ADMINISTRATIVE PROCEEDING
FILE NO. 3-5226

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

DELGER CORPORATION
8-9914
CAPITAL PLANNING SECURITIES
COMPANY, INC.
8-16856
THOMAS A. SARTAIN, SR.

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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Washington, D.C.

September 1, 1978

Ralph Hunter Tracy
Administrative Law Judge

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APPEARANCES: Leroy V. Amen and Catherine A. Gallagher of the San Francisco Branch Office for the Division of Enforcement.

Robert D. Carrow of Carrow & Forest for Thomas A. Sartain, Sr.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by Commission order (Order) dated May 31, 1977, pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 (Exchange Act), to determine whether the above named respondents[1/] committed various charged violations of the Securities Act of 1933 (Securities Act) and the Exchange Act and regulations thereunder, as alleged by the Division of Enforcement (Division), and the remedial action, if any, that might be appropriate in the public interest.

The Order alleges, in substance, that the remaining respondent in this proceeding, Thomas A. Sartain, Sr., (Sartain), directly and indirectly, singly and in concert, willfully violated and willfully aided and abetted violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

The Order included allegations that on July 6, 1976, the United States District Court for the Northern District of California had entered a consent decree permanently enjoining Sartain from violating the federal securities laws;

1/ The Commission has accepted an offer of settlement from Delger Corporation and has issued its finding and order imposing remedial sanctions in Exchange Act Release No. 13579/May 31, 1977. Capital Planning Securities Company, Inc., failed to answer the Order for Proceeding and the Commission found it in default and revoked its registration as a broker-dealer, Exchange Act Release No. 13815/August 1, 1977.

and that by order dated July 15, 1976 (Exchange Act Release No. 12607 and 12607A) the Commission had affirmed an NASD decision censuring Sartain and barring him from association with any NASD member in any capacity (this is presently on appeal to the Ninth Circuit). In addition, the Order was amended at the commencement of the hearing to include the further charge that on January 13, 1978, the Superior Court for the State of Alaska preliminarily enjoined Sartain from violating the Alaska real estate and securities laws.

Sartain was represented by counsel throughout the proceedings and proposed findings of fact and conclusions of law were filed by both parties. The Division also filed a brief in support.

The findings and conclusions herein are based upon clear and convincing evidence as determined from the record and upon observation of the witnesses.

The findings herein are applicable only to Sartain and are not binding on any of the other respondents named in the Order.

FINDING OF FACT AND LAW

Respondent

Thomas A. Sartain, Sr., (Sartain) was born on November 29, 1938. He has had two years of college. From 1961 to 1967 he was employed as a salesman and training supervisor with various

insurance companies, including Mutual Benefit Life, Washington National Life and Prudential. From 1967 to 1969 he was a registered representative with American Investors Co., selling mutual funds. In 1969 he was instrumental in organizing Capital Planning Associates (CPA) and since then has been active in running it and a number of subsidiaries engaged in various activities including the sale of securities and limited partnership interests, tax shelter programs, real estate investment trusts and property management.

Injunctions Chargeable to Respondent

Section 15(b)(6) of the Exchange Act provides that one of the bases for barring a person from association with a broker-dealer or the imposition of lesser sanctions is the existence of a described injunction issued by a court of competent jurisdiction.[2]

2/ Section 15(b)(6) provides as follows:

> "(6) The Commission, by order, shall censure or place limitations on the activities or functions of any person associated, or seeking to become associated, with a broker dealer, or suspend for a period not exceeding twelve months or bar any such person from being associated with a broker or dealer, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in subparagraph (A), (D), or (E) of paragraph (4) of this subsection,
>
> * * * *
>
> or is enjoined from any action, conduct, or practice specified in subparagraph (C) of said paragraph (4)." CONTINUED

The Order alleges, and the record establishes, that on June 28, 1976, the U.S. District Court for the Northern District of California, permanently enjoined Sartain from violations of the federal securities laws;[3/] and that on January 13, 1978, the Superior Court for the Third Judicial District at Anchorage, Alaska, preliminarily enjoined Sartain from violating the Alaska real estate and securities laws.

2/ CONTINUED
Subparagraph (C) provides that:
(C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, or municipal securities dealer, or as as affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security."

3/ The Amended Order for Proceedings shows the judgment of permanent injunction as entered on July 6, 1976 while the copy of the judgment received in evidence in this proceeding shows the date as June 28, 1976.

Background

Capital Planning Associates (CPA) was incorporated in California in 1969 by Sartain, James D. Lang (Lang) and Michael J. Scotto (Scotto). Sartain owned 32% of CPA's stock and became its president and a director. In addition to Sartain, Lang and Scotto, the founders, Michael M. Manning (Manning), a certified public accountant performed accounting and tax services for CPA and its subsidiaries, and L.G. vonSchottenstein, an attorney, provided legal services for CPA and its subsidiaries and was a director of CPA.

Beginning with CPA, which was a holding company, Sartain developed a corporate web or complex of companies, each designed to perform a special service in the overall business of issuing and selling investments to the public.

In May 1970, a wholly-owned subsidiary of CPA was formed. This was California West Properties (Cal-West) which was managed by Scotto and Sartain with Sartain being the treasurer. Cal-West was the CPA subsidiary which was to specialize in the acquisition and management of real property. It also functioned as the real estate broker for National Real Estate Trust (NREF) and furnished advice to the trustees of NREF. For these services Cal-West received a fee from CPA and NREF.

NREF was established in October 1970 as a real estate investment trust (Reit) under the sponsorship of CPA with Sartain, Lang and vonSchottenstein serving as trustees and investment advisers. Between July 1, 1971 and December 31, 1973, NREF, also known as the Fund, sold 1,902,302 shares of common stock for $10 each for a total amount of $19,023,020. 4/ According to the prospectus the proceeds were to be used to purchase income producing properties for the shareholders. Cal-West was to manage NREF's wholly-owned properties. In addition, NREF invested in a number of limited partnerships with CPA, or an affiliate, as the general partner (See below). Some of these limited partnership properties were also to be managed by Cal-West.

The firm which acted as managing underwriter for the sale of almost all of these 1,902,302 shares was Capital Planning Securities, Inc. (CPS), another wholly-owned subsidiary of CPA. CPS was registered with the Commission as a broker-dealer effective February 15, 1972, and continued to function as a broker-dealer until sometime in 1974 when it became dormant. The directors of CPS were Sartain, Lang and George Bell (Bell) with Lang acting as

4/ These securities were not registered with the Commission; reliance was placed on the exemption provided by Section 3(a)(11) of the Securities Act, the intra-state offering exemption.

president. Sartain was a salesman with CPS. Both CPA and CPS sold NREF stock and limited partnership interests in real estate partnerships to the public.

In November 1973, CPA purchased a controlling interest in Delger Financial Corporation (formerly Delger Insurance) and its wholly-owned subsidiary, Delger Corporation (Delger), both Utah corporations. Delger is a broker-dealer, incorporated in August 1961 and registered with the Commission as a broker-dealer. Delger was the successor to CPS and was used by Sartain to sell limited partnership interests. Delger Financial was purchased by Sartain, Scotto and Lang in May 1975.

Beginning in October 1971 and continuing through until December 1974, CPA and Cal-West formed a series of approximately 45 real estate partnerships which sold limited partnership interests to the public.[5/] CPA, Cal-West, NREF or Sartain, or a combination of them, were the general partner in each of the limited partnership offerings which were made through CPA and CPS. The funds used to finance the general partners participation in these offerings apparently came out of the proceeds of the NREF offerings.

5/ None of these limited partnership offerings were registered with the Commission.

Section 5 Violations

The Order charges that Sartain, and the other respondents, willfully violated and willfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act by effecting transactions in a series of limited partnership offerings when no registration statement was filed or in effect with respect to such securities.

From October 1971 through December 1974, CPA formed 45 limited partnerships, 4 in 1971, 20 in 1972, 17 in 1973, and 4 in 1974. Most of the partnerships were formed during the last three months of the year. The general partners were CPA, Cal-West, and/or Sartain. CPA was the general partner of 29 partnerships; Cal-West was the general partner of 8 partnerships; and Sartain and CPA were the co-general partners of 8 partnerships.

Most of the partnerships had two types of partnership interests, the "A" side and the "B" side. The "A" side was usually the general partner and it received a preference as to income while the "B" side which was the limited partner, or public investor, received the so-called"tax shelter" benefits. In 37 of the CPA partnerships NREF was the "A" side investor and the "B" side investors were members of the general public. In 6 of the remaining partnerships there was one class of limited partners consisting of public investors.

The number of investors in the limited partnerships ranged from 3 to 25, with 35 partnerships having 9 or more investors and 5 partnerships having 19 or more investors. The largest single capital investment was $890,000 and the smallest was $ 50,000 with most of the partnerships being between $200,000 and $400,000.

A total of over $13 million was invested in limited partnership interests of which more than $6 million was invested by NREF as the "A" side partner. Most of the limited partnership interests were sold within a 16 month period from September 1972 through December 1973, when 35 interests were sold. Interests in more than one limited partnership were often being offered simultaneously, for example, the offering circulars for Portland and Sundale are both dated December 14, 1972, while those for Clearlake and Delta Hawaii Mobile are both dated October 23, 1973.

No registration statement was filed or was in effect with the Commission for any of the 45 limited partnership offerings. In the 37 limited partnerships where NREF purchased the "A" side, the "B" side interests were purchased by approximately 343 persons. While most of these investors resided in California 63, or 19%, resided outside the state. In addition, at least 4 of the partnership properties were located outside of California.

Sartain made no claim during the course of the proceeding that the limited partnership interests herein are not a security nor did he offer any evidence to support a claim of exemption from registration.

In his proposed findings of fact and conclusions of law filed after the evidentiary hearing he simply states that the limited partnership interests here involved were not securities as defined under the federal law; that they were exempt from registration under the federal law; and that they were not offered for sale as part of an integrated offering. Sartain offers no basis for these statements by way of evidentiary proof, legal argument, case or statutory authority.

It has long been settled that limited partnership interests, such as those herein, are a security within Section 2(1) of the Securities Act which defines the term "security" broadly to include an "investment contract". Securities and Exchange Commission v. W.J. Howey Co., 328 U.S. 293,299 (1946).

Typical of the offering circulars used in the sales of the limited partnership interests is the one for Contempo/Spokane Investors, dated September 13, 1973. On the first page of the Offering Circular it is stated:

> This Security has not been registered with the Securities and Exchange Commission under the Securities Act of 1933, as amended, nor qualified under the California Corporate Securities Law, the California Real Estate Syndicate Act or Securities Laws of other States.

Nothing further is said concerning any claimed exemption until Exhibit "A" of the Offering Circular which is a Subscription Agreement and Power of Attorney, where, in paragraph 8 it is stated:

I understand that the Units are being sold under the exemption provided by Section 4(2) of the Securities Act of 1933, by Section 25102(f) of the California Corporations Code, by Section 10261 of the California Business and Professions Code (the "Private Offering" exemption) and by the "Private Offering" exemption of Securities Laws of other States and I agree that a legend may be placed on the Certificate (s) representing my Limited Partnership interest to reflect the substance of this agreement.

The elements of a prima facia case for violation of the registration provisions of the securities laws have been stated to be:

"The establishment of a prima facie case . . . for the alleged violations of Section 5 require (s) that the Commission prove three essential elements: (1) no registration statement was in effect as to the securities; (2) the defendant sold or offered to sell these securities; and (3) mails were used in connection with the sale or offer of sale." Securities and Exchange Commission v. Continental Tobacco Co., of South Carolina, 463 F.2d 137, at 155 (CA 5th Cir. 1972).

In the present case all three elements are present. In addition, as the record amply demonstrates, there was no exemption available under either Section 3(a)(11), the intrastate offering exemption, nor the private offering exemption under Section 4(2). In the first place, several of the partnership interests were sold to residents outside the State of California, and in several others the property was located outside the state, thus the intrastate offering exemption is not available for the interests in those partnerships, Securities Act Release No. 4434 (December 6, 1961).

As to the private offering exemption under Section 4(2), it is clear from the record that these 45 limited partnership interests

constituted a single integrated offering. Whether a series of offerings over a period of time should be integrated is a question of fact determined by consideration of various criteria, any one or more of which may be determinative. Among the factors to be considered are whether the offerings involve the same class of security, are made at about the same period of time and for the same general purpose, and whether the same type of consideration is received.[6/] It is evident that all of the purportedly separate offerings of partnership interests, particularly the 35 which were offered almost simultaneously during a 16 month period, were part of an integrated plan to finance the complex of companies controlled by CPA and Sartain.

As a matter of fact investors did not always know precisely which property they were investing in. One testified that when Sartain had what he thought was a good investment he came to the investor with it. Another testified that when he asked about the investment Sartain or the salesman responded with what CPA had available at the time in the way of a limited partnership interest. Another investor was told that they were trying to find a hotel which would be a suitable investment for him.

6/ Mark E. O'Leary, 43 S.E.C. 842, 847 (1968).

In any event, the investors in each of the limited partnerships did not occupy a relationship with Sartain or CPA which gave them access to the same kind of information that a registration under the Securities Act would have supplied. Nor did the investors independently possess such information. Haight & Company, 44 S.E.C. 481, 505 (1971); Securities Act Release No. 4552, November 6, 1962).

Finally, it is axiomatic that the burden of establishing the availability of an exemption from registration rests on the one who claims it.[7/] It has not been sustained by Sartain in the instant proceeding.

Accordingly, it is found that Sartain willfully violated Section 5(a) and 5(c) of the Securities Act, as alleged in the Order.

7/ Securities and Exchange Commission v. Ralston-Purina Co., 346 U.S. 119 (1953).

Anti-Fraud Provisions

A. Limited Partnership Interests.

The Order charges that Sartain, and the other respondents, willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and rule 10b-5 thereunder, the so-called anti-fraud provisions, in the offer and sale of the limited partnership interests in which CPA or its affiliate was the general partner,[8] by employing schemes and artifices to defraud and by means of untrue statements of material facts and omissions to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

8/ Section 17(a) makes it unlawful for any person "in the offer and sale of any securities 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" to do any of the following:
(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 in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.
Section 10(b) makes it unlawful, in connection with the purchase or sale of any security to use or employ, "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest for the protection of investors." CONTINUED

As part of the aforesaid conduct Sartain, among other things would and did:

1. Misrepresented and omitted to state material facts concerning the risks of investment in the proposed limited partnerships:

2. Induced investors to purchase limited partnership interests by misleading statements of material facts and omitting to state material facts concerning the participation of NREF in such partnership;

3. Induced investors to invest in limited partnerships by use of a sales approach known as a "coordinated financial plan" which was a means of obtaining confidential financial information from investors and gaining their confidence;

4. Make false and misleading statements of material facts and omit to state material facts concerning, among other things:

   a. The financial condition of the limited partnerships;

   b. The financial condition of lessees of partnership properties;

   c. The nature and extent of financial planning services;

   d. Affiliations with other entities giving rise to actual or potential conflicts of interest;

   e. The risks involved in the investments; and

   f. The past record of the general partner of certain of the partnerships:

CONTINUED

Rule 10b-5 promulgated thereunder, extends, in effect and with a few language changes, the provisions of 17(a) relating to the sales of securities to both the purchase or sale thereof.

The basic sales technique employed by CPA was developed by Sartain and was known as the Coordinated Financial Plan or CFP. The prospective investor was approached by Sartain, and other CPA salesman, with a questionnaire which called for detailed financial information to be provided by the investor which was to be used to plan the investor's estate and future retirement. Through the use of the questionnaire CPA was able to obtain a wealth of information about the prospect's finances, including taxes, income, insurance, savings, mortage and earnings. After this detailed financial information was obtained a CFP was prepared which, the investor was told, was tailored to his individual needs by attorneys, accountants and knowledgeable financial planners. As a matter of fact all of the plans were similar and a former CPA salesman testified that they contained a lot of boilerplate so that one plan read "pretty much like the next one, except for the numbers."

The plans recommended that the prospective investor place 10% of his capital in government paper, 10% in certificates of deposit, 20% in stocks, 20% in bonds and 40% in real estate. The 40% was to be divided between the two investments that CPA sponsored, limited partnerships and NREF. However, CPA's salesman were to sell only NREF shares or CPA limited partnerships as long term investments; they were not encouraged to recommend stocks, bonds or certificates of deposit.

None of the investors who testified during the proceeding purchased any government paper, certificates of deposit, stocks or bonds through CPA. Investors were encouraged to "free up capital" to make an investment and two recommended sources were the cash value of life insurance and the equity in a home. Investors also borrowed funds to make CPA investments.

Sartain conducted seminars attended by prospective investors who had been encouraged to attend upon completion of their CFP.[9] These seminars were designed to influence investors to place their faith in CPA and to purchase limited partnerships through CPA. Sartain spoke at these seminars, stressing the management ability of CPA and tax savings techniques. He answered questions and, as one investor testified, "did the arithemetic on the blackboard," to show how real estate investments would pay out.

Sartain also lectured at sales meetings where he discussed basic sales techniques and specific properties being offered by CPA. At these meetings he emphasized the strength of the lessees of the CPA projects as investors were usually interested since most projects were sale-lease backs and the success of a project would depend on the lessee.

9/ Prospects were told that a fee of $300 would ordinarily be charged for the CFP. However, if the investor implemented the plan through CPA there would be no charge. The fee was rarely, if ever, charged.

Sartain stated that CPA had strong lessees for the partnerships, so strong that the projects could be carried through the construction period when there was no income from tenants.

This was not true. Thirty-two of the thirty-seven partnerships, that both CPA clients and NREF invested in, were lost through problems with lease payments. One salesman sold $30,000 worth of partnership interests in the Fremont Inn after being assured of the strength of the lessee. However, one month after the sale, the lessee was behind on its lease payments. Sartain willfully misled both investors and salesman by assuring them of the financial viability of the lessees involved in the CPA partnerships.

Cal-West was the affiliate or subsidiary of CPA which was responsible for purchasing and managing the properties of the limited partnership. Cal-West received a real estate commission for every property it acquired for CPA and a fee of 5% of gross revenues when it operated the property and a fee of 1% of gross revenues when the property was leased back to the seller. During the period from July 1, 1971 through December 31, 1975, CPA received partnership management fees of $1,518,300 and real estate commissions of $3,543,454.

Michael J. Scotto (Scotto) was the president of Cal-West and was supposed to decide which properties should be acquired, As a matter of fact his recommendations were not followed in many instances. The Cal-West acquisition department operated in an

irregular fashion. No on-site inspections were made on some properties before they were purchased and some properties were acquired after recommendations had been made against their purchase.

The record shows property acquired with title or with defective title; no performance bonds covering construction or repair on property although Sartain stated that ~~they~~ there were such bonds; property stated to be in existence in the prospectus but in fact not built; properties in poor shape when acquired; several properties in default after a few months on leaseback. In addition, the Van Nuys Convalescent Home was closed by the local Health Department because of code violations and the Santa Rosa Student Housing was shown in the offering circular as valued at $1,045,000 when, in fact, in was never started, it was raw land which was not even zoned for student housing.

An offering circular was prepared by CPA for each of the limited partnership offerings and was used in connection with the offer and sale of the interests described therein. When CPA first started offering limited partnerships Sartain helped to lay out the format.

The offering circulars for partnerships formed prior to December 1972 contain no section on risk factors. Neither do they identify the lessees or disclose the relationship between Sartain, Cal-West, CPA and NREF. The offering circulars of partnerships formed after December 1, 1972, disclose

some risk factors, the name of the lessees and make partial disclosure of the relationship between Sartain, Cal-West, CPA and NREF.

Most of the limited partnerships leased the properties they acquired back to the sellers and, therefore, the lessees' financial condition was vital to the success of the venture. However, the offering circulars do not disclose financial information pertaining to the lessees and some do not even disclose the identity of the lessee. In some instances no financial statement was obtained from the lessee and Sartain sold these partnership interests without disclosing the lack of such information. The Commission has held that if a salesman does not have sufficient financial information upon which to base a recommendation to customers, he should withhold or qualify his recommendation to purchase or, at the very least, disclose the lack of such information and caution his customer as to the risk involved in making a purchase without such information.[10/]

10/ *Shearson, Hammill & Co.*, 42S.E.C. 811, 834 (1965). See *B. Fennekohl & Co.*, 41 S.E.C. 210, 215 (1962).

The relationships of the various CPA entities was another area not disclosed in the offering circulars. While offerees were informed that Sartain, CPA, or a CPA subsidiary were the general partners, they were not told that every entity associated with forming, selling and managing the partnerships and properties was a CPA subsidiary or affiliate.[11] CPA controlled all operations and Sartain ran CPA as well as NREF and the limited partnerships. Everyone employed in all the companies was on the CPA payroll and paid by CPA, although there were approximetly 15 bank accounts for all entities. CPA had 75 salesman in 10 offices in 5 states, 25 people in the accounting department, 17 in property management, 8 in acquistions and 6 in legal. Moreover, the fact that every real estate purchase and every service fee paid by the partnerships produced a financial gain, directly or indirectly, was not disclosed. During the period from July 1, 1971 through December 31, 1975, CPA and its affiliates received over $7,000,000 from management and maintenance fees, real estate commissions and securities sales commissions.

11/ See, Armstrong, Jones and Co., et al. 43 S.E.C. 888, 897 (1968)

It was in Sartain's interest to promote all of this activity as he received a salary of $36,000 in 1971 and $50,000 to $60,000 for 1972, 1973 and 1974. In addition, he received a bonus of around $50,000 in 1972 and 1973, and was furnished with a car and a plane. He also received loans from CPA.

Offering circulars issued after March 1973 fail to disclose defaults by Tri-West, the lessee of 6 partnership properties. When other defaults and bankruptcies occurred they were also omitted from subsequent offering circulars. The 1974 offering circulars state that CPA, or an affiliate, was the general partner in over 30 prior partnerships, but they do not disclose that many of these prior partnerships were in financial difficulty. Such failure to disclose prior adverse financial information rendered the statement made materially misleading.[12/]

12/ *Richard J. Buck & Co., et al.* 43 S.E.C. 998, 1005 (1968).

The offering circulars also fail to disclose many facts pertaining to particular partnership properties and a few examples will illustrate the misleading nature of those circulars. The Santa Rosa Student Housing offering circular (previously mentioned at page 19, *supra*) states that the property will be completed the next month. The offering circular failed to disclose that the property was not zoned for the project, that there was no building permit and that construction had not begun. The Lathrop offering circular fails to disclose that the property was encumbered by a second underlying trust deed to secure an $88,000 note. The Marin Memorial offering circular fails to disclose that the cemetery property could not be operated as there was no certificate of authority issued by the state. The Medford offering circular fails to disclose that construction was not completed and that the partnership would, in effect, "bail out" another unsuccessful limited partnership. The Villa Marin and the Plaza Nine offering circulars fail to disclose that the respective partnerships would lease, not purchase, the properties.

False representations, or representations that are false and misleading because necessary qualifications or explanations are omitted, have long been held, in a number of cases, by the courts and the Commission, to constitute activity violative of the

anti-fraud provisions of the securities acts. Charles Hughes & Co., v. Securities and Exchange Commission, 139 F.2d 434,437 (2d Cir. 1943); Norris & Hirshberg v. Securities and Exchange Commission, 177 F.2d 228,233 (D.C. Cir. 1949); Charles E. Bailey & Co., 35 S.E.C. 33, 43 (1953); Harris Clare & Co., Inc., et al, 43 S.E.C. 198,201 (1966).

Sartain filed objections to the Division's proposed findings of fact and conclusions of law and his own proposed counter findings and corrected conclusions. He did not file a brief in support. In regard to the alleged anti-fraud violations in connection with the limited partnerships he was voiced the following objections:

1. That he relied upon Lang and qualified securities counsel, as well other employees of CPA and its affiliates, in the preparation of the offering circulars and that he had no responsibility to review them.

In Kidder, Peabody & Co., et al, 43 S.E.C. 911,914, note 1, (1968), the Commission stated:

> "While reliance upon advice of counsel is a fact that may be taken into account in determining what sanctions are appropriate in the public interest, it does not excuse a failure to comply with applicable provisions of law. See, e.g. Dow Theory Forecasts, Inc."

And in connection with a corporate broker-dealer, the Commission has said that the president must see to it that his firm complies with all applicable requirements.[13/] Sartain, as president of CPA, was the center of all activities as CPA formed the limited partnerships and was the general partner in many of them. In addition, he was at times a director, consultant and shareholder of Delger Financial, the treasurer of Cal-West, and a trustee of NREF. He also sold securities as a registered representative of CPS. Moreover, as mentioned earlier, Sartain developed the format for the early offering circulars which omitted risk factors, the identity of lessees, and the affiliation of the CPA entities.

In any event, the record shows that Sartain was aware of the material misstatements and omissions in the partnership offering circulars but did not act to correct them.

2. That the limited partnership interests were separate entities and adverse economic impact on one was not transferable to partnerships subsequently formed.

This view misconstrues the applicable securities law. The point is that prospective investors should have been told whether CPA's prior limited partnerships had been successes or failures. Failure to disclose the financial condition of the partnerships rendered the offerings circulars fraudulent and misleading.[14/] Further, it has been found that this was an integrated offering.

13/ Herman M. Solomon, et al, 44 S.E.C. 910,912 (1972);
14/ _Van Alstyne, Noel & Company_, 33 S.E.C. 311,321,327 (1952).

3. That there is no evidence in the record that the offering circulars were delivered to investors in the form in which they were admitted into evidence and that the investors received or relied on them.

Contrary to Sartain's assertion there is evidence in the record from the testimony of investor witnesses that they received and relied on the offering circulars. However, it is unnecessary to show that investors in fact relied on the representations in order to establish violations of the anti-fraud provisions.[15/]

4. Sartain asserts that the omissions and false statements alleged by the Division are immaterial and were not required in light of the circumstances at the time. However, he cites no authority for this assertion.

The concept of materiality has been described as the cornerstone of the disclosure system established by the federal securities laws. The basic test adopted by the courts for determining materiality is whether "a reasonable man would attach importance * * * (to those facts) in determining his choice of action in the transaction in question."

15/ Alfred Miller, et al, 43 S.E.C. 233, 239 (1966); See Hamilton Waters & Co., Inc., 42 S.E.C. 784, 790 (1965), and cases there cited.

Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir., 1968) (quoting List v. Fashion Park Inc., 340 F.2d 457, 462 (2d Cir., 1965). Positive proof of reliance is not necessary. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of his decision.16/

Sartain also claims that some of the limited partnership investors were sophisticated investors, and points out the offerings were labeled as "speculative" and that he and other principals of CPA invested their own funds in the Marin Memorial partnership.

The Commission has addressed this argument in Richard N. Cea, 44 S.E.C. 8, where it said, at page 15:

> The fact that a customer is experienced or wishes to speculate cannot excuse fraudulent representations made to him, nor is it necessary to show that he relied on such representations in order to establish violations of the anti-fraud provisions. A Salesman's willingness to speculate with his own funds despite his knowledge of adverse factors cannot justify sales of a stock to customers through misrepresentations and a failure to disclose such factors. (See, also, R. Baruch and Company, 43 S.E.C. 13, 19 (1966) and Richard J. Buck & Co., 43 S.E.C. 988, 1005 (1968), aff'd sub. nom., Hanly v. S.E.C. 415 F.2d 589 (2d Cir. 1969).

16/ Affiliated Ute Citizens of Utah, et al. v. United States, 406 U.S. 128, 153 (1972)

The mere labeling of the investments as "speculative" did not constitute a sufficient disclosure of the risks in the limited partnerships.[17/] Neither does an investor's prior experience in investing and his knowledge that an investment is speculative justify the making to him of false statements and omissions relating to that investment.[18/]

It is found that Sartain willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the offer and sale of the limited partnership interests, as charged in the Order.

17/ M.V. Gray Investments, Inc., et al, 44 S.E.C. 567,572 (1971).
18/ Cortland Investing Corporation, et al, 44 S.E.C. 45,51 (1969).

B. National Real Estate Fund Shares.

The order charges, also, that Sartain and Capital Planning Securities (CPS) willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with the offer and sale of shares of National Real Estate Fund (NREF) by employing schemes and artifices to defraud and by means of untrue statements of material facts and omissions to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

NREF was formed on October 6, 1970, but did not commence active operation until July 1, 1971. The stated objective of NREF was "to make investments in real properties which provide opportunity for capital growth and tax sheltered income" by using the proceeds from the sale of shares to acquire "completed income - producing real property." NREF's business was to be conducted by three trustees who, from July 1972 to July 1976, were Sartain, vonSchottenstein and Manning.

Between July 1, 1971 and December 31, 1973 NREF sold 1,902,302, shares at $10 each. These shares were not registered but were sold through 5 offering circulars to California residents under a claimed intra-state exemption pursuant to Section 3 (a)(11) of the Securities Act. The managing underwriter was Capital Planning Securities, Inc., (CPS), a wholly-owned subsidiary of CPA. The cost

of issuing and selling the shares was $1,745,776, which includes primarily brokerage commissions paid to CPS.

NREF made two types of real estate investments. Approximately $9,500,000 was invested in wholly-owned properties and about $6,600,000 was invested in 37 limited partnerships, in each of which NREF, at the outset, owned a 50% interest as the "A" side partner.

On October 7, 1970, NREF and Cal-West entered into an investment Advisory and Management Agreement whereby Cal-West was to manage NREF's properties and to be paid 5% of the monthly gross income for properties directly managed and 1% for the leased back properties. From 1971 to 1975 NREF had net income of only $158,592, yet paid management fees of $150,841.[19/] This was almost 100% of NREF's profits and made the statement in the July 5, 1973, offering circular that property management fees would be a maximum of 5% of gross income, materially misleading.

Although the Investment Advisory and Management Agreement does not provide for lease commissions, a total of $92,519 was paid to CPA and its affiliates in lease commissions on the wholly-owned properties and an additional $146,607 for maintenance services.

19/ From June 30, 1971 to June 30, 1973, NREF's net income was $158,592; from June 30, 1973 to December 31, 1975, NREF had net losses of $6,053,919.

In addition to the fees on the wholly-owned properties CPA and its subsidiaries were paid a total of $1,518,300 in management fees for the partnership properties.

The NREF offering circulars state that the proceeds from the offerings will be used "primarily for the acquisition of completed income producing real property and to some extent for the payment of commissions and fees to trustees." The term "to some extent" is misleading in that NREF paid $3,982,427 of the $19,023,020 received from the offerings in fees to related entities and trustees.

Although the offering circular stated that NREF would primarily purchase completed income producing properties several of its interests in limited partnerships were not completed or income producing. In fact, 14 of the 37 limited partnerships in which NREF invested were not completed. On some projects, such as Clearlake and Contempo/Spokane, construction had not even begun at the time NREF purchased an interest in the partnership. The projects were simply vacant lots.

The offering circulars list appraisals for all properties at their completed value even though some properties have never been completed. For example construction on the Santa Rosa Student Housing was never started, it is simply raw land. In 1976 the market value of the lot was estimated to be between $35,000 and $75,000 but the offering circulars list an MAI appraisal of $1,045,000 on the property.

By the time the July 1973 offering circular was disseminated to prospective purchasers, Tri-West, the leaseholder on 6 partnership properties in which NREF was the "A" partner, had already defaulted on its lease payments but no disclosure was made of this fact.

One of the points made to prospective purchasers of NREF shares was regularity of its dividends. Investors were told that an 8% annual dividend, payable quarterly, would be paid. In fact, cash distributions were made to shareholders but they could scarcely be classified as dividends. Beginning on August 31, 1971, and continuing until November 5, 1975, they were issued quarterly on a fairly regular basis. In total, $2,199,352 was distributed to shareholders. For the two years ending June 30, 1973, NREF's net income was only $158,592 and from June 30, 1973 until December 31, 1975, NREF's net losses totalled $6,053,919. Therefore, of the $2,199,352 distributed to shareholders, only $158,592, or 7% was from actual profits; the balance of $2,040,760, or 93%, represented a return to the shareholders of their own capital investment. Nevertheless, in letters to shareholders accompanying the checks, the distributions were labeled as dividends. Such letters were sent to shareholders as late as September 24, 1974.

In addition to the cash dividends a 7½% share dividend was paid on July 5, 1973, represented by 97,698 shares issued and $13,310 paid in cash for fractional shares. The additional shares brought to 2,000,000 the total outstanding. In declaring the stock dividend NREF's trustees reduced the par value of its shares from $10 to $1 and credited $9 to a surplus account. In reality it was a recapitalization rather than a dividend.

The labeling of these distributions as "dividends" was misleading. Investors were induced to purchase shares of NREF on the false representation that NREF was paying cash dividends and declaring stock dividends. The letter which accompanied the dividend payments stated that "the Trust is doing well" and lulled investors into a false sense of security about their investments.

Sartain advances the same arguments in defense of his activities in connection with NREF as he did with respect to the CPA limited partnerships previously discussed. With regard to the dividend payments he states that he relied on the advice of the Chairman of the Board of Trustees, counsel, and Lang that the distributions were proper. However, a former tax accountant for CPA testified that when he advised Sartain that payment of a quarterly dividend in 1973 would involve using capital Sartain's response was "Do it."

In view of the foregoing it is concluded that the evidence fully supports a finding that Sartain willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the offer and sale of NREF shares, as charged in the Order.

Willfullness

All of the violations found herein have been found to have been willfull. The term willfull has been definded in Tager v. S.E.C., 344 F.2d 5 (1965) where the Court says, at p. 8:

> "It has been uniformly held that 'willfull' in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor also be aware that he is violating one of the Rules or Acts. Gilligan, Will & Co. v. SEC, 267,F.2d 461,468,cert. denied, 361 U.S. 896; Hughes v. SEC, 174 F.2d 969,977 (1949); 2 Loss, Securities Regulation 1310, n. 88 and cases cited therein."

In Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) the Court held that scienter in the sense of intent to defraud or manipulate is a prerequisite to findings of fraud. However, there is no requirement in connection with Section 17 (a) of the Securities Act in court or in administrative proceedings, and the Commission has stated that, even with respect to Section 10(b) of the Exchange Act and Rule 10b-5, scienter is not essential in administrative proceedings. Steadman Security Corporation, 12 SEC Docket 1041,1043,1050-51, (June 29, 1977); Shaw, Hooker & Co.,

13 SEC Docket 1171,1173-74 (January 3, 1978).

Other Matters

During the course of the hearing an investigative transcript was admitted into evidence. The transcript incorporates two exhibits which could not be located at the time. Counsel for Sartain stated that he considered the exhibits significant and I stated that the exhibits could be added to the record when found. On May 4, 1978, the Division filed the two exhibits with a motion that they be added to the record. Counsel for Sartain has not responded to this motion. Accordingly, the motion will be granted and the two exhibits are hereby made a part of the record in this proceeding.

Sartain objects to certain of the Division's proposed findings on the grounds that no proper foundation was laid at the hearing "for receipt of certain exhibits as evidence," and challenges exhibits 45,64,85,135 and 136. The record shows that all of these exhibits were received in evidence with no objection by Sartain's counsel. Accordingly, there appears to be no basis for disturbing the rulings accepting these exhibits into evidence.

In his proposed corrected conclusions Sartain states that his "Constitutional rights to equal protection and due process under the law were violated in this proceeding and as a consequence thereof, the proceeding should be dismissed." As

the Division points out Sartain has submitted no proposed findings of fact (or brief) which supports this conclusion; there is no evidence in the record to support the conclusion; the conclusion does not specify how Sartain's equal protection and due process rights were violated; and the conclusion and Sartain's proposed findings do not show why dismissal should result from the alleged violation of his rights.

Public Interest

The violations found herein are extensive and serious and were the result of a complex corporate scheme to defraud investors, organized and directed by Sartain. The record discloses no mitigating factors. On the contrary it shows that Sartain has been the subject of four previous disciplinary proceedings. On April 24, 1975, the NASD censured Sartain and barred him from association with any member of the NASD in any capacity. This action was affirmed by the Securities and Exchange Commission on July 15, 1976. (Sartain's appeal of this Commission decision is now pending in the 9th Circuit Court of Appeals). On June 28, 1976, Sartain was permanently enjoined from violations of the federal securities laws by the U.S. District Court for the Northern District of California. On January 13, 1978, Sartain was preliminarily enjoined by the State of Alaska from violating the real estate and securities laws. On January 24, 1978, the Department of Corporations of the State of California issued an order revoking

Sartain's agent's certificate. The Commission has found it in the public interest to impose sanctions based on an injunction issued by a court of competent jurisdiction.[20/]

ORDER

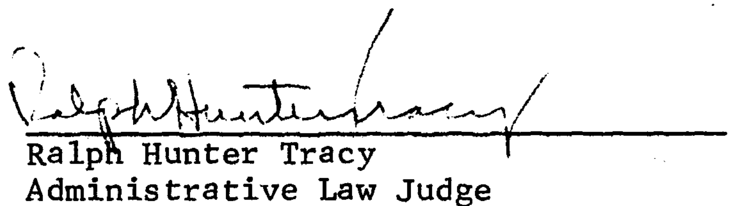
Upon careful consideration of the record and the contentions of the parties, it is concluded that the public interest requires that Sartain be barred from being associated with any broker or dealer.

Accordingly, IT IS ORDERED that Thomas A. Sartain, Sr., is barred from association with any broker or dealer.

20/ George B. Wallace & Co., 39 S.E.C. 306 (1959); Kimball Securities, Inc., 39 S.E.C. 921 (1960).

This order shall become effective in accordance with and subject to 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 services 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.[21/]



Ralph Hunter Tracy
Administrative Law Judge

Washington, D.C.

21/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this intitial decision, they are accepted.