ADMINISTRATIVE PROCEEDING
FILE NO. 3-6571

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
THOMAS J. FITTIN, JR.

INITIAL DECISION

July 31, 1987
Washington, D.C.

David J. Markun
Administrative Law Judge

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APPEARANCES: Bernard J. Barrett, Jr., and Kenneth B. Winer, Esqs. for the Division of Enforcement, Washington, D. C. Also appearing on the brief(s): Robert Mooney and Eva M. Heffernan, Esqs.

Harry Garman, Esq. of Torre, Garman & Amdur, East Rutherford, New Jersey, for the Respondent.

BEFORE: David J. Markun
Administrative Law Judge

I. THE PROCEEDING

This public proceeding was instituted by an order of the Commission dated September 27, 1985, ("Order") pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934 ("Exchange Act") [1/] to determine whether Respondent Thomas J. Fittin, Jr. ("Respondent", or "Fittin"), as the Division of Enforcement alleged in the Order, wilfully violated the antifraud provisions of Section 17(a) of the Securities Act of 1933 ("Securities Act") [2/] and Section 10(b) of the Exchange Act [3/] and Rule 10b-5 thereunder [4/] and, if he did, the remedial action, if any, that may be appropriate under Sections 15(b) and 19(h) of the Exchange Act.

The violations are alleged to have occurred during the period September 15, 1981 through May 15, 1982 ("relevant period") in connection with the sale of certain securities, i.e. limited partnerships in three oil and gas drilling programs in Texas.

Evidentiary hearings totaling 25 days were held in Freehold, New Jersey, New York, New York, and San Antonio, Texas. The parties have filed proposed findings of fact, conclusions of law, and supporting briefs pursuant to the Commission's Rules of Practice. [5/]

1/ 15 U.S.C. §78o(b), 78s.
2/ 15 U.S.C. §77q(a).
3/ 15 U.S.C. §78j (b).
4/ 17 C.F.R. §240.10b-5.
5/ 17 C.F.R. §201.16.

The findings and conclusions herein are based upon the record and upon observation of the demeanor of the various witnesses. The standard of proof applied is that requiring proof by a preponderance of the evidence.[6/]

II. FINDINGS OF FACT AND LAW

A. The Respondent; His Relationship to Robert Tonachio and Tonachio's Enterprises.

Respondent Fittin has been employed in the securities business in a regulated capacity since August 1968 and is currently a registered representative with a registered broker-dealer.

In 1981 and 1982, Fittin was the president, principal shareholder, and head of retail sales of Fittin, Cunningham & Lauzon ("FCL"), a registered broker-dealer. Within the period 1978 through 1981, Fittin assisted Robert Tonachio, a former FCL employee and long-time colleague, with the formation and bringing public of two oil and gas companies controlled by Tonachio. The two companies, United American Energy, Inc. ("United") and Major Exploration, Inc. ("Major"), were based in Tennessee; later, during the relevant period, Major commenced the oil and gas operations that are involved in this proceeding.

6/ Steadman v. S.E.C., 450 U.S. 91, 101 S.Ct. 999 (1981). Respondent's argument for a "clear and convincing" standard has no merit, since the case he relies on was overruled by Steadman.

Fittin's FCL underwrote the initial public offerings of both United and Major, for which it received substantial compensation. FCL and Tonachio thereafter maintained an ongoing business relationship. Fittin prepared a written recommendation for United stock and actively participated in the market for United and Major securities. Fittin and Tonachio remained in close touch because of this continuing relationship, as well as because of subsequent activity involving the oil and gas limited partnerships sold by Major.

B. Respondent's Participation In the Sale of Limited Partnerships in Three Texas Oil and Gas Drilling Programs.

In about mid 1981 Major began oil and gas activities in Texas, in connection with which it offered and sold limited-partnership interests to the public.

From September 15, 1981 through May 15, 1982, Major offered and sold limited-partnership interests in three limited partnerships, in each of which Major was the general partner. The three successive limited partnerships were: (1) the "1981 Major Exploration Texas Development Drilling Program" ("1981 Drilling Program"); (2) the 1982 Major Exploration Texas Development Drilling Program" ("1982 Drilling Program"); and (3) the "1982-1 Major Exploration Texas Development Drilling Program" ("1982-1 Drilling Program").

FCL underwrote and sold all of the three drilling programs, with Fittin acting as the prime mover for FCL in its underwriting capacity. Fittin directed the sales efforts of FCL, solicited investors to purchase drilling-program interests, and recommended that investors purchase interests in each of the three drilling programs. While acting as a broker and an underwriter, Fittin also acted as the offeree representative for investors purchasing interests in the program for purposes of Commission Rule 146 under the Securities Act, 17 C.F.R. §230.146 (1981).

Each drilling program was offered by an offering memorandum ("1981 Memorandum", "1982 Memorandum and "1982-1 Memorandum", respectively.) Investors were also given a pamphlet entitled "Major Exploration, Inc. Texas Development Drilling Program" ("Drilling Pamphlet") as well as letters and handouts summarizing the purported highlights of available properties.

In addition, representations regarding the Texas drilling programs were made orally to investors in individual conversations with salesmen, including Fittin, and at various seminars organized by FCL to solicit investors in the drilling programs.

Each offering memorandum contained two sections providing specific information about the planned activities of

each drilling program: first, a "management section" which described the anticipated management of the partnership; and second, a "property description" for the oil and gas properties of Major in Texas available for selection by Major and for the partnership.

The management section of each offering memorandum described the management of Major and listed consultants for the partnership. As discussed at a later point, there was one striking omission in the description of management. Fittin was well aware of this omission.

The property section of each offering memorandum started with a general paragraph describing Major's properties as "developmental" properties and estimating total "gross proven producing, proved undeveloped, and probable reserves" at $1 Billion (1981 drilling program) and thereafter at $2 Billion (1982 and 1982-1 drilling programs). Each offering memorandum followed with an identical description of each of three specific prospects, the Webb County Prospect, otherwise known as the Galvan Ranch lease, the Bob Cooper Prospect, and the Pearsall Field Prospect in Frio County. The Drilling Pamphlet gave investors in all three programs purported reserve estimates and the purported results of wells drilled on or near Major's prospects. The memoranda for the second

and third partnerships included a description of the purported results of the previous operations of Major in Texas.

The other documents given to investors as well as the information conveyed to investors individually and at investment seminars highlighted specific aspects of the proposed drilling programs including their reportedly "developmental" nature; the purportedly low-risk nature of each investment coupled with its purportedly high return; and the reportedly consistent and impressive success of Major's previous Texas wells. During the offerings of its 1982 and 1982-1 programs, Major devoted particular attention to its purported 100% success rate and to particular well results by specifically repeating the one-page description of prior well results from each memorandum in the two or three page cover letter which it simultaneously distributed to investors. Impressive numbers were announced as well values, reserve estimates, cumulative production, and initial well results.

The wells drilled by Major during the drilling program offerings were principally in the Pearsall Field Prospect where Major purported to drill for the Austin Chalk formation. The Austin Chalk is characterized by high initial production rates followed by a relatively severe

decline in production which may occur as rapidly as within a few days. The Austin Chalk area is for that reason widely considered a promoter's paradise. Wells drilled to the Austin Chalk may not properly in normal circumstances be termed "development" wells.

During Major's Texas operations, Fittin was in continuous contact with Tonachio. Fittin received documents from Major which purported to support the offering materials. Through his daily contact with Major, Fittin was aware of production from Texas wells inconsistent with public statements, including problems with the production and sale of oil and gas. Fittin knew of other problems with Major's Pearsall Field wells including delays in providing promised checks to investors; title problems with the Allerkamp lease; and the drilling of at least one well to a formation other than the Austin Chalk although the Austin Chalk had been announced as a target formation.

The first drilling program did not sell readily and did not close until almost a month after the announced deadline. In fact, it was closed with a total investment less than the originally announced minimum. Although investors had been previously informed that Allerkamp #1 would be drilled for that program, they were informed shortly after the program

closed that the 1981 Drilling Program had invested in a different well, i.e. the Allerkamp #2.

Major quickly announced the successful drilling of the Allerkamp #2 with an announced initial potential test rate of 6095 barrels of oil per day ("BOPD"), distributed these results to investors and began actively soliciting investments in the second program. The purported success of the Allerkamp #2 was highlighted during the solicitation of investors, who were urged to invest immediately in the 1982 and 1982-1 drilling programs. When Major filed the initial potential test report with the Texas Railroad Commission one month after the purported test, the Texas Railroad Commission rejected the test and retested the well at an initial potential rate of 151 barrels of oil per day. While Major had predicted that the Allerkamp #2 would be allowed to produce at 350 BOPD, the well was only permitted to produce at 100 BOPD. Fittin knew of the retest and of the actual allowable set for the Allerkamp #2, and he also knew that Major did not disclose either fact to investors, nor did Fittin.

Fittin was aware of the documents being given to investors and actively participated in the review and dissemination of most of the documents given to investors as part of

the solicitation of investors for each program. As director of retail sales at the Belmar office of FCL and resident officer at the main office, Fittin directed FCL's sales force to offer and sell the three drilling programs. He participated in conversations with investors, solicited purchasers for the drilling programs, and recommended purchases of drilling program interests to investors. Fittin also organized, and introduced speakers at, investment seminars used to solicit investors for each of the three drilling programs.

FCL received substantial compensation from its relationship with Tonachio. The promotion of the second and third drilling programs started shortly before the scheduled expiration of warrants issued during the initial public offering of Major. FCL's brokers were informed through Fittin that one purpose of the drilling programs was to support the price of Major's securities. FCL earned commissions for its role in the conversion of several hundred thousand warrants during the promotion of Major's purported success at a time when FCL needed cash to meet a dwindling net capital position. In addition, FCL received substantial commissions and fees for sales of limited partnership interests.

From November 7, 1981 through May 13, 1982, FCL sold to at least 45 investors at least 292 $5000 limited partnership

units in Major's 1981, 1982 and 1982-1 Drilling Programs, for $1,463,113.50. FCL was paid commissions of 12%, amounting to about $175,512.62, on these sales. FCL retained one half of the commissions, the other half being paid to the registered representatives who handled the sales. Fittin acted as the registered representative for sales worth about $92,605.15, which resulted in total commissions of some $11,112.61.

Additionally, in June of 1982 FCL billed Major in the amount of $50,000 for "investment banking services" and received payment in that amount in August. The record establishes that the great bulk of the investment banking services covered by that payment were related to the offerings of the oil and gas drilling programs.

C. False, Misleading, Deceptive, and Fraudulent Representations and Omissions in the Offer and Sale of the Texas Oil and Gas Drilling Programs; Fittin's Knowing or Reckless Participation Therein.

The record herein establishes that the offer and sale of securities in the form of limited partnerships in the oil and gas drilling programs by Major were permeated with materially false, misleading, deceptive and fraudulent statements and omissions to investors, both in the offering memoranda and related written communications and in oral communications. The sales of the limited partnerships in

the drilling programs were part of a massive fraud perpetrated by Major, in which Tonachio and Lanny Freeman ("Freeman"), an oil and gas promoter of notorious and ill repute, played major roles. The more salient elements of such fraudulent statements, omissions, and representations will be developed below. That there was in fact such a fraud perpetrated is not seriously disputed by Respondent.

Respondent's position is, essentially, that he did not knowingly participate in any material element of the fraud and that he did not recklessly ignore clear signals that should have put him on notice of the fraud that was occurring. The Division's position, diametrically opposed to Respondent's, is that Respondent Fittin was a knowing participant (i.e. that he acted with scienter) in the massive fraud or that, in the alternative, Fittin, in light of his legal responsibilities as broker, underwriter, and offeree representative (in which capacities FCL and Fittin admittedly functioned) was at least reckless (and thus acted with scienter) in ignoring numerous "red flags" that should have put him on notice as to the need for proper inquiry. These directly opposed positions respecting Fittin's involvement or non-involvement frame the questions that must be answered as to the various types of fraud that are found herein to have been committed.

1. False and misleading descriptions of management.

Fittin concedes that Freeman supervised the drilling operations of Major in Texas, which are the operations relevant to the limited-partnership interests here involved. Moreover the record clearly shows that Freeman, a well known oil and gas promoter, was Major's man-in-charge for the Texas operations. Freeman reported directly to Tonachio and Tonachio, who lacked oil and gas expertise, and was based in Tennessee, clearly relied upon Freeman.

The record establishes that Freeman provided Major with its Texas properties, directly or indirectly, and with all of the information purporting to justify acquisition of the particular leases. In addition, Freeman oversaw all of Major's Texas operations, including the selection of well sites and the selling of oil and gas production.

Fittin was well aware of Freeman's status both from Fittin's close contacts with Tonachio and from having visited the Texas sites, where Freeman was clearly known and was seen to be in charge.

Notwithstanding this knowledge, and notwithstanding his responsibilities as underwriter, broker, and offeree representative, Fittin did nothing to cure the glaring omission of any mention of Freeman in the description of

management in any of the three offering memoranda or any related documents describing the drilling programs. Each memorandum misleadingly presented the management of Major as the management of the Texas operations of the drilling programs. This, along with the critical omission of any mention of Freeman, was materially false and misleading.

If Fittin had properly inquired into why Freeman was not mentioned in the offering memoranda he would likely have found or confirmed facts that otherwise came to his attention, i.e. that a good part of the reason why Freeman was not disclosed was that Freeman had an unsavory background likely to scare away potential investors quickly. A significant part of Freeman's background was that in mid 1981 he had reacquired interests in certain Texas oil and gas properties including the Galvan Ranch lease as part of his settlement of a widely publicized lawsuit involving allegations of fraud in connection with oil and gas transactions. At about that time, Freeman had been accused of, among other improper activities, disseminating a false test report as a selling document for the Shell Rachal #1 on the Galvan Ranch lease, one of the leases that Freeman sold to Major, along with other properties, for approximately $4.6 million.

The record is clear that Fittin was aware that the non-inclusion of Freeman as a critical member in the

management of Major was purposeful and deliberate. He knew Freeman's management position and functions and he knew they should have been disclosed. His and Tonachio's testimony that Freeman was not disclosed because he was regarded as a "temporary" employee is not credited and is on its face without merit. Nothing in the record suggests that Freeman was not to continue in the role he had during all or a significant portion of the time that the limited partnership interests were to be operative.

In addition, there is evidence that Fittin was well aware of the unsavory reputation that Freeman had and that was widely known in the oil and gas business community. Thus, at the outset, when Fittin first learned of Freeman, he instructed Tonachio not to bring Freeman to FCL where registered representatives would have been exposed to him. This may have been, as Fittin testified, because he was put off by Freeman's flamboyant personality. However, at a later time, in August, 1981, when Fittin learned that Anders Arnheim, an attorney who had done work for both FCL and Major, was reporting Freeman's questionable credentials and past legal problems to FCL registered representatives, Fittin instructed Arnheim not to discuss Freeman's problems or reputation.

There is no basis in the record for failing to disclose Freeman's critical role in the drilling programs, which

role was known, as already found above, to Fittin. And, had Fittin properly inquired into all of the reasons for such nondisclosure, the background for certain additional false and misleading and materially fraudulent statements and omissions found herein would have become clear to Fittin.

2. False and misleading overall reserve characterizations.

The 1981 Memorandum stated that Major had 5,539 acres in four Texas fields located in Webb, Frio, and Brooks Counties, and that ". . . reserve calculations indicate gross proven producing, proved undeveloped, and probable reserves of oil and gas valued in excess of One Billion Dollars ($1,000,000,000) in place." The 1982 Memorandum stated that Major had 15,000 acres in eight Texas fields located in Webb, Frio and Brooks Counties and that ". . . reserve calculations indicate gross proven producing, proved undeveloped, and probable reserves of oil and gas valued in excess of Two Billion Dollars ($2,000,000,000) in place." The 1982-1 Memorandum stated that Major had 15,000 acres in eight Texas fields located in Webb, Frio, and Brooks Counties and that ". . . reserve calculations indicate gross proven, proved undeveloped, and probable reserves of gas and oil valued in excess of Two Billion Dollars ($2,000,000,000) in place." In none of the Memoranda were

there disclosed the consideration paid for the properties, the source of the properties, or the source of the reserve estimates.

The record indicates that the 5,539 acres referred to in the 1981 Memorandum had just been obtained from Freeman for consideration valued by Major at only $3,356,460 and that the reserve estimate of $1 Billion was provided to Major by Freeman. This was material information that should have been disclosed; failure to disclose it was misleading and fraudulent. Fittin was clearly aware that the information was not disclosed to investors.

Likewise, the record indicates that Major's Texas properties described in the 1982 and 1982-1 Memoranda had been obtained from or through Freeman for less than $4.6 million and that Freeman provided Major with the information concerning the reserves that resulted in the $2 Billion estimates set forth in those two Memoranda. Again, Fittin was aware that this information was not disclosed to investors. Failure to disclose these material facts was misleading and fraudulent. Fittin knew the undisclosed facts to be facts or should have known them to be such in light of his multiple responsibilities as underwriter, broker, and offeree-representative. He at least recklessly failed to ascertain and require disclosure of these material facts.

Moreover, it was inherently misleading and fraudulent to lump together "gross proven producing, proved undeveloped, and probable reserves" in arriving at the $1 Billion and later $2 Billion reserve estimates without differentiating among the three different categories of described reserves. As developed by both expert and knowledgeable lay testimony in the record, the different reserve categories reflect important distinctions as to the recoverability or existence of reserves and thus the percentages of each category involved in the overall reserve estimates were material facts that should have been disclosed to investors. This was clear to Fittin; yet he did nothing to insure such disclosures notwithstanding his multiple responsibilities as underwriter, broker, and offeree-representative.

Lastly, with respect to misleading overall reserve characterizations, the record shows that the offering memoranda and related written representations all presented all three of the Drilling Programs as "Development" drilling programs and as involving "development" prospects, whereas the record clearly discloses that the drilling programs were in fact involved only with exploratory prospects.

This was clearly a material and fraudulent misrepresentation.

Fittin was in fact aware of this distinction and its materiality and of the misrepresentation that was involved. Even if he in fact hadn't been aware of it, his multiple responsibilities as underwriter, dealer, and offeree-representative obliged him to make himself aware of it before underwriting or causing to be recommended, and recommending, the limited gas and oil partnership interests, and it would have been reckless of him not to have done so.

3. False and misleading reports of prior results.

In the offering memoranda and other communications to investors respecting the second and the third drilling programs, Major stressed the announced success of the Allerkamp #2 and in addition represented that its prior operations were 100% successful to the Austin Chalk formation.

It is clear from the evidence that these representations of 100% successful prior operations were false, misleading, and fraudulent. Various unsuccessful wells were simply ignored in making those false statements. Other wells were drilled to the Austin Chalk formation, found to be "exhausted" at that level, and were "recompleted" to different (i.e. non-Austin Chalk) formations, with varying but low levels of success.

At any time during the last of the three drilling programs, i.e. the 1982-1 program, the best that could have been honestly said for Major's prior record of drilling to the Austin Chalk formation was that its record of success was 4 of 10 rather than 8 of 8, which in effect is what was asserted in the "100% success" claim.

Fittin was aware of problems encountered in Major's drilling programs which should have made it clear to him that the 100% success claim was greatly exaggerated or at least suspect -- one that should be looked into further. Even without any specific warning signals, a claim of 100% prior success should on its face have been suspect to Fittin.

Notwithstanding these considerations, Fittin recklessly allowed the false claims of 100 percent success in the prior drilling operations to continue to be made to investors in this further abandonment of his responsibilities as broker, underwriter, and offeree-representative.

4. False and misleading characterizations of risks and returns.

Among other misrepresentations to investors were material representations in the cover letter for the offering Memoranda that the limited partnerships were "low-risk

development drilling programs" and that the wells were "consistently commercial with relatively short-term payout, and the risk factor is practically nil." These gross misrepresentations of the risk factors were not cured, as Fittin contends, by the boilerplate high-risk, no-assurance type language that was routinely also contained in the offering memoranda.

Fittin, of all people, with his multiple responsibilities to investors as broker, underwriter, and offeree-representative, should have been conscious of the danger of sending conflicting signals regarding the risk elements, yet he recklessly continued to allow such false representations regarding low-risk to be made to investors.

Fittin's testimony and arguments suggest a view on his part that investors were more interested in the tax-shelter aspects of the limited partnerships than in the realization of profit on the investments. This mistaken and irrelevant consideration may explain in part Fittin's reckless indifference to fulfillment of his obligations to investors.

5. False and misleading descriptions of specific prospects.

The record establishes that Major included in the offering memoranda and related written representations various

material and false misleading descriptions of specific prospects. Fittin defends against these charges by asserting in effect, that he could not have been expected to check into the accuracy of each of the numerous descriptions that he received from Major and passed on to investors. And he argues that investors were free to visit the properties themselves, as if such visits would enable an investor thereby to verify Major's representations.

If these misrepresentations of specific prospects were all that were involved, Fittin's argument might deserve more consideration. But when considered against the background of the other numerous categories of materially false, misleading, and fraudulent misrepresentations found herein, in which Fittin participated either knowingly or in reckless disregard of his multiple obligations, it becomes clear that if Fittin had properly inquired into the reasons for Freeman's non-disclosure as a critical member of management, the bases for the outlandish claims as to the value of the overall reserves, the claims of 100% successful prior results, etc., these specific fraudulent descriptions of particular prospects, which were simply a part of the overall massive and egregious fraud, would also have been unearthed.

Fittin argues that he relied on Major's geologists and other experts. This is not factually borne out by the record, but even if he had, he had no legal right to do so.

Investors were entitled to look to Fittin and FCL as broker, underwriter, and offeree-representative, for their independent assessment (including, if necessary, geologists and/or other experts retained by them, not Major) of the accuracy and completeness of the representations that were made by Major.

Fittin made use of the means and instrumentalities of interstate commerce, including transportation and communication in interstate commerce, and of the mails, in the course of his fraudulent and deceptive conduct found herein.

D. Respondent's Contentions.

As previously noted (see footnote 6 above and related text), Respondent erroneously contends that the violations charged must be proved by clear and convincing proof. The correct standard of proof is preponderance of the evidence. Steadman v. S.E.C., 450 U.S. 91, 101 S.Ct. 999 (1981).

Respondent argues (Brief, p. 59) that the Commission must prove "scienter or gross recklessness" in connection with the alleged violations of Section 17(a) of the Securities Act, citing Aaron v. S.E.C., 446 U.S. 680, 100 S.Ct. 1945 (1980). Respondent is only partially correct. Aaron

actually held, at 446 U.S. 697, that ". . . the language of §17(a) requires scienter under §17(a)(1), but not under §17(a)(2) or §17(a)(3)." As already noted above, Respondent here is charged with wilful violations of Section 17(a), and the language of the charge is such as to clearly embrace subsections 17(a)(2) and 17(a)(3) as well as subsection 17(a)(1) of §17(a). Order, Section II P, at p. 4.

The Supreme Court in Aaron summarized its holding as to §§17(a)(1), (2) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as follows, at 446 U.S. 701-2:

> "For the reasons stated in this opinion, we hold that the Commission is required to establish scienter as an element of a civil enforcement action to enjoin violations of §17(a)(1) of the 1933 Act, §10(b) of the 1934 Act, and Rule 10b-5 promulgated under that section of the 1934 Act. We further hold that the Commission need not establish scienter as an element of an action to enjoin violations of §17(a)(2) and §17(a)(3) of the 1933 Act ..."

The Aaron court (see p. 686, footnote 5) specifically left open the question of whether scienter could be established by a showing of recklessness.

The parties are in agreement that subsequent decisions of the Courts of Appeals have held that recklessness is sufficient to satisfy the scienter requirement. Eisenberg v. Gagnon, 766 F.2d 770,776 (3d Cir. 1985); Hackbart v.

Holmes, 675 F.2d 1114, 1117-18, (10th Cir. 1982); Healey v. Catalyst Recovery of Pennsylvania, Inc., 616 F.2d 641, 649 (3d Cir. 1980); McLean v. Alexander, 599 F.2d 1190, 1197 (3d Cir. 1979). 7/

Fittin's arguments make it clear that he completely misapprehends and misstates the due diligence obligation of an underwriter. The evidence indicates that Fittin and FCL relied entirely, in every meaningful matter, upon information furnished by Major and Tonachio and personnel employed by or doing work on behalf of Major. FCL and Fittin made no meaningful investigation of the drilling programs on their own nor did they cause any independent, outside source, such as an independent geologist, attorney, or CPA to make any such investigation on behalf of FCL. Periodic visits to the drilling sites in Texas by Fittin or his salesmen and/or the investors were conducted in a manner calculated not to

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7/ See also Edward J. Mawod & Co. v. S.E.C., 591 F.2d 588, 595-597 (C.A. 10, 1979); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023-1025 (C.A. 6, 1979); Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 44-46 (C.A. 2, 1978), cert. denied, 439 U.S. 1039; Coleco Industries, Inc. v. Berman, 567 F.2d 569, 574 (C.A. 3, 1977); Wright v. Heizer Corporation, 560 F.2d 236, 251-52 (C.A. 7, 1977), cert. denied, 434 U.S. 1066 (1978); Sundstrand Corporation v. Sun Chemical Corporation, 553 F.2d 1033, 1039-40 (C.A. 7, 1977), cert. denied, 434 U.S. 875; First Virginia Bankshares v. Benson, 559 F.2d 1307, 1314 (C.A. 5, 1977), cert. denied, 435 U.S. 952 (1978).

disclose anything meaningful about Major's operations. Instead, such visits served only as an aid in "reinforcing" the fraudulent statements and omissions found herein to have been made.

The very case cited by Respondent, i.e., Feit v. Leasco Data Processing Equipment Corporation, 332 F.Supp. 544 (1971), properly sets forth the obligations of underwriters to investors and the proper relationship of underwriters to the issuer of shares or interests being underwritten, at pp. 581-582:

> Section 11 holds underwriters to the same burden of establishing reasonable investigation and reasonable ground to believe the accuracy of the registration statement. The courts must be particularly scrupulous in examining the conduct of underwriters since they are supposed to assume an opposing posture with respect to management. The average investor probably assumes that some issuers will lie, but he probably has somewhat more confidence in the average level of morality of an underwriter who has established a reputation for fair dealing. Judge McLean expressed the proper relationship between underwriters and management in BarChris:
>
> > "In a sense, the positions of the underwriter and the company's officers are adverse. It is not unlikely that statements made by company officers to an underwriter to induce him to underwrite may be self-serving. They may be unduly enthusiastic." Escott v. BarChris Construction Corp., 283 F.Supp. 643, 696 (S.D.N.Y. 1968).
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> In light of this adverse position they must be expected to be alert to exaggerations and rosy outlooks and chary of all assurances by the issuer. Their duty is to the investing public under Section 11 as well as to their own self-interest and that duty cannot be taken lightly.

> "Such adversity is required since the underwriter is the only participant in the registration process who, as to matters not certified by the accountant, is able to make the kind of investigation which will protect the purchasing public. . . . Only the underwriter and the accountant are free to assume an adverse role, have little incentive to accept the risk of liability, and possess the facilities and competence to undertake an independent investigation. They may therefore reasonably be required to share the burden of verification.
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> "The duty of the underwriter, then, is not merely limited to listening to management's explanations of the company's affairs. Rather he must make an investigation reasonably calculated to reveal all of those facts which would be of interest to a reasonably prudent investor. If he undertakes such an investigation, he will not be liable for material misrepresentations which his efforts did not uncover. If he does not, he will be liable for all misrepresentations which such an investigation would have uncovered.
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> * * *
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> Comment, BarChris: Due Deligence Refined, 69 Col.L.Rev. 1411, 1421 (1968).

> Dealer-managers cannot, of course, be expected to possess the intimate knowledge of corporate affairs of inside directors, and their duty to investigate should be considered in light of their more limited access. Nevertheless they are expected to exercise a high degree of care in investigation and independent verification of the company's representations. Tacit reliance on management assertions is unacceptable; the underwriters must play devil's advocate. [citations omitted]

Contrary to Respondent's argument, there is no lessening of the diligence obligation of an underwriter in an unregistered private offering as compared with that of an underwriter of a registered public offering.

In re Kidder Peabody & Co., 46 S.E.C. 928 (1977); In re Schwarm & Co., Securities Act of 1933 Release No. 5275, 37 F.R. 16,011 (July 26, 1972) ("Underwriters of offerings exempt from registration under Regulation A, although not subject to Section 11, also have an obligation to make a reasonable investigation," at n. 9); In the Matter of Leonard Lazaroff, 43 S.E.C. 43, 47 (1966).

In light of the findings made herein, the record completely belies Respondent Fittin's protestations of having performed proper due diligence.

Respondent Fittin, in contending that in recommending the purchase of the oil and gas limited partnerships he and FCL fulfilled their obligations as a broker, correctly urges that those duties are well set forth in Hanly v. S.E.C., 415 F.2d 589, 597 (2nd Cir. 1969), where the Court stated in part:

> In summary, the standard by which the actions of each petitioner must be judged are strict. He cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information.

In light of the specific findings herein that Fittin personally recommended the purchase of the Texas oil and gas

limited partnerships and caused others in FCL to recommend such purchases in the face of fraudulent statements or omissions known to Fittin to be false or misleading and in the face of numerous "red flags" that legally obligated Fittin to make further inquiry before recommending purchase, and without disclosing that he lacked information essential to forming a reasonable judgment as to whether the drilling program interests could reasonably be recommended or not, it is abundantly clear that Fittin failed to meet all aspects of the standards for a broker enunciated by the Court in Hanly.

Fittin also mistakenly urges that he fully met the obligations of an offeree representative.

In acting as the offeree representative for the investors in the limited partnership offerings, Fittin and FCL explicitly represented that FCL possessed such knowledge and experience in financial and business matters as to be able and willing capably to evaluate the merits and risks of oil and gas limited partnership offerings. At the time of these offerings, the term offeree representative was defined by Rule 146 as one who:

> Has such knowledge and experience in financial and business matters that he, either alone, or together with other offeree representatives or the offeree, is capable of evaluating the merits and risks of the prospective investment.

17 C.F.R. §230.146(a)(1)(ii) (1981). Implicit in the profession of the ability to evaluate the merits of the offering is the representation that the offeree representative will in fact evaluate the offering and advise the offeree accordingly. An offeree representative therefore has a duty to have or acquire and to exercise knowledge and experience to evaluate the investment and advise the offeree concerning the merits and risks of the investment. Rule 146, 17 C.F.R. §230.146 (1981).

In view of the specific findings made herein of Fittin's knowing or reckless participation in fraudulent statements or omissions, and in view of the fact that the record further shows that among the materials furnished by Major to FCL and to Fittin there were numerous material internal contradictions, which Fittin failed to investigate or attempt to reconcile through any sort of independent investigation, on the grounds that he and his firm were not competent to do so and had to rely on what Major and its people furnished him, it is clear that Fittin and FCL failed totally to meet the obligations of an offeree representative within the meaning of Rule 146.

Respondent Fittin also contends that he lost some $400,000 in trading in Major's stock ". . . much of which Fittin bought indirectly from FCL's customers after the

publication of the very negative Barron's article." [An article that publicly disclosed information regarding Freeman and Major's fraud in its operation of the three Texas drilling programs]. Fittin argues that these losses are inconsistent with any finding of scienter on his part in this proceeding.

As already found herein, FCL and Fittin earned roughly $1 million from having underwritten the initial public offerings of Major and United, from fees for serving as investment banker to United and Major, and from commissions in connection with selling the limited partnerships in the three Texas oil and gas drilling programs here involved.

The record is not clear as to how much of FCL/Fittin's losses in trading Major stock occurred prior to the public disclosure of the limited-partnership fraudulent activities and how much occurred thereafter. As to any losses that occurred after the public disclosure, it is not clear whether Fittin was motivated by speculation, a desire to minimize litigation risks, or by some other purpose, or by a combination thereof. Fittin did not establish with sufficient clarity how, when, and why these purported losses occurred or how they support his claim of lack of scienter.

In any event, the particular findings made herein of knowing or reckless fraudulent statements or omissions on

the part of Fittin are not predicated upon a finding that Fittin was equally culpable with Tonachio in planning, orchestrating, and carrying out the overall fraud in the three Texas oil and gas drilling programs, which is what Fittin seems to posit in making his argument that his losses in trading Major stock indicate a lack of scienter on his part. To the contrary, the specific findings of scienter on Fittin's part made herein stem from his knowing or reckless conduct in the various particulars found herein in the offer and sale of the limited partnerships in the face of his obligations as underwriter, broker, and offeree-representative, and such findings of scienter are not at all refuted by the claimed losses in trading Major stock.

E. Conclusions of Law.

In general summary of the foregoing, and in addition thereto, the following conclusions of law are reached.

The limited partnership interests in the 1981, 1982 and 1982-1 drilling programs were securities for purposes of the Securities Act of 1933 and Securities Exchange Act of 1934. Mayer v. Oil Field Systems Corp., 721 F.2d 59, 65 (2d Cir. 1983).

Fittin had a duty as a broker to conduct an investigation

and ascertain a reasonable basis for his advice bfore recommending and selling an interest in each drilling program. Hanly v. Securities and Exchange Commission, 415 F.2d 589 (2d Cir. 1969).

Fittin had a duty as an underwriter to exercise due diligence in the reasonable investigation of the offerings.

Through his participation as underwriter in the offerings, Fittin represented that FCL had exercised due diligence in investigating the operations of the drilling programs and the accuracy and adequacy of the information supplied to investors.

Fittin had a duty as an offeree-representative pursuant to Rule 146 to have and to exercise knowledge and experience in evaluating the investment and advising the offerees concerning the merits and risks of the prospective investment. Rule 146, 17 C.F.R. 230.146(a)(1), (1981).

Through his participation in the recommendation of interests in the 1981, 1982 and 1982-1 drilling programs, Fittin implicity represented that a reasonable investigation had been made as a basis for the recommendations. Fittin's duties as an underwriter and broker obligated him to independently verify material representations of the issuer. In re Schwam & Co., Exchange Act Release No. 18,800 (June 10, 1982) (undewriter); In re Frank W. Leonesio, Exchange Act Release No. 23524 (August 11, 1986) (broker-dealer).

Fraudulent conduct carried out knowingly or with reckless disregard of the consequences is carried out with the requisite scienter for purposes of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder and Section 17(a)(1) of the Securities Act. Violations of Section 17(a)(2) and 17(a)(3) of the Securities Act require only a finding of wilfulness within the meaning of §15(b) of the Exchange Act.

Fraudulent conduct carried out knowingly or with reckless disregard of the consequences is, a fortiori, "wilful" conduct for purposes of Sections 15(b) of the Exchange Act. Where a finding of scienter is not required, as is the case under §§17(a)(2) and 17(a)(3) of the Securities Act, all that is required to support a finding of wilfulness under the securities laws is proof that a respondent acted intentionally in the sense that he was aware of what he was doing and either consciously, or in careless disregard of his obligations, knowingly engaged in the activities which are found to be illegal. Arthur Lipper Corp. v. S.E.C., 547 F.2d 171, 180 (2nd Cir. 1976). cert. denied, 434 U.S. 1009 (1978); Hanly v. Securities and Exchange Commission, 415 F.2d 589, 595-6 (2d Cir. 1969); NEES v. Securities and Exchange Commission, 414 F.2d 211, 221 (9th Cir. 1969); Dlugash v. Securities and Exchange Commission, 373 F.2d 107, 109-10 (2d Cir. 1967);

Tager v. Securities and Exchange Commission, 344 F.2d 5, 8 (2d Cir. 1965).

Fittin wilfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") from on or before September 15, 1981 through about May 15, 1982 in that in the offer and sale of certain securities, namely limted partnership interests in the 1981 Drilling Program, 1982 Drilling Program, 1982-1 Drilling Program, by use of the means and instruments of transportation and communication in interstate commerce and by use of the mails, Fittin, directly and indirectly, employed devices, schemes and artifices to defraud, obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of such securities.

Fittin wilfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder from on or before September 15, 1981 through on or about May 15, 1982, in that, in connection with the sale of certain securities, namely limited partnership interests in the 1981 Drilling Program, the 1982 Drilling Program, and the 1982-1 Drilling Program, Fittin, while acting on behalf of a registered broker-dealer, directly or

indirectly employed devices, schemes or artifices to defraud; made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and engaged in acts, practices and a course of business which operated as a fraud and deceit by the use of a means or instrumentality of interstate commerce, and of the mails.

III. THE PUBLIC INTEREST

In determining what sanctions, if any, it is appropriate to apply in the public interest, it is necessary for the Commission, among other factors, to ". . . weigh the effect of . . . action or inaction on the welfare of investors as a class and on standards of conduct in the securities business generally."[8/]

All violations found to have been committed herein by Fittin are by their nature very serious. All were found to have been committed with scienter, i.e., knowingly or with a reckless disregard for carrying out his obligations in the face of clear red flags indicating the need for appropriate,

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

independent investigation. This is true even of violations of §§17a(2) and 17(a)(3) of the Securities Act, which do not require a finding of scienter.

Fittin's prior record for sanctions is less than unblemished.

On December 30, 1980, the NASD Board of Governors, in District Business Conduct Committee for District No. 11 v. Fittin, Cunningham & Lauzon, Inc., et al., fined Fittin $1000 and censured him for the execution of sellout transactions at unfair prices and the selling of personal and inventory positions ahead of, and at prices better than the prices obtained for customer positions, in violation of Article III, Sections 1, 4 and 12 of the Association's Rules of Fair Practice. FCL was also fined $5,000 and censured for the same conduct.

In February 1982, Fittin and FCL settled a second NASD disciplinary proceeding, In the Matter of District Business Conduct Committee for District No. 11 v. Fittin, Cunningham & Lauzon, Inc., et al., Complaint No. PHL-502-AWC. Fittin and FCL admitted failures to disclose to customers FCL's role as a market maker and failures to disclose mark-ups, mark-downs and other remuneration, in violation of Commission Rules 10b-10(a)(5)(ii) and 10b-10(a)(5)(i). Fittin and FCL each consented to a censure and a $500 fine imposed jointly and severally.

On May 26, 1982, the Commission entered an Order Instituting Proceedings, Waiving Findings and Imposing Remedial Sanctions in In the Matter of Fittin, Cunningham & Lauzon, Inc. et al., Administrative Proceeding File No. 3-6136. The Commission suspended Fittin from association in any capacity with any broker or dealer for a period of 30 days for failing reasonably to supervise personnel with a view to preventing the sale of unregistered limited partnership interests and the making of fraudulent representations and omissions concerning activities of limited partnerships in connection with the marketing of limited partnerships interests, in violation of Sections 5(a), 5(c) and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The Commission suspended the suspension on condition that Fittin not receive any compensation from FCL during the 30-day period. FCL was censured, subjected to limitations upon its activities for 30 days, and required to comply with undertakings.

On April 3, 1986, the New York Stock Exchange Board of Governors made a final determination that Fittin was responsible for violations of Exchange Rules 342, 346(f)(1), 410 and 472 for the failure to supervise employees, the employment of a person subject to a statutory disqualification, the failure to properly maintain required records, and the failure to properly approve research reports. Fittin was censured,

fined $7,500, and barred from employment in a supervisory capacity with any member or member organization for twelve months. In a simultaneous proceeding, the New York Stock Exchange determined that FCL engaged in the same and other violations, censured FCL, and fined FCL $35,000.

The Division urges that Fittin be barred from association with a regulated entity with the proviso that he may reapply to be associated in a nonsupervisory capacity after two years.

Respondent, while not conceding that any sanction is called for, urges that if any sanction is to be applied, a bar from acting as a principal of a broker dealer would be sufficient in the public interest.

Taking into account the gravity of the violations by Respondent, his prior record regarding sanctions, and the entire record as a whole, it is concluded that the sanction ordered below both for remedial and deterrent purposes is necessary, appropriate, and adequate in the public interest.

IV. ORDER

Accordingly, IT IS ORDERED that Respondent Thomas J. Fittin, Jr. is hereby barred from association with a broker or dealer with the proviso that after a period of fifteen months he may reapply to become associated with a broker dealer in a non-proprietary, non-principal and non-supervisory

capacity upon satisfactory showing to the Commission that he will be adequately supervised.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this intial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party. 9/

David J. Markun
Administrative Law Judge

Washington, D.C.
July 31, 1987

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