INITIAL DECISION NO. 67

ADMINISTRATIVE PROCEEDING
FILE NO. 3-8370

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of ROBERT A. MAGNAN, STEVEN J. LABRASCIANO, and DONALD A. ROCHE, JR.	)	INITIAL DECISION JULY 5, 1995

APPEARANCES: Maureen Maguire Bailey and Stephen J. Korotash for the Division of Enforcement, Securities and Exchange Commission

Donald A. Roche, Jr., pro se

BEFORE: Brenda P. Murray, Chief Administrative Law Judge

The Securities and Exchange Commission (Commission) instituted this proceeding on May 19, 1994, pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b)(6) and 21C of the Securities Exchange Act of 1934 (Exchange Act). In the Order Instituting Proceedings (Order), the Division of Enforcement (Division) alleged that Donald A. Roche, Jr. (Mr. Roche), Robert A. Magnan and Steven J. Labrasciano violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. 1/ These sections are referred to as the antifraud provisions of the federal securities laws. They make unlawful the use of the mails or facilities of interstate commerce in connection with the offer or sale of any security by means of a manipulative, deceptive or fraudulent device, an untrue or misleading statement or omission of a material fact, or any other action or conduct which operates to defraud or deceive a customer.

The Order sets out the allegations against Mr. Roche at II, Paragraphs R, S, and V. Mr. Roche's Answer does not deny the violative conduct set forth out in Paragraph V. The Commission's Rule of Practice 7(c), 17 C.F.R. 201.7(c), provides that "any allegation not denied shall be deemed to be admitted." In view of Mr. Roche's position that he has done nothing wrong, I consider this an oversight and have not treated it as an admission.

I held hearings in Tampa, Florida, on September 19 and 20, 1994. The Division called eight witnesses, seven of whom were Mr. Roche's former customers and one of whom was an expert. Mr. Roche, a non-lawyer, who appeared pro se testified and called one other witness. I received fifty exhibits offered by the Division, and eleven exhibits offered by Mr.

1/ The Commission entered Orders Making Findings and Imposing Remedial Sanctions on Mr. Labrasciano and Mr. Magnan on January 30, 1995 (58 SEC Docket 1960), and April 5, 1995 (59 SEC Docket 7), respectively.

Roche.

The Division filed Proposed Findings of Fact and Conclusions of Law and a brief in support thereof (Div. Brief) on November 22, 1994. After requesting and receiving additional time in which to file a reply brief, Mr. Roche sent me on January 3, 1995, via telephone facsimile, a handwritten one-page sheet stating that "I disagree on all the SEC findings & deny all the SEC accusations and take offence to their unjust portrayal." 2/ The Division did not file a rebuttal brief because Mr. Roche had not addressed the Division's initial filing.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

My findings and conclusions are based on the record and my observations of the witnesses' demeanor. I applied preponderance of the evidence as the applicable standard of proof. 3/

Respondent

Mr. Roche received a bachelor of arts degree in economics and history from Hobart College in 1980. (Tr. 27, Vol. I) 4/ He entered the securities industry in 1982 as a registered representative with Apple Financial in Buffalo, New York. (Tr. 121, Vol. II) In November 1984, after a short stint in the video retail business, Mr. Roche joined the Tampa, FL, office of Stuart-James Co., Inc. (Stuart-James), a broker-dealer registered with the

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2/ Mr. Roche's filing (Roche Letter/Brief) does not contain proposed findings of fact and conclusions of law as required by Rule of Practice 16(d), 17 C.F.R. § 201.16(d) (1994).

3/ I have considered all proposed findings and conclusions and all contentions, and I accept those that are consistent with this decision.

4/ The volume citation is necessary because the two transcript volumes are not numbered consecutively.

Commission pursuant to Section 15(b) of the Exchange Act. Stuart-James has been the subject of considerable regulatory activity because of its use of high pressure sales tactics in selling low-priced, speculative securities underwritten by the firm. 5/ Stuart-James went out of business in September, 1990. Many, perhaps 90 percent, of the companies which issued securities underwritten by Stuart-James no longer exist. (Tr. 84, Vol. I; Tr. 45, Vol. II)

Mr. Roche enjoyed considerable financial success as a result of his employment with Stuart-James. In 1987, he became manager of the firm's Clearwater, FL, office, and he earned approximately $1 million dollars in compensation in the years 1986 until he left Stuart-James in 1990 (Tr. 25-26, Vol. I; Tr. 91-92, Vol. II). Mr. Roche's compensation was derived in large part from commissions charged on transactions in the approximately 300 accounts he handled for customers. (Tr. 87, Vol. II) As a matter of policy, Stuart-James required its registered representatives to sell securities where Stuart-James was the underwriter. Salespeople received higher commissions for selling these securities. (Tr. 133, Vol. II)

Since Mr. Roche left Stuart-James, he has worked as a registered representative with broker-dealer firms in Florida and California - Rosencrantz, Lyons & Ross, Burnett, Grey & Co., Inc., Lew Lieberbaum & Co., Inc., and Schneider Securities, Inc. He was with the latter firm at the time of the hearing. (Tr. 125, Vol. II)

Allegations

5/ The Stuart James Co., Inc., et al., Initial Decision Release No. 32 (March 17, 1993), 53 SEC Docket 2622, 2834-37

I find that the allegations in the Order are true. From about 1987 through May 1993, Mr. Roche acted in interstate commerce and used the mails, the telephone, and the facilities of a national exchange to violate the antifraud provisions of the federal securities laws in that, in connection with the offer and sale of securities, he willfully (1) employed manipulative and deceptive devices and contrivances to defraud, (2) obtained money by means of untrue statements of material fact, and he omitted to state material facts necessary to make the statements he made not misleading, and (3) engaged in acts, transactions, practices, and courses of business which operated as a fraud on purchasers and sellers of securities.

I. Mr. Roche's Price Predictions Violated the Antifraud Provisions

"[I]t is inherently fraudulent to predict specific and substantial increases in the price of a speculative security." Cortlandt Investing Corporation, 44 S.E.C. 45, 50 (1969) 6/ Such predictions "of substantial price increases within relatively short periods of time with respect to a promotional and speculative security of an unseasoned company are a 'hallmark' of fraud and cannot be justified." Alfred Miller, 43 S.E.C. 233, 235 (1966) Further, a prediction of a substantial increase in the price of any security (not just speculative securities) with no reasonable basis is fraudulent. Lester Kuznetz, 48 S.E.C. 551, 553 (1986); SEC v. Hasho, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992)

Mr. Roche took advantage of his customers' trust and lack of knowledge about individual stocks and the penny stock market as a whole by inducing them to purchase

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6/ Accord, Armstrong, Jones & Co., 43 S.E.C. 888, 896 (1968), aff'd, 421 F.2d 359 (6th Cir. 1970) cert. denied, 398 U.S. 958 (1970); Charles P. Lawrence, 43 S.E.C. 607, 610 (1967); Crow, Brourman & Chatkin, 42 S.E.C. 938, 944 (1966)

stocks he recommended with false and misleading information including baseless and unrealistic predictions that the securities would increase in price. Mr. Roche had no rational basis for the totally unrealistic price increases he predicted for these speculative securities.

The record demonstrates that Mr. Roche used price predictions that he knew or should have known were false to convince six customers to purchase the securities regarding four companies. His actions were willful in that he intentionally made predictions which conveyed materially false information to investors. Stuart-James was the underwriter on three of these offerings, so that Mr. Roche made a higher commission on transactions in these securities than he did on others, and all these securities were traded over-the-counter and either were or had been quoted on the National Association of Securities Dealers' Automated Quotation system (NASDAQ).

A. Securities of Sigmatron Nova, Inc. (Sigmatron Nova)

Sigmatron Nova, organized in 1985, developed flat panel information display products utilizing thin film electroluminescent technology. Stuart-James was the underwriter on the company's September 22, 1987 initial public offering (IPO) of 650,000 units, with each unit consisting of 50 shares of common stock and 25 warrants. Each warrant, exercisable after September 22, 1988, and expiring on September 22, 1992, entitled the holder to purchase one share of common stock at a price of $0.28125. (D. Ex. 15A at 1, 3)

Sigmatron Nova's prospectus stated in large bold print that the securities "involve a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." (D. Ex. 15A at 1). The company's IPO prospectus listed seventeen risk factors, including (1) Sigmatron Nova's limited operating history and lack of profits, (2)

the inability to assure that the company would stay in business because its resources and capital would remain low relative to its competition in an industry requiring high capital expenditures, (3) the failure of the company to ever generate positive cash flow from operations, (4) the risk associated with the fact that the company's technology, a flat panel display, had achieved only limited acceptance in military and industrial applications and involved a complex manufacturing process to produce, (5) the inability to assure that other technological developments would not render Sigmatron Nova's technology uneconomical or obsolete, (6) the company relied primarily on unpatented, proprietary know-how and the performance of key personnel, and (7) the offering would cause an immediate dilution in the company's book value to public investors. (D. Ex. 15A at 6-10)

Mr. Paresh Doshi (Mr. Doshi), a motel and restaurant owner in Cross City, FL, opened an account with Mr. Roche in 1985 or 1986. Mr. Doshi had not invested in stocks prior to opening his Stuart-James account. (Tr. 58-59, Vol. I) Mr. Doshi did not understand securities investments and he understood Mr. Roche was able and had studied the information on the stocks he recommended. (Tr. 62, 67, Vol. I) Mr. Roche asked Mr. Doshi to trust him and he did. (Id.)

Mr. Roche proposed all the stocks that were purchased in Mr. Doshi's account. (Tr. 62, Vol. I) When Mr. Roche proposed a stock for purchase, he would tell Mr. Doshi that "it would be a good stock to make money [and] [i]t was a well-studied stock." (Tr. 67, Vol. I) By March, 1988, Mr. Doshi's account reflected a $15,000 loss. (Tr. 64-65, Vol. I)

Mr. Doshi purchased 100,000 Sigmatron Nova warrants on March 3, 1988 for $4,007.50 based on Mr. Roche representation that he had good knowledge of this security,

that there was money to be made, and his prediction that this investment would make up the $15,000 in losses in Mr. Doshi's account. (Tr. 63-65, Vol. I; D. Ex. 2A).

The Sigmatron Nova warrants became worthless within a year after Mr. Doshi purchased them. Sigmatron Nova notified the Commission on March 31, 1989 that it had suspended its operations due to a lack of working capital, and on September 20, 1989 that it would liquidate within 30 days and it did so. (D. Ex. 15F and 15G; Tr. 84, Vol. I) Mr. Doshi's July 1989 statement from Stuart-James showed no ask price for the warrants. Mr. Doshi estimates that he lost approximately $35,000 trading with Mr. Roche and Stuart-James. (Tr. 79, Vol. I)

B. Europa Cruises Corp. Securities (Europa)

Europa was organized in November, 1988 to promote and operate "moderately priced day and evening cruises" which provided gambling and entertainment. (D. Ex. 13A at 3) The company began an initial public offering of its securities on June 22, 1989. The IPO was underwritten by Stuart-James. (D. Ex. 13A at 1) As detailed in the next section of this decision at page 15-16, Europa's IPO prospectus listed some twenty factors which made this a risky investment.

Mr. Roche took over the account of Fred Scheidker (Mr. Scheidker) of St. Petersburg, FL, from another registered representative at Stuart-James in 1988. Mr. Scheidker, a retired businessman, had no experience in penny stocks when he opened his account with Stuart-James. Mr. Roche represented that he would make up for all the "mistakes" that his previous Stuart-James salesperson had made in Mr. Scheidker's account.

(Tr. 100, Vol. I) 7/ Mr. Roche sold most of the stocks that were in the account but later bought some of those same stocks back. (Tr. 97-98, Vol. I) Mr. Scheidker trusted Mr. Roche because of he held a managerial position, and he was confident that Mr. Roche was looking out for his interests. (Tr. 122, Vol. I) Mr. Scheidker "would have been proud to have him [Mr. Roche] as a son." (Tr. 103, Vol. I) Mr. Roche selected all the numerous securities in Mr. Scheidker's account. (Tr. 101, 103, 110, Vol. 1) 8/ He did not mention much on the downside about any of these securities. (Tr. 101-02, Vol. I) Most times Mr. Roche executed trades in the account without first obtaining authorization from Mr. Scheidker. (Tr. 98, 108, Vol. I)

On June 29, 1989, Mr. Scheidker purchased 1,500 shares of Europa at $1.00 per share based on Mr. Roche's representation that "the stock would go to like $2 [from $1] pretty fast." (Tr. 105, 107-08, 120, 126, Vol. I; D. Ex. 3A) Mr. Scheidker believed he had assurance from Mr. Roche that the price was going to go to $2.00 quickly. Instead, the shares quickly went down in price, leveled off at $0.25, and, according to Mr. Roche, the company later did some things. (Tr. 126, Vol. I) On July 10, 1989, Mr. Scheidker sold his shares in Europa at a profit of $0.15 per share. (Tr. 126, Vol. I; D. Ex. 3B)

7/ Stuart-James representatives told Mr. Scheidker that people who participated in new issues made money. "Of course, every time I bought it, it was after the stock had been out and then they proceed[ed] to go down." (Tr. 97, Vol. I) Mr. Roche told Mr. Scheidker that he would get him involved in Stuart-James's new issues. (Id.) Mr. Scheidker had "great hopes that some of things were going to hit", that is what Mr. Roche told him. (Tr. 98, 113, Vol. I) Mr. Scheidker became disillusioned when he heard Mr. Roche talked about dumping worthless stocks on new salespeople at Stuart-James to sell. (Tr. 111, 113, Vol. I)

8/ Mr. Scheidker paid for these trades because he had a great faith that dealing with Stuart-James gave him an opportunity "to hit" it with a securities purchase because the company had researched these offerings so well. (Tr. 98, 113, Vol. I)

C. Securities of The Meadow Group, Inc. (Meadow)

Meadow was a blind pool IPO underwritten by Stuart-James that began on March 17, 1988. (D. Ex. 14A at 1) 9/ Meadow was organized for the purpose of identifying and acquiring businesses engaged in manufacturing, distribution, sales or services. Acquisitions would be made by means of a combination of cash, loans secured by assets of the acquiree, and Meadow's own securities. (D. Ex. 14A at 4) As detailed in the next section of this decision at page 17, Meadow's IPO prospectus listed some seventeen factors which made this a risky investment.

Mr. Roche took over Theodore Glen Boe's (Mr. Boe) account at Stuart-James in February, 1987. (Tr. 156, Vol. I) Mr. Boe, a resident of Marathon, FL, purchased securities in his account based entirely on recommendations from Mr. Roche who consistently characterized the stocks he recommended as good companies with good profit potential, and who kept promising to make money in the account. (Tr. 156, 172, Vol. I). 10/ Mr. Boe generally accepted Mr. Roche's advice except when he did not have sufficient funds to make additional purchases. (Tr. 164, Vol. I)

Mr. Boe purchased 20,000 shares of Meadow at $0.28 per share on November 16, 1989 and 10,000 shares at $0.27 per share on November 29, 1989 because of representations

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9/ According to Meadow's prospectus, a "blind pool" offering is one in which a significant portion of the funds raised are only generally allocated rather than specifically allocated. Thus investors "entrust their funds with management, on whose judgement the investors must depend." (D. Ex. 14A at 4)

10/ In the years 1988-90, Mr. Boe, at Mr. Roche's recommendation, purchased securities approximately sixty times, with an equivalent number of sales. (Tr. 159-60, Vol. I)

by Mr. Roche that Meadow securities would rise in price to permit Mr. Boe to recoup $11,000 in losses. (Tr. 160-63, Vol. I) Mr. Roche's claims of anticipated profits were part of an overall representation to Mr. Boe in July that his goal in recommending purchases was to recover the substantial losses in his portfolio by Christmas 1989. (Tr. 160-61, Vol. I) There is no evidence that Mr. Roche had any reasonable basis for his prediction. 11/

Meadow securities dropped substantially in price after Mr. Boe's purchase. Mr. Boe lost approximately $5,700 when he sold his shares of Meadow on May 14, 1990, for $0.0325 per share. (Tr. 162-63, Vol. I) 12/

D. Securities of CM Communications, Inc. (CM Communications)

CM Communications was a holding company formed in January 1989 for Marline Communications, Inc., a distributor of cellular telephones, and Cavanah Cellular Products, which designed, assembled and distributed cellular telephone accessories. (D. Ex. 12A at F-6) Donald & Co. Securities, Inc. and Kashner Davidson Securities Corp. were underwriters on CM Communications's IPO which began on January 11, 1990. (D. Ex. 12B at 1) The IPO prospectus mentioned the following risk factors among the twenty listed: (1) the offering was speculative, and involved a high degree of risk and substantial dilution from the public offering price; (2) the company had a limited operating history; (3) the company was unable to assure its revenues "will increase or remain at the same levels in the future

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11/ Based on a total investment of $8,300, Meadow securities would have to have risen in price 32.5% in a month, exclusive of transaction costs, to recoup Mr. Boe's $11,000 in account losses by December 1989.

12/ Mr. Boe invested approximately $55,000 of his retirement funds with Mr. Roche at Stuart-James. His losses were in excess of $50,000. (Tr. 163, 165, Vol. I)

or that the Company will continue to earn a profit;" (4) CM Communications had limited experience in national distribution, and that aspect of the business required the rapid development of a nationwide sales organization; (5) the company was largely dependent on a single supplier; (6) the cellular phone industry was generally risky, involving rapid economic and technological changes; and (7) that CM Communications had competitors with "significantly greater financial resources and more established marketing and technical capabilities." (D. Ex. 12B at 1, 6-11)

At least three of Mr. Roche's customers - Kenneth C. Gregory (Mr. Gregory), Steven Johnson (Mr. Johnson), and Robert J. Maegerle (Mr. Maegerle) purchased shares of CM Communications based on Mr. Roche's prediction that the price of the stock would rise to a specified level during a specific period of time.

Mr. Gregory, who had spent most of his life in construction and was a semi-retired, self-employed Florida real estate broker, opened an account at Stuart-James in 1987 after he sold Mr. Roche a house. Mr. Roche told Mr. Gregory that he could make a lot of money by buying the stocks of new companies, that he was Stuart-James's office manager, and he had information and could get Mr. Gregory some good buys. (Tr. 26, Vol. II) Mr. Roche asked Mr. Gregory to trust him. Mr. Gregory did and he let Mr. Roche manage the account. (Tr. 27-28, Vol. II) Mr. Gregory knew nothing about penny stocks, and he told Mr. Roche that the $25,000 he placed in the account represented his savings which he did not want to put at risk. (Tr. 24-28, Vol. II) On April 2, 1990, Mr. Gregory purchased 350 shares of CM Communications stock at $7.875 per share for a total investment of $2,771 based on Mr. Roche's representation that the price of the stock would rise to approximately $15 per share.

(Tr. 30-32, Vol. II; D. Ex. 7)

Mr. Roche took over the Stuart-James account of Mr. Johnson, who is employed in the aviation business and resides in Ruskin, FL, in approximately June of 1989. (Tr. 3, Vol. II) On January 22, 1990, Mr. Johnson purchased 700 shares of CM Communications at $7.35 a share for a total investment of $5,160 based on Mr. Roche's representation that the stock price would rise to $20 to $25 per share within 30 to 60 days. 13/ (Tr. 8-11, Vol. II; D. Ex. 6)

Mr. Roche began handling the Stuart-James account of Mr. Maegerle, a semi-retired consulting engineer, who resided in Delaware in early 1990. (Tr. 144, Vol. I) Mr. Roche told Mr. Maegerle that investing in CM Communications could potentially recover the $8,500 in cumulative losses in his account. (Tr. 145, Vol. I) As a result, during the period January 30, 1990 to February 14, 1990, Mr. Maegerle sold the securities in the account and used the proceeds to purchase 1,065 shares of CM Communications at prices ranging from $7.00 to $9.20, for a total investment of $8,620.50. (Tr. 146-50, Vol. I; D. Ex. 4A) On April 5, 1990, Mr. Maegerle invested an additional $8,265 for 1,000 shares of CM Communications based on information from Mr. Roche which predicted that the price of CM Communications stock would rise to $13.00 per share in six to nine months, and to $26.00 per share within eighteen months. (Tr. 148-49, Vol. I; D. Ex. 4B; R. Ex. 3)

The highest bid price for the CM Communications in 1990 was $8.875 per share; in

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13/ On cross-examination, Mr. Johnson denied that Mr. Roche had referred to the price increase as "a potential range or possible range". According to Mr. Johnson, "No, it was that's where it's going. And -- between 20 and 25. And my comment was, I'd like to get out at 15 or so. " (Tr. 15, Vol. II)

1991 the highest bid price was $1.4375 per share; by 1992, the highest bid price of the stock was $0.625 per share. (D. Ex. 10A) Mr. Gregory did not sell his shares, and his last statement from Stuart-James on September 28, 1990 put the bid price of the stock at $0.687 a share. (Tr. 33, Vol. II; D. Ex. 7) Mr. Johnson and Mr. Maegerle lost approximately $4,700 and $12,000 to $13,000, respectively, on their CM Communications shares. (Tr. 151, Vol. I; Tr. 16, Vol. II) On September 28, 1992, the company informed the Commission that its stock was being delisted from the NASDAQ and that it would be liquidating under a bankruptcy proceeding. (D. Ex. 12D)

CM Communications, Europa, Meadow, and Sigmatron Nova were all relatively new business enterprises. They all had limited operating histories, a history of operating losses, or very little earnings during their limited operating period, and they were all in activities which involved a high degree of competitive, economic, and in some cases technological risk. 14/ With good reason, the prospectus of each company noted its speculative nature.

Mr. Roche's price predictions as to these securities violated the antifraud provisions of the federal securities laws because they were willful misrepresentations and/or omissions of material facts regarding the financial and operating condition of the companies recommended, given the "significance the reasonable investor would place on the withheld

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14/ See, Lester Kuznetz, 48 S.E.C. 551, 553-54 n.3 (1986) (finding no reasonable basis for predictions that an investment was guaranteed or relatively safe where company with four years of operating losses, and noting that a salesman recommending a security must disclose material adverse information which is known or readily ascertainable); SEC v. R.A. Holman & Co., 366 F.2d 456, 458-59 (2d Cir. 1966), reh'g denied, 377 F.2d 665 (2d Cir. 1967), cert. denied, 389 U.S. 991 (1967) (finding no reasonable basis for price predictions when company sustained a loss, even though it had been profitable for three years); SEC v. Hasho, 784 F. Supp. 1059, 1109 (S.D.N.Y. 1992) (finding no reasonable basis for predictions about unseasoned companies either operating at a loss or with small profits).

or omitted information." Basic Inc. v. Levinson, 485 U.S. 224, 240 (1988)

I reject Mr. Roche's position that he was victimized by Stuart-James, who "enforced their belief system through its management and propaganda." 15/ (Roche Letter/Brief ¶ 1) The case law is clear that a registered representative cannot disclaim responsibility for her/his actions, as Mr. Roche has attempted to do, by claiming to have been misled by others.

> Brokers and salesmen are 'under a duty to investigate, and their violation of that duty brings them within the term 'willful' in the Exchange Act.' Thus a salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant. He must analyze sales literature and must not blindly accept recommendations made therein. Hanly v. SEC, 415 F.2d 589, 595-96 (2d Cir. 1969)

The basic governing principle is that a securities sales person who recommends a security or makes a representation concerning an issuer represents that he/she has conducted a reasonable investigation and that there exists a reasonable basis for the recommendation or representation. Heft, Kahn and Infante, Inc., 41 S.E.C. 379, 382-83 (1963); Ross Securities, Inc., 41 S.E.C. 509-11 (1963); Merrill Lynch, Pierce, Fenner & Smith, Inc., 13 SEC Docket 646, 650-51 (1977) See also SEC v. Hasho, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992) (Defendant's argument that he was naive and relied upon information from employer did not negate intent, but rather established it. Those who hold themselves out as professionals with specialized knowledge and skill to furnish guidance can not be heard to claim youth

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15/ I grant Mr. Roche's request and allow in evidence as Respondent's Exhibit Number 1, a tape of a Stuart-James Regional Vice President discussing CM Communications. (Tr. 80-82, Vol. II) Mr. Roche claims to have misled by such things as a research report prepared by a former Stuart-James analyst (R. Ex 3) and the presentation in R. Ex. 1. (Tr. 96, Vol. II)

or inexperience when faced with charges of violations of the antifraud provisions of the securities laws.)

From observing the witnesses I am persuaded that their testimony is truthful and that Mr. Roche told them that stocks would rise to certain levels or ranges of prices or dollar returns. Such predictions, whether or not precise, are fraudulent. Alfred Miller, 43 S.E.C. 233, 235 (1966) (finding predictions of stock price rise to range of 50 to 80 cents and to $1.00 or $1.50 by year-end were fraudulent) Mr. Roche offered no support for his disclaimer that "I never stated to any client that a stock was going to a certain price and definitely go there, and that's why they should buy it." (Tr. 88, Vol. II), and that "[he] never gave precise price predictions, it's going to a certain price at a certain time." (Tr. 96, Vol. II) Finally, even if Mr. Roche had couched his predictions as his own opinion of the potential of the stock, rather than as guarantees (Tr. 88, Vol. II), it would not lessen his responsibility for making fraudulent predictions. Armstrong, Jones and Co., 43 S.E.C. 888, 896 (1968), accord SEC v. Hasho, 784 F. Supp. at 1109 ("The fraud is not ameliorated where the positive prediction about the future performance of securities is cast as opinion or possibility rather than as a guarantee.")

II. Mr. Roche's Material Misrepresentations and Omissions Violated the Antifraud Provisions

The record is replete with evidence that Mr. Roche intentionally made false statements and failed to disclose material information to investors. When he recommended that Mr. Doshi buy Sigmatron Nova warrants, Mr. Roche did not advise Mr. Doshi of the following material information: that (1) the NASDAQ stopped listing Sigmatron Nova

warrants on December 9, 1987, three months before he recommended that Mr. Doshi purchase the securities, (D. Ex. 10D at 2) 16/ (2) certain risk factors existed with the company which could jeopardize his investment, (3) the company had a limited operating history and lack of profits, 17/ (4) the company's financial stability was uncertain, (5) a complex manufacturing process could pose a risk to the company, (6) significant competition existed in the industry, and (7) Forbes News Service rated Sigmatron Nova's IPO as one of the worst in 1987. (Tr. 66-68, Vol. I)

When he recommended that Mr. Scheidker purchase Europa securities, Mr. Roche did not disclose to Mr. Scheidker any risks associated with an investment in Europa. (Tr. 108, Vol. I) He did not inform him that Europe's prospectus for the IPO stated in large, bold typeface that "[t]hese securities involve a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." (D. Ex. 13A at 1) Or that the prospectus listed among twenty items such risk factors as (1) the company's recent formation and limited operating history; (2) the inability of the company to ensure it could operate a viable business or earn a profit; (3) Europa was in competition with other vacation activities in its operating area, including direct competition of other cruise ships in

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16/ It appears that at the time of the purchase the warrants were listed in the pink sheets published by the National Quotation Bureau, however, Mr. Roche at the hearing stated that he did not trade or recommend securities that were so listed. (Tr. 83, Vol. I; Tr. 86, Vol. II)

17/ According to its report for the third quarter ended March 31, 1988, Sigmatron Nova had a quarterly net loss from operations in 1988 of $922,808, a quarterly net loss from operations in 1987 of $682,771, and a cumulative net loss from its inception in 1985 of $7,524,938. (D. Ex. 15C at 4). The third quarter results for 1988 came out after Mr. Doshi's purchase, but the other information was available to Mr. Roche at the time he recommended that Mr. Doshi purchase these securities.

some markets; (4) the existing of laws or proposed legislation which would adversely affect the firm's operations; (5) the inability to secure ports for Europa's cruise ships; and (6) the SEC administrative proceeding then pending against Europa's underwriter and principal-market maker, Stuart-James. (D. Ex. 13A at 6-12)

In connection with his recommendation that Mr. Boe purchase Meadow securities, Mr. Roche did not inform Mr. Boe of any negative information about Meadow. (Tr. 159, Vol. I) Mr. Roche did not tell Mr. Boe that Meadow's prospectus described its shares, in large bold type, as "involving a high degree of risk and should be considered only by persons who can afford the loss of their entire investment." (D. Ex. 14A at 1) Further, the prospectus outlines seventeen risk factors which included (1) the company's lack of an operating history; (2) the risky nature of "blind pool" offerings; (3) the potential inexperience with managing acquired business; (4) and the fact that no prospective acquisitions had been identified, along with the possibility that the company may not find suitable businesses to acquire or to secure necessary financing. (D. Ex. 14A at 4-7) Mr. Roche told Mr. Boe that he "shouldn't pay any attention to the risk factors [set out in prospectuses], that they were only something that was put in there because the SEC insisted on it. And it was really of no concern." (Tr. 158, Vol. I)

When making sales recommendations to Mr. Gregory, Mr. Roche did not disclose existing material information that was negative about the companies whose securities he was recommending, and he told Mr. Gregory to ignore the language in the prospectus which described the risks associated with the enterprise. (Tr. 26-27, 29, Vol. II) Mr. Roche also represented to Mr. Gregory that he had information so that Mr. Gregory could get some

"good buys." (Tr. 26, Vol. II) In recommending securities to Mr. Gregory, Mr. Roche "... just told me straight, they're going to make money. I've got to get on this one. It's going to go up, ..." (Tr. 29, Vol. II)

In sales presentations to his customer Robert Novak (Mr. Novak), Mr. Roche never disclosed anything negative about stocks he was recommending, but always disclosed only positive information. 18/ (Tr. 39, Vol. I)

Mr. Roche told Mr. Johnson that he had access to non-public information so that he had made profits of from twenty-five to forty percent and higher for his other clients and he expected to do the same for Mr. Johnson. (Tr. 6, Vol II) There is no evidence that this information is true. Mr. Roche never stated anything negative about the companies he recommended to Mr. Johnson. (Tr. 7, Vol. II)

Mr. Roche's failure to disclose risk factors concerning the securities he recommended that persons buy was a failure to state material facts in violation of the antifraud provisions. B. Fennekohl & Co., 41 S.E.C. 210, 215-17 (1962); Merrill Lynch, Pierce, Fenner and Smith, 13 SEC Docket 646, 653-54 (1977). In addition, his advice to customers that they should ignore statements in prospectuses amounted to a willful denial that highly speculative securities were risky in nature. This conduct violated the antifraud provisions of the securities laws. Lester Kuznetz, 48 S.E.C. 551, 553 (1986) (held untrue statements that an

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18/ Mr. Novak was a partner with an architectural firm in Cincinnati, Ohio, when Mr. Roche took over his Stuart-James account in early 1988. (Tr. 32-33, Vol. I) Mr. Novak prior investment experience had been rolling over an IRA into a brokerage account which has mainly blue chip stocks, some non-taxable money market funds, and some Fidelity mutual funds. (Tr. 33-34, Vol. I) Mr. Novak knew little about penny stocks, and believed that were at the medium risk level. (Tr. 36-37, Vol. I)

investment was relatively safe violated the antifraud provisions)

Based on his education, experience, the knowledge he displayed at the hearing, and the evidence of his dealings with customers, I find that Mr. Roche knew about the risks in the investments he recommended and deliberately did not disclose them. Mr. Roche acted with a high degree of scienter when he made false statements of material fact and omitted to state material facts necessary to make the statements not misleading about the business performance, prospects, and risks of the securities he was recommending, and that he thereby violated the antifraud provisions of the securities laws as alleged in the Order.

III. Mr. Roche's False Limit Order Information Violated the Antifraud Provisions

In July 1990, Mr. Gregory hesitated about purchasing CM Communications at $7.875 a share as Mr. Roche recommended because of previous losses suffered in his account. Mr. Roche induced Mr. Gregory to purchase the securities, by volunteering to put a "stop/loss" on the shares at $7.00 so that if the price declined to that level Stuart-James would sell the shares thus limiting Mr. Gregory's loss. 19/ When the price of CM Communications dropped and Mr. Gregory requested that Stuart-James implement the stop/loss order, he learned that such things did not exist. (Tr. 31-33, Vol. II)

Mr. Roche suggested that he explained to Mr. Gregory before he purchased the securities that the NASDAQ did not have stop/loss orders so that his reference was to a "mental stop". (Tr. 46, Vol. II) Mr. Gregory understood that Mr. Roche meant a computer generated procedure that would occur automatically. According to Mr. Gregory, Mr. Roche

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19/ As noted previously, when Mr. Gregory, who was semi-retired, opened his account with Mr. Roche he told him the $25,000 he was investing was savings he did not want to put at risk. (Tr. 24-28, Vol. II)

told him that the NASDAQ did not allow such orders only after the price dropped and the stop loss procedure did not take effect.

In view of Mr. Roche's many false statements in evidence, I believe Mr. Gregory's version of what Mr. Roche told him and when. Other factors that convince me Mr. Roche is lying are that his witness, Theodore Ben Benetis, a Stuart-James registered representative during the period March 1987 until late 1990, stated that it was impossible to implement a customer's stop/loss directive because the stocks recommended by Stuart-James often plummeted in price so that "there would be no stopping", and Mr. Roche's stop/loss definition would not have protected Mr. Gregory if Mr. Roche was unavailable when the stock dropped in price, which is what happened in this situation. (Tr. 197-98, Vol. II)

Mr. Gregory did not sell his shares, and his last statement from Stuart-James in September 1990 valued the stock at $0.687 a share. (Tr. 33, Vol. II; D. Ex. 7) The company ultimately went bankrupt so that Mr. Gregory's $7,875 investment was worthless.

I find that Mr. Roche's representations to Mr. Gregory and his failure to disclose that the NASDAQ did not allow stop/loss or limit orders constitute material misrepresentations and omissions made willfully to induce Mr. Gregory to buy CM Communications stock. Such misrepresentations and omissions constitute a sales technique lending a "highly speculative investment an unwarranted air of certainty as to future profits and to obscure the risks involved in such an investment" in violation of the antifraud provisions of the federal securities laws. Ross Securities, Inc., 41 S.E.C. 509, 514 (1963)

IV. Mr. Roche's Excessive and Unsuitable Trading Violated the Antifraud Provisions

Mr. Roche controlled trading in the accounts of at least three of his customers: Mr.

Gregory, Robert & Mary Novak (Mr. Novak), and Fred & Bette Scheidker (Mr. Scheidker). The accounts were not designated as discretionary accounts, however, each of these customers routinely followed Roche's investment advice because he asked them to trust him and they did so believing that he was looking out for their interests. Often, Mr. Roche executed trades in these customer accounts without first getting authorization to do so. The evidence is unanimous that all of the activity in the accounts occurred based on Mr. Roche's buy and sell recommendations. When customers gave Mr. Roche prior approval for transactions, their lack of knowledge of penny stocks and general unsophistication with trading securities, Mr. Roche's many misrepresentations and omissions, his failure to independently investigate the stocks himself, his position that customers had to act quickly on his recommendations, were all conditions that made it impossible for these customers to make informed, independent judgements. Davis v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 906 F.2d 1206, 1212 (8th Cir. 1990); Eugene J. Erdos, 47 S.E.C. 985, 989-90 (1983), aff'd 742 F.2d 507, 508 (9th Cir. 1984); Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980); Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 433 (N.D. Cal. 1968), aff'd, 430 F.2d 1202 (9th Cir. 1970)

In a fraud context, the term churning describes excessive trading by registered representatives who controlled trading in the accounts and who, acting to benefit themselves rather than their customers, traded excessively in light of the customers' investment objectives. Cases cited above and Albert Vincent O'Neal, 56 SEC Docket 2447, 2450 (1994); See e.g. Mihara v. Dean Witter & Co., 619 F.2d 814, 820 (9th Cir. 1980); Shad v. Dean Witter Reynolds, Inc., 799 F.2d 525 (9th Cir. 1986)

Unsuitable trading occurs where a registered representative engages in risky transactions that were directly contrary to the customer's stated investment objectives. Richard N. Cea, 44 S.E.C. 8, 18 (1969)

Churning and unsuitable trading violate the antifraud provisions of the federal securities laws because they involve the fraudulent management of customer accounts when registered representatives enter transactions and manage customer accounts for the purpose of gaining commissions and in disregard of the customer's interests. Miley v. Oppenheimer & Co., 637 F.2d 318, 324 (5th Cir. 1981); McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 890 n.1 (5th Cir. 1979); "Churning, in and of itself, may be a deceptive and manipulative device under Section 10(b), the scienter required by Section 10(b) being implicit in the nature of the conduct." Armstrong v. McAlpin, 699 F.2d 79, 91 (2d Cir. 1983)

I find Dr. Stewart Leon Brown, an expert sponsored by the Division, persuasive that Mr. Roche caused churning and unsuitable trading in the accounts of Mr. Gregory, Mr. Novak, and Mr. Scheidker. (D. Ex 11) 20/ Using information from account statements, trade tickets, and trade runs, Dr. Brown analyzed the activity in the accounts which involved securities which were all unlisted over-the-counter stocks in which Stuart-James made a market and was thus a principal. 21/ The vast majority of transactions involved penny

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20/ Dr. Brown, a finance professor at Florida State University and a Chartered Financial Analyst, was called by the Division. Dr. Brown is a consultant to a $40 billion pension fund, conducted training for the Florida Division of Securities and the National Association of Securities Examiners in the analyses of retail brokerage accounts, has published in numerous scholarly and professional journals, and has testified over fifty times as an expert witness primarily in retail securities cases. (Tr. 51-52, Vol. II)

21/ The Division's analysis was limited by Mr. Roche's failure to respond to a subpoena for (continued...)

stocks which Dr. Brown defines as stocks priced at less than one dollar. 22/ (Tr. 62, Vol. II; D. Ex 11 at 5)

Mr. Gregory - Fourteen purchases and corresponding sales transactions occurred during the period April 29, 1988 through April 2, 1990. On average securities were held 103 days. (D. Ex. 11 at 17) Five securities were held for less than 64 days, and another two instances securities were bought and sold within one day. (D. Ex. 11 at 20)

Mr. Novak - Twenty-one purchases and corresponding sales transactions effected in the account from March 25, 1988 through May 8, 1990. One security was held for just ten days, and four other securities were held for less than two months. On average, securities purchased and sold in Mr. Novak's account during the period were held 123 days. (D. Ex. 11 at 21, 24-24A)

Mr. Scheidker - Eighteen securities were bought and sold from July 1988 through June 30,

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21/(...continued)
the trading records of his customers. At the hearing, the Division learned Mr. Roche had materials that he did not turn over that were covered by the subpoena. (Tr. 37-41, 117, Vol. II)

22/ According to a committee of the United States Congress that examined the issue in 1990:

> Penny stocks are low-priced, highly speculative stocks generally sold in the over-the-counter (OTC) market and generally not listed on an exchange. Often, they do not qualify for listing on the National Association of Securities Dealers Automated Quotation System (NASDAQ). ... out of an estimated 55,000 publicly traded corporations in the United States, ... 4,970 are quoted on the NASDAQ system. ...47,000 securities fall entirely outside exchange or NASDAQ listings. Although these stocks have been used in the past to finance small, innovative companies, some of which have developed into successful corporations, recently the issuance and subsequent trading of such securities has been increasingly used as a means for defrauding investors. (H. Rep. Rep. No. 101-617, 101st Cong., 2d Sess. 8 (1990)

1989. The average holding period was 92 days. Five securities were bought and sold in same two weeks or less, and another six securities were held less than 88 days. (D. Ex. 11 at 28-28A)

A crucial ingredient in determining whether churning exists is the customer's investment objectives. Dr. Brown's analysis used the following: Mr. Gregory - low risk, Mr. Novak - growth, moderate risk, and Mr. Scheidker - moderate risk. 23/(D. Ex. 11 at 2) The evidence supports the use of these risk levels. Mr. Gregory was semi-retired when he began doing business with Mr. Roche and told him that the money in the account was savings which he did not want to lose. (Tr. 27, Vol. II) Mr. Novak understood that penny stocks involved medium risk. He told Mr. Roche that he was willing to take medium risk but he did not wish to take high risks because he intended to use the funds for retirement. (Tr. 37, 38, Vol. I) Mr. Scheidker was retired. One of his accounts was an Individual Retirement Account, he was looking for price appreciation and thought that buying many stocks would lower the risk. (Tr. 92-93, 115-19, Vol. I) A low to moderate risk level was appropriate for these investors considering their age, employment, and their investment objectives, i. e., the funds were intended to support their retirement. Mr. Gregory was semi-retired, Mr. Novak's funds were from his retirement funds with a previous employer and he wanted to add to this amount since the architectural firm he began had no formal retirement plan, and Mr. Scheidker, age 76, had turned his businesses in St. Louis over to his sons and was dividing his time between Florida and St. Louis. (Tr. 143, Vol. I) Mr.

23/ The Division furnished Dr. Brown with this information and he does not know the basis for assigning these customers these objectives. (Tr. 56, Vol. II)

Roche's misrepresentations about the risk associated with penny stocks in general, and the particular stocks he recommended in particular, led his customers to believe they were investing funds consistent with their objectives, when in fact their funds were being used to repeatedly purchase and sell securities for Mr. Roche's benefit.

I reject Mr. Roche's position that he was justified in assuming that all the customers who invested with him wanted high risk investments because his clients knew that Stuart-James engaged in an aggressive strategy to make money in low cost securities. (Tr. 107, Vol. II) The evidence is that Mr. Roche did not inform customers of the risks involved investing in penny stocks. Rather, Mr. Roche downplayed the risks by emphasizing his knowledge and his market successes for other customers 24/, he described Stuart-James's in-house research as excellent, he described all equity investments as involving risks and failed to disclose that penny stocks are high risk investments, he dismissed as insignificant prospectus materials which described investments as risky, he consistently failed to disclose any negative information about the investments he proposed, and he hinted that he had information that other registered representatives did not have.

Dr. Brown's application of two measures - annual turnover ratio and breakeven cost factor, demonstrate that churning and unsuitable trading occurred in these accounts in that, given the level of trading and the costs imposed, there was little reason to expect that these customers would maintain their original investments, there was no reasonable basis to expect that the accounts would achieve satisfactory results, and Mr. Roche, not his customers, benefited from the transactions he recommended. (D. Ex. 11, at 7-8). Mr. Roche did not

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24/ There is no evidence that this representation was true.

dispute the results of Dr. Brown's analysis which are as follows (D. Ex. 11 at 2, 7-8):

CUSTOMER	NET FUNDS INVESTED	OUT OF POCKET LOSSES	TOTAL COMMISSIONS
Mr. Gregory	$12,667	$9,896 (78%)	$15,571
Mr. Novak	51,767	38,917 (75%)	37,107
Mr. Scheidker	56,248	53,748 (95.6%)	49,504

CUSTOMER	ANNUAL TURNOVER RATE	BREAKEVEN COST FACTOR
Mr. Gregory	3.3 times	109.7%
Mr. Novak	4.6 times	138.8%
Mr. Scheidker	7.1 times	256.7%

The annual turnover rate, i.e., ratio of total purchases in the account divided by the average equity in the account and annualizing the result, measures how many times a year the portfolio [all the securities in the account] is turned over. 25/ (D. Ex 11 at 3) It is relevant when considering turnover rates to keep in mind that when an investor buys and sells securities he/she incurs transactions costs, i.e., direct costs resulting from the transaction such as commissions and transfer taxes, which cut into profits. Unsophisticated investors are often surprised to learn that transactions which appear profitable can change into a net loss situation after consideration of transaction costs. Frequent buying and selling - high turnover ratios - is expensive. Transaction costs on penny stocks are proportionately

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25/ The "annual turnover ratio" (ATR) is based on the so-called "Looper Formula" which the Commission has applied in churning cases for some time. See Looper and Company, 38 S.E.C. 294, 297 n.6 (1958)

much higher than on higher priced stocks. (D. Ex. 11 at 6) 26/ Dr. Brown's opinion that turnover rates understate excessive trading in penny stocks because penny stocks have extraordinarily high transaction cost is unrefuted. (D. Ex 11 at 6) Traditional thinking is that a portfolio has a greater opportunity to earn a higher return the fewer times the securities in the portfolio are turned over due to the imposition of transactions costs.

To determine if the turnover rate is relevant on the question of churning, requires consideration of the customer's investment objectives and the types of securities involved. Given these customers' investment objectives, I find that these turnover rates of 3.3, 4.6 and 7.1 for customers willing to take low and moderate risk with their investments demonstrate that Mr. Roche churned these accounts. A turnover rate of 7.4 has been found excessive where the customer instructed the registered representative to handle the account aggressively, and turnover rates of from 3.5 to 4.4 27/ have been held excessive where the customers were individuals generally uninformed about trading in securities who wanted income consistent with safety. Shearson Lehman Hutton, Inc., 43 SEC Docket 1322, 1325-26 (1989); Samuel B. Franklin & Co., 42 S.E.C. 325, 328-30 (1964); Behel, Johnsen & Co., 26 S.E.C. 163, 167-68 (1947) 28/ The facts in the cited cases were similar to this situation

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26/ Dr. Brown calculated that in these accounts stocks priced at between $.30 and $1.00, had transaction costs of between 18.4 percent (purchases) and 9 percent (sales), while stocks priced greater than $5.00, had transaction costs of between 5.4 percent (purchases) and 3.4 percent (sales). (D. Ex. 11 at 6)

27/ The 3.5 rate occurred over a 25-month period, the 4.4 rate occurred over an 18-month period, and the 4.4 rate occurred over a three year period.

28/ One authority has proposed a "2-4-6" rule, whereby the presence of an ATR greater than two indicates the possibility of churning, the presence of an ATR greater than four establishes a presumption of churning and an ATR in excess of six conclusively establishes churning. Stuart Goldberg, 1 Fraudulent Broker-Dealer Practices, § 2.9(b)(1) at 2-43 to .50

in that the customers' accounts suffered major losses or small profits while the transaction costs, which includes payments to the registered representatives, were considerable.

The breakeven cost ratio, i.e., the return necessary to cover transaction costs (commissions on agency trades and markups and markdowns on principal trades) is an even better indicator that Mr. Roche churned these accounts because it directly measures trading costs which are proportionately higher for penny stocks. (D. Ex. 11 at 7) Dr. Brown uses the term breakeven ratio for what others have referred as commission/equity ratios and cost/equity maintenance factors. The breakeven ratios for the three accounts from 109.7 percent to 256.7 percent indicate the extraordinary and unrealistic level of return these accounts would have had to earn before the customers would receive any profit. Dr. Brown's expert opinion that a breakeven cost factor of over twelve percent is excessive - based on the long run arithmetic average annual rate of return on S&P 500 stocks of twelve percent - because there is little likelihood that an account could cover costs exceeding this level and earn a satisfactory return is unrefuted on this record. (D. Ex. 11 at 5) The fact that these accounts lost from between 75 to 95.5 percent of principal while they were paying huge transactions costs, which in one instance exceeded the net funds invested, is a conclusive indicator that Mr. Roche churned these accounts to benefit himself and not his customers. (See infra at 26; D. Ex. 11 at 2) These losses are extraordinary given that during the general time period analyzed for these three investors, returns on a variety of indexes and mutual funds were all positive. Returns on conservative investments such as corporate bonds, utility stocks, and other high quality stocks ranged between 9 percent and 22 percent and returns on generally riskier small capitalization stocks and NASDAQ stocks ranged

between 4 and 17 percent. (D. Ex. 11 at 2-3, 11)

As noted these customers paid large commissions. Mr. Gregory paid commissions that were 123 percent of his net investment, Mr. Novak paid commissions that amounted to 72 percent of his net investment, and Mr. Scheidker paid commissions amounting to 88 percent of his net investment. 29/ Shearson Lehman Hutton, Inc., 43 SEC Docket 1322, 1323-25 (1989) (Commission found churning where in a little over a year the account with an original balance of $100,000 lost about $55,000, while charges amounted to $53,222.); Michael David Sweeney, 50 SEC Docket 59, 64 (1991) (Commission found, inter alia, 22% to 44% depletion of net investments by transaction costs "a clear indication applicants engaged in excessive trading").

Mr. Roche does not deny that he recommended that these customers engage in these security transactions so it is clear that he acted willfully and with scienter. He demonstrated at the hearing that he clearly understood the costs of trading low-cost securities. In addition, his consistent urging to clients who lacked funds for recommended purchasers that they sell securities they held, his refusal to explain to his clients how he was compensated, and his misrepresentation that his primary compensation came from trading stocks for himself, further demonstrate his willful intent to defraud his customers by churning their accounts. (Tr. 41, 97-98, 100-01, 116-17, 147-49, Vol. I; Tr. 29-30, Vol. II; D. Ex. 2D at 6)

Finally, the relatively short holding periods for these three customers - average of 92 days, 103 days, and 123 days with instances where securities were bought and sold within

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29/ Mr. Gregory was under the mistaken belief that the amount of commission he paid was negligible. (Tr. 34, Vol. II)

days and months - is another indicia of excessive trading. J. Logan & Co., 41 S.E.C. 88 (1962), aff'd, 325 F.2d 147 (9th Cir. 1963), cert. denied 377 U.S. 937 (1964); Behel Johnsen & Co., 26 S.E.C. 163, 167 (1947).

In summary, the overwhelming evidence is that Mr. Roche's conduct fits the three established criteria that demonstrate churning in violation of the antifraud provisions of the securities laws:

(1) he exercised control over trading in the accounts,

(2) trading in the accounts was excessive in light of the customers' objectives, and

(3) he acted with scienter.

V. Mr. Roche's Unauthorized Transactions Violated the Antifraud Provisions

The evidence is overwhelming that as part of a scheme to defraud which used misrepresentations, omissions, and deception, Mr. Roche effected unauthorized stock transactions in customer accounts in the period 1987 to 1990 thus violating the antifraud provisions of the federal securities laws. Martin Herer Engelman, 59 SEC Docket 1038 (1995) (two respondents compounded the fraud by engaging in unauthorized transactions); SEC v. Hasho, 784 F. Supp. 1059, 1096-99, 1110 (S.D.N.Y. 1992) (unauthorized trading violates 10b-5 when a pattern of unauthorized trading and misrepresentations relating to unauthorized trade); United States v. Pray, 452 F. Supp. 788, 795 (M.D.Pa. 1978) (unauthorized trading a deceptive practice prohibited by the anti-fraud provisions of the securities laws). 30/

30/ The courts have varied in their treatment of claims under the securities laws for unauthorized trading. While unauthorized trades are not per se a Rule 10b-5 violation, they (continued...)

In early May 1989, Mr. Doshi learned from confirmation slips that Mr. Roche had sold 25,000 shares of Wine Society securities at $0.0312 per share for a total of $770, and had purchased 750 shares of Denpac Corporation stock at $1.00 per share for a total of $750 in his account. (Tr. 68-70, Vol. I; D. Ex. 2C) Mr. Doshi was upset and taped his phone conversation with Mr. Roche in which he sought an explanation for Mr. Roche's unauthorized actions. (D. Ex. 2E and 2D at 2-3, 7-8)

Mr. Doshi — But, you see, you never even mentioned that thing, you just bought it without telling me all that stuff.

Mr. Roche — It was a new issue. I, I, I --- you know, where's it at now, it's ... On those new issues you have to react quickly, ... I've had to get down and I've had to get, uh, into researching and making sure these companies are ... what they're telling me they are, and I don't just take, take it for granted anymore.... my research is stepped up ...

Mr. Doshi — You bought this Denpak (sic) Corporation. I don't even know about it, you didn't even tell me that you were -- whatever, even if it was $5, $10, I don't care. You bought that without even -- I don't even know about it.

* * *

Mr. Roche — Paresh, you're right . . . It's a new -- it was a new issue, and all I can say is, is, you're right, and, and -- you're right, and I never -- in the past -- I, I, you're right about that. That's not, it's not protocol; it's not correct, and if I, if I, any, any chance that -- we had talked, but if there was any chance that I thought we were . . . going to lose on it, I, I wouldn't have, but you're right about that, and [inaudible] it's too late to cancel, but I'm saying, saying, the money is, is, is, uh, is there for you, okay? Don't worry about that.

30/(...continued)
can be where it is shown that there was an intent to deceive or defraud. Thomas Lee Hazen, The Law of Securities Regulation 439 (2nd ed. 1990); See R.A. Holman & Co., Inc., 42 S.E.C. 866, 876 (1965), aff'd, 366 F.2d 446, 451 (2d Cir. 1966); Shelley Roberts & Co. of California, 38 S.E.C. 744, 751 (1958); First Anchorage Corp., 34 S.E.C. 299, 304 (1952)

When Mr. Doshi complained, Stuart-James refunded the funds Mr. Roche spent to purchase the Denpac Corp. securities, but only after Mr. Doshi furnished Stuart-James with a copy of the taped conversation.

According to Mr. Scheidker, "[t]here were times stocks were bought without any previous discussion or approval. He had already bought them and I would hurry down to make payments on them. And that was about the most usual situation." (Tr. 98, Vol. I) For example, Mr. Roche, without Mr. Scheidker's approval, purchased 30,000 warrants of International Microcomputer for $4,510, on February 21, 1989, and an additional 65,000 warrants for $9,760 on February 24. (Tr. 109-10, Vol. I; D. Ex. 3A) Mr. Scheidker paid for these securities without complaint because he wanted to continue to do business with Stuart-James. (Tr. 112-13, Vol. I)

On approximately six occasions, Mr. Roche conducted unauthorized trading in Mr. Boe's account which he had taken over in 1988. On at least one occasion, Mr. Boe notified Stuart-James that the purchase was unauthorized and requested that no further transactions occur without his authorization. (Tr. 164-65, Vol. I)

Mr. Gregory told Mr. Roche when he opened his account in 1987 that would not invest more than $25,000 so he was upset when Mr. Roche effected unauthorized purchases in his account that required Mr. Gregory to pay $700 over that limit. (Tr. 35, Vol. II) Mr. Gregory paid the additional funds because Mr. Roche said if Mr. Gregory did not pay he would have to pay for it out of his own pocket. (Tr. 35-36, Vol. II).

Mr. Roche offered no plausible defense for his intentional acts done willfully as part of a scheme or course of business to defraud investors in violation of the antifraud

provisions of the securities statutes.

PUBLIC INTEREST

Having found that Mr. Roche has violated the Securities Act and the Exchange Act, the next consideration is whether it is in the public interest to sanction him, order him to cease and desist, and order him to disgorge funds.

The applicable factors used to assess the public interest are enunciated in Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981):

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

Measured against these criteria, Mr. Roche's violations were serious and blatant. By fraudulent means he took substantial sums of money from people, including some who were either retired, semi-retired, or close to retirement, who he knew expected to have their funds available to them in the short-term. His illegal activities were pervasive in that they involved several clients and many transactions, and they were recurrent in that he continued the same type of wrongdoing for at least a three-year period. Mr. Roche possessed a high degree of scienter when he carried out this fraudulent scheme.

I find Mr. Roche's defense that he was not a wrongdoer but a victim of Stuart-James's illegalities like his customers implausible. (Tr. 79, Vol. II) There is not one shred of evidence in this record to support his claim that he did not know at the time that what his conduct was illegal. Mr. Roche has a college degree with a major in economics. He told his customers he had an excellent understanding of penny stock trading, and he

demonstrated that knowledge at the hearing. Additionally, he continued to commit illegal acts for at least a year and a half after he claims he realized in the spring of 1989 that Stuart-James's representations were false. (Tr. 133-136, Vol. II)

The fact that Mr. Roche made over a million dollars from his activities at Stuart-James in the four years from 1986 until he left in 1990, and he has earned considerably less since then - $30,000 in 1993 - makes it reasonable to assume that Mr. Roche committed these illegal acts to benefit himself financially. And he succeeded. (Tr. 25-26, Vol. I; Tr. 91-94, Vol. II) 31/ This income disparity also increases the likelihood that Mr. Roche will, if allowed, commit additional violations and supports a bar and an order to cease and desist.

The record is replete with evidence that Mr. Roche asked people to trust him to act in their best interests. When their accounts lost money, he begged for another chance and gave assurances that he would make up the losses. Mr. Roche's statements to Mr. Doshi, when Mr. Doshi called seeking an explanation for unauthorized transactions that Mr. Roche effected in his account, shows how Mr. Roche lied and cajoled people into believing that if they continued to deal with him their investments would be profitable.

> I lost a hundred forty thousand on the market, by the way; I learned by that also, by the way, but I mean -- you know -- I'm taking care of -- I don't care about that. I care about our relationship, it's no bullshit and I want to get up there and sit down with you...
>
> your business and your whole thing is very important to me. That's what makes me, I think a little bit different, is I'm not going anywhere; I'm not somebody that doesn't care; and I'm going to drive up to Carson City Tuesday, if it,

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31/ Noting my surprise that someone who earned a million dollars in four years could see themselves as a victim, Mr. Roche explained that there were people in the securities industry [presumably engaging in similar conduct] who had made and were making more than he did. (Tr. 93, Vol. II)

> if nothing else changes, and we'll sit down.
>
> ... let me get my ass up there to, to see you and, and we'll, we'll look eye-to-eye again, and we'll understand each other...
>
> I'm thinking clients first, okay; I'm not thinking brokerage firm, I'm not thinking anything but client...
>
> with some, some right moves, any monies that we lost will seem , will seem -- uh, will come back to us. I'm not gonna give up. I'm having some better success this year with some of the stocks. I just had a stock that I mentioned that, that ran for me ... You know why? Because I'm researching these stocks. ... You've been one of the ones that's been loyal to me, and I want to, I want to bring you back. Uh, not ... I don't need your business, okay? I want to do it for you, though, okay? You gotta believe that ... (D. Ex 2D at 6, 8, 9-10)

In September 1990, Rose C. Maslack (Ms. Maslack), complained that she trusted her nephew, Mr. Roche at his request, but that he had mismanaged her Stuart-James account, effected unauthorized transactions, and caused severe losses in the funds she had given him to invest. (D. Ex. 16) According to Ms. Maslack,

> [Y]ou would have to talk to Donald Roche to realize what a smooth operator he is & how he can evade a direct answer and make what he is doing seem right. (D. Ex. 17)

Ms. Maslack notified Stuart-James that she withdrew her complaint against Mr. Roche on November 30, 1990. (R. Ex. 6)

The probability is very high that Mr. Roche will commit additional violations if permitted to remain in the securities industry. He does not acknowledge his wrongful conduct, or represent that he will discontinue the way he has conducted his business. Like so many of his statements, his representation that he has "constantly worked to learn more about the business and the companies, and research analysis and technical analysis, fundamental analysis, down the line to where the example of the Stuart-James episode

wouldn't happen to me again" is meaningless. 32/ (Tr. 180, Vol. II) Things did not happen to him, he caused illegal things to happen to others.

Mr. Roche knows no shame. After hearing seven former customers and an expert describe how he illegally enriched himself at the expense of others, he insisted that "that the [securities] industry needs brokers, conscientious brokers like myself", and he viewed the hearing as a way of letting his former customers know he tried his best. (Tr. 88, Vol. I; Tr. 179-80, Vol. II)

I reject Mr. Roche's claim that a five year statute of limitations had run on the underlying allegations. 33/ The Order issued May 19, 1994, alleges that he committed illegal acts from April 1987 through April 1990 so that the action was brought within five years. In addition, if Mr. Roche was referring to the five year statute of limitations contained in 28 U.S.C. 2462, that provision is inapplicable because (1) the Commission has held that the federal five year statute of limitations contained in 28 U.S.C. § 2462 is not applicable to remedial actions under Section 15(b) of the Exchange Act (Patricia A. Johnson, 59 SEC Docket 0963, 0872-73 (May 10, 1995); Howard Rubin, 58 SEC Docket 1478, 1481 (1995)), and (2) neither an order to cease and desist nor an order to disgorge illegal gains pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act are in the nature of penalties.

32/ Mr. Roche's recommendations to clients were based only on the information Stuart-James provided. (Tr. 145-47, Vol. II)

33/ Mr. Roche stated "During the course of your research, Your Honor, I would like you to look into if there are [sic] a statute of limitations regarding the alleged allegations. It's almost 1995. For five years I've had no complaints." (Tr. 90- 91, Vol. II)

Mr. Roche should receive the severest sanction available to prevent him from preying further on the investing public. Based on the evidence in this record and my observation of the respondent, I find his continued employment in the securities industry in any position is contrary to the public interest. Mr. Roche should be barred from association with any broker or dealer, and ordered to cease and desist from violating the antifraud provisions.

DISGORGEMENT

Sections 8A(d)(4)(e) of the Securities Act and Section 21C(d)(4)(e) of the Exchange Act, 15 U.S.C. § 78u-3(d)(4)(e), 77h-1(d)(4)(e) (1988 & Supp. V 1993) 34/, provide:

> In any cease-and-desist proceeding under subsection (a), the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

The purpose of disgorgement is to prevent a wrongdoer from profiting from his/her illicit conduct. In view of Mr. Roche's outrageously illegal behavior from which he gained substantial financial benefit, disgorgement is appropriate in this action to "deprive a wrongdoer of his unjust enrichment and to deter others from violating the securities laws." SEC v. First City Financial Corp., Ltd., 890 F.2d 1215, 1230 (D.C. Cir. 1989)

Mr. Roche earned over one million dollars as a registered representative with Stuart-James in the period during which he violated the antifraud provisions of the securities laws. During this time he handled over 300 customer accounts. The unrefuted evidence in this record establishes that he committed illegal acts for which he unjustly earned commissions

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34/ Added to the Acts by the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931.

in seven customer accounts. Because Mr. Roche did not fully comply with a Commission subpoena, the Division was only able to introduce evidence that three of Mr. Roche's customers paid the following transaction costs in accounts where he engaged in unsuitable and excessive transactions. 35/ The evidence from the Division's expert is unrefuted on this record. (D. Ex. 11; Tr. 73-77, Vol. II) 36/

CUSTOMER	COMMISSIONS
Mr. Gregory	$15,571
Mr. Novak	37,107
Mr. Scheidker	49,504
	102,182

I find that Mr. Roche should be required to return to investors the commissions they paid on these transactions which occurred from his excessive trading in their accounts, $102,182, and prejudgment interest on that amount. Prejudgment interest is applicable as a matter of fairness to compensate people who were deprived of the use of their funds by a person who took advantage of his position of trust.

The Commission has waived payment based on a sworn statement of financial

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35/ Dr. Brown shows these figures as commissions, yet his workpapers describe them as transaction costs which include all commissions on agency trades, mark-ups and mark-downs on principal trades, all exchange fees and SEC fees. (D. Ex. 11 at 8, 13) The courts have held that disgorgement need only be a reasonable approximation of profits causally connected to the violations. When the government has made this showing, the burden shifts to the respondent to show that the amount is not a reasonable approximation. SEC v. First City Financial Corp., Ltd., 890 F.2d 1215, 1231 (D.C. Cir. 1989)

36/In its Proposed Findings of Fact and Conclusions of Law, the Division puts the amount at $102,561. I do not understand the discrepancy.

condition which demonstrates that a person is unable to pay. The record does not contain such a statement from Mr. Roche, and the evidence does not demonstrate by a preponderance of the evidence that he is unable to pay this amount. 37/

ORDER

IT IS ORDERED that Donald A. Roche, Jr.:

1. is barred from association with any broker or dealer;

2. shall cease and desist from committing or causing any violations or future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder; and

3. shall disgorge $102,182.00, plus prejudgment interest from October 1, 1990 through the last day of the month preceding which payment is made at the rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), compounded quarterly. 38/ Payment shall be made on the first day following the day this initial decision becomes final by certified check, U. S. Postal money order, bank cashier's check or bank money order made payable to the Securities and Exchange Commission, and shall be transmitted to the Comptroller, United States Securities and Exchange Commission,

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37/ Mr. Roche testified that a 1991 bankruptcy filing was "terminated or discharged". According to the Division, the case was dismissed. (Tr. 181-82, Vol. II) Mr. Roche currently owes the Internal Revenue Service approximately $350,000 in taxes on his income for the years 1987 through 1990 (Tr. 127-28, Vol. II). He does not recall whether he has satisfied a $10,000 debt to a gambling casino. (Tr. 130, Vol. II)

38/ I have used October 1, 1990 as the date to begin assessing interest because it appears to be the first day of the month after Mr. Roche left Stuart-James. The Division would have the interest run from September 28, 1990. (Division's Findings of Fact and Conclusions of Law at 49)

Room 2067, Stop 2-5, 450 5th Street, N.W., Washington, D.C. 20549, with a cover letter identifying the respondent, Donald A. Roche, Jr., and proceeding designation, Administrative Proceeding No. 3-8370. A copy of the cover letter should be sent to the Commission's Division of Enforcement at the above address.

If and when Mr. Roche pays any or all of the disgorgement amount and interest, the parties, shall submit, within 60 days, a plan for the administration and distribution of those funds to the Office of Administrative Law Judges.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice (17 C.F.R. 201.17(f)). Pursuant to that rule, this initial decision shall become the final decision of the Commission as to each party who has not filed a petition for review pursuant to Rule 17(b) within 15 days after service of the initial decision upon him/her, unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to a party. If a party timely files a petition for review, or the Commission acts to review as to a party, the initial decision shall not become final as to that party.

Brenda P. Murray
Chief Administrative Law Judge

Washington, D.C.
July 5, 1995