ADMINISTRATIVE PROCEEDING
FILE NO. 3-6740

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
JOSEPH A. LUGO	:

INITIAL DECISION

May 10, 1988
Washington, D.C.

David J. Markun
Administrative Law Judge

Filed 4/10/88

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APPEARANCES: Ronald Massumi, William Kuehnle, Esqs., Washington, D.C., for the Division of Enforcement.

Gary Ettelman, Joseph V. Filippone, Esqs., Sommer, Ettelman & Schneider, Great Neck, N.Y., for the Respondent.

BEFORE: David J. Markun
Administrative Law Judge.

I. THE PROCEEDING

This public administrative proceeding was instituted by an order of the Commission dated September 29, 1986 ("Order") pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), (15 U.S.C. §78o(b)(6)), against Respondent Joseph A. Lugo ("Lugo" or "Respondent"), vice president and registered principal of First State Securities Corp., ("First State"), a Miami, Flordia broker-dealer during the relevant period.

The Order contains allegations of the Division of Enforcement ("Division") that Respondent Lugo wilfully violated the antifraud provisions of Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act of 1933 ("Securities Act") (15 U.S.C. §§77(q)(a)(1),(2),(3)) and Section 10(b) of the Exchange Act (15 U.S.C. §78j(b)) and Rule 10b-5 thereunder during the period January 1, 1980 to July 1, 1981 (the "relevant period") in the offer and sale and in the purchase and sale of the common stock of Creditbank, Inc. ("Creditbank"), a small state bank in south Miami.

The Order directed the holding of a public hearing to determine whether the Division's allegations are true, to afford Respondent the opportunity to establish any defenses, and to determine what, if any, sanctions may be appropriate in the public interest.

A twelve-day hearing was held during June and July, 1987, in Miami, Florida, and Washington, D.C., after which the parties filed proposed findings of fact, conclusions of law, and supporting briefs.

The findings and conclusions herein are based upon the record and upon the demeanor of the various witnesses. The standard of proof applied is that requiring proof by a preponderance of the evidence.[1/]

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

Respondent Lugo, while vice president and a registered principal of First State, directed a public distribution of common stock of Creditbank within the relevant period. The distribution of Creditbank stock began on May 8, 1980 and continued until on or about July 21, 1981, when First State collapsed due to financial problems.

As background to that distribution, it is necessary to set forth some of the preceding history of Creditbank.

In March of 1978 Jose Luis Calonge ("Calonge"), a Spanish-born investor, acquired Creditbank, then known as the Bank of Cutler Ridge,[2/] by purchasing all of the 31,250

1/ Steadman v. S.E.C., 450 U.S. 91, 101 S.Ct. 999 (1981).

2/ Although the name was not changed until sometime later, the bank is uniformly referred to herein as "Creditbank" for narrative simplicity.

shares of common stock for approximately 1.6 million dollars or about $51.20 per share. Calonge had earlier met Lugo, in 1977, in the course of looking for a U.S. bank to buy.

Upon acquiring Creditbank, Calonge transferred without cost 12.5% of the bank stock (3,906 shares) to Jorge DeOna ("DeOna"), to induce DeOna to serve as president of the bank and to compensate him for having served as agent in the acquisition of the bank. This left Calonge with 27,344 shares of Creditbank, acquired at a cost of 1.6 million dollars, or a per share cost to him of $58.51, which compares closely with his investigative testimony that he acquired Creditbank for $1.6 million or about 57 to 58 dollars a share. Thereafter Calonge sold half of his remaining 87.5% investment in Creditbank to two Panamanian corporations, at the "same cost" per share that he had incurred. These two Panamanian corporations, KEOPS and IBEBAFIN, had been formed by two groups of Spanish investors to enable them to participate in ownership of American banks and perhaps other investments without disclosure of the identities of the investors (stock in the Panamanian corporations was bearer stock).

A two for one stock split in August of 1978 doubled the number of shares without affecting the ownership ratios: Calonge with 27,344 shares and 43.75% of the stock; KEOPS and IBEBAFIN (together) with the same number of shares and the same percentage; and DeOna with 7,812 shares at 12.5% ownership.

This respective ownership and management of Creditbank continued until October, 1979, when Calonge bought out DeOna's interest after the two came to a parting of the ways for one reason or another. Thereafter, Calonge, with the aid and active participation of Lugo, proceeded to assert more active control of Creditbank. These steps culminated in the January 28, 1980 annual shareholders meeting at which Calonge and Lugo (voting 1000 of Calonge's shares by proxy) voted Lugo onto the board of directors, increased the number of directors, and, of most significance to the KEOPS and IBEBAFIN investors, abolished KEOPS's and IBEBAFIN's preemptive rights as shareholders. KEOPS and IBEBAFIN representatives were present at the meeting but they mostly abstained as they were powerless to affect the outcome as minority shareholders.

In or about April of 1980 Creditbank received inquiries from Florida banking authorities concerning the identities of the shareholders of KEOPS and IBEBAFIN. Those investor-shareholders were unwilling to have their identities disclosed.

The foregoing sets of circumstances were both factors that prompted the owners of KEOPS and IBEBAFIN to enter into negotiations with Calonge and Lugo for the sale of their Creditbank shares. Lugo was the principal negotiator in the ensuing negotiations, which involved numerous meetings over a period of time, held mostly in Lugo's offices.

The negotiations ultimately resulted in an agreement in May 1980 under which the 27,344 shares of Creditbank stock held by KEOPS and IBEBAFIN were transferred into First State accounts of Calonge (8,849 shares), Jose Camprubi Sala ("Camprubi") [3/] (5,625 shares), and First State's trading account (12,870 shares). [4/] It was Creditbank stock from these accounts that was the source of the stock involved in the public distribution of Creditbank shares that is the subject of this proceeding.

The compensation received for the 27,344 shares of Creditbank sold, or rather exchanged, by the KEOPS and IBEBAFIN investors consisted of portfolios comprising various over the counter stocks in which First State was a principal or the principal marketmaker, principally Asrow, Bunnington, California Leisure, and Blueboy. These OTC portfolios were placed into First State accounts of two Panamanian Corporations, TULA and TALINGO (see footnote 4 above), formed to hold such assets for the former KEOPS/IBEBAFIN investors, with the

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3/ Calonge and Camprubi were friends for over twenty years and Calonge was at times a coinvestor in Camprubi's construction enterprises. Camprubi participated in this venture primarily as a favor to Calonge.

4/ Along with the Creditbank shares the KEOPS and IBEBAFIN corporations (the record does not indicate they had any assets other than the Creditbank stock) were transferred, and the former investors therein formed new Panamanian corporations -- TULA and TALINGO -- to hold the "proceeds" from their sale of the Creditbank stock.

promise from Lugo that they were good-quality stocks that would in short order be sold off and converted into cash. These OTC securities were valued by Lugo at a total of $1.462 million, or some $53.46 per Creditbank share involved in the transaction. 5/

After the 27,344 shares of Creditbank became available on May 8, 1980, as a result of the transaction with KEOPS and IBEBAFIN, Lugo embarked upon an aggressive effort to market the stock to the public. He made numerous large sales to his own customers within the first two days of public trading, including one sale of 2,000 shares for $240,000 and eight sales of 200 or more shares for a total of $294,000. 6/

Sales of Creditbank continued thereafter until July of 1981, when First State collapsed. The price per share of the stock was $120 through June 30, 1980; thereafter, following

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5/ Respondent Lugo's contention that in fact the Creditbank shares were acquired at $120.00 per share is discussed at a later point in this decision.

6/ Major sales within the first two days of public trading included:

Ira Blum	200 shares	$ 24,000
Dr. Walter Garst	250 shares	$ 30,000
Garst Pension Plan	250 shares	$ 30,000
Dr. Salvatore Giusti	200 shares	$ 24,000
Dr. Neil J. Karlin	500 shares	$ 60,000
Portnoy Pension Fund	450 shares	$ 54,000
Dr. Thomas Rodenberg	300 shares	$ 36,000
Adolph Schuster	2,000 shares	$ 240,000
Joseph Sciortino	300 shares	$ 36,000

a 4 for 1 stock split [7/] on June 30, 1980, the share price ranged from $30 to about $32.

On the day trading in Creditbank began, Lugo sold about $0.5 million worth of the stock to Rodger W. Garrity ("Garrity"), a registered representative with Investors Financial Services, a small brokerage firm owned by Joseph Sebag, Inc. ("Sebag"), a broker-dealer in Los Angeles, California.

The evidence is clear and essentially uncontradicted that throughout the period of the public distribution of Creditbank Lugo effectively controlled the market activities of Garrity. Thus, Lugo set the initial price for the Creditbank shares sold through Sebag by instructing Garrity at what price to begin trading. Throughout the period, Garrity relied on Lugo for daily price quotations. Lugo was the only supplier of Creditbank to Sebag, and the only outlet Sebag had when Garrity needed to dispose of Creditbank stock for which he could find no other takers. Garrity's testimony on these points makes it clear that the West Coast market for Creditbank through Sebag was not in fact an independent market but merely an extension of a single market established,

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7/ This was actually a 2 for 1 split followed by a 100% stock dividend, with the result that the number of shares was quadrupled.

dominated, and controlled by Lugo. Lugo and Garrity were confederates, not competitors.

While Allen C. Ewing & Co. ("Allen C. Ewing") [8/] and a few other broker-dealer firms appeared in the pink sheets as marketmakers in Creditbank, they were in fact completely inactive, with no trades and no inventory of the stock. The record suggests that at least two of these additional "market-makers" entered the pink sheets at the request of and as an accommodation to Lugo. In any event, they were not actual marketmakers, realistically viewed, for the reasons already stated.

In sum, it is clear that throughout the period during which Creditbank stock was sold to the public, Lugo was, in Garrity's words, the "ball", i.e. it was Lugo who dominated and controlled all aspects of the market through his total control of all wholesale and retail activity.

The record establishes beyond cavil that Lugo failed to inform purchasers of Creditbank that he and First State

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8/ Lugo in fact got Richard Galione ("Galione") of Allen C. Ewing to place the initial price quote for Creditbank in the pink sheets as a favor to him by indicating to Galione that he (Lugo) was unfamiliar with the procedure and didn't have the necessary forms. The price quote Galione used was that suggested by Lugo, $110 bid and $120 asked, based upon Lugo's representation that there had been recent transactions at that price level. First State did not enter the pink sheets until somewhat later.

dominated and controlled the market in Creditbank stock and that there was in fact no free and open market in the stock. Failure to disclose the true nature of the market for Creditbank was clearly fraudulent,[9/] as charged in Section IIB 1,2,4, and 6 of the Order. In particular, with reference to Section IIB 6 of the Order, Lugo failed to disclose the "source of the Creditbank stock being offered and sold", i.e., that the Creditbank stock being offered to the public became available as a result of an insider transaction in which Lugo through First State was a major player and principal negotiator and in which the Creditbank stock had been obtained in exchange for various over-the-counter stocks in which First State was a principal or the principal marketmaker.

The record herein further establishes, conclusively, as charged in Section IIB of the Order that the Creditbank stock sold to the public was grossly overpriced, whereas Lugo represented to customers, directly or impliedly, that the price was reasonably related to the interplay of forces in a free and open market.

As already noted, from May 8 to June 30, 1980, Lugo sold Creditbank at $120 a share, and after the 4 for 1 stock

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9/ D. Earle Hensly Co., Inc., 40 S.E.C. 849, 851-52 (1961); S.T. Jackson & Co., Inc., et al., 36 S.E.C. 631, 656 (1950); Floyd A. Allen & Co., Inc., 35 S.E.C., 176, 185 (1953); Norris & Hirschberg, Inc., 21 S.E.C. 865, 882 (1946).

split on June 30, 1980, the price ranged from $30 to about $32. Thus, on an adjusted basis, the stock remained at or above its initial price throughout the 14-month period of its distribution to the public.

Financial statements filed by Creditbank with state banking regulators show a book value of about $40 per share during the period Lugo was selling the stock for $120 per share, or 3 times book value. In the months after the 4-for-1 split, the price-to-book ratio, on the basis of a $30 price per share, was never lower than 2.47, and was usually between 2.78 and 3.

The Division's two expert witnesses, Erwin Katz and Marc Perkins, each with extensive experience in the pricing and evaluation of Florida bank stocks, both testified that Creditbank stock was greatly overpriced during the relevant period. Their expert opinions were that the stock should have sold for no more than book value and probably somewhat less, in part because of its lack of liquidity. Thus, Lugo was selling the stock for at least three times its intrinsic value. They testified that there was nothing, including hypotheticals regarding growth potential or chances of being a merger target, and the like, that could justify a recommendation to buy Creditbank stock at the price Lugo sold it to the public.

The Division's expert testimony establishes that at a price equivalent to about 3 times book value, Creditbank was selling for at least triple the usual price of Florida bank stocks. And although Lugo touted Creditbank as a potential merger or acquisition candidate and suggested that investors would profit from such an event, the expert testimony establishes that bank mergers and acquisitions typically and normally occur at prices around 2 times book value. Thus the purchase price per share in any such transaction, had it come about, would still have been less than what public investors had paid for their shares.

Katz testified that in May 1980, when trading in Creditbank commenced, the average price of freely traded bank stocks in Florida was only .71 times book value, all such stocks were selling for less than book value, and all offered the investor liquidity. The average price-to-earnings ratio was less than 4 1/2. Given such comparative investment opportunities, there would be no basis to recommend Creditbank at 3 times book value and over 100 times earnings. An appropriate price for Creditbank in the public market would have been book value at most, and probably less. In June 1980, for example, the highest justifiable price would have been $40, i.e., book value. A price of $30-35 a share would have been more realistic. Moreover, the illiquidity of an investment in

Creditbank was an important factor that should have been disclosed to investors.

Perkins agreed that under no circumstances could Creditbank stock be recommended at anything approaching the prices at which Lugo priced and sold it. On the basis of his analysis he concluded that the price for Creditbank pre-split should have been between $28 and $36 dollars per share, and, post-split the price should have been between $7 and $9 per share.

Katz and Perkins were in accord that purchasers of Creditbank had little or no chance of realizing a reasonable return on their investment given the prices Creditbank was sold for.

Both experts also testified that the fact that the price of Creditbank stock, although plainly unjustified in economic terms, did not drop to an economically appropriate level, as would inevitably have occurred if free market forces had operated, is itself evidence that the market for the stock was artificial and that the price of the stock was artificially maintained, as is concluded herein, above.

Respondent did not even try to establish that the price of Creditbank was within normal parameters. Respondent's expert, Professor Arnold A. Heggestad, conceded that the price as a multiple of book value was very high relative to other banks, e.g.: "[I]t is high. I mean, no question it is high."[10/]

10/ R. 2013.

Essentially, what Respondent attempted to establish through Heggestad was not a specific justification for the $120/$30-32 price but only that the price was not per se out of line if relevant special circumstances could be shown.

When challenged repeatedly on cross-examination to provide a specific valuation in the form of a statement as to the appropriate price for Creditbank in a merger/acquisition transaction, 11/ Heggestad conceded that the price would fall in the range usual for such transactions (i.e., about 2 times book value) unless there were extraordinarily good reasons to pay more. 12/ An acquisition price of 3 times book value would demand an extraordinary justification: "[T]he average bank looking to acquire this bank * * * would be very skeptical of a price three times book. Now, if you ask me a question, might they pay that much, yes, I can see scenarios where they might, but I believe they'd be very very skeptical and their stockholders would hold their feet to the fire. They'd have to make a case." Heggestad declined to state what in his opinion would be a financially correct acquisition price for Creditbank. However, he admitted that in order to justify an

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11/ R. 2054-61. Heggestad agreed with the Division's experts that merger/acquisition price represents a premium paid for control and that the price of the stock when sold in minority blocks on the open market should be below the potential merger/acquisition price.

12/ R. 2057-58.

acquisition price outside the normal price range, "you'd expect some unique characteristics for that to occur;" and when asked, "Is there anything about Creditbank that would have made it more desirable than other small banks in Miami?" he replied that he was not aware of anything. In stark contrast to Heggestad's cautious limitation of the scope of his testimony, both of the Division's experts, on the basis of their extensive experience in bank mergers and acquisitions, concluded that the proper buyout price for Creditbank would have been no more than 2 times book value.

Ultimately, Heggestad testified that the price of Creditbank as sold to the public was so high relative to other bank stock investments that he could not have advised investors to purchase it without first obtaining an "expert analysis to prove that the Creditbank price was justified." But time and again Heggestad declined to provide that expert analysis and declined to give an opinion as to whether the price was in fact a justifiable price.

Both of the Division's experts were asked to take into account just the kinds of factors -- e.g., Creditbank's size, its location, its supposed connection to the Latin market, the existence of a prior insider transaction at $120 per share -- posited by Respondent's counsel and later by Professor Heggestad as possible "justifications." Both experts included consideration of these factors in making their valuations, and

both unreservedly stated, in light of their intimate knowledge of all aspects of the Flordia banking market, that none of such factors provided any justification whatsoever for pricing Creditbank at anywhere near the price for which Lugo sold it. Respondent shied away from asking his expert such direct questions.

In lieu of direct rebuttal on any of the principal conclusions reached by the Division's experts, Respondent offered only an oblique argument. Both experts for the Division testfied that at a price of three times book value there was litle or no likelihood that Creditbank investors could have made a reasonable return on their investments. In response to this, Professor Heggestad produced calculations to show that there was one Florida bank holding company stock that could have been purchased in 1980 at a price greater than 3 times book value and still achieved an annual return of 17% (Exchange Bank), and one other that would have yielded 17% even if bought at 2.93 times book value (Gulfstream Bank). The suggestion, of course, was that Creditbank could have done just as well.

The problem with this argument is that the extraordinary returns shown for these stocks could not have been achieved but for the fact that the companies where acquired (at least once) at significant premiums over their market prices. The kind of returns shown for Exchange and Gulfstream are only

possible due to the fact that both were at some point acquisition targets and their shareholders enjoyed the multiplying effect of the acquisitions.[13/] Using the results for these companies to suggest that Creditbank shareholders could, theoretically, have done as well is to ignore the fact that the likelihood of Creditbank shareholders enjoying comparable gains due to an acquisition was realistically out of the question.

At three times book value, the market price was so high that it exceeded the highest acquisition price that could reasonably be expected. If a bank like Creditbank were to change hands at all, it would do so at a price less than what the public shareholders paid for their stock. Moreover, because of the grossly inflated stock price, no one would have seriously considered acquiring the company in the first place. Firstly, asking shareholders to tender stock for which they paid 3 times book value in exchange for consideration worth 2 times book value (a normal acquisition price) is unrealistic. Secondly, offering more than 3 times book value

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13/ To see how crucial this fact is, as the Division argues, one need only consider that if a stock selling at half of book value (as Exchange was on 1/1/80) was bought the next day for an acquisition price of 2 times book value (an acquisition price within the normal range) the effect would be an instant fourfold gain for the shareholders.

for Creditbank when any number of comparable banks could easily be had for twice book value or less is likewise unrealistic and not to be expected. In short, Creditbank's inflated stock price practically insured that it would not be acquired.

The evidence that Lugo grossly overpriced Creditbank stock in offering it to the public is overwhelming.

Respondent Lugo contends he was justified in relying upon "recent transactions", purportedly made at $120 per share, in setting the price of Creditbank. This contention lacks merit for two basic reasons.

Firstly, I do not credit the testimony that the transactions referred to occurred at $120 a share, but, instead, have concluded, as found above, that the share transaction, at best, was at the equivalent of about $53 per share.

Calonge testified in his investigative testimony prior to the hearing herein that he paid $120 per share for his 8,849 shares of Creditbank stock acquired from KEOPS/IBEBAFIN, paid by two checks in the amount of $125,000 each and the "rest in cash" paid in the Principality of Andorra, an independent political entity at the French and Spanish border. Camprubi testified in his investigative transcript [14/] that his 5,625

14/ Neither Calonge nor Camprubi was called to testify at the hearing, nor did Lugo elect to testify, though his investigative transcript was also received, at the instance of the Division.

shares were also acquired at $120 per share, or $675,000, with payment being made in cash in Andorra. By this account, Lugo would have received the remaining 12,870 shares of Creditbank in exchange for $1.462 million in OTC stocks, at a purported valuation of $113.60 per share of Creditbank for Lugo's interest.

I do not credit this testimony. The $120 per share purported payment would have been over three times book value, as already discussed herein, and there was thus no economic justification for paying that amount. Moreover, Calonge did not need the Creditbank shares of KEOPS and IBEBAFIN, since he already had an absolute majority of the bank's stock after acquiring DeOna's 12.5% holding. Calonge testified he was being "pressured" to buy back the Creditbank stock by the KEOPS and IBEBAFIN investors, but it is difficult to find in this record any basis upon which the KEOPS and IBEBAFIN investors would have been in a position to exert the claimed "pressure". Indeed, if anything, the KEOPS and IBEBAFIN investors were under greater "pressure" to sell, since they were being told they must disclose their identities, which they were obviously unwilling to do, which fact may well account for their willingness to take OTC stocks rather than cash in payment.

Of course, it is always possible that the KEOPS and IBEBAFIN investors had knowledge of matters not discernible

from this record that would have enabled them to pressure Calonge into payment of a price of $120 per share that was clearly not warranted in economic terms. But, assuming arguendo this were established, then it would be crystal clear that the $120 per share transaction did not reflect a true market price in a free and open, continuous market, but an insider transaction influenced by extraneous, non-market-relevant circumstances that would not permit it to form a basis for Lugo's setting the price at the level at which he set it.

Secondly, since the acquisition of the KEOPS/IBEBAFIN shares of Creditbank represented an insider transaction, irrespective of what the actual price per share in the transaction may have been, this would have called for full disclosure of the circumstances of the transaction, including Lugo's key role therein as negotiator not only for First State but for Calonge and Camprubi as well, before the insider transaction price could be justified as a basis for recommending the Creditbank stock at the $120 price. But the record is clear that such disclosure was not made.

Respondent's expert witness, Professor Heggestad, testified that he would consider recent insider transactions in determining an appropriate price for Creditbank, but, on cross examination, it became abundantly clear that Heggestad, as was the case with Galione as well, had not been apprised

of the relevant circumstances, as found herein, concerning the insider transaction by which the Creditbank shares of KEOPS/IBEBAFIN were acquired.

The Division's experts, Katz and Perkins, both testified that even if Creditbank stock had been exchanged at $120 per share between insiders at the bank prior to its public trading, that could not justify its sale to the public at that price, nor a broker's recommendation to buy at that price. An isolated insider transaction is no indication of market value. Prior sales can be taken into account only when they take place in an active and continuous market, for it is only then that they may be assumed to reflect a meaningful market value, they testified. Indeed, that is why relevant case law proscribes the use of isolated insider transactions when appraising bank stocks under dissenter's-rights statutes. This expert testimony is persuasive, in accord with settled legal principles; and is credited.

For the foregoing reasons, I conclude that Respondent's reliance upon purported recent transactions in Creditbank stock at $120 a share as a basis for his setting the price at that figure is without merit.

Respondent did not disclose to customers how the $120 per share price had been arrived at (or, later, the $30-$32 price after the 4 for 1 stock split), e.g. that it was based on insider transactions, and not upon a free and open market.

Lugo did not disclose his own central role in fixing the Creditbank price per share, though he used to his advantage in terms of credibility with customers the fact that he was a director of Creditbank. Lugo failed to disclose to customers that the price of Creditbank was set on the basis of a valuation of various OTC stocks in which First State was the principal marketmaker and that it was these stocks, rather than cash, that were exchanged in order to acquire the Creditbank shares that were now being actively recommended to the public for purchse. Lugo did not disclose to purchasers that the price of Creditbank stock was 3 times book value and thus overpriced by a factor of three. Nor did Lugo disclose that even if there were an acquisition of Creditbank, the possibility of which Lugo used as a selling point, the acquisition of Creditbank would never occur at 3 times book, but at about 2 times book, if it occurred at all, since there were no factors presented in this record to warrant an acquisition price that would yield the shareholder a price that would even keep him whole, much less give him a profit. These were all material facts relating to the price at which Lugo recommended Creditbank, and the failure to disclose them and related facts as found herein relating to the source of the Creditbank stock and to the lack of any basis for pricing it at the level that Lugo priced it at constituted fraud.

The fraudulent mispricing of Creditbank stock and Lugo's domination and control of the market therein over a period of about 14 months, both found herein, are closely interrelated, and both should have been, but were not, disclosed to customers and potential customers by Lugo and his confederate. Failure to do so constituted fraud, as charged in Section IIB of the Order. See decisions cited in footnote 9 above and related text.

In making a recommendation concerning a security a broker-dealer impliedly represents that there is a reasonable basis for that recommendation and that he has no knowledge of undisclosed material adverse factors that might affect the customer's investment decision. Hanly v. S.E.C., 415 F.2d 589, 597 (2d Cir. 1969). Here Lugo failed to meet both of these tests, i.e. he had no reasonable basis for recommending the stock and he had a great deal of adverse information that he deliberately failed to disclose.

Lugo's violations of the antifraud provisions of the securities laws as found herein are by their nature of a kind that necessarily involved scienter. 15/ His manipulation and

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15/ Scienter is an element in Commission proceedings under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and under Section 17(a)(1) of the Securities Act. Sections 17(a)(2) and 17(a)(3) require only a finding of negligence. Aaron v. S.E.C., 446 U.S. 680, 689-91 (1980).

As to the mispricing element, it is significant that Lugo continued in his fraudulent activity even after Galione had cautioned him that Creditbank was grossly mispriced.

control of the market for Creditbank and his failure to disclose his gross overpricing of the stock and related material and adverse information were deliberate, knowing and intentional.

In general summary of the foregoing conclusions of law, it is concluded that within the period May 8, 1980 through July 21, 1981, Respondent Lugo wilfully violated the antifraud provisions of Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

III. THE PUBLIC INTEREST

In determining what sanctions, if any, it is appropriate to apply in the public interest, it is necessary for the Commission, among other factors, to ". . . weigh the effect of . . . action or inaction on the welfare of investors as a class and on standards of conduct in the securities business generally." 16/

The Division urges that in light of the severity of the frauds committed by Lugo, the deliberate and intentional nature of the misconduct, the injury caused to investors, and

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16/ Arthur Lipper Corporation, Securities Exchange Release No. 11773 (October 24, 1975) 8 SEC DOCKET 273, 281. Although the reviewing court in Arthur Lipper Corp. v. S.E.C., 547 F.2d 171, 184-5 (2nd Cir. 1976) reduced the Commission's sanctions on its view of the facts, it recognized that deterrence of others from violations is a legitimate purpose in the imposition of sanctions.

Respondent's prior violations, the public interest requires that he be barred from association with any broker or dealer.

Respondent contends that no sanction is warranted, on the ground that the Division has failed to carry its burden of proof on the charges.

The record discloses significant losses to Creditbank investors. As already noted, some invested rather heavily. After the collapse of First State the price of Creditbank, which had theretofore been in the (post-split) range of $30 to $32 per share, dropped dramatically and has not rebounded. Occasional open market price quotes since July 1981 have never been at more than $3 to $4 per share. There has been since July 1981 no active market for the stock. Some investors are still holding their unmarketable Creditbank stock. Others have converted their Creditbank stock for stock of the CreditbankShares holding company that has acquired Creditbank. The holding company shares received in the conversion are unmarketable, and even when a buyer can be found are worth only 12 to 15 dollars, no more than half of what the investors originally paid. Some investors were able to negotiate to have their shares repurchased by the bank, the holding company, or an officer of the holding company, but were able to recoup only $15 to $18 per share.

Since there is no market for the stock of Creditbank or of CreditbankShares holding company, investors who today still

hold such stock must be deemed, for all practical purposes, to have lost essentially all of their investment.

Even more significant than the losses to customers is the egregious nature of Lugo's violations. Both the Commission and the Courts have long recognized the corrosive, destructive effect on the public's confidence in the securities markets of deliberate manipulation and control of the market in a security and the knowing and gross mispricing of the security, and have applied stringent sanctions accordingly.

The violations found herein would alone warrant a bar. But there is more. The record indicates a significant number of prior violations by the Respondent.

On May 23, 1972 the Commission barred Lugo for one year from associating with any broker-dealer or investment adviser, after which he was permitted for the two following years to be associated with a brokerage firm only in a non-supervisory capacity. The action involved alleged stock manipulation while Lugo was employed by Executive Securities Corporation. In the Matter of Executive Securities Corporation, Administrative Proceedings File No. 3-3719.

Lugo was fined $10,000 and censured by the NASD for his alleged participation, while at First State, in the manipulation of the securities of Bunnington Corporation in 1976 and 1977. Division's Exhibit 35A (NASD decision, July 9, 1980, No. ATL-601).

In 1983 Lugo was suspended by the Commission from association with any broker-dealer for 10 days for alleged violations of Rule 10b-6 in connection with his trading in the securities of Intercontinental Diamond Corporation while he was at First State. In the Matter of Joseph Lugo, Administrative Proceedings File No. 3-6034.

The NASD sanctioned Lugo in connection with the collapse of First State, suspending him from association with any member broker-dealer for four months, barring him from association in a principal capacity with any member broker-dealer, and requiring that his conduct be subject to rigorous oversight by his then-employer, Rooney, Pace, Inc. Division's Exhibits 35 and 35B (NASD decisions, May 14, 1984 and July 31, 1985, No. ATL-670).

I conclude, based on the findings and conclusions herein, that a bar is required and fully justified in the public interest.

IV. ORDER

Accordingly, IT IS ORDERED as follows: Respondent Joseph A. Lugo is hereby barred from association with any broker or dealear.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c) determines on its own initative 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. 17/

David J. Markun
Administrative Law Judge

May 10, 1988
Washington, D.C.

17/ All proposed findings, conclusions, and supporting arguments of the parties have been considered. To the extent that the proposed findings and conclusions submitted by the parties, and the arguments made by them, are in accordance with the findings, conclusions and views stated herein they have been accepted, and to the extent they are inconsistent therewith they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the material issues presented. To the extent that the testimony of various witnesses is not in accord with the findings herein it is not credited.