next day at which he expected to hear great news about a stock. He would ask if he should call the customer after the meeting. The next day, he would

call back and pretend that he had just left the meeting and that the news had been as expected. He would then urge that the customer buy the house stock with the biggest "chop" or commission on that day. Tr. 147-48, 152, 180-81.

DeMaio and his assistant manager, Vincent Beatty, encouraged Morton to use this technique and gave him a written script when he became a broker in the Boca Raton office in approximately June 1988. Tr. 147-48, 153. Morton told DeMaio on that occasion "this was what you used to do to me. Weren't there any meetings or anything? I would venture to say a majority percentage of the time there was never a meeting. Richard [DeMaio] said but it worked, didn't it? Use it on your prospects." Tr. 152.

DeMaio initially was evasive about whether he used the "two call close," but then admitted that he had. Tr. 389.

DeMaio Falsely Told Clients that He Sold House Stocks to His Mother

In order to convince his customers that it was not risky to buy house stocks, DeMaio would falsely tell his customers that he was selling the house stocks to his mother and other relatives. Tr. 149, 196-97. DeMaio denied using this tactic and said that it would not have had any impact on investors. Tr. 334. When questioned about his belief, DeMaio conceded that the technique would obviously have had an impact on investors. Id.

The Collapse of Graystone

When Graystone closed in December 1988, the value of virtually all of the house stocks immediately dropped to zero. Div. Ex. 1,

Stipulation at ¶ 8; Tr. 208; Div. Ex. 10. Many of DeMaio's clients lost virtually all of their investments in the Graystone house stocks. Tr. 162, 185, 197. Ahluwalia alone lost at least \$40,000; DeMaio conceded that Ahluwalia's losses were in that amount, while Ahluwalia believes his losses were more than \$125,000. Tr. 197-350.

Only one client of DeMaio's claimed to have been able to get most of his money out of Graystone, and that was a situation where he made it clear to DeMaio that he had an urgent need for his money in order to sustain his business. Tr. 292-94.

Despite these losses, DeMaio continued working with Thomas Ackerly, the president of Graystone, after the Boca Raton office closed. Tr. 397. DeMaio even attempted to convince other brokers to follow him and to continue with Graystone. Tr. 51-53, 397.

Ackerly was the person who devised a number of the practices used at Graystone. Tr. 124. He announced at a managers' meeting attended by DeMaio that he intended to engage in "cleaning the street" in a number of house stocks, which meant that Graystone was going to take the stocks away from "unfriendly" market makers, in order to make it easier for Graystone to control the price of the stock. Tr. 112-13.

DeMaio's Character

DeMaio worked for two and a half years at the penny stock firm First Jersey Securities immediately prior to joining Graystone. Tr. 201-02, 298-99. One of the other brokers who was at First Jersey Securities with DeMaio left after 18 months when one of

First Jersey's house stocks suddenly doubled in price for no apparent reason other than the efforts of First Jersey brokers to recommend the stock. Tr. 202. Nevertheless, DeMaio continued working at First Jersey for approximately a year after that, and only left because he thought the firm was "falling apart." Tr. 298-99, 326.

Harold Mette, the Regional Vice President for Chubb Life and Chubb Securities for the State of Florida, appeared as a character witness for DeMaio. Tr. 264. DeMaio is currently a broker with Chubb Securities, a registered broker-dealer which sells both securities and insurance products. Tr. 278. Mette said that DeMaio was one of Chubb's top 10 to 15 producers in the entire country and there had not been any complaints made about him in the over three years he has worked at Chubb. Tr. 266, 268.

Mette is responsible for the recruitment, training, motivation and supervision of more than 100 securities brokers and insurance agents in 70 separate offices throughout Florida. Tr. 264, 269-71. His office is in Melbourne, Florida, a one hour and 45 minute drive from DeMaio's office in Palm Beach Gardens. Tr. 271.

Bruce Prevost, not Mette, is DeMaio's immediate supervisor at Chubb. Tr. 271. Prevost and his brother, Mark, owned and operated Graystone's office in Stuart, Florida. Tr. 159-60. The Prevosts engaged in the same illegal practices as DeMaio, such as requiring that clients resell their units to Graystone, refusing to send cash back to clients, and delaying sell tickets. Tr. 157-60.

Mette thought that it was important when hiring DeMaio to inquire into DeMaio's actions at Graystone. He did not recall whether DeMaio mentioned anything about his years at First Jersey. Mette knew nothing about any of Graystone's fraudulent practices or DeMaio's role in enforcing such practices; all he knew was that Graystone was a penny stock firm which had gone bankrupt. Tr. 281.

Mette did not inquire about DeMaio's activities as a penny stock broker and manager, even after DeMaio told him that, while he was not under suspicion, regulators thought that others at Graystone had behaved inappropriately. Tr. 273-74. DeMaio made the representation to Mette about himself even though he knew he too was at risk. DeMaio also knew that he had engaged in illegal activities when he told Mette about the others. Tr. 324-25. Mette testified that he interviewed DeMaio in November or December 1989 but that DeMaio had not told him about the Commission's investigation of him until three to six months before the hearing. Tr. 275-77.

DeMaio testified in the Commission's investigation on November 13, 1989 and December 19, 1989, and asserted his Fifth Amendment rights as to every substantive question on the latter occasion. Tr. 393-95. 3/ Prior to the December 19, 1989 testimony, DeMaio had

3/ DeMaio asserted his Fifth Amendment right against self-incrimination during his December 19, 1989 investigative testimony as to all substantive questions asked, including whether he had participated in stock manipulation, whether he had offered securities subject to buy-back arrangements not disclosed in the registration statements, and whether he had made false or misleading statements to his customers. Tr. 395-96.

been contacted by a United States postal inspector regarding a federal grand jury and his role at Graystone. Tr. 396.

In addition to his investigative testimony, his assertion of the Fifth Amendment, and his contact with the postal inspector, DeMaio failed to inform Mette that he had received a Wells notice from the Division in 1991, which informed him of impending Commission action against him personally and offered him an opportunity to submit a defense for his actions. Tr. 396, 275-77.

When asked if DeMaio had ever told him about the "two call closing," the Buy-Sell Formula, or any of DeMaio's other activities at Graystone, Mette represented that he had "most certainly not" or "no," and responded that DeMaio "has never mentioned any behavior to me that ... was either illegal or unethical." Tr. 278-82.

CONCLUSIONS

DeMaio Willfully Violated the Federal Securities Laws

DeMaio concedes (Proposed Findings of Fact ¶¶ 113-16, 118-19) that from January 1, 1987 through December 20, 1988, he willfully violated, aided and abetted or caused violations of Sections 17(a) of the Securities Act and 10(b) and 15(c) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. DeMaio participated in schemes to defraud devised by Graystone in which securities were offered and sold in initial public offerings by means of misstatements or omissions and other manipulative and deceptive practices and the aftermarkets in such securities were established at artificial

prices and thereafter maintained, dominated, controlled and manipulated.

DeMaio concedes that he directly or through other brokers: a) prior to the effective dates of such offerings, simultaneously solicited orders to purchase both the units in the offerings and the common stocks in the aftermarket and collected the funds to pay for such purchases; b) received and allocated units for sale in the offerings on the basis of tie-in arrangements, including the requirement that purchasers of units in the offerings also buy common stock in the immediate aftermarket; c) required that units sold to customers in the offerings be resold to Graystone at a premium upon request; d) allocated common stock for sale in the immediate aftermarket at a series of predetermined increasing "tick" prices, the lowest of which was higher than the exercise prices of the warrants; and e) after trading commenced in the immediate aftermarket, participated in the execution of the customer orders at the successively higher tick prices.

DeMaio also concedes that in connection with initial public offerings, he disseminated or caused the dissemination of preliminary and final prospectuses to actual and prospective purchasers which contained materially false and misleading statements with respect to, among other things, the matters referred to in the preceding paragraph, the securities offered and the terms, the plans of distribution of the securities and compensation to be received by Graystone.

While DeMaio maintains that he did not suppress sales orders, a preponderance of record evidence shows that he did. The record establishes that DeMaio engaged and participated in fraudulent sales practices to generate purchase orders and suppress sell orders for the securities brought public by Graystone and in which it made over-the-counter markets. DeMaio discouraged, delayed and prevented the execution of customer orders to sell such securities.

DeMaio concedes that during the same time period he willfully violated, aided and abetted or caused violations of Section 5 of the Securities Act when he directly or indirectly: a) made use of means or instruments of transportation or communication in interstate commerce or of the mails to sell securities for the purpose of sale or for delivery after sale, when a registration statement was not in effect as to such securities; and b) made use of means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell securities, when a registration statement had not been filed as to the securities. In connection with Graystone's IPOs, DeMaio, directly or through other brokers solicited customers to purchase common stock in addition to the units and collected the sums due for both prior to the effective dates and, following the sale of the units and their repurchase by Graystone, offered and sold the common stocks to customers at the tick prices when no registration statements had been filed or were in effect as to such securities.

During the same time period, DeMaio willfully violated, aided and abetted or caused violations of Section 10(b) of the Exchange

Act and Rule 10b-6 when he caused Graystone to purchase for accounts in which it had a beneficial interest, securities which were the subject of such distribution or securities of the same classes and series, or rights to purchase such securities, or attempted to induce persons to purchase such securities or rights prior to the completion of Graystone's participation in the distributions.

Public Interest Considerations: Remedial Action Pursuant to §§15(b)(6) and 21C of the Exchange Act

The Division urges that DeMaio be barred from the industry, ordered to cease and desist and disgorge his earnings. The particular factors to be considered in determining whether the public interest requires a bar include the following:

[T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. S.E.C., 603 F.2d 1126, 1140 (5th Cir., 1979), aff'd on other grounds, 450 U.S. 91 (1981); Donald T. Sheldon, 52 SEC Docket 3826, 3867-68 (November 18, 1992).

DeMaio engaged in outrageous conduct in enforcing a massive penny stock fraud at Graystone and defrauding his own clients over a two-year period. The public invested many millions of dollars in the house stocks, and the value of virtually all of these stocks dropped to zero when Graystone ceased its illegal operations. The evidence of his scienter is overwhelming; he admittedly engaged in

illegal activity, knowing full well that he had personal exposure, and that he had a duty to inform the Commission and other regulators of any illegal activities by others. He made numerous misrepresentations in the course of this proceeding. While he concedes that he violated the law, he argues that he should not be culpable because he did not devise the schemes he embraced and enforced as a manager.

DeMaio claims that he was only a "trivial cog in the large, improper Graystone Nash scheme" and therefore he should only be ordered to cease and desist. The record does not reflect that DeMaio's role was trivial. He was second-in-command of Graystone's largest retail office and he was involved in enforcing every aspect of Graystone's illegal scheme. He was paid \$430,000. DeMaio admits that he was enthusiastic about enforcing the requirement that units be immediately resold to Graystone. He concedes that he participated in the allocation of aftermarket stock at artificial, preset tick prices in which the amount of stock that could be purchased increased as the price and commission increased. DeMaio also concedes that he caused prospectuses to be distributed which failed to describe the true nature of the scheme under which shares could be purchased and sold.

DeMaio admits that he told brokers to sell house stock to customers that would pay the firm and the broker the highest commission. He also had his assistant manager dissuade customers from selling house stocks whenever the client's broker failed to do so. He does not contest the fact that he enforced the Buy-Sell

Formula, even though he had been told that it was a form of stock manipulation and that he had personal legal exposure for his role.

DeMaio does not controvert the Division's proposed findings that he repeatedly prevented his own clients from selling their house stocks and taking cash out of Graystone. He has admitted that he used the fraudulent "two call close" on his own customers.

DeMaio's illegal conduct continued for two years and did not end until Graystone closed its doors in December 1988. DeMaio was a proponent and enforcer of Graystone's practices involving house stocks. In September 1988, he won a special bonus for selling a special "basket" of house stocks. He also sought to open a new Graystone office in Orlando in 1988. When the owner of the Boca Raton office, Dennis Williams, broke away from Graystone in December 1988, the Boca Raton office closed and DeMaio went to another Graystone office and tried to get other brokers to stay with Graystone instead of joining Williams' new firm. DeMaio left Graystone only when it closed its doors. He concedes the willfulness of his repeated violations of the securities laws.

DeMaio implies, through his willingness to cease and desist, that he will not violate the securities laws again. But his conduct in this proceeding shows that his representations are not reliable. He did not admit that he had violated the law until after the hearing when he was faced with the overwhelming evidence against his claim of innocence. Both his answer and his amended answer filed in this proceeding were untruthful and he did not testify honestly at the hearing. Moreover, DeMaio's description

of his role as trivial, shows that he still does not view his violations of the securities laws as a serious matter.

As one of Chubb's top producers, he is currently in a position to commit further securities fraud, particularly since his immediate supervisor, Bruce Prevost, was also prominently involved in Graystone's illegal scheme. He is authorized to trade securities, and his employer, Chubb, is a broker-dealer which sells both securities and insurance products. It is the case, as DeMaio argues, this record does not reflect any complaints against him since he has worked at Chubb. But that fact does not offer assurance that there will not be violations again. In the past, DeMaio's clients often have had serious complaints about him but they were never formally submitted. DeMaio knew that his performance at Chubb would be observed by the Commission. DeMaio knew prior to beginning his employment at Chubb that he would most likely be the subject of a Commission enforcement proceeding. He had asserted his rights under the Fifth Amendment during the investigation of this case. It also reflects on DeMaio's credibility that preceding his two-year employment at Graystone, he was a broker at First Jersey Securities for two and a half years even though he knew at the time there were similar fraudulent practices there.

The only assurance there is that DeMaio will not violate the same statutory provisions is to bar him from association with any broker, dealer, municipal securities dealer, under Section 15(b)(6) of the Exchange Act. In addition, DeMaio has agreed to an order

directing him to cease and desist from committing or causing any violation and committing or causing any future violation of Sections 5 and 17(a) of the Securities Act of 1933 and 10(b) and 15(c) of the Exchange Act and Rules 10b-5, 10b-6, and 15c1-2 thereunder. The preponderance of the evidence leads to the conclusion that DeMaio be barred from the securities industry and that he be ordered to cease and desist.

DeMaio's Disgorgement of Gains from Statutory Violations

Congress has authorized the Commission to order disgorgement of funds improperly gained, including reasonable interest, in any proceeding in which a cease-and-desist order is sought. Exchange Act of 1934 §21C(e), 15 U.S.C. §78u-3(e). The Division has requested that DeMaio be ordered to disgorge his 1987 and 1988 earnings of \$430,000, plus interest from December 31, 1988 (the date on which the violations stopped). The Division requests that interest be calculated pursuant to the delinquent tax rate set by the Internal Revenue Service. See Internal Revenue Code Section 6621(a)(2), 26 U.S.C. §6621(a)(2). The Division urges that the full amount of DeMaio's 1987-88 earnings were improperly gained because approximately 65-70 percent, or \$279,500 - \$301,000, consisted of his commissions as a broker from selling house stocks to his personal clients and the remaining \$129,000 - \$150,500 was his override on the sales of house stocks by other brokers. The record indicates that DeMaio's income was tied directly to retail sales of the house stocks and that his sale of the house stocks was fraudulent. Although DeMaio also sold some mutual funds, his

income from that activity was a "tiny fraction" of his overall compensation, and yielded "minimal" revenue for the office.

DeMaio has not challenged the Division's assertion about the nature of his income and he has not put forth any evidence to show that \$430,000 is not a reasonable approximation of what he earned from illegal activities. SEC v. First City Financial Corp., 890 F.2d 1215, 1232 (D.C. Cir. 1989). The record indicates that disgorgement by DeMaio of his earnings for the period that he violated the statutes will serve to prevent unjust enrichment. Id. at 1231.

DeMaio points out that the two other respondents in this proceeding stated under oath that they were insolvent and that the Commission waived disgorgement. He represented at the hearing that he "probably" has a debt of \$80,000, and a house mortgage and car payment. The Division argues that this is not comparable to the sworn financial statements that the other respondents presented to establish insolvency before the Commission waived disgorgement for them. DeMaio did not submit a financial form and the record indicates that he may have substantial income. Harold Mette, the Regional Vice President for Chubb Life and Chubb Securities for the State of Florida testified that DeMaio was one of the top 10-15 producers at Chubb for the entire country in 1992. DeMaio does not claim that he is insolvent. In any event, DeMaio's showing is too incomplete to warrant excusing him from disgorgement. At the Division's suggestion the money to be disgorged will bear interest

at the rate of seven percent, which is the rate currently applied to delinquent taxes by the Internal Revenue Service.

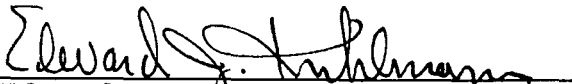
ACCORDINGLY, IT IS ORDERED pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 that DeMaio be and hereby is, barred from association with any broker, dealer or municipal securities dealer.

IT IS FURTHER ORDERED pursuant to Section 21C of the Securities Exchange Act of 1934 that DeMaio permanently cease and desist from committing or causing any violation and committing or causing any future violation of Sections 5 and 17(a) of the Securities Act of 1933 and 10(b) and 15(c) of the Securities Exchange Act of 1934 and Rules 10b-5 and 15c1-2 thereunder.

IT IS FURTHER ORDERED pursuant to Section 21C(e) of the Securities Exchange Act of 1934 that DeMaio shall disgorge \$430,000 received as a result of the conduct found in this proceeding and pay interest on that amount from December 31, 1988 at a rate of seven percent compounded annually. The amount owed will be due the first day after the order in this case becomes final.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision will become the final decision of the Commission as to any party who has not, within fifteen days after service of this initial decision, filed a petition for review pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review the decision. If the applicants

timely file a petition for review, or the Commission takes action to review, the initial decision will not become final. 4/


Edward J. Kuhlmann
Administrative Law Judge

Washington, D.C.
August 4, 1993

4/ The respondent raises various other arguments which have been considered and rejected. All proposed findings and conclusions submitted by the parties have been considered, as have their arguments. To the extent such proposals and contentions are consistent with this initial decision, they are accepted. In all cases where applicable, the demeanor of the witnesses has been considered in assessing their testimony. The conclusions reached are based upon a preponderance of the evidence.