ADMINISTRATIVE PROCEEDING
FILE NO. 3-5218

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
RISERS' VENTURE MANAGEMENT CO., INC.	:
(24NY-8038)	:
	:

INITIAL DECISION

June 1, 1978
Washington, D.C.

Jerome K. Soffer
Administrative Law Judge

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APPEARANCES: Edwin H. Nordlinger, Alexander Bienenstock and A. Thomas Tenenbaum, for the Division of Corporation Finance.

William H. Shames, Chief Executive Officer of Risers' Venture Management Co., Inc., Issuer.

BEFORE: Jerome K. Soffer, Administrative Law Judge

This is a proceeding pursuant to Section 3(b) of the Securities Act of 1933 (Act) and Rule 261 of the General Rules and Regulations - "Regulation A" - thereunder to determine whether to vacate or make permanent an Order issued by the Commission on August 30, 1977 (Order) temporarily suspending the exemption from registration under Regulation A of Risers' Venture Management Co., Inc. (Risers' or Issuer).

On August 16, 1976, Risers' filed a notification pursuant to Regulation A in connection with the proposed offering of 100,000 shares of its $.01 par value common stock at $5.00 per share. The offering was to be conducted on a "best efforts" basis by the Issuer through its officers and directors without the aid of an underwriter, for an offering period up to 120 days initially. Following the receipt of an extensive and detailed "comment letter" sent on August 30, 1976 by the Commission's staff with respect to the contents of the initial filing, Risers' filed an amended notification and offering circular on December 20, 1976.

No sales have ever been made under the offering.

The Order alleges that the notification, offering circular and sales literature filed by Risers' contain untrue statements of material facts and omissions of material facts in five specified respects.[1/] The Order further alleges that

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1/ These charges will be measured against the current state of the filing, i.e., the contents of the amended notification and offering circular, rather than the original, except where the original is pertinent in the interest of continuity.

the Issuer failed to amend its notification and offering circular to disclose its delinquency in meeting obligations undertaken in connection with a rescission offer, and, finally, that the offering, if made, would be in violation of Section 17 of the Securities Act.[2/]

At the request of the Issuer made pursuant to the Order, a hearing was held in New York City on January 24 and 25, 1978, at which the Division of Corporation Finance (Division) appeared by counsel and the Issuer appeared by its

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2/ Rule 261(a) of Regulation A provides, in pertinent part:

> "The Commission may, at any time after the filing of a notification, enter an order temporarily suspending the exemption, if it has reason to believe that -
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> (1) no exemption is available under this regulation for the securities purported to be offered hereunder or any of the terms or conditions of this regulation have not been complied with, including failure to file any report as required by Rule 260;
>
> (2) The notification, the offering circular or any other sales literature contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading;
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> (3) the offering is being made or would be made in violation of Section 17 of the Act."

Rule 261(c) provides:

> "The Commission may at any time after notice of and opportunity for hearing, enter an order permanently suspending the exemption for any reason upon which it could have entered a temporary suspension order under paragraph (a) of this rule. Any such order shall remain in effect until vacated by the Commission."

president, William H. Shames (Shames). Following the conclusion of the hearing, the parties submitted respective and consecutive proposed findings of fact and conclusions of law, together with supporting briefs. Additionally, the Division served a reply brief.

The Issuer

Risers', with its principal office in New York City, was incorporated in the state of Delaware on April 11, 1974. It describes itself as basically a holding company providing "venture management" consulting services on a fee basis, but primarily engaged in the opportunities afforded in the business of better health. Virtually all of its income heretofore has been from fees received for consulting services.

Sometime in May or June, 1976, Risers' purchased approximately 59.4 per cent of the outstanding common stock of Richard Nickolaus, Ltd. ("RN Ltd").[3/] This corporation owns the "Nickolaus technique" of exercise-through-dance. It operates studios where the technique is taught to the general public, and it also franchises others with rights to teach the technique. In fact, Risers' is one of its franchisees and delivers the exercise

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3/ The original purchase was for 60 shares which, after a stock split in June, 1976, amounted to 276,900 shares. Mr. Shames is listed as the owner of 10,462 shares and other Risers' officers and officials as owning 18,088 shares. It is not clear that the latter figures are included in the total of RN, Ltd owned.

programs to employees of large industrial and other business enterprises.

According to the offering circular herein, Risers' would devote most of the proceeds of the sale of the subject securities to the interest of RN Ltd. It proposes specifically to pay $150,000 therefrom for the franchise obtained from RN Ltd either directly or in the form of assumption of bonded indebtedness of RN Ltd. Risers' anticipates that the major source of its own income would be dividends derived from RN Ltd.'s profits.

Untrue Statements - the RN Ltd Convertible Notes

The first three of the five specifications of alleged untrue statements in the notification and offering circular, as alleged in the Order, have their basis in the sale by RN Ltd of some $200,000 worth of convertible notes during 1975 and continuing into 1976. These notes, as exemplified by Exhibit 3, were payable two years after sale with interest of 8 1/2 percent per annum payable quarterly, and were convertible within one year of sale into RN Ltd, common stock at the rate of one share for each $100 of indebtedness. The amended offering circular, however, states that the notes were convertible at the rate of one share for $2 of indebtedness (probably because of an intervening stock split).

The exact amount of notes sold is not clear. Records

of RN Ltd submitted to Commission staff since the preliminary investigation show that between May, 1975 and February, 1976 (all prior to Issuer's acquisition of the majority of the stock of RN Ltd), a total of 90 notes were sold to 83 individuals for a principal sum of $154,900. The amended offering circular has a balance sheet liability entry as of May 31, 1976, of $203,500 for these notes, and in a balance sheet as of August 31, 1976, the same liability is listed at $195,500. Both of these entries refer to "Note 12" which places the debt at the higher figure. However, a footnote on page 21 of the offering circular talks about a total indebtedness under the notes of $141,500.[4/]

About half of the notes sold were signed on behalf of RN Ltd by Mr. Shames as "treasurer", although he denies ever having been elected to or appointed to hold that office in the company. Prior to the acquisition of the majority stock interest by Risers', Shames served as an advisor to RN Ltd.

That no registration statement has ever been filed with respect to these securities in accordance with the provisions of Section 6 of the Act is not disputed. Hence, this lack of registration is found to be an established fact.

4/ This discrepancy is explained, to some extent, by the fact that RN Ltd exchanged some $50,000 of its convertible notes for those sold previously by a defunct affiliated company, Diet Lunch Club.

I.

The first charge with respect to these notes is Risers' alleged failure to disclose in the notification and offering circular the issuance by an affiliate (i.e. RN Ltd) of unregistered debt securities (i.e., the convertible notes) in violation of Section 5(a) of the Act, which makes such sale unlawful.

In its brief, the Division has broken down this specification into several parts. Thus, it charges severally: (a) an absence of any information concerning the sale of those notes in appropriate items in the notification; (b) that there are only "oblique" rather than complete references to the details of the sale in the amended offering circular; and (c) that nowhere is it disclosed that the sales were in violation of Section 5(a).

(a)

The notification required to be filed under Regulation A, designated "Form 1-A", contains, as pertinent hereto, two items which are to be answered. Item "9", entitled "Unregistered Securities Issued or Sold Within One Year," requires that details be given relating to "any unregistered securities issued by the issuer . . . or affiliated issuers within one year prior of this notification." (Underlining added). There is no mention made in Item "9", in either the original or amended

notifications, of the sale by RN Ltd of the convertible notes, which had all occurred within one year of the filing. Item "10", entitled "Other Present or Proposed Offerings", asks for a statement as to whether or not the issuer or any of its affiliates is offering or contemplating the offer of any securities. No mention is made in either the original or amended notification that RN Ltd would be offering its common stock to noteholders who might exercise the conversion option under the notes.

The Issuer argues that the instructions in the notification form are not clear as to who is an "affiliate" and that he acted under advice of "special counsel" when filling it out. It further contends that RN Ltd was not truly an affiliate since Risers' was not, even with a majority of stock ownership, in actual "control" of RN Ltd whose officers and supervisory officials were temperamental individuals who could neither be managed nor whose skills could be replaced.

While Mr. Shames may have felt he could not "control" the activities of those individuals, for all legal purposes and for those of this exemption application, RN Ltd was an affiliate of Risers'. Rule 251 under Regulation A defines an "affiliate" as a person controlled by or under common control with the Issuer, and Rule 405 of the General Rules under the Act defines "controlled by" and "under common control with"

as meaning the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, "whether through ownership of voting securities, by contract or otherwise." (Cf. Rule 100(c) of the General Rules).

There can be no doubt that, with Risers' owning almost 60 percent of RN Ltd voting stock, plus the fact that Mr. Richard Reininger, who ran the day-to-day affairs of RN Ltd, owned 27.8 percent of Risers' common stock, and that Mr. Shames, who ran Risers' affairs, was an advisor to a stockholder and sometimes treasurer of RN Ltd, Risers' was in control of RN Ltd for all legal and practical purposes. This is so recognized in Item "2" of the original and amended notification which names RN Ltd as an "affiliate" of Risers'.[5/] Any argument to the contrary is deemed, under the circumstances, frivolous.

Respondent further urges that the omission in the notification is not serious since the offering circular, as will be shown hereinafter, contains several references to the sale of the convertible notes by RN Ltd. However, this argument is not persuasive.

Where the notification is deficient in not supplying information called for under the various items set forth in

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5/ Mr. Shames blames this statement on his lawyers who, he asserts, acted without his authority and did not understand the true situation. This blame seems misplaced.

Form 1-A, it has been held that disclosures in the offering circular cannot be considered to cure such defects, and that it is necessary that the answer to each item of the notification be complete and accurate in itself through a full statement of the relevant facts. Jackpot Exploration Corp., 44 S.E.C. 303, 307 (1970).

Accordingly, it is found that the notification is misleading in the respects charged.

(b)

The amended (but not the original) offering circular contains financial statements which make reference in several places to the sale by RN Ltd of the convertible notes. In RN Ltd's balance sheet as at May 31, 1976, under "long term debt" is an item in the amount of $203,500, described as "notes payable, 8-1/2 percent, convertible into 101,750 shares, of common stock at $2 - note 12". This entry also appears in an August 31, 1976 balance sheet except that the amount of shares is stated to be 97,750 and the total liability to be $195,500. This latter entry is also found in a third place, namely in the consolidated balance sheet for both Risers' and RN Ltd.

The "note 12" to which all of the 3 financial statements makes reference reads as follows: "In 1975 and 1976 Richard Nickolaus Ltd. sold to individuals a total of $203,500 of 2-year convertible notes, with quarterly interest payments at 8-1/2 percent interest per year. The notes are convertible after one year from the date of the note into 101,750 shares of common stock on the basis of $2 per share". Textual references in the

offering circular recite at several places that $150,000 of the proceeds of the sale of the Risers' stock may be in the form of the promissory notes of RN Ltd.

The Division complains that these references are insufficient to acquaint one reading the offering circular of the terms and other pertinent factors relating to the sale of the convertible notes. This contention must be rejected in the face of the information contained in the circular as described above. As seen, however, this does not cure the deficiencies in Items 9 and 10 of the notification with respect thereto.

(c)

Since the filed papers do not disclose the fact that the convertible notes were not registered, it necessarily follows that the papers would also be silent as to whether a violation of Section 5(a) of the Act had occurred by virtue thereof. However, it is clear that such a violation did in fact, exist in the absence of any proof or claim by Issuer, in the face of the allegation in the Order, that the sale of these admittedly unregistered securities was exempt under any statutory provision from the registration requirements.[6/] Since disclosure was not made in the offering papers that the notes were not registered or that a concomitant violation of the registration requirements resulted therefrom, they misrepresent the situation in this respect.

6/ The burden of proving the existence of an exemption from the registration requirements falls upon the one asserting it. S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953). Hence, the burden was on the Issuer herein to assert and prove the sale was exempt; otherwise it can be assumed it was not.

II.

Further with respect to the convertible notes, the Order asserts that there was a failure to disclose in the offering circular the possible adverse impact of the convertible feature of the notes upon Risers' control of RN Ltd. The basis of this allegation is the assumption that if $203,500 of these notes were sold, the holders thereof could have within one year of purchase exercised their option to acquire shares of RN Ltd stock, for a total of 101,750 shares. This would have had the effect of reducing Risers' equity interest from 59.4 percent to 48.6 percent, with a possible loss of its control over RN Ltd.

Apart from the fact that no consideration was given as to the holding by Risers' officers individually of RN Ltd shares, it would have required a conversion by all 83 noteholders, who would then have to concur jointly with all other stockholders in a unanimous effort to disturb Risers' control. This is rather far-fetched.

As a practical matter, the eventuality foreseen by the Division could not have occurred for the reason that, as pointed out by Risers' in its brief, by the time of the filing of the original notification and offering circular on August 16, 1976, some $10,400 of noteholders representing some

5,200 possible shares had lost their eligibility to convert because more than a year had passed since their purchase. By the time the amended papers were filed on December 20, 1976, the overwhelming number of noteholders had lost their conversion rights for the same reason.

Accordingly, there was no way for Risers' to have lost its majority status as a shareholder of RN Ltd when the amended offering circular was filed. Hence, there was no untrue statement in this respect.

III.

The Order's third specification relating to the RN Ltd convertible notes is the failure of the Issuer to disclose in the offering circular the default by its affiliate in the payments required by the terms of these securities.

RN Ltd had apparently paid the quarterly interest due to the noteholders through the end of 1975, although these payments were as much as three months late. Interest due for the first quarter of 1976 was not paid to one holder (amounting to $21.25); by the end of the second quarter eight individuals holding 10 notes were not paid the interest due (amounting to $544); and by the end of the third quarter, interest due all of the noteholders (amounting to $3,298.26) was not paid. In addition, as some of the notes began to mature, RN Ltd defaulted in the payment of the principal thereof, and no further interest payments appear to have been made.

The Division contends that the fact of these defaults gave rise to the risk that RN Ltd could become bankrupt. Risers', on the other hand, minimizes this failure and points out that in other portions of the amended offering circular it is stated that RN Ltd has liabilities in excess of $800,000 a sum compared to which the defaulted interest payments were quite small.

Misrepresentation of RN Ltd Profit

One of the specifications in the Order refers to an "unqualified statement in the offering circular that an affiliate's profit for a certain period was $172,252.82 when $150,000 of such figure represents extraordinary income."

The statement complained of is found on page 1 of the amended offering circular in preliminary text material purporting to be descriptive of "The Company" (Risers'), and in full context, reads as follows:

> "Risers' has recently purchased 60% ownership and control (50.3% fully diluted) of Richard Nickolaus, Ltd. (RN Ltd) from its founder/artist Richard Nickolaus. From March, 1975 until May 31, 1976, the 14 months before Risers' acquired it, Richard Nickolaus, Ltd. showed a loss of $604,373.70. Risers' became consultant to Richard Nickolaus, Ltd. in August of 1975. In May, 1976, Risers' purchased 60 shares (276,900 after the stock split-up) of Richard Nickolaus, Ltd. from Richard Nickolaus. (See Certain Transactions p. 36). In the period since its acquisition by Risers' and until August 31, 1976, Richard Nickolaus, Ltd. has shown a profit of $172,525.82. (See Financial Statements, p. 42). It is intended that Richard Nickolaus, Ltd. be a major source of income to Risers' by way of dividends. Risers', however, expressly disclaims assurance of profitability." (underlining added).

The Financial Statements referred to consist of balance sheets and profits and loss statements for Risers' and RN Ltd,

respectively, and consolidated statements for both corporations. They treat the item of $150,000 complained of as "extraordinary income". Thus, the RN Ltd income statement for the period June to August 31, 1976 discloses a claimed net profit from operations of $22,525.82 and "Extraordinary Income - Sale of License to Parent Company Risers' Venture Management Inc. for new Market Applications of the Nickolaus Technique - $150,000.00" for a total Net Income for the Period of $172,525.82.

Other financial documents show that the sale of the franchise was not represented by the payment of any money from Risers' to RN Ltd.[7/] In fact, the consolidated income statement for the two corporations eliminates the item of extraordinary income, as it quite should, and shows a combined net loss for the period of $59,066.88.

The Division contends that the recital in the text that RN Ltd earned a net profit of $172,525.82 during the three-month period stated should have been qualified at that point in the circular by further statements that (a) $150,000 thereof represented extraordinary income and (b) both corporations suffered a combined net loss during the same period of over $59,000. Otherwise, it is argued the circular

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7/ The RN Ltd balance sheet as at August 31, 1976 shows that this sum is owed it by Risers', and Risers' balance sheet as of that date shows the sum to be due and owning to RN Ltd. Further, Risers' indicated that $150,000 of the proceeds of the funds to be realized from the sale of the shares involved in this issue would be used to pay RN Ltd. for the license.

is misleading in its present form.

Respondent, on the other hand, urges that the nature of the transaction is properly set forth in the financial statements and that, in combination with other statements in the narrative text, prospective investors are fully and adequately advised of the true financial situation. Thus, it points to statements in the introductory portion of the circular to the effect that from the date of its formation until the second quarter of 1976 Risers' did not have a profit from operations; that as of August 31, 1976 the combined operation of Risers' and RN Ltd was technically insolvent because liabilities exceeded assets and there was an inability to pay expenses as they become due; and that on said date the company had a combined deficit of $262,020.52, which would have amounted to $622,829.57 if additional expenses had not been capitalized. These statements are followed by one giving no assurance that Risers' would be able to operate on profitable basis or to meet its obligations as they became due in the future. There are other places in the offering circular to the effect that there may be competition for the business activities engaged in by Nickolaus, that sales efforts may not be successful, that purchasers of the shares faced the risk of losing their entire investment, that there is no present market for the company stock or any assurance that any would develop in the future, and that there may be later

difficulty in disposing of the stock by any purchaser thereof.

The conclusion is inescapable that, whether intended to or not, the statement in the offering circular quoted above misstates the fact of actual profitability of RN Ltd, and that, without appropriate qualifying language, would mislead a prospective purchaser of the Risers' stock as to the financial future for Risers' and its affiliate, the ultimate recipient of the bulk of the moneys to be raised and intended to be "a major source of income to Risers' by way of dividends".

The true net profits for the period stated should not include the $150,000 commitment by Risers' to RN Ltd, since all that is involved is a bookkeeping transaction between affiliates. This is so recognized in the consolidated financial statements.[8/] However, by failing to similarly qualify the quoted statement, a patent misrepresentation occurs.

The way the offering circular is structured now, the impression is conveyed that despite all that is said concerning the poor financial track record of RN Ltd - being "technically insolvent", having large capital deficiencies, suffering large operating losses, the bleak future for the operation, etc. - just look what happened after Risers' venture became a consultant and then majority stockholder. Why (it would seem

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8/ Transactions should be accounted for a manner which follows substance rather than legal form. Major Realty Corp., 40 S.E.C. 535, 537 (1971).

to say), in just a few months a loss of over $604,000 by RN Ltd was turned around into a profit in excess of $173,000. By failing to disclose at this very point in the recital that this was an inflated figure, a false picture is painted as to the salutary effect that Risers' management and ownership has had on RN Ltd's previously poor profitability and suggest a future of continued profits. This statement, in the context that it appears, has the effect of derogating all the other cautionary advisories in the offering circular and hence is misleading. Income Estates of America, Inc. 2 SEC 434 (1937).

Misrepresentation in Sales Material

Both the original and amended offering circulars state that Risers' publishes a bi-monthly newsletter entitled "The Marketplace Column" which "includes facts and opinions about new products and services" and which is sent without charge to the company's mailing list of approximately 1,200 industrialists and other people in the financial community to inform them of the activities of the Company. Advertising income is received, but neither the income nor expense is said to be significant.

Following the filing of the original offering circular, attorneys for the Issuer advised the Division that those to whom the publication was circulated would be those who might

purchase the Risers' stock, and further, that it was the Issuer's intention to send the publication in conjunction with offering circulars. Upon the Division's request two issues (July-August 1976 and September-December 1976) were filed with the amended Circular as proposed sales literature in accordance with Rule 258.

Both of the Risers' newsletters prominently feature the business and related activities of RN Ltd together with the fact that Risers' had acquired a controlling interest therein and a license to use the Nickolaus technique.

The basis for the charge of misrepresentation arises from a purported advertisement by a corporation named "Harford-West Associates, Inc.", found in both publications, which is described as a specialist in structural enclosures, among other listed activities. Conspicuous in these advertisements is the appearance of the distinctive Risers' logo (a modernistic upward trusting arrow) with the inscription: "a Risers' Company".[9/]

The Division contends that the proffered sales literature contains a material misrepresentation in that the Risers' references connote that Harford-West is an affiliate or a subsidiary of Risers' when in truth and in fact it is not.

9/ Mr. Shames and an office associate prepared the copy for the advertisements.

Admittedly, Harford-West is not an affiliate of Risers', nor is it so named in Item 2 of the notification, which calls for a description of affiliates. There is no common ownership, directors or officers.

Mr. Shames, on the other hand, disputes the interpretation placed on the use of the logo and the phrase "a Risers' Company", and argues that such use was justified by other factors. These include that he had been called upon by the incorporators of Harford-West for advice in marketing various products and inventions, that there was some discussion between them and a public relations firm with respect to setting up common ownership among the three of them (which never came to fruition), and that he had arranged for Harford-West to obtain, from an individual who was also involved with the financing of Risers', a loan of $25,000 (for which he received a finders fee of $1,250 which he thinks was also meant to include the charge for advertising in the newsletter).[10/]

Finally, the Issuer asserts that the newsletters were not, in fact, intended as sales literature and that it was a mistake for its attorneys to have so submitted them to the Commission.

10/ Risers' brief set forth other purported grounds of affiliation which do not merit further consideration, such as an allegation that Mr. Shames must have been "nominally" chairman of Harford-West's board of directors since he was once introduced as such to a retired admiral, or that since Harford-West was "an engineering - or new products-oriented new venture," it deserved "in context" to be called "A Risers' Company." This reasoning makes no sense.

It is clear that "The Marketplace Column" newsletter attempted to puff up the status of Risers" (its brief stated that its purpose was to "obliquely notify the mailing list that Shames was back in business") by conveying the meaning that Harford-West was affiliated with it as a subsidiary. The whole tone of the publication - its playing up of the business of RN Ltd and Risers' majority control thereof, for example, -- is to enhance Risers' image to those on its mailing list. In that context, a gratuitous advertisement of a new venture, which is characterized as a "Risers' Company", and the use of the Risers' logo could have only one meaning -- that Harford-West was an affiliate.

The conclusion is also justified that these publications were intended as sales material and would have the effect of influencing readers thereof to acquire the stock of Risers'. This, of course, was so recognized by the Issuer's attorneys who filed them on that basis. In a similar situation found in Thomas C. Bennett, Jr., et al., 43 S.E.C. 75 (1966), wherein it appeared that six days after the filing of the notification for an exemption under Regulation A the issuer sent a letter, described as an "interim report" describing its earnings, to its stockholders and to a number of broker-dealers, it was held that the letter was "sales material" within the meaning of Rule 258 in view of the fact that it was distributed at a time when a public offering of the issuer's stock pursuant to Regulation A was clearly in mind and the letter would have had a

tendency to make purchase of the issuer's stock attractive to existing or potential stockholders.

Finally, the belated contention that Risers' attorneys were without authority to file the publications as sales material at a time when they were in negotiation with Commission staff members concerning the filings is totally without merit.

Hence, it is concluded that the described publication were "sales materials" within the meaning of the Rule, and that they contained misleading statements that Harford-West was an affiliate of the Issuer, when in fact it was not. 11/

Failure to Amend Notification and Offering Circular

Item 9(a) of the original notification shows that in May and June, 1976, Risers' sold $36,000 of its common stock to seven investors under a claim that such sales were exempt from the registration requirements of the Act. When the Commission's staff challenged the claim of exemption, Risers' offered to rescind the sale and made mention of this in its amended notification and offering circular.

Two of the seven investors representing $8,000 worth of stock accepted the written rescission offer and received 90-day promissory notes in payment. A $3,000 payment due on

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11/ It is noted that the advertisements contained other misleading impressions, such as the length of time that Harford-West was in business, as well as in depicting the products made by that company. However, since these matters were not cited in the Order, they will not be considered as calling for a finding in this respect.

March 8, 1977 was not paid until April 11, 1977. The $5,000 note due on March 13, 1977 was not paid on that date, but $3,000 was paid in early summer of 1977, and the balance remains unpaid.

The Division contends that Issuer should have further amended its offering circular and notification to disclose its delinquencies in making payment on the 90-day notes issued pursuant to its rescission offer. It cites in support of this contention the provisions of Rule 256(e) of Regulation A which, after providing for the filing of an amended offering circular if the offering is not completed within 9 months from the date of the offering circular, states that

> In no event shall an offering circular be used which is false or misleading in the light of the circumstances then existing.

The Division argues that since the amended offering circular could have been used at least until its temporary suspension on August 30, 1977, the failure to so amend violated this rule.

On this theory, perhaps the circular should also have been amended to show that Risers' and Mr. Shames had transferred back to Nickolaus all of their stockholdings in RN Ltd,[12/] or that on March 31, 1977, Risers' made an oral offer to Commission staff to withdraw its filing, but then declined to

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12/ Risers' contends that it and RN Ltd had severed all relations by the summer of 1977.

do so when advised that such withdrawal would not affect any other Commission action that might be taken arising out of the transactions.

In any event, in the opinion of the Administrative Law Judge, there was no violation of Rule 256(e) because the amended offering circular was never "used" in connection with any sale of the Risers' stock since none was sold after the filing. The offering circular was never furnished or distributed to any prospective purchaser or anyone else, and further amendment for any reason would have been superfluous. The Rule does not say "could be used", but merely "shall . . . be used".[13/] In Robert Manufacturing Corporation, SEA Rel. No. 5489 (April 30, 1974), 4 SEC Docket 222, fn. 6, it was pointed out that corrective written amendments to the offering circular are essential under Rule 256(e) if the issuer intends to go forward with the offering Risers' did not go forward.

Violation of Section 17

Rule 261(a) under Regulation A provides for the suspension of the exemption where the offering would be conducted in violation of Section 17 of the Act, the so-called antifraud

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13/ In its brief, the Division argues that since the circular became a public record upon its filing and available for inspection by prospective investors, Rule 245(e) requires that it be amended when necessary to make it current. This would be true if sales were ever commenced without further distribution. Since no sales were ever attempted, the filing did not constitute a "use" in connection with a sale of the stock.

section.[14/]

The Division contends that because of the misrepresentations and omissions in the offering circular, an essential selling document, any sale attempted of the securities involved herein would necessarily be in violation of Section 17(a) and hence subject to suspension.

However, to the extent that there were material misrepresentations and omissions sufficient to constitute a violation of Section 17, they would also constitute grounds for suspension of the exemption under Rule 261(a)(2). Hence, any consideration of the effect of these violations under Section 17(a) would be redundant.

14/ Section 17(a) of the Securities Act of 1933, as amended, provides:

> "It shall be unlawful for any person in the offer or sale of any security by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly --
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, or
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> (3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser."

DISCUSSION AND CONCLUSIONS

As seen, the notification, offering circular and related sales material filed by respondent in connection with its proposed offering pursuant to Regulation A contained misrepresentations and omissions to the extent heretofore indicated. The issue remains as to whether any of them were "material", since Rule 261(a)(2) requires a suspension of the exemption with respect to the making of an untrue statement of "a material fact", or the omission to state "a material fact" necessary to make the statements not misleading.

Although materiality has been defined differently in different contexts, all of these definitions are grounded on the legitimate expectations of the reasonable investor. Thus, Rule 405 under the Act, relating to the registration of securities, states that:

> The term "material" when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered. (underlining added).

This standard of materiality for information in a registration statement has been adopted in a number of court and Commission cases.

Thus, in S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), cert. den. 394 U.S. 976 (1969), the Court of Appeals defined a material fact as information to

which a reasonable man would attach importance in determining his choice of action in the transaction in question. In Affiliated Ute Citizens v. U.S., 406 U.S. 128, 153 (1972), the Supreme Court defined a material fact as one which "a reasonable investor might have considered important" in the making of an investment decision. The Commission, in Investors Management Co., 44 S.E.C. 633, 642 (1971), defines a material fact as one of such importance that it could be expected to affect the judgment of investors whether to buy, sell or hold a security.

The definition of "material fact" as applicable to registration of securities, and as adopted in the cases cited, should be adopted in connection with filings for exemption under Regulation A because of the similarity of purpose, i.e., to furnish prospective investors with appropriate information upon which to make an investment decision.

In the light of the basic circumstances surrounding the proposed sale of Risers' securities, it is quite clear that the misrepresentations and omissions heretofore found are "material". The offering circular lays great importance on the role that the acquisition of majority ownership of RN Ltd was expected to play on the profitability of Risers'. In fact, it appears therefrom that virtually the sole source of income would be from this association, and from the profits to be derived by way of dividends and the use of the license to operate the Nickolaus technique. Hence, factors affecting RN Ltd would be of equal importance to prospective

investors as those affecting Risers'.

The failure to disclose in Item 9 of the notification the issuance by RN Ltd of the convertible notes and in Item 10 that RN Ltd stock might have to be issued to converting noteholders is a direct violations of the express requirements of the Commission's filing Rules respecting exemptions under Regulation A and hence is "material". As stated, this is not cured by statements found in the offering circular. The availability of the exemption is determined from the information supplied in the notification. Thus, had the Issuer supplied the information called for, it would have become clear that since the amount of debt securities issued by the affiliate when added to the planned offering by Risers' would have exceeded the $500,000 ceiling found in Rule 254, the exemption would have been unavailable. Complete information as called for in Form 1-A is mandatory.

The failure to disclose that the convertible notes of RN Ltd were (a) unregistered and (b) sold in violation of Section 5(a) of the Act is significant because it exposed RN Ltd, a financially unstable company, to the added liability to noteholders for the immediate return of their investment plus interest under Section 12 of the Act. This constituted a "material" omission.

The failure to disclose in the offering circular that RN Ltd had defaulted in the payment of interest and principal

due under the convertible notes was material since it would make known to prospective purchasers of Risers' stock that the virtual sole source of income was in further financial difficulty and unable to meet current obligations when due (and hence, bordering on bankruptcy).

The failure to qualify the statement in the offering circular to show that the claimed profit of over $172,000 following a period of high deficits included $150,000 of extraordinary "income" is material because of the heretofore described distorted picture that is otherwise painted as to earnings.

The statement in the "Marketplace Letter" unjustifiably describing Harford-West as "A Risers' Company" is material to prospective purchasers of the stock since, in context, it is an attempt to endow Risers' with the appearance of owning more than one subsidiary company.

While there were several other allegations of misrepresentations and omissions which have not been proven, those enumerated, taken individually or together, constitute the kind of information about which a prospective investor ought to be appraised in arriving at a decision to purchase the stock involved.

The foregoing misrepresentations and omissions having been found, the questions remains as to whether they require

that the temporary suspension be made permanent pursuant to the provisions of Rule 261(c).

Respondent urges that rather than making the suspension permanent, it be permitted to withdraw the proposed offering. This would avoid some of the consequences which would flow from a permanent suspension, such as under Section 252(c)(2) denying availability of the Registration A exemption for five years thereafter.

In support of this contention, respondent argues that Risers' was never made aware of an obligation to further amend the amended offering circular; that there was never any intention wilfully to mislead or deceive anyone, or to cause individuals to invest their money under misrepresentations of fact; that it relied upon counsel; that disclosure was attempted of the true financial situation of the parties; and that the purposes of the Regulation A exemption (i.e., to assist small business in raising capital) would best be served by not making the suspension permanent.[15/]

Contrary to the contention of the issuer, it is not entitled to a notice of the deficiencies as a matter of right. International Aerospace Associates, Inc., 44 SEC 432,

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15/ These arguments are in addition to those urging that there there were, in fact, no material misrepresentations or omissions, and that there were adequate and sufficient disclosures, arguments which have hereinbefore been disposed of.

435 (1970); and Jackpot Exploration Corp., supra, at p. 308. Having sent one very long and detailed comment letter which resulted in an amended filing containing the deficiencies found hereinabove, the Division was under no obligation to send further advisories when the first one had not been fully complied with.[16/]

The claimed lack of intent to deceive on the part of Issuer and, particularly, of Mr. Shames, is not a factor in the ultimate determination as to whether the exemption should be suspended. The Commission has heretofore stated, in Blue Star Productions, Inc., 43 S.E.C. 4, 6 (1966), that

> The mere assertion that such deficiencies (in the notification and offering circular) were inadvertent and did not result from malice provides no basis for vacating the permanent suspension.

As further stated with respect to the suspension of a Regulation A exemption, in Robert Manufacturing Corporation, supra, at page 223:

> Robert's intentions and those of its president seem to have been good. Like the administrative law judge, we find nothing in the record to suggest an intent to deceive. However, our concern here is not with the purity of the issuer's motives but with the accuracy of its filing. (Underlining added)

16/ While it is stated in Section 202.3 of the Code of Federal Regulations (17 CFR 202.3) that "the usual practice is to bring the deficiency to the attention" of the issuer, that Section further provides that "this informal procedure is not generally employed where the deficiencies appear to stem from careless disregard of the statutes and rules or a deliberate attempt to conceal or mislead or where the Commission deems formal proceedings necessary in the public interest".

As pointed out in Tabby's Inernational, Inc. v. S.E.C., 479 F.2d 1080, 1082-3 (C.A. 5, 1973), the exemption provided by Regulation A is a conditional one based upon strict compliance with express provisions and standards, and its suspension is appropriate where they are not met, even though the issuer was not directly responsible for the misleading contents in the offering circular.

The Commission has frequently asserted the standard applicable in proceedings of this type to be whether the filing exhibits a lack of "careful and honest preparation". Thus, as was stated in Blue Star Productions, Inc., supra, at page 6.

> As we stated in General Automation, Inc. (41 SEC 228) in considering the propriety of an amendment of the filings after the issuance of a temporary suspension order, 'we have emphasized that a careful and honest preparation is an absolute prerequisite to the exercise of our discretion in the area. We cannot countenance a practice of deliberate or even irresponsible submission of inadequate material by permitting the correction of deficiencies found by our staff in the examination of such material'.

See, also, Thomas C. Bennett, Jr., 43 SEC 75 (1966) in which neither withdrawal nor amendment was permitted where the filing did not exhibit such "careful and honest preparation", and International Aerospace Associates, Inc., 44 S.E.C. 432 (1970).

In this case, Risers' failure to make the disclosures called for in Items 9 and 10 of the notification, the misleading way it portrayed the net income of RN Ltd, the failure to disclose the sale by RN Ltd of unregistered securities and its

default in meeting its obligations thereunder, and the unwarranted puffery in "The Marketplace Letter" relating to Harford-West, all reflect a lack of "a diligent and careful effort to present an adequate and accurate filing" and do not justify in the exercise of discretion, the withdrawal of the papers filed under the exemption. This is so even though there have been no sales of stock to the public and no use made of the offering circular. See Jackpot Exploration Corp., supra, at pages 307 and 308.

In view of the number and nature of the deficiencies in the papers filed, it is concluded that a permanent suspension is required to protect the public interest.

Although the suspension of the exemption may have collateral consequences for the issuer, it must be emphasized, as was recognized in Tabby's International, Inc. v. S.E.C., supra, that a suspension is not a sanction or a penalty, but rather serves the remedial purpose of protecting investors by making the safeguards of a registration statement under the Act a pre-requisite for any further public offering of securities by the Issuer. In any event, the Issuer may seek relief from these consequences under Rule 252(f).[17/]

17/ In their briefs and arguments, the parties have requested the Administrative Law Judge to make findings of fact and have advanced arguments in support of their respective positions other than those heretofore set forth. All such arguments and expressions of position not specifically discussed herein have been fully considered and the Judge concludes they are without merit, or that further discussion is unnecessary in view of the findings herein.

Accordingly, IT IS ORDERED pursuant to Rule 261 of the General Rules and Regulations under the Act that the exemption from registration with respect to the offering of securities by Risers' Venture Management Company, Inc., be permanently suspended.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen 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 initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Jerome K. Soffer
Administrative Law Judge

Washington, D.C.
June 1, 1978