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ADMINISTRATIVE PROCEEDING  
FILE NO. 3-4032

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of :  
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PROPERTY UNDERWRITERS, INC. :  
CALVIN A. MERRIMAN :  
:  
File No. 8-16242 :  
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**FILED**  
JUL 16 1973  
SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Edward B. Wagner  
Administrative Law Judge

Washington, D. C.  
July 16, 1973

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File No. 8-16242 :  
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APPEARANCES: William M. Hegan and Robert S. Luce of the Chicago  
Regional Office for the Division of Enforcement.  
Dwight D. Chinnock of Happer, Happer, Hall & Eppard,  
Ltd., Burnsville, Minnesota for Respondents Property  
Underwriters, Inc. and Calvin A. Merriman.

BEFORE: Edward B. Wagner, Administrative Law Judge

This public proceeding pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 (Exchange Act) was instituted by Commission Order (Order), dated December 13, 1972. In the Order the Division of Enforcement (Division) alleged that Respondent Property Underwriters, Inc. (Registrant) willfully violated and Respondent Calvin A. Merriman (Merriman) willfully aided and abetted violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder; Section 17(a) of the Exchange Act and Rules 17a-3, 17a-4, 17a-5, and 17a-11 thereunder; Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder; and that Registrant and Respondent Merriman failed reasonably to supervise (Section 15(b)(5)(E) of the Exchange Act). The Order also alleged that Registrant willfully violated and Merriman willfully aided and abetted violations of Sections 5(a) and 5(c) of the Securities Act of 1933 (Securities Act).

An evidentiary hearing was held on February 5 and 6, 1973 at St. Paul, Minnesota. Although the hearing was called for the purpose of considering the interim suspension issue, counsel for the parties stipulated that the entire case dealing with all issues, including both the remedies of revocation and interim suspension, would be presented and that decisions with respect to all of these issues could be based upon the record presented. Initially, filings with respect to the interim suspension issue were scheduled for February 14, 1973. Thereafter, on motion by the Division based upon representations from Registrant that it was suspending operations pending resolution of an offer of settlement, the time for filings was postponed until March 26, 1973. On that date Proposed Findings of Fact, Conclusions of Law and

Briefs were simultaneously filed by the Division and by counsel for the Respondents.

On April 12, 1973 the Division with the concurrence of counsel for respondents filed a motion stating that Registrant had suspended operations pending final disposition of the proceeding and requesting that an initial decision be issued on the substantive allegations of the Order rather than on the interim suspension issue. The motion stated that the parties had agreed that the filings which had been made on the interim suspension issue would constitute their filings on the ultimate issues to be decided.

The Division's motion of April 12, 1973 is hereby granted.

The findings and conclusions herein are based upon the evidence as determined from the record and upon observation of the witnesses. Preponderance of the evidence is the standard of proof applied.

#### Respondents

Property Underwriters, Inc. (Registrant) became registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act on January 9, 1971 and is a member of the National Association of Securities Dealers, Inc.

Calvin A. Merriman (Merriman) is president, treasurer and director of Registrant and owns all of its outstanding common stock.

Registrant employs 4 salesmen and a secretary. It is operated as a one-man corporation by Merriman who has assumed

supervisory responsibility for books and records, sales and back-office matters.

Violations of Rules 17a-3 and 17a-4

The record establishes that from around January 9, 1971 to around December 14, 1972 Registrant did not keep and maintain the following required books and records: a purchase and sale blotter, a receipt and delivery of securities blotter, a cash receipt or cash disbursements blotter, a general ledger, a firm inventory ledger and a securities position record. During this period certain required monthly trial balances and monthly computations of net capital were not made and maintained.

The records which Registrant did keep were inadequate. For example, the only records of cash receipts were bank deposit slips which were sometimes not dated and did not indicate the source of the funds. The check stubs which Registrant maintained as a means of recording disbursements did not always specify the purpose for which the payment was made. The customer account forms which were kept were not adequate as customer account ledgers because dates and dollar amounts in terms of securities transactions and receipts and deliveries of securities were not recorded.

Although, after a staff accountant had conducted an inspection in November, 1972, steps were taken to improve the condition of the records, no substantial progress had been made over a month later.

An examination of Registrant's books and records produced pursuant to subpoena at the hearing disclosed numerous material deficiencies.

As of the date of the hearing Registrant had no securities position record, no inventory ledger and did not have properly executed questionnaires or applications for employment for each associated person.

Although Merriman contended that he had all required information available and that it was merely in an unconventional format, this was obviously not the case. Merriman stated that his accountant had made no complaints, but the accountant had had no experience - other than this part-time work for Registrant - with broker-dealer books and records. Further, the information provided his accountant was so deficient that the latter prepared an NASD quarterly financial report (signed and filed by Merriman) for Registrant reflecting a \$10,000 certificate of deposit as an asset when it had been redeemed prior to the date of the report. On another occasion, Registrant's accountant prepared a balance sheet as of September 30, 1972 from Registrant's records reflecting the same certificate of deposit as an asset when it had been redeemed on May 22, 1972 and replaced by certain Boise Cascade debentures.

Merriman had supervisory responsibility for Registrant's books and records.

Under the above circumstances it is concluded that Registrant willfully violated the bookkeeping requirements of Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder and that Merriman willfully aided and abetted such violations.

Net Capital Violations

The record clearly demonstrates that Registrant was not in compliance with the requirements of the Net Capital Rule as of December 31, 1971, May 31, 1972 and October 31, 1972.

Registrant had a net capital deficit of \$1,261 with a total net capital deficiency of \$6,261 as of December 31, 1971. As of May 31, 1972 Registrant's net capital was \$542 which was \$4,458 below the required amount. As of October 31, 1972 Registrant had a net capital deficit of \$1,196 and a total net capital deficiency of \$6,196.

The October 31, 1972 net capital deficit and deficiency were attributable to failure to subordinate the obligation of Registrant to return Boise Cascade debentures in the amount of \$15,000 which were maintained in the Registrant's account at Dain, Kalman & Quail (Dain) and which Merriman had transferred from his own personal account.

Whether Registrant was also out of compliance with the requirements of the Net Capital Rule on December 31, 1972 and on January 31, 1973 depends upon whether credit is given for a \$10,000 cash deposit made by Merriman in the Registrant's account at Dain. <sup>1/</sup> The Division contends that

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<sup>1/</sup> Merriman testified that in December 1972 the Boise Cascade debentures were sold for around \$15,000 by Dain, and the proceeds obtained by Merriman personally. In that same month Merriman deposited \$10,000 of this amount in Registrant's account at Dain. It is assumed that this deposit constituted a contribution to capital.

the \$10,000 deposit is an unsecured account receivable in the nature of an advance. It is therefore argued that, since the deposit "cannot be readily convertible into cash" within the language of the rule, it must be deducted. Registrant's position at the hearing was that the account should be treated as cash.

The Division cites John W. Yeaman, Inc., Securities Exchange Act Release No. 7527, p. 6 (February 10, 1965), which states that a tax refund claim is not readily convertible into cash because it is "not payable on demand by the taxpayer" and because "there is an uncertain interval between the assertion of the claim and its payment by the taxing authorities." The Division also argues that it is conceivable that a brokerage firm in which such an account is maintained may experience financial difficulties in the future which would affect retrieval of the deposit. This last consideration would appear to be determinative. It is noted that the Commission Staff has been treating deposits in solvent, federally insured savings and loan associations which have been paying such deposits on demand as though such amounts were cash in a bank. Securities Exchange Act Release No. 8024, p. 10 (January 18, 1967). However, the account in question here is not insured.<sup>2/</sup> The Staff practice described above appears appropriate, but no justification is perceived for extending such treatment to non-insured accounts of the type involved here. Accordingly, it is concluded the \$10,000 deposit must be deducted for purposes of the Net Capital Rule. After deduction

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<sup>2/</sup> See Section 6(f)(1)(D) of the Securities Investor Protection Act of 1970 (SIPC), 15 U.S.C.A. §78fff(f)(1)(D).



of this deposit as indicated, the record establishes that Registrant was not in compliance with the requirements of the Net Capital Rule as of December 31, 1972 and January 31, 1973.

The record indicates that Registrant was effecting transactions in non-exempt securities while it was experiencing net capital deficiencies on December 31, 1971, May 31, 1972 and October 31, 1972 (Tr. 24)<sup>3/</sup>. However, no satisfactory showing appears in the record that transactions in such securities were being effected on December 31, 1972 or on January 31, 1973.

Based upon the foregoing, it is concluded that Registrant willfully violated Section 15(c)(3) and Rules 15c3-1 thereunder as of December 31, 1971, May 31, 1972 and October 31, 1972, and that Merriman willfully aided and abetted such violations.

#### Reporting and Confirmation Requirements

The record establishes and it is concluded that Registrant willfully violated, and Merriman willfully aided and abetted violations of, Section 17(a) of the Exchange Act and Rule 17a-5 thereunder in that Registrant's initial X-17A-5 Report was prepared as of a date later than that required and was not filed within the time required.

The record establishes and it is concluded that Registrant willfully violated, and Merriman willfully aided and abetted violations of, Section 17(a) of the Exchange Act and Rule 17a-11 thereunder

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<sup>3/</sup> Respondents concede a Net Capital Violation as of October 31, 1972 (Respondents' Proposed Findings, Conclusions and Brief, p. 1).

in failing to give the Commission telegraphic notice and file required reports regarding its insufficient net capital and deficient books and records.

The record establishes and it is concluded that Registrant willfully violated, and Merriman willfully aided and abetted the violation of, Section 15(c)(1) of the Exchange Act, and Rule 15c1-4 thereunder in that confirmations of Registrant to customers failed to disclose the capacity in which it was acting.

Violation of Section 5 of the Securities Act

In October, 1970 Merriman purchased 11,250 original issue shares of Med General, Inc. common stock in a private placement. The certificates for these shares contained a restrictive legend. Merriman sold this stock in a series of transactions beginning in January, 1972 and ending in May, 1972.<sup>4/</sup> Two of these transactions were confirmed to the purchasers by Registrant (Div. Ex. 6, 7, Tr. 63-<sup>5/</sup>72). It was stipulated that the United States mails were used in the sale of Med General stock. One transaction was run through the books of Registrant (Tr. 26). Merriman testified that in selling his stock he was relying upon an opinion from his attorney that his need for funds for his new business venture as a broker-dealer would qualify as an unforeseen change of circumstances permitting resale of the securities.<sup>6/</sup> The letter of opinion was furnished to

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<sup>4/</sup> The sales price ranged from 2-1/8 per share to 2-7/16 in the transactions for which records were introduced.

<sup>5/</sup> This evidence is credited over testimony given at Tr. 132-133.

<sup>6/</sup> Counsel's letter of opinion was not produced at the hearing.

Med General's counsel and to its transfer agent, and no objection was raised to the transfer of the stock.

As the Division contends, the burden of proving an exemption is on the person claiming it,<sup>7/</sup> and exemptions should be strictly construed against the claimant.<sup>8/</sup> The change of circumstances here was largely under the control of Merriman, since he chose to enter his new venture, and is not the type of calamitous or extraordinary event which would qualify as genuinely "unforeseen". See Securities Act Release No. 4552, p. 4 (November 6, 1962). As the Division argues, "If a businessman who purchased stock in a private placement were entitled to sell that stock whenever a new business need arose, the disclosure requirements of the '33 Act could be simply avoided by the application of this artificial subterfuge". (Division Brief, p. 35).

Based upon the foregoing, it is concluded that Registrant and Merriman willfully violated Sections 5(a) and 5(c) of the Securities Act.

#### Supervision

From January 9, 1971 to the present Merriman has been president and treasurer of Registrant, the owner of 100% of its stock, a member of its board of directors and its manager. Although the record shows that Registrant employed four salesman and a secretary, Registrant - in relation to the violations established here - is a one-man operation, and Merriman personally aided and abetted commission of the violations. There is nothing in the record to indicate that any other persons

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7/ S.E.C. v. Ralston Purina Co., 346 U. S. 119, 126 (1953)

8/ S.E.C. v. Sunbeam Gold Mines Co., 95 F. 2nd 699, 701 (1938).

who were subject to supervision participated in the violations. Under these circumstances, a charge that Registrant and Merriman failed reasonably to supervise persons who were subject to their supervision and who committed violations is essentially a charge that Merriman failed to supervise himself. While there is no doubt that Merriman failed to "manage" and "organize" his operation properly, it is not believed that such deficiencies equate with a failure of "supervision" as that term is used in Section 15(b)(5)(E) of the Exchange Act.<sup>9 /</sup>

Accordingly, it is concluded that no failure to supervise on the part of Registrant and Merriman has been established.

#### Public Interest

Respondents concede that certain of the violations which have been established did occur, state that Registrant has voluntarily suspended all business activities as of February 10, 1973 and argue that in view of the nature of the violations appropriate sanctions would be a 30-day suspension of Registrant's registration and a 30-day bar for Merriman from association with any broker-dealer. Respondents state that during the suspension period Merriman will undertake a study of the provisions of the Exchange Act, and will, thereafter, set up any and all books and records which the Commission deems necessary.

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<sup>9 /</sup> See Anthony J. Amato, Securities Exchange Act Release No. 10265, p. 5 (June 29, 1973).

The Division argues that the violations are of a nature warranting revocation, and it is assumed, would contend that Merriman should be barred from association with any broker-dealer.<sup>10/</sup> The Division notes that Registrant has repeatedly been in violation of the Commission's net capital requirements and that it is difficult to accept the fact that some of his arguments are being made in good faith in view of his 15 years of experience in the securities business.

The Division further notes Merriman's carelessness or worse in filing false reports with the National Association of Securities Dealers (NASD). As the Division states, the record shows that Merriman deceived a Staff accountant making an inspection of Registrant concerning the existence of a certificate of deposit which was allegedly an asset of the firm. The Staff accountant was given to understand by Merriman that the certificate was unredeemed and had been in his possession and available for inspection the day before the accountant returned to Registrant's office, when, in fact, it had been redeemed some six months earlier.

Serious and continuing violations and gross indifference to the requirements of the law have been demonstrated. Merriman's conduct and attitude do not warrant his continuation in the securities business in an unsupervised capacity. In view of the foregoing, it is

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<sup>10/</sup> No explicit recommendation is made in respect to the bar because the Division brief was addressed to the suspension issue.

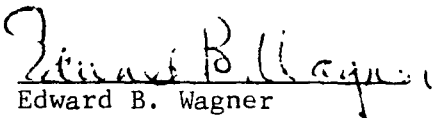
concluded that the registration of Property Underwriters should be revoked and that Merriman should be barred from association with any broker or dealer, except that after a period of one year he may apply to the Commission to return to the securities business in an adequately supervised capacity. It is concluded that the one-year period of total exclusion from the business will serve the purpose of adequately impressing upon Merriman the need for strict compliance with the securities laws in the future.

Accordingly, IT IS ORDERED that the registration of Property Underwriters, Inc. as a broker-dealer is revoked and that Calvin A. Merriman is barred from association with any broker or dealer, except that after one year from the effective date of this order Calvin A. Merriman may apply to the Commission for permission to become associated with a broker-dealer in a position in which he will receive adequate supervision.

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 (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own 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 <sup>11/</sup> shall not become final with respect to that party.

  
Edward B. Wagner  
Administrative Law Judge

Washington, D.C.  
July 16, 1973

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<sup>11/</sup> 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 initial decision, they are accepted.