INITIAL DECISION RELEASE NO. 292
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11626

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of JOHN A. CARLEY, MARK N. DOHLEN, EUGENE C. GEIGER, PAUL A. GILES, ROY E. GOULD, THOMAS A. KAUFMANN, ALFRED PEEPER, EDWARD H. PRICE, CHRISTOPHER H. ZACHARIAS, LE FOND MONDIAL D'INVESTISSEMENT S.A., and SPENCER EDWARDS, INC.	: : : : : : : : : : : : : : :	INITIAL DECISION July 18, 2005

APPEARANCES: Thomas J. Krysa and Julie K. Lutz for the Division of Enforcement, Securities and Exchange Commission.

Thomas D. Birge for John A. Carley.

Robert T. McAllister for Eugene C. Geiger.

Christopher B. Wells for Roy E. Gould.

Jeffrey J. Scott for Thomas A. Kaufmann.

David A. Zisser for Christopher H. Zacharias.

Gordon D. Dihle for Edward H. Price and Spencer Edwards, Inc.

BEFORE: James T. Kelly, Administrative Law Judge.

The Securities and Exchange Commission (SEC or Commission) issued its Order Instituting Proceedings (OIP) on September 1, 2004, pursuant to Section 8A of the Securities Act

of 1933 (Securities Act) and Sections 15(b), 21B, and 21C of the Securities Exchange Act of 1934 (Exchange Act).

The OIP alleges that four officers of Starnet Communications International, Inc. (Starnet), John A. Carley (Carley), Mark N. Dohlen (Dohlen), Paul A. Giles (Giles), and Christopher H. Zacharias (Zacharias), enriched themselves by selling millions of dollars of Starnet stock without registering the sales as required by the federal securities laws and without making required disclosures concerning those sales. The OIP also charges that Alfred Peeper (Peeper) and Roy E. Gould (Gould) directed resales of Starnet securities purportedly issued under Regulation S of the Securities Act into the United States in violation of Section 5 of the Securities Act and caused and/or aided and abetted the Starnet officers' antifraud violations. The OIP asserts that Gould also functioned as an unregistered broker. According to the OIP, Starnet, its officers, Peeper, and Gould failed to file accurate reports, and in some cases filed false reports, concerning the beneficial ownership of Starnet securities.

The OIP further alleges that Eugene C. Geiger (Geiger) and Thomas A. Kaufmann (Kaufmann) facilitated the unlawful sale of Starnet stock and the antifraud violations in their capacities as registered representatives of Spencer Edwards, Inc. (Spencer Edwards). The remaining two Respondents, Edward H. Price (Price) and Spencer Edwards, are charged with failing reasonably to supervise Geiger and Kaufmann.

As relief for these alleged violations, the Division of Enforcement (Division) seeks cease-and-desist orders, civil monetary penalties, disgorgement of ill-gotten gains plus prejudgment interest, registration sanctions, and accountings.

One of the eleven Respondents, Le Fond Mondial D'Investissement S.A. (Le Fond Mondial), failed to file an Answer to the OIP and I issued a Default Order as to it. John A. Carley, 84 SEC Docket 648 (Nov. 23, 2004). The Commission severed three other Respondents, Peeper, Dohlen, and Giles, who have not yet been served with the OIP. John A. Carley, 84 SEC Docket 2317 (Jan. 3, 2005).

I held a nine-day public hearing in Denver, Colorado, during January 2005. The Division and the seven actively defending Respondents have filed proposed findings of fact, proposed conclusions of law, and supporting briefs, and the matter is ready for decision. I base my findings and conclusions on the entire record and on the demeanor of the witnesses who testified at the hearing.[1] I applied "preponderance of the evidence" as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). I have considered and rejected all arguments, proposed findings, and proposed conclusions that are inconsistent with this decision.

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[1] References in this Initial Decision to the hearing transcript are noted as "Tr. ___." References to the Division's exhibits are noted as "DX ___." References to Carley's exhibits are noted as "Carley Ex. ___;" to Gould's exhibits, "Gould Ex. ___;" to Zacharias's exhibits, "Zach. Ex. ___;" to Kaufmann's exhibits, "TK Ex. ___;" and to Spencer Edwards and Price's exhibits, "SEI Ex. ___." Geiger did not sponsor any exhibits.

FINDINGS OF FACT

Many of the relevant transactions were conducted through corporations, partnerships, and trusts in the South Pacific, the Caribbean, Ireland, Luxembourg, Hong Kong, and elsewhere. Many of the officers, directors, shareholders, and beneficial owners of these entities remain unknown. Three of the eleven Respondents were not served with the OIP and did not testify at the hearing. The result is an evidentiary record with sketchy and inconsistent details. The parties attempt to fill these gaps, sometimes with assumptions and sometimes with reasonable inferences from known facts. As summarized below, the weight of the evidence shows that Respondents participated in a scheme to distribute unregistered securities.

The factual findings in this Initial Decision are not binding on the severed Respondents, in this proceeding or in any other proceeding. All dollar figures are expressed in United States dollars, unless otherwise noted.

Active Respondents

Carley, age fifty-nine, resides in Antigua, West Indies (Tr. 1238, 1279). He previously resided in Delta, British Columbia, Canada (Tr. 1238-39). Carley earned a diploma of business administration from the Manitoba Institute of Technology in 1970 (Tr. 1240). He has extensive experience in the Canadian banking industry and is a certified general accountant in Canada (Tr. 1240-44, 1349).

Carley was the chief financial officer of Starnet from March 10, 1997, to December 23, 1999, and a director from January 27, 1997, to December 23, 1999 (Carley Answer). From April 8, 1998, to December 23, 1999, Carley was chairman of the board of Starnet (Carley Answer; Tr. 1248-49). From August 12 to September 10, 1999, Carley was also the secretary of Starnet (Carley Answer). Carley continued to work for Starnet in Antigua until 2001. He was the president of EFS Caribbean, Inc. (EFS Caribbean), Starnet's electronic credit card subsidiary, until April 3, 2000 (Carley Ex. 38). Thereafter, he was a consultant (Carley Answer; Tr. 1238).

Zacharias, age thirty-nine, resides in Costa Rica (Tr. 1076, 1079). He previously resided in Port Moody, British Columbia, Canada (Zacharias Answer). Zacharias earned a law degree from the University of Manitoba in the early 1990s and an MBA degree from Simon Fraser University in 1995 (Tr. 1079-80). From January 27, 1997, through August 12, 1999, Zacharias was the secretary, treasurer, and a director of Starnet (Zacharias Answer; Tr. 1093). From August 14, 1997, through February 14, 2000, Zacharias was in-house corporate counsel for Starnet (Zacharias Answer; Tr. 1093).

Gould, age fifty-seven, is a resident of Vancouver, British Columbia, Canada (Tr. 1367). Since 1995, Gould has been a partial owner and operator of United Capital Securities, Inc. (United Capital), a Canadian introducing broker and dealer (Gould Answer; Tr. 1367, 1370, 1559). At the relevant times, United Capital cleared trades through First Marathon Securities, Inc. (First Marathon), a Canadian broker and dealer (Tr. 1367-68, 1559, 1562). Gould has been a registered securities industry professional in Canada since 1987 (Tr. 1368, 1370). He has never

been registered with the Commission as a broker. He has never been associated with any broker registered in the United States.

Geiger, age forty, is a Colorado resident (Tr. 1646-47). He is a high school graduate and entered the securities business in 1987 as a registered representative of R.B. Marich, Inc. (Marich) (Tr. 1647-49; DX 257). In 1990, Geiger became associated with Cohig & Associates, Inc. (Cohig) (Tr. 1649; DX 257). From November 1993 through January 2001, Geiger was a registered representative associated with Spencer Edwards or its predecessor, World Securities Corp. (World Securities) (Geiger Answer; Tr. 1650; DX 257). During the period at issue in the OIP, Geiger was a significant revenue producer for Spencer Edwards (Tr. 1823-24, 2121). He resigned under pressure, effective January 31, 2001 (Tr. 1778-80, 2017, 2063-64; DX 257).

Kaufmann, age forty-nine, is a Colorado resident (Kaufmann Answer). He earned a BS degree in mechanical engineering from Colorado State University in 1976 and an MBA degree from the University of Denver in 1980 (Tr. 1826). Kaufmann entered the securities industry in 1980 (Tr. 1825). He was associated with Marich from 1984 to 1990, and with Cohig from 1990 to 1993 (Tr. 1844-45). From November 1993 through the present, Kaufmann has been a registered representative associated with Spencer Edwards or its predecessor, World Securities (Kaufmann Answer; Tr. 1825-26).

At all relevant times, Kaufmann and Geiger worked together under Spencer Edwards joint account executive number 6808 (Tr. 1669, 1829-30). Kauffmann and Geiger shared an office and split commissions on all trades executed under their joint account executive number (Tr. 1669-72, 1686, 1830).

Spencer Edwards, formerly known as World Securities, is a Colorado corporation that is registered with the Commission as a broker and dealer (Spencer Edwards Answer). Its only office is located in Englewood, Colorado (DX 453). Spencer Edwards made a market in Starnet stock from September 1997 through May 2001 (Spencer Edwards Answer; Tr. 2025, 2119-20). At the relevant times, Spencer Edwards was an introducing broker and cleared trades through Hanifen, Imhoff Clearing Corporation and its successor, Fiserv Correspondent Services, Inc. (Fiserv) (Tr. 83-84; DX 460 at 6770).

Price, age sixty-three, is a Colorado resident (Price Answer; Tr. 1988). He earned a BS degree from the University of Colorado and has been licensed in the securities industry since 1969 (Tr. 1989-90). From 1989 through 1993, Price, like Geiger and Kaufmann, was employed by Cohig (Tr. 1649, 1826-27, 1990, 2077). He then co-founded Spencer Edwards. From March 1994 to the present, Price has been the president, chief executive officer, and chief compliance officer of Spencer Edwards. He is also a registered representative and currently owns 45% of the firm (Price Answer; Tr. 1989). Price owned 33% of the firm in 1997 and 50% of the firm in 1999 (Tr. 1989). At the relevant times, Price directly supervised the registered representatives at Spencer Edwards, including Geiger and Kaufmann (Price Answer; Tr. 1688, 1834, 1994).

Severed Respondents

Dohlen, age forty-three, was chief executive officer of Starnet from April 1997 to September 1999 (DX 445 at 34; Form 10-K/A for Starnet, fiscal year 2000, at 8-9 (official notice)). He was also a director of Starnet from January 1997 to September 1999 (DX 445 at 34, DX 446 at 38; Form 10-K/A for Starnet, fiscal year 2000, at 8-9 (official notice)). Dohlen holds a law degree (Tr. 1697, 1786; DX 445 at 34). He also earned an MBA from Simon Fraser University, where he and Zacharias were classmates (Tr. 1091; DX 445 at 34).

Giles, age thirty-eight, was president and a director of Starnet from January 1999 through November 1999 (DX 445 at 35, DX 446 at 38-39; Form 10-K/A for Starnet, fiscal year 2000, at 8-9 (official notice)). At various other times from 1997 to 1999, Giles was secretary, treasurer, and vice president of offshore operations for Starnet (DX 445 at 35, DX 454 at 25, 75, 122).

Peeper, age sixty, is a citizen of the Netherlands who resides in Spain (Tr. 374, 1869-70; DX 455). He has been investing in U.S. securities for his own account and pursuant to powers of attorney for several non-U.S. companies for decades (Tr. 1665-66). Peeper has been a customer of Kaufmann's since 1984 and a customer of Kaufmann's and Geiger's since 1988 (Tr. 373-74, 1665-66, 1844-46). He opened a Spencer Edwards account in November 1993, when Kaufmann and Geiger joined that firm (Tr. 1869; DX 455).

Starnet

Starnet was incorporated in Nevada in June 1996 as Creative Sports Marketing, Inc. (Creative Sports Marketing) (DX 446 at 3-4). Its first business plan contemplated celebrity golf promotions (DX 446 at 4). Within a month, the company changed its name to Gelato Brats, Inc. (Gelato Brats), and adopted a revised business plan that focused on manufacturing non-fat dairy ice cream and desserts (DX 446 at 4). In early 1997, the company again changed its name to Starnet and redomiciled in Delaware (DX 446 at 5).

At the times relevant to the OIP, Starnet's principal places of business were in Vancouver, British Columbia, Canada, and St. John's, Antigua, West Indies (DX 445, DX 446). From September 1997 to May 2001, Starnet's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act (Tr. 1097-98; DX 445, DX 446, DX 454 at 13-23). In September 1997, the National Association of Securities Dealers (NASD) approved Starnet for listing on the Over-the-Counter Bulletin Board (OTC Bulletin Board) and Spencer Edwards became Starnet's first market maker (Tr. 2025, 2119-20; DX 454). Starnet's goal was to obtain a listing on the NASDAQ National Market System (Tr. 1097; DX 454 at 80).

Until April 1998, Starnet derived its revenues principally from adult entertainment sites on the Internet (DX 445 at 23; DX 446 at 29). In March 1998, Starnet launched a proprietary Web site, licensed in Antigua, to accept, process, and manage wagers over the Internet (DX 446 at 6). Revenues from Internet gambling soon exceeded revenues from Internet adult entertainment (DX 446 at 30).

Starnet's net revenue nearly tripled in one year, from approximately $3.3 million during fiscal 1998 to approximately $9.7 million during fiscal 1999 (DX 446 at 29-30, 55-56). The company reported a net loss in excess of $1.0 million during fiscal year 1998 and net income in excess of $2.0 million during fiscal year 1999 (DX 446 at 29-30, 55-56). At the end of fiscal year 1999 (April 30, 1999), Starnet had 163 employees (DX 446 at 20).

When the price of technology stocks rose during 1999, Starnet stock rode the crest of the wave (Tr. 1948-49). Between June and December 1998, Starnet's stock traded at prices between $0.37 and $1.50 per share (DX 457). By early July 1999, Starnet's stock traded at prices above $26 per share and its daily trading volume exceeded 1.5 million shares (Tr. 1949; DX 457). In these favorable market conditions, Starnet's officers and employees exercised their options and sold their stock throughout 1999.

On August 20, 1999, the Royal Canadian Mounted Police (RCMP) executed search warrants at Starnet's Vancouver office and at the houses of several Starnet officers and directors (Tr. 546-47). The RCMP confiscated computer equipment and other records (Tr. 547). On the day that news of the search broke, Starnet's stock price plunged from $13 to $4 per share on a trading volume of 10.5 million shares (DX 457). As the criminal investigation continued, the RCMP also searched United Capital's office (Tr. 556-57, 567-69).

Notoriety from the police search had immediate consequences. Ernst & Young LLP promptly resigned as Starnet's independent auditor (DX 454 at 65). Starnet relocated its gambling operations from Canada to Antigua in September 1999 (Tr. 1279; DX 454 at 76). Between September and December 1999, Carley, Dohlen, and Giles resigned from their positions as officers and directors (Tr. 1088; Form 10-K/A for Starnet, fiscal year 2000, at 8-9 (official notice)). In March 2000, Starnet sold all the assets related to its adult entertainment business to focus on its Internet gambling business (Form 8-K for Starnet, dated Mar. 17, 2000) (official notice).

Starnet never achieved its goal of obtaining a listing on the NASDAQ National Market System. In May 2001, Starnet became a wholly owned subsidiary of World Gaming PLC, a company organized in England and Wales and located in Antigua (Form 20-F for World Gaming PLC, fiscal year 2001, at 11) (official notice).

In August 2001, Starnet pleaded guilty to criminal charges of illegal Internet gambling in British Columbia. The court imposed a fine of $100,000 (Canadian) and ordered the company to forfeit $3,925,000 (Canadian) (Form 20-F for World Gaming PLC, fiscal year 2001, at 41-42) (official notice). No individual associated with Starnet was charged with a criminal offense (Tr. 565-67).

Dennis Brovarone

Dennis Brovarone (Brovarone) is an attorney who practices in Westminster and Littleton, Colorado (Tr. 368, 372, 757). In the late 1980s, Brovarone was in-house counsel to Marich, where he became friendly with Geiger and Kaufmann (Tr. 369-73, 767-68, 961-62). Once Brovarone went into private practice in 1990, it became common for Geiger, Kaufmann, and

Brovarone to refer business to each other (Tr. 1690). In the early 1990s, Geiger recommended that Peeper retain Brovarone for securities transactional work (Tr. 374). During the period at issue, Peeper paid Brovarone a monthly retainer of $2,000 (Tr. 376-77, 475, 709). When Starnet was looking for a market maker in 1997, Brovarone recommended that Starnet contact Geiger and Kaufmann at Spencer Edwards (Tr. 1689-91). Brovarone is not a party to this proceeding, but he was a key witness at the hearing.

A. Starnet Issues Thirty-Two Million Shares of Unregistered Stock.

From July 1996 through February 2001, Starnet and its corporate predecessors distributed more than thirty-two million shares of common stock into the public market (DX 318). The relevant transactions were not registered with the Commission (DX 440).

July 1996: Creative Sports Marketing Sells
Ten Million Unregistered Shares Pursuant
to Rule 504 of Regulation D

In July 1996, Starnet's predecessor, Creative Sports Marketing, conducted a private offering in which twelve individuals and businesses purchased ten million unregistered shares of common stock for $10,000 (Tr. 466; DX 318, DX 445 at 3, DX 446 at 4). Pacific Rim Investments, Inc. (Pacific Rim), a corporation organized in Vanuatu, South Pacific, acted as sales agent for the transaction (DX 445 at 3, DX 446 at 4). Brovarone wrote a legal opinion in support of Creative Sports Marketing's claim that the transaction was exempt from registration under Rule 504 of Regulation D (Tr. 380, 457-58, 998).[2]

Pacific Rim then established a "non-quotation bargain market" for the resale of these shares (DX 445 at 3, DX 446 at 4). The record provides no clue as to what a "non-quotation

[2] Securities Act Regulation D, Rules Governing the Limited Offer and Sale of Securities without Registration under the Securities Act of 1933, 17 C.F.R. §§ 230.501-.508, provides various exemptions from Securities Act registration for securities offerings. Rule 504 of Regulation D, 17 C.F.R. § 230.504, is the limited offering exemption designed to aid small businesses in raising "seed capital."

Rule 504 of Regulation D, as in effect during 1996, permitted a non-reporting issuer to offer and sell securities to an unlimited number of persons, without regard to their sophistication or experience and without delivery of any specified information in a public offering. The aggregate offering price of this exemption was limited to $1 million in any twelve-month period. Securities sold under this exemption could be resold freely by non-affiliates of the issuer who were not otherwise acting as underwriters.

Although securities sold under a Rule 504 offering during 1996 were not "restricted securities" within the meaning of Securities Act Rule 144(a)(3), 17 C.F.R. § 230.144(a)(3), that did not mean that all such securities could be sold freely by any party. Affiliates of the issuer who received securities in a Rule 504 offering were always subject to resale limitations, even if the securities themselves were unrestricted.

bargain market" might be, and my own research has shed little light on the terminology. The amount of capital raised, $10,000, was rather modest. When this fact is coupled with the steady turnover of shares, there is considerable reason to question whether this was a legitimate "seed capital" transaction or a sham. I find that Pacific Rim functioned as an unregulated, offshore exchange.

Some of these ten million unregistered shares eventually wound up in the hands of Starnet's management. For example, Carley and Zacharias acquired 25,000 shares and 10,000 shares, respectively, of this unregistered Rule 504 stock in early 1997 (Tr. 1100; DX 454 at 22-23, 27, 36). Dohlen acquired another 200,000 shares of this unregistered Rule 504 stock. Using Gould as an intermediary, Dohlen utilized these shares to make a market in Starnet once the NASD approved Starnet for listing on the OTC Bulletin Board (Tr. 1413).

The circumstances were as follows. In September 1997, Gould caused Celestine Asset Management (Celestine) to open a brokerage account at Spencer Edwards, with Geiger and Kaufmann as its account executives (Tr. 1411-12; DX 88).[3] This occurred at about the same time that Spencer Edwards became Starnet's first market maker (Tr. 2025, 2119-20; DX 454).

On October 1, 1997, Gould deposited 200,000 shares of Starnet into Celestine's account at Spencer Edwards (DX 2 at 3, DX 89). Gould had obtained these shares from Dohlen, at the request of either Geiger or Kaufmann (Tr. 1413-14). Geiger and Kaufmann then used Celestine's shares to facilitate Spencer Edwards's market-making activity in Starnet (Tr. 1411-13, 1691-92). During September and October 1997, Celestine sold 126,000 of these shares into the public market (DX 2 at 3). The Division aptly characterizes Geiger's and Kaufmann's activities as "priming the pump."

January 1997: Starnet Grants Gould/Celestine
a Beneficial Interest in 287,500 Unregistered Shares

In January 1997, Gould, through Celestine, entered into an ongoing consulting contract with Starnet. At the time, Starnet was still a private company. Gould promised to use his best efforts to raise capital for Starnet, in return for a share of any financing he obtained (Tr. 1374-76, 1379-81). As part of the contract, Gould also agreed to maintain brokerage accounts for Zacharias, Carley, and other Starnet officers at United Capital and "track" these officers' holdings in Starnet stock (Tr. 1377-78).

Gould raised $400,000 (Canadian) through a private debenture offering (Tr. 1375-76). In return, Celestine received a consulting fee of $40,000 (Canadian) and a beneficial interest in 287,500 shares of Starnet (Tr. 1380-81).

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[3] Gould and two other individuals formed Celestine in the British Virgin Islands in 1994 (Gould Answer; Tr. 1372-74). Half of Celestine's shares were allocated to Gould and half were allocated to the other individuals, who are not involved in this proceeding (Tr. 1381, 1473-74, 1515-16). Gould was the only beneficial owner of Celestine from 1999 to 2001, when Celestine was dissolved (Tr. 1372-74).

March 1997: Starnet Issues Another Ten Million
Unregistered Shares to Murray Partners

In March 1997, while Starnet was still a private company, Murray Partners (BVI), Inc. (Murray Partners), acquired Starnet in return for ten million shares of unregistered common stock (Tr. 1510; DX 445 at 4, DX 446 at 5). When Starnet began publicly trading, the trustee of Murray Partners filed a Form 3 with the Commission (DX 437).[4]

Murray Partners was incorporated in the British Virgin Islands, and it was comprised of seven to ten shareholders whose identities changed over time (Tr. 1510-11; DX 91; Carley Ex. 23 at 8212).[5] Some of the Murray Partners' shareholders were trusts whose beneficiaries were Starnet officers and directors, including Carley, Dohlen, and Giles (Tr. 737, 1282, 1284, 1515; DX 91, DX 445 at 40, DX 446 at 44). Madison Park Trust was one of the original Murray Partners. Celestine eventually became a shareholder in Murray Partners (Tr. 1514-16).

Murray Partners' shares in Starnet were represented by a single stock certificate bearing a restrictive legend (Carley Ex. 27) (# 10251). First Marathon, the clearing broker for United Capital, held the shares of Murray Partners in trust until September 1999 (Tr. 448-49; Carley Ex. 27). I find as a fact that this was one of the ways that Gould followed through on his pledge to "track" the holdings of Starnet's officers and directors.

May 1997 and December 1997: Starnet Issues
Units Potentially Representing 7.35 Million Unregistered
Shares Through a Regulation S Offering

In 1997, Starnet decided to issue unregistered securities to foreign investors pursuant to Commission Regulation S.[6] Dohlen informed Geiger that Starnet was contemplating a

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[4] As a beneficial owner of more than 10% of Starnet's common stock, Murray Partners was required to file with the Commission a Form 3, Initial Statement of Beneficial Ownership of Securities. See Section 16(a) of the Exchange Act.

[5] Three of the original Murray Partners vanished between March 1997 and September 1999 (Indigo Crown Trust, Millenium 2000 Trust, and Stratus Council Trust). Six new Murray Partners replaced them over the same period (Pacific Well Trust, Blueline Trust, Provincial Alliance Trust, Trico Trust, Brisbane Capital, and Celestine) (Carley Ex. 29). In March 1997, each of the original Murray Partners held an equal number of shares in Murray Partners. By mid-1999, the fractional interests of the individual shareholders of Murray Partners differed significantly from each other (Carley Ex. 23 at 8215, Carley Ex. 29 at 488). However, Murray Partners as a whole still retained its original ten million shares of Starnet.

[6] The Commission adopted Regulation S, Rules Governing Offers and Sales Made Outside the United States without Registration under the Securities Act of 1933, 17 C.F.R. §§ 230.901-.905, to clarify and simplify the extraterritorial application of the registration provisions of the Securities Act. See Offshore Offers and Sales, 46 SEC Docket 40 (Apr. 24, 1990). The Commission intended to provide American issuers with an efficient capital-raising alternative

Regulation S offering, and Geiger recommended the offering to Peeper for consideration by his clients (Tr. 1698). Accounts associated with Peeper had actively participated in other Regulation S offerings throughout the mid-1990s (Tr. 375-76, 1667).

In May 1997, Starnet agreed to issue 2.45 million shares of common stock to seven foreign investors in a private offering under Regulation S, in exchange for $2.45 million in bridge financing (DX 450). The seven subscribers to Starnet's private offering were Oriental New Investments, Ltd., LaSalle Investments, Ltd., Rial Equity Group S.A., Orienstar, Ltd., Le Fond Mondial, Eur-Am, B.V., and Orpac Portfolio Management Group (DX 450). The seven subscribers were domiciled in far-flung jurisdictions, including Ireland, Luxembourg, and Hong Kong (Tr. 1801-03). Peeper held powers of attorney to buy and sell stocks for each of these seven entities and he executed the bridge financing agreements on their behalf (Tr. 476-77; DX 450). For simplicity, these seven subscribers will be identified as the "Peeper entities" or the "Peeper accounts."

The bridge financing agreements provided that each of the foreign investors would receive 350,000 shares of Starnet common stock issued under Regulation S (DX 450). Warrants were attached to the shares issued. The warrants could be exercised at $2.00 per share, but they expired in one year. Each warrant conveyed the right to obtain units composed of another share of common stock plus a piggyback warrant (DX 211). The foreign investors could exercise the piggyback warrants at $4.00 per share and obtain another share of common stock (DX 90, DX 211, DX 450). Thus, the bridge financing agreements and subscription agreements collectively entitled the seven foreign investors to obtain up to 7.35 million shares of Starnet stock, if they exercised every warrant and every piggyback warrant within the time allowed.

Dohlen negotiated the agreements for Starnet and Zacharias reviewed them prior to execution (Tr. 1110, 1112). At Peeper's request, Brovarone also reviewed the subscription agreements (Tr. 383, 386, 748; TK Ex. 3). Consistent with Peeper's preferred practice, Brovarone recommended the use of an escrow agent, as distinguished from a restrictive legend, to prevent the shares from being resold in the United States during the Regulation S restricted period (Tr. 750; TK Ex. 3).[7]

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whereby stock could be issued and sold outside the United States without registration. Regulation S contains a general statement providing that Section 5 of the Securities Act does not apply to offers and sales of securities that occur outside the United States. The rule also has two non-exclusive safe harbors. See id. at 41. One safe harbor applies to offers and sales by issuers, distributors, and their affiliates who are involved in the distribution process. The other safe harbor applies to resales by persons other than an issuer. If both safe harbors within Regulation S are met, the offer and resale of securities are deemed to take place outside the United States for the purpose of Section 5. See 17 C.F.R. §§ 230.903 (issuers), 230.904 (sellers).

[7] Until its amendment in 1998, Regulation S contained a forty-day restricted period, during which securities sold in offshore transactions pursuant to Regulation S could not be offered or sold to a United States person. See 17 C.F.R. § 230.903(c)(2)(iii) (1995).

In December 1997, Dohlen informed Brovarone that Starnet had received $2.45 million in bridge financing (Tr. 381; DX 279). Starnet then issued 2.45 million shares of unregistered common stock to the foreign investors and filed a mandatory current report (Form 8-K) to notify the Commission of the transaction (DX 318, DX 442, DX 454 at 11).[8] Starnet's directors, including Dohlen, Carley, and Zacharias, approved the Regulation S financing plan (Tr. 1253-54). The Peeper entities paid market prices for these securities (Tr. 1759-60).

Brovarone wrote a letter to Pacific Stock Transfer, Inc. (Pacific Stock Transfer), Starnet's transfer agent, opining that the sale of 2.45 million shares of Starnet stock was exempt from the registration requirements of the Securities Act pursuant to Rule 903 of Regulation S (DX 281). Brovarone also opined that the stock certificates could be issued without restrictive legends because he would be holding the shares in escrow for at least forty-one days before turning them over to the foreign purchasers (Tr. 384-85, 477, 776, 1701-02; DX 281). The transfer agent issued the certificates without restrictive legends.

October 1997 to November 1998: The
Foreign Purchasers Handle Their Starnet
Shares in Different Ways

From October 1997 through November 1998, the Peeper entities took different approaches to their respective portfolios of Starnet securities. Orienstar received 350,000 Regulation S shares in its Spencer Edwards account on February 18, 1998 (DX 1 at 11, DX 460 at 6772). LaSalle received 350,000 Regulation S shares in its Spencer Edwards account on October 28, 1998 (DX 1 at 4, DX 51 at 7722). After these foreign entities bought Starnet stock at $1.00 per share, the price fell to $0.50 per share and remained there for a year (Tr. 1692). One of the Peeper entities sold some Starnet shares at a loss during this interval (Tr. 1692).

Oriental New Investments bought and sold Starnet shares between October 1997 and July 1998, although not Regulation S shares (DX 1 at 6-7, DX 53 at 7780, 7794). Eur-Am, LaSalle, Orpac, Rial Equity, and Le Fond Mondial followed a buy-and-hold strategy with respect to their Regulation S shares, and only began offering their shares for resale in December 1998 and later (DX 1). Orienstar sold 10,000 of its Regulation S shares into the market during June 1998, and retained the rest of its Regulation S shares for one year (DX 1 at 11).

Some of the foreign purchasers of Starnet's Regulation S stock had maintained trading accounts at Spencer Edwards for several years (DX 47, DX 51, DX 53, DX 455). Other foreign purchasers did not open accounts at Spencer Edwards until 1999 (DX 22, DX 28, DX 99, DX 455). None of the Regulation S purchasers had accounts at United Capital/First Marathon.

I find as a fact that the foreign purchasers treated their Starnet shares, including their Regulation S shares, in an individualized and differentiated fashion between October 1997 and November 1998. I find nothing in the 1998 trading patterns to support the Division's claim that these foreign purchasers were acting as affiliates of each other or otherwise coordinating their

[8] In a separate transaction unrelated to Regulation S, Oriental had already purchased 100,000 shares of Starnet on October 2, 1997 (DX 1 at 6).

conduct with respect to Starnet before December 1998. Any parallel behavior is adequately explained by market conditions. Finally, I find that Gould was not involved in any resales of Starnet's Regulation S shares by the Peeper entities through November 1998.

March 1998 and March 1999: Starnet Authorizes Issuance of Seven Million Shares to Its Officers and Employees on Form S-8

Starnet created two employee stock option plans (ESOPs) as incentive compensation for its officers, directors, and employees. Starnet filed its first Form S-8 with the Commission on March 12, 1998 (DX 441a).[9] The 1998 ESOP authorized the issuance of three million shares of common stock and set the strike price of the options at $0.74 per share (DX 80, DX 285, DX 286, DX 441a).

Starnet filed its second Form S-8 with the Commission on March 10, 1999 (DX 441). The 1999 ESOP authorized the issuance of four million shares of common stock and set the strike price of the options at $1.44 per share (DX 80, DX 441).

Zacharias prepared Starnet's Forms S-8, with input from Scott Reed (Reed), an attorney in Boulder, Colorado, and Peter Jensen (Jensen), an attorney in British Columbia (Tr. 789-91, 1146; DX 208). Starnet never filed any post-effective amendments to its Forms S-8 (Tr. 791, 1174; DX 440).

Starnet Learns That Its Officers and Employees Could Not Resell Their Shares in British Columbia After Exercising Their Options

On April 8, 1998, Starnet received a letter from Canadian attorney Jensen, opining that the British Columbia Securities Act would impose an indefinite holding period on any stock certificates issued to Starnet's Canadian employees, officers, and directors who exercised their options (Gould Ex. 3, Attachment 5). Jensen further opined that British Columbia securities laws could also limit the resale of shares resulting from the exercise of such options in the United States (Gould Ex. 3, Attachment 5).

Having identified this potential problem, Jensen also proposed a solution. In his letter, Jensen suggested a mechanism for avoiding violations of British Columbia law by reselling S-8 shares outside of British Columbia. While such shares could not be resold in British Columbia,

[9] SEC Form S-8 is available to register the offer and sale of securities to an issuer's employees in a compensatory or incentive context. The Commission reasoned that employees' familiarity with the business of the issuer through the employment relationship and the compensatory purpose of the offering justified the use of abbreviated disclosure that would not be adequate in the context of a capital-raising offer of securities to the general public. Form S-8 registration statements are not reviewed by the Commission's staff and become effective immediately on filing. See Registration of Securities on Form S-8, 66 SEC Docket 1644, 1644 (Feb. 17, 1998).

Jensen reasoned that they might be transferred out of British Columbia, and then resold. In broad terms, Jensen outlined a proposal by which Starnet might issue stock options to a non-Canadian trustee, who would manage a portfolio of options for the benefit of Starnet's Canadian employees, officers, and directors, and thus, avoid the complications of the British Columbia Securities Act (Gould Ex. 3, Attachment 5). Jensen advised that, if Starnet chose to implement his proposal, it should amend its ESOP and its Form S-8 to disclose the alternative approach described in his letter (Gould Ex. 3, Attachment 5). Jensen further advised that implementation of his proposal was contingent on the plan complying with United States law (Gould Ex. 3, Attachment 5).

Jensen asked Reed to determine whether his proposal complied with United States securities laws (Tr. 805-06). Reed never provided a written response to Jensen's proposal (Tr. 806). However, Reed advised Jensen orally that any shares Starnet issued under its ESOPs would need to be issued in the names of the employees receiving the shares in order to comply with the requirements of Form S-8 (Tr. 807-08).

Starnet Develops Its Own Plan to Exercise the
S-8 Options and Sell the Resulting Stock

As the price of Starnet's stock began to appreciate in late 1998 and early 1999, Starnet's Canadian officers, directors, and employees were eager to exercise their 1998 options and sell the resulting stock (Tr. 1164).

If Starnet's management ever contemplated providing appropriate written disclosure to the investing public and undertaking an initial public offering (IPO) that would allow its officers and employees to resell their shares after exercising their S-8 options, there is no evidence of it on this record.[10]

Instead, Starnet's management, Gould, Peeper, Geiger, and Kaufmann developed a scheme to finance the exercise of Starnet employee stock options and the resale of the resulting shares without an IPO. Zacharias discussed Starnet's "conundrum" with Gould, and Gould contacted Kaufmann at Spencer Edwards (Tr. 1384-88, 1400). At about the same time, Dohlen contacted Geiger at Spencer Edwards to ask if Peeper would be interested in private transactions that swapped Starnet Regulation S stock for Starnet S-8 stock (Tr. 1759-60). Peeper said that he would (Tr. 1760).

In its early stages (December 1998 through September 1999), the scheme involved public sales of Starnet Regulation S stock held by the Peeper entities, followed by so-called private sales of S-8 stock to the Peeper entities that had just sold Regulation S stock (Tr. 660-63; DX 67). The Peeper entities then resold the S-8 stock into the public market at a time of their choosing. In its later stages (October 1999 through February 2001), this scheme evolved and

[10] Zacharias assumes that Starnet "could have easily filed" post-effective amendments to its Forms S-8 (Zach. Br. at 2-3). Gould dismisses Starnet's failure to file such amendments as "a technical issue" (Gould Br. at 22 n.22). I reject both of these self-serving claims.

expanded to include public sales of unregistered Starnet stock held by two of the Murray Partners (Celestine and Madison Park Trust).

The common denominators to this scheme were the following: the transactions were brokered by Gould at United Capital and by Geiger and Kaufmann at Spencer Edwards, and the proceeds were transmitted from one participant to another through client trust accounts maintained by Brovarone.

December 1998: Starnet Extends the Time to
Exercise the Regulation S Warrants for One Year

An early obstacle to the success of the scheme was an imbalance between the anticipated quantities of S-8 stock and the existing quantities of Regulation S stock. By December 1998, Starnet's officers and employees held options for three million shares (exercisable at $0.74 under the March 1998 ESOP) and they would soon hold options for another four million shares (exercisable at $1.44 under the March 1999 ESOP).

In contrast, the Peeper entities had already sold some of the Starnet shares they had acquired during 1997.[11] To complicate matters further, by early December 1998, the warrants attached to the original 2.45 million Regulation S shares were expiring out of the money. The Peeper entities had no incentive to exercise them at $2.00 per warrant when Starnet was trading at about $1.00 per share (DX 457). In these circumstances, Starnet extended for one year the time in which the Peeper entities could exercise their Regulation S warrants (DX 443, DX 444). The advantage of this extension to the Peeper entities is obvious and the Division's theory of the case presents a plausible explanation of its advantage to Starnet. I find that Starnet's decision to extend the warrant exercise period brought the scheme to life.

December 1998: Zacharias Obtains a Legal
Opinion that Shares Issued upon Exercise of the Warrants
Could Be Issued Without Restrictive Legends

In December 1998, Zacharias asked Reed to prepare opinion letters as to whether any stock certificates to be issued upon the exercise of the warrants and piggyback warrants could be issued without restrictive legends (Tr. 793-94). Reed reviewed Starnet's public filings and consulted with the Commission's staff (Tr. 796-97). In a series of letters, Reed opined that the transfer agent could issue the certificates without restrictive legends (Tr. 798, 804-05; DX 90, DX 209, DX 211, DX 212, DX 220).

Before Reed wrote these opinion letters, he questioned Zacharias about the facts of the underlying Regulation S transaction in December 1997 (Tr. 794-95). Reed noted that some of the foreign purchasers had similar names (Oriental New Investments, Orienstar, Orpac Portfolio Management). Reed expressed concern that there might be a problem with the original

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[11] By early December 1998, LaSalle had already sold 37,500 shares; Orienstar, 10,000 shares; and Oriental, 99,000 shares (DX 1 at 4, 6-7, 11).

Regulation S placement if the seven entities were related to each other, and were acting as one large underwriter (Tr. 795, 847). Reed asked Zacharias if the seven entities were separate and unaffiliated, and Zacharias assured him that they were (Tr. 795-96, 846-47, 849).

On January 20, 1999, Dohlen asked Geiger to obtain Peeper's backdated signature on the Regulation S subscription agreements and to return them to Zacharias (DX 341). Dohlen stressed that his request was urgent. When Reed issued his first opinion letter on January 25, 1999, he assumed that Peeper had executed the Regulation S subscription agreements on November 30, 1997 (DX 211). I infer that Reed did not know of Dohlen's and Zacharias's tactics.

The Scheme From Peeper's Perspective

As Starnet's market price began to rise during 1999, the Peeper entities exercised their warrants (January-April 1999) and their piggyback warrants (July-October 1999) (Tr. 1124; DX 1, DX 318).

The procedure worked as follows: Peeper advised Dohlen of his clients' intent to exercise their warrants and piggyback warrants, and Zacharias processed the paperwork (Tr. 1123, 1127). The Peeper entities that did not already have trading accounts at Spencer Edwards opened new accounts in 1999, with Geiger and Kaufmann as their account executives (DX 455). Zacharias obtained opinions from Reed. Zacharias then directed Pacific Stock Transfer to issue certificates without restrictive legends and to forward them to Geiger at Spencer Edwards (Tr. 1126-27; DX 90, DX 212, DX 213). The transfer agent did so.[12]

In this manner, the Peeper entities acquired an additional 4.9 million shares of Starnet common stock during 1999 and immediately deposited the shares in their Spencer Edwards accounts. The total number of Starnet shares issued to the seven foreign purchasers pursuant to Regulation S was approximately 8,050,000 (DX 1, DX 22, DX 28, DX 47, DX 50, DX 54, DX 99, DX 210).[13]

The OIP alleges that the Peeper entities were acting as affiliates of each other, or were otherwise under the common control of Peeper. It made perfect economic sense for the Peeper

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[12] The subscription agreements called for shares issued on exercise of the warrants to be held in escrow for forty days (DX 211 at 4). However, the record fails to show that Starnet and the Peeper entities followed this procedure. For example, Reed wrote a letter to the transfer agent concerning Orienstar on January 25, 1999 (DX 211). Orienstar received the unrestricted certificates in its Spencer Edwards account on January 28, 1999 (DX 213).

[13] Although the subscription agreements only entitled the seven foreign entities to 7.35 million shares, Starnet issued an additional two blocks of 350,000 shares to these foreign purchasers. The total number of purported Regulation S shares issued was thus 8,050,000 (DX 1 at 1, 3, 6, 10, 13, 16, 19) (Div. Prop. Find. # 109).

entities to exercise their warrants and piggyback warrants during 1999, because Starnet stock was trading at prices above the exercise price (DX 457). All parallel action is adequately explained by market conditions. An adverse inference of collusion is not appropriate from the warrant exercises alone.

The Scheme From
Starnet's Perspective

No single witness could fully explain the mechanics of the scheme (Tr. 1163-64, 1296, 1425-26, 1763-64). The only document that describes the scheme is a memorandum that Brovarone wrote at Peeper's request on September 29, 1999 (Tr. 657-61; DX 67). Respondents agreed that Brovarone's memorandum accurately described the scheme as it was implemented (Tr. 1170, 1404-05, 1899-1900).

Under the scheme, Starnet required its employees and officers to open brokerage accounts with Gould at United Capital/First Marathon (Tr. 1258-59, 1296). When these employees and officers wished to exercise their stock options, they would sign an Irrevocable Authorization permitting Gould to exercise their options and sell the shares obtained as a result of that exercise (DX 67, DX 449; Gould Ex. 8).

Gould would then notify Kaufmann or Geiger of an aggregate number of shares that had to be sold from one of the Peeper accounts. The number of Regulation S shares to be sold would equal the aggregate number of shares as to which Starnet's employees and officers wished to exercise options (DX 67).

Geiger and/or Kaufmann, acting under their joint account executive number, would sell that number of Starnet shares to public customers out of one of the Peeper accounts (Tr. 1722-24; DX 67).

Gould would occasionally exercise time and price discretion or place limit orders for the sale of the stock from the Peeper accounts (Tr. 1434, 1438-39; DX 77). At some point, Peeper provided Geiger with a letter authorizing Gould to conduct transactions in Starnet stock in the Spencer Edwards accounts over which Peeper held powers of attorney (Tr. 1407-08; DX 66).

After the sale of Starnet stock by the Peeper accounts, a Spencer Edwards employee directed Fiserv, the clearing broker, to deduct Spencer Edwards's trading commissions and to forward the net proceeds to Peeper's attorney, Brovarone (DX 67). Brovarone deposited the funds into one of several trust accounts he had opened. Brovarone then wired a portion of the proceeds to Starnet. This sum was equal to the strike price for the aggregate number of shares for which options were to be exercised (DX 67). For each exercising employee or officer, Brovarone also wired the remaining proceeds (net proceeds minus the strike price paid to Starnet) to an account maintained at First Marathon for the benefit of the employee or officer (DX 67). Brovarone confirmed such payments with Gould at United Capital (DX 67). In transferring funds from the trust accounts of the Peeper entities, Brovarone acted only on Peeper's instruction (Tr. 602-03, 712-13, 901-03, 974-75).

Following receipt of the option exercise price from Brovarone, Starnet would issue the S-8 stock to its employees and officers. However, as part of the Irrevocable Authorization, the employees and officers had already given prior approval for Gould to transfer this stock back to a Peeper account to "reimburse" the account for the Regulation S stock it had sold to finance the option exercise (DX 67, DX 449). The employees and officers would receive their net proceeds after delivering the stock certificates to Gould (Tr. 1394-95). Starnet's officers sold their S-8 stock purportedly pursuant to Securities Act Rule 144.[14] Kaufmann provided substantial assistance to Starnet's officers in completing the necessary forms.

In this manner, the Peeper accounts sold more than 5.2 million of the 8.0 million Starnet shares issued to them pursuant to Regulation S (DX 1, DX 22, DX 28, DX 47, DX 50, DX 54, DX 99, DX 210).

Gould requested and received a fee of approximately $1 million for coordinating the sales and managing the transfer of funds (Tr. 1401, 1404-05, 1523-24; Gould Ex. 25). Gould also received 100,000 options under Starnet's March 1998 ESOP. He subsequently exercised the options, sold the resulting stock into the public markets through Spencer Edwards, and directed the net proceeds to his wife's account at First Marathon (Tr. 1436-37; DX 71).

Gould Uses Celestine's Accounts to
Distribute Starnet's Purported Rule 504 Stock
and Its S-8 Stock to the Public

As previously discussed, Celestine had opened an account at Spencer Edwards in September 1997 to facilitate Geiger and Kaufmann's efforts to make a market in Starnet stock. See supra p. 8. Celestine also maintained accounts at United Capital (Tr. 1377-78).

Between September 1997 and June 1998, Celestine's accounts at Spencer Edwards and United Capital received transfers of 2,167,385 shares of Starnet stock from Pacific Rim, the reseller of the unregistered stock issued by Creative Sports Marketing in the original Rule 504 offering (DX 2 at 1, 9-10).

Beginning in February 1999, the Celestine account at Spencer Edwards also began to receive shares that had been issued to Starnet's officers and employees pursuant to the S-8 program (DX 2 at 4-8). For example, on February 1, 1999, the Celestine account at Spencer Edwards received 224,953 Starnet S-8 shares (DX 2 at 4). On April 5 and 12, 1999, the Celestine account at Spencer Edwards received another 62,733 Starnet S-8 shares (DX 2 at 5). Between July 19 and September 3, 1999, the Celestine account at Spencer Edwards received 175,470 more Starnet S-8 shares (DX 2 at 5-7). Celestine sold these shares into the public market, and only rarely purchased Starnet shares on the public market.

[14] Securities Act Rule 144, Persons Deemed not to be Engaged in a Distribution and Therefore Not Underwriters, 17 C.F.R. § 230.144, is a safe harbor provision that allows persons affiliated with an issuer to sell limited quantities of unregistered securities without being deemed underwriters, if they meet certain conditions.

Between July 1998 and February 2000, one of Celestine's accounts at United Capital obtained and resold more than 1.5 million shares of Starnet S-8 stock (DX 2 at 11-17). During this same period, that Celestine account at United Capital made no purchases of Starnet stock on the open market.

September 1999 to September 2000:
Two of the Murray Partners
Sell Their Starnet Shares

As previously discussed, Murray Partners received ten million restricted shares when it acquired Starnet in March 1997. See supra p. 9. United Capital/First Marathon held these shares in trust for Murray Partners for the next two years. In June 1999, as the price of Starnet's stock reached its peak, Murray Partners decided to distribute these shares to its constituent members. Brovarone wrote a letter to the transfer agent, opining that the shares would be eligible for resale immediately upon distribution to the constituent members, pursuant to Rule 144 (DX 91).

On September 27, 1999, as part of the breakup of the Murray Partners' ten-million-share certificate, Starnet issued 287,500 restricted shares to Celestine and 356,250 restricted shares to Madison Park Trust (Carley Ex. 29 at 488; Carley Ex. 32). Gould was an owner of Celestine. Carley and his wife were the sole beneficiaries of Madison Park Trust (Tr. 1282-85).

Celestine deposited 287,500 restricted shares into its account at Spencer Edwards (Tr. 101, 430; DX 2 at 2, 7; DX 38 at 3739; DX 88 at 8128-30; Carley Ex. 29 at 488; Carley Ex. 36 at 7508; Gould Ex. 80, Tab F at 6). Celestine purported to sell this stock pursuant to Rule 144 (Tr. 1470-71; DX 88 at 8120-24). After the transfer agent removed the restrictive legend, Celestine sold these shares to the public between November 1999 and September 2000 (DX 38, DX 375; Carley Ex. 36 at 7516-17, 7528).

Madison Park Trust opened a Spencer Edwards account on December 20, 1999, and deposited 356,250 restricted shares of Starnet into the account on January 7, 2000 (Tr. 47, 100-01; DX 2 at 40; DX 113 at 8729). The transfer agent then removed the restrictive legend on the shares (Tr. 733, 735; DX 328; Carley Ex. 32; Carley Ex. 36 at 7530, 7552; Carley Ex. 37; Carley Ex. 38). Between January and September 2000, Madison Park Trust sold 332,500 shares of Starnet to the public through its account at Spencer Edwards (DX 113). Madison Park purportedly sold 135,000 shares pursuant to Rule 144 (DX 328). It asserts that the remaining shares were exempt from registration pursuant to Rule 144(k). As of October 27, 2000, Madison Park Trust still held 23,750 shares of Starnet in its Spencer Edwards account (DX 113 at 8720).

B. Respondents' Roles.

Carley

The evidence linking Carley to specific misconduct is limited. The Division's theory stresses that Carley had a big title at Starnet, that he was fifteen years older than his fellow officers, that he was brought in to provide adult supervision, and therefore, that he must have

known what was going on. Carley's theory of the case depends on shortening his time on the job, narrowing the scope of his responsibilities, and stressing his inexperience.[15]

Carley became involved in Starnet through his son-in-law, Mitch White, who was an officer and director of Starnet and its predecessors during 1996 and 1997 (Tr. 1245; DX 454 at 24). Carley supervised Starnet's accounting department and controller (Tr. 1250). He also reviewed Starnet's public filings as a director and chief financial officer (Tr. 1251, 1254, 1314-17).

Carley opened a brokerage account at United Capital/First Marathon in December 1998 (Tr. 1259). The Peeper entities paid Carley $2.48 million through this account in connection with his exercise of stock options and his sale of the resulting stock between February and August 1999 (Tr. 1301-03; DX 3 at 21).

A brokerage account was opened in Carley's name at Spencer Edwards during February 1999, with Geiger and Kaufmann as the account executives (Tr. 1261; DX 26). Carley insists that he did not personally open the account, nor did he authorize anyone else to do so. In support, he identified various discrepancies on the account opening documents (Tr. 1264-66). Carley received monthly account statements from Spencer Edwards regarding this account (Tr. 1277-78). He also exercised options, sold 200,000 Starnet shares through his Spencer Edwards account, and executed Forms 3 and 4 to report those transactions (DX 2 at 38-39; DX 434). In connection with these sales, Carley signed blank seller's representation letters and blank Forms 144 (Tr. 1307-09, 1346, 1361-62).

Brovarone opened a trust account for Carley's benefit in March 1999 (DX 33 at 7251). Carley did not learn of the account until October 1999 (Tr. 725-26; Carley Ex. 30).

Carley signed Starnet's amended Form 10-KSB/A in August 1999 (Tr. 1316-18; DX 446).

Zacharias

Dohlen hired Zacharias to assist Starnet in becoming a public company (Tr. 1092, 1094). Their objective was to have Starnet become a reporting company with the Commission and then to apply for a listing on the NASDAQ National Market System (Tr. 1097; DX 454 at 80).

Zacharias reviewed the bridge financing agreements and the subscription agreements for Starnet's Regulation S private placement (Tr. 1109-17). He also reviewed and signed Starnet's December 1997 Form 8-K, disclosing the Regulation S issuance (Tr. 1097, 1118-19; DX 442). Zacharias was Starnet's liaison with attorneys Jensen and Reed (Tr. 1095-96).

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[15] For example, Carley testified that he moved to Antigua in June 1999 (Tr. 1279). This conflicts with evidence that the RCMP searched his Delta, B.C., residence in August 1999 (Tr. 547). Carley's Form 4 of September 7, 1999, still used his Delta, B.C., address (DX 434). Other aspects of Carley's testimony also conflicted with the documentary evidence. See infra note 24.

Zacharias processed all the warrant exercises by the Peeper accounts during 1999. Peeper gave written instructions to Dohlen and Dohlen then handed them to Zacharias (Tr. 1127). As to each exercise, Zacharias directed the transfer agent to issue shares pursuant to the warrants and send the certificates to Geiger at Spencer Edwards (DX 212, DX 213, DX 281).

Zacharias participated in establishing Starnet's ESOPs (Tr. 1157). He also reviewed Starnet's March 1998 Form S-8 and drafted its March 1999 Form S-8 (Tr. 1146; DX 441, DX 441a). Zacharias insists that he sold his S-8 shares to the Peeper accounts in private transactions (Tr. 1152).

Zacharias opened a brokerage account at United Capital before December 1998, with Gould as his account executive (Tr. 1099-1101; Zach. Ex. A). He had received 10,000 shares of Starnet when he joined the company in 1997, and deposited the shares in his United Capital account (Tr. 1100; Zach. Ex. A). Zacharias sold these shares no earlier than January 2000 (Zach. Ex. A).

Zacharias also opened a brokerage account at Spencer Edwards in February 1999, with Geiger and Kaufmann as his account executives (Tr. 1101-02; DX 455). Thereafter, he received monthly statements relating to the activity in the account (Tr. 1104-05, 1156). Zacharias claims that someone at Spencer Edwards (otherwise unidentified) told him that the account was needed to exercise his stock options (Tr. 1104). Zacharias also claims that someone at Spencer Edwards (otherwise unidentified) told him that the monthly account statements were unimportant because the money in his account was not his money, and the transactions in his account did not involve his shares (Tr. 1105-06, 1159-60). Zacharias accepted this advice without question. He did not read any monthly account statements after the first one (Tr. 1160).

Zacharias prepared his own Forms 3 and 4, and assisted the other Starnet officers in preparing their Forms 3 and 4 (Tr. 1195-96). Reed assisted Zacharias at first, and Zacharias confirmed the sale prices of the relevant transactions with Gould (Tr. 1195-96).

Brovarone opened a trust account for Zacharias's benefit in March 1999 (DX 33 at 7251). Zacharias did not learn of the account until November 1999 (Tr. 1154-55).

Gould

Early in 1997, Gould entered into an ongoing consulting contract with Starnet. In return for raising capital through a private debenture offering, Celestine received a consulting fee and 287,500 shares of Starnet stock.

Gould first transacted business with Geiger in September 1997 (Tr. 1414). At that time, Gould caused Celestine to open a brokerage account at Spencer Edwards. He then obtained 200,000 shares of Starnet from Dohlen and deposited the shares into Celestine's account. Geiger and Kaufmann used these shares to help Spencer Edwards make a market in Starnet stock.

Gould used Celestine's accounts at Spencer Edwards and United Capital to receive more than 2.1 million shares of Starnet stock from Pacific Rim (DX 2 at 1, 9-10). This was

unregistered stock issued in the original Rule 504 offering. Celestine then resold that stock to the public.

Gould was not involved in the Regulation S financing that occurred during 1997 (Tr. 1506). In November or December 1998, Gould agreed to become involved in financing the resale of Starnet's S-8 shares (Tr. 1385, 1404). Gould knew that Spencer Edwards held a large quantity of Regulation S stock that could be swapped with the employee and officer stock then being issued under Starnet's S-8 plan (Tr. 1386). Gould contacted Geiger and Kaufmann to inquire if Spencer Edwards's customers would be willing to swap their Regulation S shares with Starnet's officers and employees to facilitate the sale of the officers' and employees' S-8 shares (Tr. 1386-87, 1391, 1485).

Gould did not inquire into whether the Regulation S shares at Spencer Edwards could be sold lawfully (Tr. 1389). He reviewed Jensen's letter and knew that it proposed a plan that differed from the one Starnet was implementing (Tr. 1398-99). Gould knew that no one else had obtained any written opinion of counsel concerning the scheme adopted (Tr. 1399, 1401).

As part of the scheme, Starnet required its officers and employees to open brokerage accounts with Gould at United Capital/First Marathon.

Gould sent hundreds of facsimile messages to Kaufmann to direct sales of Starnet Regulation S stock from the Peeper accounts, and to Brovarone to direct the disposition of the proceeds from the sales (Tr. 1408-09, 1439-40; DX 66). Gould also telephoned Kaufmann daily to give directions (Tr. 1859). Gould and Kaufmann kept a running total of the proceeds being raised (Tr. 1444-45; DX 84).

Gould knew that the seven Peeper accounts at Spencer Edwards were being used interchangeably to finance the exercise of the Starnet employees' stock options (DX 83). Gould told Kaufmann that it did not matter which Peeper account sold Regulation S stock because "it should all balance out in the end" (DX 82, DX 83). Gould also used Celestine's accounts at Spencer Edwards and United Capital to receive shares of S-8 stock from Starnet's officers and employees. Celestine then resold these shares into the public market. Gould received a fee of approximately $1 million, plus 100,000 Starnet options, for his role in coordinating the scheme.

In September 1999, following the distribution of Murray Partners' shares to its constituent members, Celestine deposited 287,500 Starnet shares into its account at Spencer Edwards. Celestine then sold the shares to the public between November 1999 and September 2000.

Geiger

Peeper has been a Geiger customer since 1988 (Tr. 1666). Geiger earned substantial commissions on trades he executed for the accounts over which Peeper exercised powers of attorney (Tr. 1667, 1669-70; DX 4). Geiger was in contact with Peeper almost daily (Tr. 1755-56).

Geiger took two trips to Vancouver to meet with Starnet's officers and to satisfy himself that Starnet was an appropriate investment opportunity for the Peeper accounts (Tr. 1485-86,

1692, 1694). Geiger concluded that Starnet was a very promising company, and he referred the 1997 Starnet Regulation S private offering to Peeper (Tr. 1697-98). Geiger reviewed the Regulation S private offering documents (Tr. 1699). From time to time, Geiger would also review Starnet's public filings on the Internet (Tr. 1700).

Geiger knew when the original Regulation S stock was placed into the Peeper accounts at Spencer Edwards (Tr. 1703). He also knew when the shares Starnet issued upon the exercise of warrants and piggyback warrants were placed into these same accounts (Tr. 1704-05). In connection with these deposits of Regulation S shares into the Peeper accounts, Geiger spoke with the transfer agent, reviewed the legal opinions, spoke with the customer, and sent the information to Spencer Edwards's back office (Tr. 1708-12, 1783).

Geiger spoke to Gould about Starnet's ESOP during November or December 1998 (Tr. 1485). He then advised Peeper that stock held by Starnet's officers and employees might become available in private transactions, if Peeper were willing to swap them for Regulation S shares (Tr. 1759-60).

In January 1999, Dohlen sent Geiger a facsimile message asking Geiger to obtain Peeper's back-dated signature on documents associated with shares to be issued upon the exercise of the warrants and piggyback warrants (DX 341). Geiger could not explain why Dohlen made this request (Tr. 1733-37).

Geiger was the account executive with Kaufmann on all the Peeper accounts and took direction from Peeper and Gould regarding stock sales and the disbursement of Starnet stock proceeds (Tr. 1669-70, 1721-23, 1729-32, 1754, 1757-58). Peeper gave Geiger written notice that he had authorized Gould to conduct transactions in the Peeper accounts at Spencer Edwards (Tr. 1729; DX 66). Geiger accepted these orders from Gould (Tr. 1744-45; DX 342, DX 348). Geiger knew during 1999 that Starnet stock was being placed into the Peeper accounts and immediately being resold to the public (Tr. 1753-54). He had no concerns regarding the trading activity in the Peeper accounts at Spencer Edwards (Tr. 1758).

Geiger and Kaufmann were also account executives and shared commissions on trades in Celestine's, Dohlen's, Giles's, Carley's, and Zacharias's accounts at Spencer Edwards (Tr. 1671, 1761-62).

Peeper and Geiger were close family friends (Tr. 1793). Orienstar owned two houses where Geiger lived and Geiger did not make rental or mortgage payments (Tr. 1777). Geiger received the gain from one of these houses when it was sold (Tr. 1773). Between February 1999 and December 2000, Oriental New Investments, Orienstar, and Le Fond Mondial also provided funds to pay for Geiger's legal fees, house-related improvements and expenses, and a country club membership (Tr. 675, 1030-31, 1769, 1771, 1775, 1794-96; DX 3 at 3, 9-10).

Kaufmann

Kaufmann disregards the fact that he and Geiger transacted their business from the same office under a joint account executive number. Kaufmann acknowledges that he executed orders for Starnet officers who were selling shares through Spencer Edwards (Tr. 1721, 1860). However, he contends that Geiger was responsible for handling all of the other Starnet

transactions at issue in this proceeding (Tr. 1858-59, 1901). To the extent that Kaufmann assisted Geiger, Kaufmann maintains that he functioned as a mere clerk (Tr. 1860, 1903, 1927).

Kaufmann was not involved in Starnet's Regulation S offering during 1997 (Tr. 1705). As part of the ESOP exercise scheme, Kaufmann accepted orders from Gould and ensured that Brovarone had funds to wire as directed by Gould (Tr. 1859). Although Geiger executed most of the sales out of the Peeper accounts, Kaufmann executed at least some of these sales (Tr. 1858-59, 1901). Sales of Starnet stock from the Peeper accounts were "continuous" during the time period at issue in this proceeding (Tr. 1928).

Kaufmann and Gould exchanged hundreds of facsimile messages, dozens of electronic mail (e-mail) messages, and frequent telephone calls to keep track of Regulation S and S-8 transactions in Starnet stock. Kaufmann kept a running total of the stock being sold (DX 84). He added handwritten notes to certain facsimile messages before transmitting them to Brovarone (DX 77, DX 79, DX 84). Kaufmann knew that the Peeper accounts at Spencer Edwards were being used as a fungible pool of stock to fund the exercise of options by Starnet's officers and employees (Tr. 1909; DX 82, DX 346). Kaufmann also processed S-8 transactions through Celestine's account at Spencer Edwards at the direction of Gould (Tr. 1940-43).

Kaufmann took no steps to examine the legality of the scheme (Tr. 1924-25). He did not inquire into the origin of the stock in the Peeper accounts (Tr. 1852). He did not review the Regulation S opinion letters in his files (Tr. 1854-55).

Kaufmann filled out most of the Rule 144 paperwork in connection with the sale of control stock by Starnet's officers and directors (Tr. 1878-79). He did not adequately explain the large number of errors in that paperwork. Likewise, Kaufmann's explanation for the discrepancies on Carley's account opening documentation was not credible (Tr. 1860-64, 1963-69).

C. Ownership and Trading Reports by Starnet's Officers, Directors, and Principal Securities Holders.

Carley

Carley acquired 25,000 shares of common stock when he joined Starnet in 1997 (DX 454 at 22, 27). He reported the acquisition to the Commission on Form 3 (DX 434). Carley sold these "founders shares" in May 2000 and reported the transaction to the Commission on Form 144 (DX 439).

Under Starnet's ESOPs, Carley received options for at least 375,000 shares of common stock (DX 208, DX 434). Carley began to exercise his options in January 1999. He eventually exercised the options for 200,000 shares (DX 434). Carley reported these transactions to the Commission on Forms 3 and 4 (DX 434).

Carley received 225,000 shares of Starnet common stock and reported the acquisitions to the Commission on Forms 3 and 4 (DX 2 at 37, DX 434). Carley reported the sale of 200,000

shares of Starnet common stock on Forms 3 and 4 (Tr. 46-47, 344-45; DX 2 at 38-39, DX 434). He reported the sale of the remaining 25,000 shares on Form 144 (DX 439).

Documentary evidence shows that Carley's account at Spencer Edwards received 40,000 shares of Starnet on September 3, 1999 (DX 2 at 39, DX 26 at 3631). Moreover, 120,000 shares of Starnet were sold from Carley's Spencer Edwards account between September 16 and October 21, 1999 (DX 2 at 39, DX 26 at 3630-40). All the certificates were issued in Carley's name (Carley Ex. 36 at 7474-97). No Forms 4 were filed for these transactions (DX 434).

Carley insists that these were not his transactions, and that he never exercised any options or acquired or sold any Starnet stock after August 19, 1999 (Carley Prehearing Br. at 5-6; Carley Find. at 8 # 8; Carley Br. at 7, 11). This claim is at odds with Madison Park Trust's Form 144, which states that Carley sold 50,000 shares on October 18, 1999 (DX 328). However, it is consistent with the fact that Brovarone and Gould would not permit Carley to withdraw funds from his trust account at the end of October 1999. See infra note 47.

Madison Park Trust

As set forth above, Starnet issued ten million unregistered shares to Murray Partners in March 1997. See supra p. 9. Two years later, Murray Partners distributed its shares to its component members, one of which was Madison Park Trust (Carley Ex. 29). Carley and his wife were the only beneficiaries of Madison Park Trust (Tr. 1284, 1634; DX 328 at 14).

On September 27, 1999, Pacific Stock Transfer issued 356,250 shares of Starnet common stock to Madison Park Trust (Carley Ex. 29 at 488).

Madison Park Trust opened an account at Spencer Edwards on December 20, 1999, with Geiger and Kaufmann as its account executives (DX 113 at 8729). Carley resigned as a Starnet officer and director on December 23, 1999 (Carley Answer). Madison Park Trust deposited 356,250 shares of Starnet into its Spencer Edwards account on January 7, 2000 (Tr. 47, 100-01; DX 2 at 40, DX 113 at 8696).

Between January and September 2000, Madison Park Trust sold 332,500 shares of Starnet to the public through its account at Spencer Edwards (DX 2 at 40, DX 113). Madison Park Trust did not file any Forms 3, 4, or 5 with the Commission. Madison Park Trust executed a Form 144 for the sale of 135,000 shares, but there is no evidence that it filed the Form 144 with the Commission (DX 328). As of October 27, 2000, Madison Park Trust still held 23,750 shares of Starnet in its Spencer Edwards account (DX 113 at 8728).

Zacharias

Zacharias received 10,000 shares of common stock when he joined Starnet in 1997 (Tr. 1100). He held these shares in his United Capital account and reported the acquisition to the Commission on Form 3 (Tr. 1100, 1106; DX 438; Zach. Ex. A). Zacharias ultimately sold these 10,000 shares through United Capital (Tr. 1100). I find as a fact that the sale occurred after

December 1999 (Zacharias Answer; Zach. Ex. A). At that time, Zacharias was no longer an officer or director of Starnet.

Under Starnet's ESOPs, Zacharias received options for 275,000 shares of common stock (DX 438). He began to exercise these options in January 1999 (DX 438). By August 1999, Zacharias had exercised options for 160,000 shares and reported the transactions to the Commission on Forms 4 (DX 438).

Zacharias reported the acquisition of 170,000 shares of Starnet common stock to the Commission on Forms 3 and 4 (DX 438).[16] Zacharias sold 170,000 shares of Starnet common stock and reported the sales of 160,000 shares on Forms 4 (DX 2 at 42-43, DX 438).[17]

Zacharias acquired 5,000 Starnet shares on January 28, 2000, another 25,000 shares on February 23, 2000, and another 12,500 shares on March 14, 2000 (Carley Ex. 36 at 7532, 7538, 7545). He sold all these shares to Rial Equity on February 14, March 8, and April 14, 2000, respectively (DX 2 at 31, 33-34; Carley Ex. 36 at 7535, 7543, 7551). Zacharias did not report these acquisitions or dispositions to the Commission on Forms 3 or 4 (DX 438). At the time of the acquisitions and dispositions, Zacharias was no longer an officer or director of Starnet.

Gould

Gould was never a Starnet officer or director. He did not file any Forms 3, 4, or 5 with the Commission.

Gould received 100,000 options under Starnet's 1998 ESOP (Tr. 1436). In January 1999, he exercised the options, sold the resulting shares into the market through Spencer Edwards, and directed the net proceeds to his wife's account at First Marathon (Tr. 1436-37; DX 71).

Gould also caused Celestine to sell 287,500 shares of Starnet common stock into the market through Spencer Edwards between November 1999 and September 2000. Celestine had received beneficial ownership of these shares in January 1997, as payment for Starnet's private

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[16] The documentary evidence shows that Zacharias received 232,500 shares of Starnet common stock (Tr. 47-49; DX 2 at 41). Zacharias resigned his positions as a Starnet officer and director in August 1999. He acquired the unreported 52,500 shares between February and April 2000, well after his resignation (Tr. 47-49; DX 2 at 31, 34, 41).

[17] The documentary evidence also shows that Zacharias acquired an additional 10,000 shares of Starnet on July 21, 1999, while he was still a Starnet officer and director (DX 2 at 41; Carley Ex. 36 at 7504). Zacharias did not report that acquisition to the Commission on Form 4 (DX 438). The 10,000 share certificate was reissued in the name of Fiserv on September 15, 1999, and reissued again in the name of Cede & Co. on September 21, 1999 (Carley Ex. 36 at 7504, 7507). The transfer agent cancelled the certificate in the name of Cede & Co. on January 5, 2000 (Carley Ex. 36 at 7527-28). I infer that Zacharias sold these 10,000 shares to the public between September 21, 1999, and January 5, 2000. At the time of the sale, Zacharias was not a Starnet officer or director.

debenture offering. Between 1997 and September 1999, these shares had been part of the ten-million-share block that United Capital held in the name of Murray Partners. The trustee of Murray Partners filed a Form 3 with the Commission after Starnet became a reporting company (DX 437).

D. Alleged False Filings and Alleged Antifraud Violations.

Paragraph II.D of the OIP alleges that certain of the current and annual reports that Starnet filed between December 1997 and August 1999 were materially misleading.

Starnet's Forms 8-K and 8-K/A

In a mandatory current report filed with the Commission on December 11, 1997, Starnet disclosed its sale of common stock and warrants under Regulation S (DX 442). Starnet identified the purchasers as "seven separate sophisticated foreign investment groups" (DX 442). Starnet repeated that characterization of the purchasers in a Form 8-K it filed with the Commission on December 17, 1998, and in a Form 8-K/A it filed with the Commission on March 18, 1999 (DX 443, DX 444). Zacharias signed all three Forms 8-K as secretary (DX 442-DX 444).

Starnet's Forms 10-KSB and 10-KSB/A

On July 30, 1999, Starnet filed its annual report for fiscal year 1999 with the Commission on Form 10-KSB (DX 445). On August 12, 1999, Starnet filed an amended annual report for fiscal year 1999 with the Commission on Form 10-KSB/A (DX 446).

Starnet listed as one of its 1997 "development milestones" that "[s]even private placements [were] completed with individual investors, for gross proceeds of $2.45 million" (DX 445 at 5, DX 446 at 6).

In Item 9 of its Forms 10-KSB and 10-KSB/A, Starnet represented that its directors and officers, including Carley and Zacharias, had filed all the required forms to report changes in their beneficial ownership of Starnet stock (DX 445 at 37, DX 446 at 40).[18]

In Item 10 of its Forms 10-KSB and 10-KSB/A, Starnet reported Dohlen's executive compensation during fiscal year 1999 (DX 445 at 37-39, DX 446 at 41-42). The information included Dohlen's salary, options issued, and shares sold.

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[18] A director's, officer's, and/or 10% beneficial owner's failure to file a timely Section 16(a) report is part of a small business issuer's disclosure obligation. The obligation is set forth in Item 405 of Regulation S-B, Compliance with Section 16(a) of the Exchange Act, 17 C.F.R. § 228.405. Item 405 requires small business issuers to identify delinquent filers in their annual reports. The small business issuer's duty to report is based solely upon a review of the Forms 3 and 4 furnished to it by its directors, officers, and 10% beneficial owners.

In Item 12 of its Forms 10-KSB and 10-KSB/A, which inquired about "Certain Relationships and Related Transactions," Starnet stated that there was "nothing reportable" (DX 445 at 42, DX 446 at 46).[19]

Zacharias prepared and signed Starnet's Form 10-KSB for fiscal year 1999 (Tr. 1189-90; DX 445). Zacharias and Carley signed Starnet's Form 10-KSB/A, which was filed with the Commission a week later (DX 446).

E. Supervision of Geiger and Kaufmann by Price and Spencer Edwards.

Paragraph II.G of the OIP alleges that, between June 1998 and February 2001, Price and Spencer Edwards failed reasonably to supervise Geiger and Kaufmann, with a view to preventing and detecting Geiger's and Kaufmann's willful violations of the federal securities laws.

Background: The Kirby Administrative Proceeding

During 1995 and 1996, a series of transactions resulted in the unregistered distribution of almost three million shares of the common stock of Golden Eagle International, Inc. (Golden Eagle), a development-stage company that intended to acquire and operate mining properties. As here relevant, the stock was sold in two private transactions orchestrated by the president of Golden Eagle to an account controlled by Peeper, a Geiger client who managed investment accounts at Spencer Edwards on behalf of LaSalle and Eur-Am, two of the foreign entities involved in the present proceeding. Both LaSalle and Eur-Am paid substantially less than the prevailing market price and, shortly thereafter, began reselling the stock at a large profit.

In May 1998, the Commission instituted an administrative proceeding against Geiger, Peeper, Price, and another individual (Admin. Pro. No. 3-9602). Following a three-day hearing, the Chief Administrative Law Judge (Chief ALJ) found that Geiger and Peeper willfully violated Sections 5(a) and 5(c) of the Securities Act through the unregistered sale of Golden Eagle stock. However, the Chief ALJ determined that Price had not failed reasonably to supervise Geiger, and she dismissed all charges against Price. The Chief ALJ also refused the Division's request for an order requiring Peeper to disgorge $1.3 million that had been paid to LaSalle. She found that Peeper had not been shown to be an owner of LaSalle. Charles F. Kirby, 73 SEC Docket 3550, 3583-84 (Dec. 7, 2000) (Kirby Initial Decision). No petitions for review were filed as to Peeper or Price, and the Commission eventually declared the Initial Decision final as to them. Alfred Peeper, 78 SEC Docket 422 (July 29, 2002). Geiger and the other respondent appealed to the Commission.

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[19] Item 404 of Regulation S-B, Certain Relationships and Related Transactions, 17 C.F.R. § 228.404, requires a small business issuer to disclose any transactions with related parties during the last two years. With certain exceptions, item 404 requires an issuer to disclose transactions or a series of transactions in which the issuer was a party, the amount exceeds $60,000, and a director, officer, holder of more than 5% of the company's voting securities, or any members of their immediate families, had a direct or indirect material interest.

The Commission subsequently affirmed the liability determinations and most of the sanctions imposed in the Initial Decision. Charles F. Kirby, 79 SEC Docket 1081 (Jan. 9, 2003) (Kirby Opinion). The U.S. Court of Appeals for the District of Columbia Circuit denied Geiger's petition for judicial review. Geiger v. SEC, 363 F.3d 481 (D.C. Cir. 2004).

Most of the events in this proceeding occurred after the Kirby hearing and before the Kirby Initial Decision.

Spencer Edwards and Price

Spencer Edwards is a small brokerage firm. It reported annual revenues of approximately $3.0 million in 1998, $10.0 million in 1999, $8.0 million in 2000, and $2.4 million in 2001 (DX 453). The firm reported net losses in 1998, 2000, and 2001, and net income of approximately $483,000 in 1999 (DX 453). Until May 1999, Spencer Edwards leased 10,000 square feet of office space at 6120 Greenwood Plaza Building in Englewood. From May 1999 to the present, Spencer Edwards has leased a smaller office at 6041 South Syracuse Way in Englewood.[20]

Price is a full-time registered representative, and he earns most of his income from commissions on the trades he executes for his customers (Tr. 2019). At times, Price did not receive a salary for serving as Spencer Edwards's president and compliance officer (Tr. 2019). At other times, he did receive a salary for performing these duties (Tr. 2288-89).

Geiger and Kaufmann's Office

Geiger, Kaufmann, and their assistant, Jeff Michaels (Michaels), shared an office at Spencer Edwards (Tr. 1685-86). From 1998 to February 2001, Price was Geiger's and Kaufmann's immediate supervisor (Tr. 1688, 1834, 1994). Before Spencer Edwards moved in May 1999, Price's office was located approximately four doors down the hallway from Geiger and Kaufmann's office (Tr. 1687, 1995). There is no evidence as to the proximity of the two offices after the move. Consistent with Spencer Edwards policy, the door to Geiger and Kaufmann's office was typically open (Tr. 1687-88).

Enhanced Supervision Following
the Kirby Investigation

In September 1996, after Price gave investigative testimony in the Kirby matter, he called a special compliance meeting at Spencer Edwards (Tr. 2006). All registered representatives, including Geiger and Kaufmann, were required to attend (Tr. 2006-07). Until that time, registered representatives had verified the origin of a stock certificate by checking with the transfer agent, and speaking with the issuer and the customer (Tr. 2006). Price told the registered representatives that they needed to do more to understand a transaction, such as requiring a legal opinion, before they processed it through Spencer Edwards (Tr. 1833, 2019-20).

[20] Price recalled that the firm moved in May 2000 (Tr. 1994-95, 2120). I give greater weight to Spencer Edwards's monthly account statements, which demonstrate that the move occurred in May 1999 (DX 47 at 7610, DX 51 at 7740).

As a result of what Price learned during the Kirby investigation, he placed Geiger on special supervision from September 1996 to September 1997 (Tr. 2007; DX 249; SEI Ex. B). The purpose of the special supervision was to ensure that Geiger would investigate the origin of securities before he engaged in a transaction involving those securities (DX 249). Price reviewed all trading activity in Geiger's accounts on a daily basis. He also approved all transactions involving wires, letters of authorization, and verification of certificates during this period (DX 249; SEI Ex. B).

Price placed Kaufmann on special supervision from September 1996 to March 1997 (TK Ex. 5). This sanction was also a result of what Price learned during the Kirby investigation (Tr. 2096, 2121-23; SEI Ex. B). Kaufmann had signed Rule 144 documents without authority to do so (Tr. 2121-22, 2174-75). As a result, a block of Golden Eagle stock had been sold through Spencer Edwards unlawfully. See Kirby Initial Decision, 73 SEC Docket at 3578 n.33 (item 3).

Enhanced Supervision Following
the Kirby Hearing

In September 1998, after the Kirby hearing, Price adopted enhanced supervisory procedures for the entire firm (Tr. 1832; SEI Ex. B). As part of this program, Price testified that he reviewed trading activity associated with the Peeper accounts and examined closely the related legal documents (Tr. 1832, 2019).

During the investigation leading to the present proceeding, Price told the Division that the Kirby hearing had been an "eye opening" event because he learned that Geiger "had lied about the whole thing" (Tr. 2010, 2014-15).[21] Nonetheless, Price did not discharge Geiger after the Kirby hearing. He considered the facts of the Kirby proceeding still to be in dispute and he was also concerned that Geiger might bring a wrongful discharge suit if he were to be discharged while the adjudicatory proceeding remained pending (Tr. 2015-16). Price also explained that he had no reason to believe that Geiger lied to him about Starnet during 1999 (Tr. 2078).

In December 1998, Price rehired Lilith Zoe Cole (Cole), an attorney, to be Spencer Edwards's full-time, in-house compliance officer (Tr. 1999, 2018-19, 2115-16). Cole had been Price's assistant from 1996 to April 1998, but then left the firm for eight months (Tr. 1999). Although Price relied on Cole after December 1998, he acknowledged that he was ultimately responsible for compliance issues at Spencer Edwards, including the legality of the transactions in the Peeper accounts (Tr. 2000, 2033-34).

Price knew that Starnet's officers and employees were exercising options and selling stock to the Peeper entities in private transactions (Tr. 2018-19). He also knew that Peeper held powers of attorney over the seven foreign entities involved in this proceeding (Tr. 2024). Peeper assured Price that the seven entities were separate and had their own businesses (Tr. 2068-69).

[21] The Division offered Price's investigative testimony for the limited purpose of showing Price's state of mind in September 1998 (Tr. 2011-14). I have not considered Price's investigative testimony against Geiger.

Price knew that the Peeper entities typically purchased stock away from Spencer Edwards and then deposited the shares in their Spencer Edwards accounts (Tr. 2025). Price also knew that the Peeper accounts were very active (Tr. 692-93, 2025). Price never asked to see any legal opinion letters associated with the Regulation S shares that the Peeper accounts were selling during 1999 (Tr. 2031). He asked Geiger and Kaufmann only if such opinion letters existed and if Geiger and Kaufmann felt comfortable with the transactions (Tr. 2031). Price assumed that Cole had reviewed any such letters (Tr. 2032, 2034).

Spencer Edwards attempted to keep informed about Starnet's public filings (Tr. 1842-43). However, Price did not know about Starnet's Regulation S placement when it occurred (Tr. 2026-27).

Price and Kaufmann discussed the August 1999 search of Starnet's office by the RCMP (Tr. 1843-44). Although the search was "big news," Spencer Edwards did not change any of its procedures with respect to Starnet after the search (Tr. 1843-44).

Supervision: September
1998 to February 2001

The Division contends that Price's supervision of Geiger and Kaufmann was deficient in several respects: Price permitted Geiger extensive time away from the office; Price failed to monitor Geiger's and Kaufmann's facsimile traffic; Price was inattentive in reviewing Rule 144 transactions by Starnet's officers and directors; and Price failed to monitor Kaufmann's e-mail traffic (Div. Br. at 42-44).

Price allowed Geiger to work away from Spencer Edwards's office more than half the time (Tr. 2021, 2099-2101). Price acknowledged that effective supervision of Geiger was impossible during these absences (Tr. 2021-22).

It was a Spencer Edwards requirement from 1998 to 2001 that Price or the compliance office should review incoming correspondence from the firm's customers before the firm delivered it to the registered representative (DX 390 at 59, 62). Notwithstanding this policy, Price allowed Geiger and Kaufmann to maintain a separate facsimile machine in their office (Tr. 1686, 1725, 1995).[22] Price never considered removing the facsimile machine from Geiger and Kaufmann's office. He stated: "I assumed if there was anything of importance, they would bring me the fax like everybody else in the firm did" (Tr. 2036).

Most of the facsimile traffic in this proceeding was between Kaufmann and Gould (DX 69-DX 70, DX 76-DX 80, DX 84). Dohlen sent two facsimile messages to Geiger (DX 341, DX 348) and Gould sent one facsimile message to Geiger and Kaufmann (DX 342). Price never saw any of this facsimile traffic (Tr. 2035-36, 2118).

[22] Messages sent from this machine bore a facsimile trailer identification that included the name "Jeff," for Jeff Michaels (Tr. 1687, 1724, 1847-48). The "Jeff" facsimile trailer identification is associated with two telephone numbers: AC 303, 874-1075 (DX 66) and AC 303, 409-1391 (DX 68-DX 70, DX 76-80).

It was also a Spencer Edwards requirement from 1998 to 2001 that a registered representative who received a written customer complaint should immediately bring the complaint to Price's attention (DX 390 at 62). When Gould sent a facsimile complaint to Kaufmann about untimely executions and unauthorized transactions in Starnet stock, neither Price nor Spencer Edwards's compliance office knew about it (Tr. 1986; DX 69).

It was a Spencer Edwards requirement from 1998 to 2001 that the compliance office would review e-mail messages between the firm's registered representatives and customers at least on a quarterly basis (DX 390 at 59-60). Spencer Edwards's employees used e-mail message addresses that included the employee's name and the firm's address, as follows: "___ @ spenceredwards.com" (DX 6 at 3547, DX 40 at 3809, DX 113 at 8750).

Kaufmann did not use the Spencer Edwards e-mail account to communicate with Gould about Starnet (Tr. 2118). Rather, Kaufmann used two e-mail message accounts of his own: one at "ix.netcom.com" (DX 345-DX 347, DX 356-DX 365) and another at "uswest.net" (DX 371, DX 372, DX 374). Kaufmann "registered" these accounts with Spencer Edwards's compliance office, but the record is silent as to what supervisory goal is accomplished by "registering" private e-mail accounts (Tr. 2174). Kaufmann transmitted many, but not all, of his e-mail messages to Gould after normal business hours (DX 345 (10:28 p.m.), DX 346 (7:30 p.m.), DX 349 (3:50 p.m.), DX 350 (9:23 p.m.), DX 353 (7:11 p.m.), DX 357 (9:04 p.m.), DX 358 (9:14 p.m.), DX 359 (2:58 p.m.), DX 374 (10:36 p.m.)). Price was not aware of the e-mail traffic between Kaufmann and Gould (Tr. 2117-18).

Price knew that Kaufmann filled out most of the Rule 144 paperwork in connection with the sale of control stock by Starnet's officers and directors (Tr. 2041). Price expressed the view that it was "industry practice" for an issuer's officers to sign Forms 144 in blank and rely on their registered representatives to complete the Forms (Tr. 2042, 2044).

Price personally reviewed the Forms 144 and signed the accompanying broker-dealer representation letters in connection with Rule 144 sales by Starnet's officers and directors (Tr. 1996-98, 2041-42, 2045-47; DX 283, DX 375). Several of the Rule 144 packages that Price reviewed contained obvious errors. For example, both Carley's and Zacharias's Forms 144 repeatedly misspelled "Vancouver" as "Vanouver" and inflated the number of outstanding shares of Starnet (to forty-four million) (Tr. 2042; DX 318, DX 326, DX 392). Some of the Forms 144 that Kaufmann filled out and Price reviewed contained an Office of Management and Budget (OMB) control number that had expired in 1990 (Tr. 2045; DX 44, DX 283, DX 326, DX 392).[23] A seller's letter that Kaufmann filled out for Celestine erroneously referred to a Regulation S transaction and stated that the sale would be executed on the Vancouver or Toronto Stock Exchanges (Tr. 1944-47; DX 375). Moreover, the Forms 144 that Kaufmann prepared and Price reviewed were never filed with the Commission (Tr. 1975-76, 2047-50; DX 439).

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[23] Under the Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520, the Commission cannot require a person to respond to an information collection request unless the request displays a currently valid control number from OMB.

Price Allows Geiger to Resign

Price eventually permitted Geiger to resign (DX 257; SEI Ex. B). Price was responding to pressure from the NASD in the weeks after the Chief ALJ issued the Kirby Initial Decision (Tr. 1778-80, 2016-17, 2063-64). Geiger's resignation took effect on January 31, 2001.

During February and March 2001, Orienstar and Oriental New Investments paid another $39,600 for Geiger's legal expenses and for improvements to Geiger's home (DX 3 at 3, 10, DX 262, DX 263).

DISCUSSION AND CONCLUSIONS

This Initial Decision concludes that Carley and Zacharias violated, and Gould, Geiger, and Kaufmann willfully violated Sections 5(a) and 5(c) of the Securities Act between December 1998 and February 2001. It rejects the OIP's claim that such violations began in June 1998. The Initial Decision also concludes that Zacharias violated Section 16(a) of the Exchange Act and Exchange Act Rule 16a-3 by failing to file one beneficial ownership report. It rejects the OIP's claim that Gould and Carley also committed Section 16(a) reporting violations. It also dismisses the OIP's claim of group reporting violations under Section 13(d) of the Exchange Act and Exchange Act Rules 13d-1 and 13d-2.

The Initial Decision sustains, in part, the charge that Carley and Zacharias violated the antifraud provisions of the federal securities laws and caused Starnet's violations of Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1, 13a-11, and 12b-20. It rejects the OIP's claim that Gould, Geiger, and Kaufmann willfully aided and abetted and caused these antifraud violations. The Initial Decision also concludes that Gould acted as an unregistered broker and willfully violated Section 15(a) of the Exchange Act. Finally, the Initial Decision concludes that Price and Spencer Edwards failed reasonably to supervise Geiger and Kaufmann, insofar as Geiger and Kaufmann willfully violated the securities registration provisions.

The Commission imposed a deadline for issuing the Initial Decision in this matter. In view of that deadline, I have ruled strictly against the parties on certain matters. For example, Carley admitted in Paragraph A.3 of his Answer that he became a Starnet director in January 1997. Shortly before the hearing, Carley developed a new theory: he asserted that he began to work for Starnet on a part-time basis in October 1997 and on a full-time basis in March or April 1998 (Carley Prehearing Br. at 3; Tr. 1246, 1256, 1354). Carley also claimed to be unaware that his name was being used in connection with Starnet at earlier times, and asserted that any statements identifying him as a Starnet director in January 1997 were false (Tr. 1247, 1352-54). I decline to consider Carley's new theory. If Carley wished to extricate himself from matters he had previously admitted, he should have sought leave to amend his Answer. See Rule 220(e) of the Commission's Rules of Practice. I freely granted several Respondents an opportunity to file amended Answers, but Carley elected not to amend his Answer on this point. Under the

circumstances, the Division was not required to devote hearing time to re-proving matters that Carley had already admitted.[24]

Likewise, Respondents were not required to devote posthearing briefing time to issues that the Division's posthearing pleadings failed to address with particularity. The Division's posthearing pleadings ignored Giles entirely. See infra note 38. The Division also asserted that Carley and Zacharias each failed to file "at least one" Form 4, but left it to Carley and Zacharias to guess which Forms 4 they may have missed. See infra p. 49. The Division asserted that a group collectively owned enough Starnet securities to require group beneficial ownership reports, but it failed to identify the quantities of securities held by each member of the group, and by the group as a whole, on the dates in question. See infra pp. 46-49 and note 37. Finally, the Division attempted an end-run around the decision-making deadline by asking for post-proceeding accountings. See infra pp. 75-77. I have ruled against the Division on each of these issues, just as I have ruled against Carley. Absent extraordinary circumstances, there are no "mulligans" in cases subject to decision-making deadlines.[25]

Respondents vigorously attack Brovarone's credibility. In response to this onslaught, the Division has remained silent. Brovarone was not a fully credible witness. His testimony generally lacked clarity, precision, and consistency.

Brovarone was involved at all stages of the misconduct that led to this proceeding. He wrote an opinion letter for Starnet's predecessor company. He introduced Starnet to Geiger and Spencer Edwards. He was the retained attorney for Peeper and the Regulation S purchasers. He issued a Regulation S opinion letter for Starnet. He proposed an escrow account as an alternative to restrictive legends on the Regulation S stock certificates and acted as escrow agent. He established attorney trust accounts for Carley and Zacharias, and disbursed funds from those accounts without the knowledge of the beneficiaries.[26] See infra notes 47, 49. He used these and

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[24] In any event, Carley's testimony conflicts with the documentary evidence. Carley signed Amendment No. 1 to Starnet's Form 10-SB, dated August 14, 1997, and Starnet's Form 10-KSB/A for fiscal year 1999 (Tr. 1317-18; DX 446 at 77, DX 454 at 163). Both documents stated that Carley had been a Starnet director since January 1997 (DX 446 at 38, DX 454 at 146, 157). Carley did not explain why he approved these documents if they contained inaccurate information about him. If the information was false, signing the documents was at least reckless.

[25] A "mulligan" is a free shot sometimes given a golfer in informal play when the previous shot was poorly played. Merriam-Webster's Collegiate Dictionary 764 (10th ed. 1998).

[26] Brovarone's handling of these client trust accounts may involve issues of professional conduct of interest to the Office of Attorney Regulation Counsel of the Colorado Supreme Court. I infer that the Division has not made such a referral. If the Division had done so, it would have filed and served a notice to that effect under Rule 230(b)(2) of the Commission's Rules of Practice. The Division knows that its obligation not to withhold documents that contain material exculpatory evidence is ongoing. It is beyond question that a report to the Colorado Bar would constitute material exculpatory evidence.

other attorney trust accounts to disburse proceeds of Starnet sales for Peeper and the Peeper entities. He wrote Rule 144 opinion letters for Starnet's officers. He wrote an opinion letter to free up the Murray Partners' shares. The Division is holding a possible enforcement proceeding over Brovarone's head (Tr. 908-11; Gould Ex. 83).

Brovarone's credibility was also an issue in the Kirby proceeding. See Kirby Initial Decision, 73 SEC Docket at 3564 (finding that Brovarone testified evasively and had been privately censured by the Colorado Supreme Court).

Pending Motions

Respondents assert that the Division's summary exhibits, DX 1 through DX 4, are unreliable and should either be stricken or disregarded. The exhibits are far from perfect, as cross-examination of the sponsoring witnesses established. In response to counter-exhibits TK Ex.7 and TK Ex. 8, the Division has scaled back the collective sum to be disgorged by Spencer Edwards, Kaufmann, and Geiger. See infra note 57. Based on my review of DX 1 through DX 4 and the related testimony, my order of disgorgement also reduces the sums to be disgorged by Carley and Zacharias. I have given the Division's summary exhibits reduced weight, but I decline to strike them from the record or to disregard them.

Gould claims that he was prejudiced because a Division attorney misled Brovarone about the source of a document during the investigation (Tr. 560-61, 572-74; Gould Br. at 32). I believe that the Division's error was inadvertent. Gould has not established prejudice. Gould also claims that he was prejudiced because the Division withheld certain materials from inspection and copying (Gould Br. at 32). Pursuant to Rule 230(c) of the Commission's Rules of Practice, I required the Division to file and serve a privilege log (Order of Sept. 23, 2004). If Gould believed the Division's assertion of privilege was not well grounded as to any entries on that log, he should have filed a motion to compel production of specific documents. Having failed to do so, Gould is in no position now to raise a blanket challenge to every entry on the Division's privilege log. At this juncture, Gould must show that the Division's failure to make specific documents available to him was not harmless error. See Rule 230(h) of the Commission's Rules of Practice. He has failed to do so.

Spencer Edwards and Price renew their claim that severing the case against Dohlen, Giles, and Peeper deprived them of testimony that "may" have been vital to their defense (Spencer Edwards Br. at 17, 25-27). I decline to rule on the matter because the decision to sever was the Commission's. Spencer Edwards and Price are free to raise this issue on appeal to the Commission.

The Division is still prosecuting two civil injunctive actions against Peeper in New York, and Brovarone has been deposed in one of those matters (Tr. 321, 379-80, 675, 694, 911-12). The Division may be concerned that referring Brovarone to the Colorado Bar could impeach his credibility in those actions. If Respondents believe that Brovarone's handling of their client trust accounts should be investigated by the Colorado Bar, they may wish to refer the matter on their own.

A. Securities Registration Violations.

Paragraphs II.C.1 and II.C.2 of the OIP allege that, from June 1998 through February 2001, Carley and Zacharias violated, and Gould, Geiger, and Kaufmann willfully violated, Sections 5(a) and 5(c) of the Securities Act by offering to sell, selling, and delivering after sale to members of the public Starnet stock when no registration statement was filed or in effect and no exemption from registration was available.[27]

Section 5(a) of the Securities Act provides that, unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly, to sell or deliver the security through the use of any means or instrumentality of transportation or communication in interstate commerce or of the mails. Section 5(c) of the Securities Act provides a similar prohibition as to offers to sell a security unless a registration statement has been filed with the Commission.

The purpose of the registration requirement, and the Securities Act as a whole, is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions." SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953).

A prima facie case for a violation of Section 5 of the Securities Act is established by showing that: (1) no registration statement was in effect or filed as to the securities; (2) a person, directly or indirectly, sold or offered to sell the securities; and (3) the sale was made through the use of interstate facilities or the mails. See SEC v. Continental Tobacco Co., 463 F.2d 137, 155 (5th Cir. 1972). A showing of scienter is not required. SEC v. Universal Major Indus. Corp., 546 F.2d 1044, 1046-47 (2d Cir. 1976).

The Division has presented a prima facie case here. Thus, the burden shifts to Respondents to prove the availability of any exemptions. See Ralston Purina, 346 U.S. at 126. Sections 3 and 4 of the Securities Act provide various exemptions from registration and certain Commission regulations provide safe harbors from registration. Exemptions from registration are affirmative defenses that must be proved by the person claiming the exemptions. Swenson v. Engelstad, 626 F.2d 421, 425 (5th Cir. 1980); Lively v. Hirschfeld, 440 F.2d 631, 632 (10th Cir. 1971). Claims of exemption from the registration provisions of the Securities Act are construed strictly against the claimant. SEC v. Murphy, 626 F.2d 633, 641 (9th Cir. 1980); Quinn & Co. v. SEC, 452 F.2d 943, 945-46 (10th Cir. 1971). Evidence in support of an exemption must be "explicit, exact, and not built on mere conclusory statements." Robert G. Weeks, 81 SEC Docket 1319, 1337 & n.35 (Oct. 23, 2003).

Willfulness is shown where a person intends to commit an act that constitutes a violation. There is no requirement that the actor also be aware that he is violating any statutes or

[27] The Division seeks civil monetary penalties and associational bars against Gould, Geiger, and Kaufmann. Securities registration violations occurring more than five years before the Commission issued the OIP (i.e., before September 1, 1999) will not be considered in imposing these specific sanctions. See infra p. 63. The Division does not seek civil monetary penalties or registration sanctions against Carley or Zacharias.

regulations. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 & n.5 (2d Cir. 1976).

Participant Liability

The prohibitions in Section 5 extend not only to those who engage in the actual sale of securities, but also to those who engage in significant steps in the distribution process. A respondent may be held primarily liable for a securities registration violation if he or she was a "necessary participant" and a "substantial factor" in an unlawful transaction. See SEC v. Calvo, 378 F.3d 1211, 1215 (11th Cir. 2004); SEC v. Holschuh, 694 F.2d 130, 139-40 (7th Cir. 1982); Murphy, 626 F.2d at 649-52. "[N]ot everyone involved in the chain of intermediaries between a seller of securities and the ultimate buyer is sufficiently involved in the process to make him responsible for an unlawful distribution." Owen V. Kane, 48 S.E.C. 617, 620 (1986), aff'd, 842 F.2d 194 (8th Cir. 1988). "Fringe participants, although possibly liable as aiders and abetters, are not liable as sellers under Section 5." SEC v. Rogers, 790 F.2d 1450, 1456 (9th Cir. 1986); see also Steven Chios, 47 S.E.C. 617, 619-20 (1981) (vacating an NASD order finding participant liability).

Zacharias, who has been charged in the OIP as a seller or offerer, maintains that he cannot be held liable as a non-seller participant (Zach. Prehearing Br. at 4; Zach. Br. at 2, 15-16). Zacharias was directly involved in the sale of his own shares and indirectly involved in the sale of millions of Starnet shares by Starnet's other officers and employees. The OIP gave Zacharias appropriate notice that he was being charged as a primary violator of Section 5. Primary liability includes both direct and indirect participation. The notice was sufficient.

Gould and Geiger argue that they were not necessary and substantial participants in the transactions under scrutiny (Gould Br. at 18-21; Geiger Br. at 5-6). Gould was directly involved in the sale of his own and Celestine's Starnet shares. Both Gould and Geiger were indirectly involved in the sale of millions of Starnet shares by Starnet's officers and employees and the Peeper accounts. Geiger was not a seller, but he, like Gould, played an indispensable role in brokering the relevant transactions.

"Free Trading" Starnet Shares

Gould and Kaufmann point to Creative Sports Marketing's private offering of ten million shares in July 1996. See supra pp. 7-8. They contend that nearly all of these ten million shares were "free trading" at the times relevant to the OIP (Gould Br. at 9-11, 24; Kaufmann Prop. Find. ## 3-5; Kaufmann Br. at 3-4, 9-10).

DX 2 reflects that some of the shares held by Pacific Rim were eventually deposited into Celestine's account at Spencer Edwards, commingled with Regulation S and S-8 shares, and eventually resold to the public. Gould and Kaufmann fault the Division for failing to segregate these "free trading" Starnet shares from the Starnet shares issued pursuant to Regulation S and Form S-8 (Tr. 144-46, 317-18). They argue that the Division cannot properly seek disgorgement of commissions generated by sales of these "free trading" shares.

The term "free trading" is misleading. The transactions in question were either registered, exempt from registration, or illegal. The Division proved that there was never a registered public offering of Starnet stock (DX 440). Accordingly, it was Respondents' burden to show that these ten million shares were exempt from registration, both initially and on resale.

First, Respondents developed almost no record to support their assumption that Creative Sports Marketing's July 1996 offering was exempt from registration pursuant to Rule 504 of Regulation D. Starnet's transfer agent assumed that the July 1996 offering had been a public offering (Tr. 466). It was not so characterized at the time. Brovarone assumed that the ten million Starnet shares must have been free trading because they were trading on the OTC Bulletin Board (Tr. 777-78, 861-62, 981-82). The alternative possibility (that the original offering and any subsequent resales may have been illegal) appears not to have occurred to Brovarone or Respondents.

Just because Creative Sports Marketing claimed a registration exemption in July 1996 does not mean that its claim was valid. The whole notion of a "non-quotation bargain market" in Vanuatu and the modest amount of seed capital raised ($10,000 when the limit was $1 million) warranted closer scrutiny at the hearing.[28] At a minimum, Respondents should have presented evidence that included the subscription agreements between Creative Sports Marketing and the Pacific Rim investors, the stock certificates Creative Sports Marketing issued at the time (with evidence of Rule 504 restrictions affixed), and the private placement memorandum authored by Brovarone.

Second, even assuming that Respondents could show that the original offering qualified for an exemption under Rule 504 of Regulation D, then every resale of those ten million shares had to be registered or qualified for its own specific exemption from registration. See Preliminary Notes 4 and 6 to Regulation D. With one exception, Respondents did not even attempt to make the required showing.[29]

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[28] "[B]ecause the [Rule 504] exemption is designed to raise 'seed' capital, most of the issuers and the type of transaction the rule is designed to reach are in the early stages of their development. These issuers are interested in attracting patient investors who are committed to remaining with the business for some period of time. As such, it seems reasonable that these investors and the companies would expect the securities to be held for some period of time; certainly for at least one year. Our experience shows that many of the active trading markets that develop shortly after securities are issued under Rule 504 are artificial. While liquidity is an important feature with any securities investment, whether it is sufficiently significant in connection with a 'seed' capital offering to require a substantial discount in the offering price is debatable." Revision of Rule 504 of Regulation D, the "Seed Capital" Exemption, 67 SEC Docket 480, 490 (May 21, 1998).

[29] The handwritten notes on TK Ex. 11 show that one unaffiliated individual purchased 100,000 shares from another unaffiliated individual who had held the shares for three or four months before September 1997. Respondents presented no evidence as to the ownership of those shares between July 1996 and May 1997.

Gould asserted that the shares owned by Dohlen and Giles and deposited in Celestine's United Capital account # 3P1009B were free trading (Tr. 1545; Gould Prop. Find. ## 248, 324, 326). However, both Dohlen and Giles were affiliates of Starnet. Gould did not show that shares in the hands of Dohlen and Giles were exempt from registration on resale. See Preliminary Note 4 to Regulation D. It was his burden to do so if he hoped to succeed on his "free trading" shares argument.

I conclude that Gould and Kaufmann have failed to sustain their burden of showing that the ten million shares issued in purported reliance on Rule 504 of Regulation D were exempt from registration, either initially or on resale. Respondents have failed to prove that the ten million shares were "free trading."

Nor have Respondents sustained their burden of showing that any of the original 2.45 million Regulation S shares issued to the Peeper entities in December 1997 were exempt from registration on resale. Brovarone held such shares in escrow for forty days. See supra note 7. Three of the Peeper accounts resold 146,500 Regulation S shares into the United States markets before December 1998. See supra note 11. Moreover, I have rejected the Division's contention that the Regulation S purchasers were acting in concert with each other during the period from December 1997 through November 1998. See supra p. 11. Nonetheless, Respondents were required to offer proof that these shares were registered or exempt from registration on resale. See Preliminary Note 6 to Regulation S. They failed to do so.

Absence or Removal of Restrictive Legends

Kaufmann argues that the absence or removal of restrictive legends from Starnet certificates meant that the shares were "free trading" and could lawfully be sold to the public (Kaufmann Br. at 17-19). There is no merit to this position. The presence of a restrictive legend on a certificate precludes its transfer. However, the absence or removal of a restrictive legend merely makes transfer of the certificate possible, not lawful.

Spencer Edwards contends that it had a right to rely on the restriction-free certificates Starnet provided to it (Spencer Edwards Br. at 22). It invokes Section 8-204 of the Uniform Commercial Code (U.C.C.), which provides that a restriction on transfer of a security imposed by an issuer is ineffective unless conspicuously noted on the certificate, except against a person with actual knowledge of the restriction. Spencer Edwards cites Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640, 644-45 (10th Cir. 1973), which held that the phrase "restrictions imposed by the issuer" as used in U.C.C. § 8-204 was broad enough to include restrictions arising out of the Securities Act. Edina reasoned that restrictions on the resale of shares received in a private offering from an issuer were thus restrictions "imposed by the issuer."

This U.C.C. requirement of actual knowledge has been criticized "as being improper and not supported by the weight of authority." See Mark S. Rhodes, Transfer of Stock 84 (6th ed. 1985). Edina is the only case equating restrictions "imposed by the issuer" with restrictions arising from the federal securities law. In addition, the plaintiff in Edina sought only damages, and so the reviewing court did not need to consider whether U.C.C. § 8-204 could validate a

transfer that was illegal under the Securities Act. Subsequent judicial opinions have distinguished Edina, or limited it to its own facts. See Brass v. Am. Film Technol., Inc., 987 F.2d 142, 146-48 (2d Cir. 1993); DeWitt v. Am. Stock Transfer Co., 440 F. Supp. 1084, 1086-87 (S.D.N.Y. 1977).

Section 4(1) Exemption

Section 4(1) of the Securities Act exempts from the registration requirements "transactions by any person other than an issuer, underwriter, or dealer." The intent of Section 4(1) is to exempt routine trading transactions between members of the investing public. Kane, 48 S.E.C. at 619.

Section 2(a)(11) defines "underwriter" to include "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security." Section 2(a)(11) further defines "issuer" to include "any person directly or indirectly controlling or controlled by the issuer." "Distribution" refers to "the entire process in a public offering through which a block of securities is dispersed and ultimately comes to rest in the hands of the public." Jacob Wonsover, 54 S.E.C. 1, 12-13 n.25 (1999), pet. denied, 205 F.3d 408 (D.C. Cir. 2000). A distribution within a relatively short period after acquisition is evidence of an original intent to distribute. Id.

I conclude that the Peeper entities functioned as statutory underwriters of Starnet's common stock in and after December 1998. These entities sold the public nearly all the Starnet shares they acquired through the exercise of warrants and piggyback warrants. They did so within a very short period after exercising the warrants and acquiring the shares. The volume of shares sold represented a large percentage of Starnet's available stock. In these circumstances, the Section 4(1) exemption was not available for the resales.[30]

Form S-8 Shares

The Forms S-8 only registered offers and sales of securities to Starnet's officers and employees. See supra note 9. I agree with the Division that the Forms S-8 did not register the resale transactions under scrutiny in this proceeding.[31]

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[30] The actively defending Respondents provided little evidence about the intent of the seven foreign entities during 1997. They merely asked me to infer an original intent to invest from the fact that the foreign entities held most of their original Regulation S shares for one year (Kaufmann Br. at 12, Zach. Br. at 17, Gould Br. at 21 n.21). Whether these shares came to rest abroad could be an important part of the Division's case against severed Respondent Peeper. It is not necessary to resolve the question here.

[31] The Commission has explained that Form S-8 is not available to register offers and sales of securities to employees where: (1) by prearrangement or otherwise, the issuer controls or directs the resale of the securities in the public market; or (2) the issuer or its affiliates directly or indirectly receive a percentage of the proceeds from such resales. See Registration of Securities on Form S-8, 69 SEC Docket 487, 490 & nn.30-31 (Feb. 25, 1999). The Forms S-8 arguably

As affiliates of the issuer, Starnet's officers and directors could have resold their shares publicly pursuant to an effective registration statement or pursuant to Securities Act Rule 144. See SEC v. Cavanagh, 155 F.3d 129, 133 (2d Cir. 1998); Employee Benefit Plans, 19 SEC Docket 465, 499 (Feb. 1, 1980). It is uncontested that the officers and directors did not resell their S-8 shares pursuant to an effective registration statement; whether their resales were subject to the Rule 144 safe harbor is addressed below.

Rule 144 Safe Harbor

Securities Act Rule 144 provides a non-exclusive safe harbor for the unregistered resale of restricted and other securities held by affiliates of an issuer. The Rule sets forth specific standards that, if met, permit persons who hold such securities to sell them publicly without being deemed "underwriters" under Section 2(a)(11) of the Securities Act and in reliance on the Section 4(1) exemption from registration. See SEC v. Lybrand, 200 F. Supp. 2d 384, 393-94 (S.D.N.Y. 2002).

Carley and Zacharias sold their Form S-8 stock into the public market through brokerage accounts at Spencer Edwards.[32] For sales during the time period they were officers of Starnet, they purportedly sold this stock pursuant to Rule 144. However, the sales did not qualify for the Rule 144 safe harbor. Through the Peeper entities, Carley and Zacharias acted as conduits to distribute Starnet's S-8 securities to the public. See Preliminary Note to Rule 144. The Rule also requires the filing of a notice of the proposed sale with the Commission on Form 144. See Rule 144(h). The notice must be filed concurrently with the placing of the order for sale with a broker or the execution of the sale with a market maker. Id. Although Carley and Zacharias ostensibly prepared Forms 144 relating to some of their sales of S-8 stock, these Form 144 notices were not filed with the Commission. I conclude that Carley and Zacharias have not

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failed the first of these tests, as Starnet required its officers and employees to open accounts with United Capital and sell their S-8 shares through Gould.

On the other hand, Starnet raised no capital when it granted options to its officers and employees. It raised a modest sum when its officers and employees exercised their options at strike prices of $0.74 and $1.44 per share. Over the life of the scheme, the Peeper accounts paid $16.5 million to Starnet (DX 3 at 4). I infer that these transfers reflected payment of the strike price on behalf of the exercising officers and employees, and nothing more. The payment of the strike price cannot be equated to kickbacks of proceeds from resale of the stock. The Division overstates the matter when it asserts that the S-8 program was "a means of capitalizing Starnet" (Div. Br. at 18, 22).

[32] Carley and Zacharias insist that they sold their S-8 shares in private transactions to the Peeper accounts (Carley Prop. Find. p. 5 # 12, Carley Prop. Concl. Law # 1, Zach. Prop. Find. # 21, Zach. Br. at 16). Neither Respondent has offered specifics to support the claim that the purported transactions qualified for the private placement exemption under Section 4(2) of the Securities Act.

carried their burden to show that their sales of S-8 shares were exempt transactions pursuant to the Rule 144 safe harbor.

Celestine sold 287,500 shares to the public between November 1999 and September 2000, purportedly pursuant to Rule 144. See supra p. 18. Although Celestine ostensibly prepared a Form 144 notice relating to the sale of these shares, Gould has presented no evidence that the Form 144 was filed with the Commission. I conclude that Gould has not carried his burden to show that Celestine's sale of 287,500 shares was an exempt transaction pursuant to the Rule 144 safe harbor.

Madison Park Trust sold 332,500 shares to the public between January and October 2000 (DX 113). See supra p. 18. Madison Park Trust sold the first 135,000 of these shares to the public between January and March 2000 (DX 113). Its trustee ostensibly prepared a Form 144 notice relating to the sale of these shares (DX 328).[33] However, Carley has presented no evidence that the Form 144 was filed with the Commission.

Madison Park Trust sold another 197,500 shares to the public between May and October 2000 (DX 113; Carley Ex. 36 at 7530, 7552). Carley contends that these sales qualified for the safe harbor of Rule 144(k). To qualify for the protection of Rule 144(k), Carley must establish that, at the time Madison Park Trust sold these shares, he had not been an affiliate of the issuer for the preceeding three months and a period of at least two years had elapsed since the later of the date the securities were acquired from the issuer or from an affiliate of the issuer. See Lybrand, 200 F. Supp. 2d at 394-97.

Madison Park Trust could not properly tack its holding period with that of Murray Partners, the original shareholder, to satisfy the two-year requirement. Although Murray Partners had acquired its shares from the issuer more than two years previously, Murray Partners was itself an affiliate of Starnet during that time. The presence of an affiliate in the chain of title triggered the commencement of a new holding period for Madison Park Trust. As a result, Madison Park Trust had not held these shares for more than two years at the time of sale, and it could not rely on Rule 144(d) or Rule 144(k).[34]

I conclude that Carley has not carried his burden to show that Madison Park Trust's sales of these 332,500 shares were exempt transactions pursuant to the Rule 144 safe harbor.

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[33] The 135,000 shares in question were represented by Starnet certificate # 12045 and then by Starnet certificate # 12068 (Carley Ex. 36 at 7530, 7532). Madison Park Trust sold these 135,000 shares by March 14, 2000 (DX 113).

[34] Although Carley resigned as a Starnet officer and director on December 23, 1999, he remained an officer of EFS Caribbean until April 3, 2000. I decline to assume that Carley had ceased to be an affiliate of Starnet, within the meaning of Rule 144(a)(1), merely because he had ceased to be a Starnet officer and director. As the party claiming the safe harbor, it was Carley's burden to prove that his status as an affiliate of Starnet had ended. He failed to do so. Brovarone did not address EFS Caribbean when drafting his opinion letter (Tr. 737-38).

"Section 4(1½)" Exemption

Zacharias contends that he sold his Starnet stock in a private transaction to foreign institutional investors, namely, the Peeper accounts (Tr. 1152, 1157, 1165, 1201, 1203). Carley makes similar representations. Zacharias maintains that such sales were exempt from registration under Section 4(1) of the Securities Act through operation of the so-called Section 4(1½) exemption (Zach. Prehearing Br. at 5; Tr. 834-35; Zach. Br. at 3, 13, 16, 19).

The "Section 4(1½)" exemption was first discussed in the secondary literature. See Christopher D. Olander & Margaret S. Jacks, The Section 4(1½) Exemption: Reading Between the Lines of the Securities Act of 1933, 15 Sec. Reg. L.J. 339 (1988). It refers to an implied exemption to registration that falls between the cracks of the Sections 4(1) and 4(2) exemptions. Those provisions allow, respectively, for securities transactions among persons who are not issuers, underwriters, or dealers, and for securities transactions by an issuer not involving a public offering. The "Section 4(1½)" exemption is said to allow affiliates of an issuer to sell substantial amounts of their stock to private investors without registration. See United States v. Lindo, 18 F.3d 353, 358 (6th Cir. 1994); Ackerberg v. Johnson, 892 F.2d 1328, 1335 n.6 (8th Cir. 1989); SEC v. Cavanagh, 2004 U.S. Dist. LEXIS 13372, at *67-70 (S.D.N.Y. July 16, 2004); SEC v. Cavanagh, 1 F. Supp. 2d 337, 368 (S.D.N.Y. 1998).

As is the case for an issuer claiming an exemption for a private sale under Section 4(2) of the Securities Act, an affiliate claiming a "Section 4(1½)" exemption has the burden of establishing that such sales do not constitute a disguised public distribution. See Cavanagh, 1 F. Supp. 2d at 368-69. Although the Commission has never articulated exactly what steps an issuer or affiliate must take to fall within the private placement exemption under Section 4(2), a representation that the "buyer does not have any present agreement not to resell is plainly insufficient." Cavanagh, 2004 U.S. Dist. LEXIS 13372, at *69.

Zacharias's S-8 shares did not come to rest with the Peeper entities. Rather, the Peeper entities were conduits for a wider distribution of those shares to the general public. Moreover, Zacharias's resale of his S-8 shares to the Peeper entities cannot be considered in isolation, as Respondents would prefer. It must be evaluated with the simultaneous resale of the shares Starnet issued in connection with the exercise of the Regulation S warrants and piggyback warrants. The larger offering, viewed as a whole, did not meet the requirements for any exemption. See Nonpublic Offering Exemption, 27 Fed. Reg. 11,316 (1962). Even assuming that the law recognized an implied exemption under "Section 4(1½)," Zacharias has not shown that his sale of S-8 stock to the Peeper entities was a qualified private placement.

Section 4(4) Exemption

Kaufmann invokes Section 4(4) of the Securities Act, which exempts "brokers' transactions executed upon customers' orders" from the registration requirements of Section 5 of the Securities Act (Kaufmann Br. at 2, 12-15, 20; see also Div. Prehearing Br. at 18-19; Div. Br. at 22-25; Div. Reply Br. at 25-31). Kaufmann argues that he relied in good faith on attorney opinion letters and on the fact that the transfer agent removed restrictions from Starnet officers' stock certificates.

The Section 4(4) exemption is unavailable to a registered representative acting as an agent who has reasonable grounds to believe that his principal is an underwriter. See Wonsover, 54 S.E.C. at 13; Paul L. Rice, 45 S.E.C. 959, 960-61 (1975). A registered representative relying on the Section 4(4) exemption must make whatever inquiries are necessary to determine that the transaction is not part of an unlawful distribution. See Wonsover, 54 S.E.C. at 14-15; Robert G. Leigh, 50 S.E.C. 189, 193 (1990); Kane, 48 S.E.C. at 620-21; Securities Act Rule 144(g)(3). The reasonableness of a registered representative's belief that shares were exempt from registration is only relevant to the willfulness of the Section 5 violation and whether the registered representative properly discharged his obligations to inquire into the source of the shares. Kane v. SEC, 842 F.2d 194, 198 (8th Cir. 1988).

Kaufmann was incredible in claiming that he had nothing to do with the resale of Regulation S shares. Here, the number of securities transactions executed by Kaufmann and Geiger under their joint account executive number was large enough to put them on notice that they were facilitating a distribution. For that reason, the brokers' transaction exemption was inapplicable.

The attorney opinion letters addressing Regulation S were not nearly as broad as Respondents now argue. The opinion letters scrutinized only pieces of the entire transaction. In some cases, such as Jensen's letter, the course Respondents followed differed from the course Jensen actually recommended. Brovarone opined only that the sale of Starnet stock to the Peeper entities was exempt from registration; he did not address resales of those shares by the Peeper entities into the United States (Tr. 478-79, 1047, 1050; DX 281).[35] Brovarone did not know how any of the Regulation S shares were resold (Tr. 988). Similarly, Reed opined only that Starnet could issue shares upon the exercise of the warrants without restrictive legend (DX 90, DX 209). Reed credibly testified that he did not address resales of those shares by the Peeper entities into the United States (Tr. 803-05).

Kaufmann and Geiger cannot now rely on these attorney letters as evidence of their good faith inquiry into the source of Starnet stock. Geiger's efforts to give broader interpretations to Brovarone's and Reed's letters were not persuasive (Tr. 1746-52; DX 90, DX 281). Kaufmann maintained copies of Brovarone's and Reed's Regulation S letters in his files, but he did not review them at the time (Tr. 1854-55, 1925-26). One of Kaufmann's expert witnesses, James L. Rothenberg (Rothenberg), characterized DX 67 as an "informal legal opinion" by Brovarone (Tr. 1925-26, 2226-29). This testimony was not persuasive. It conflicted with Brovarone's hearing testimony and Kaufmann's investigative testimony on the subject (Tr. 1925-26).

Carylyn K. Bell (Bell), Kaufmann's other expert witness, opined that it is industry practice for brokers to rely on transfer agents to determine if stock certificates are properly free of restrictions and available for sale and transfer to third parties (Bell Statement, dated Dec. 20,

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[35] Zacharias, Gould, and Geiger argue that the last substantive paragraph of Brovarone's December 3, 1997, opinion letter did address resales (DX 281; Zach. Br. at 18; Gould Br. at 23-24; Geiger Br. at 8). I disagree with this expansive reading. Brovarone could not have anticipated the course of future events.

2004). To make that decision, transfer agents rely on information from the issuer and attorneys. A broker is obligated to determine whether securities are registered or that they are not required to be registered before selling securities to the public. Kane, 842 F.2d at 198-99. Brokers who delegate this responsibility completely to others do so at their peril. Sorrell v. SEC, 679 F.2d 1323, 1327 (9th Cir. 1982); Stead v. SEC, 444 F.2d 713, 716 (10th Cir. 1971).

Kaufmann presented some evidence of a good faith inquiry into the origin of Starnet stock and the preparation of Forms 144. When Kaufmann encountered a Gelato Brats stock certificate in September 1997, he discussed his concerns with Brovarone and the transfer agent and kept notes of what they told him (Tr. 2175-77; TK Ex. 11). Cole purportedly reviewed Kaufmann's Rule 144 paperwork in detail, because Kaufmann did not understand the documents at first (Tr. 2162). During August 1999, when an SEC staff examiner was visiting Spencer Edwards on an unrelated matter, Kaufmann asked the examiner whether he had correctly completed two Forms 144. Although the examiner "didn't do detailed research," his review gave Kaufmann some comfort that he had properly completed the Forms 144 (Tr. 1890, 2162-65).

I find this evidence outweighed by several other factors. Kaufmann did not review with Starnet's officers the representations they made in their Rule 144 sellers' letters. Nor did he make an independent inquiry into the matters discussed in the letters (Tr. 1891-93). Two of these officer representations were incorrect (DX 283 at 6) (item 11) (seller is not acting in concert with any other person) (item 12) (seller is not engaged in a distribution in concert with others). Kaufmann had a duty to inquire.

Kaufmann was brokering transactions in large blocks of a little-known security, and he was required to make a searching inquiry. He was not entitled to rely on the bare representations of the issuer's officers, or the acquiescence of the transfer agent and clearing broker. Finally, the sheer number of discrepancies in the Rule 144 paperwork reflects the lack of care that Kaufmann devoted to these documents.

Respondents have failed to show that the transactions were exempt from registration. I conclude that the weight of the evidence shows that Carley and Zacharias violated, and Gould, Geiger, and Kaufmann willfully violated, Sections 5(a) and 5(c) of the Securities Act between December 1998 and February 2001.

B. Reporting Violations.

Paragraphs II.E.2 and II.E.3 of the OIP allege that, from February 1999 through November 2000, Carley and Zacharias violated, and Gould willfully violated, Section 13(d) of the Exchange Act and Rules 13d-1 and 13d-2 thereunder by failing to file with the Commission reports on Schedule 13D, with respect to their acquisitions and dispositions of millions of shares of Starnet stock over which they had dispositive control and as to which they were the beneficial owners.[36]

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[36] No civil monetary penalty or associational bar may be imposed against Gould for reporting violations occurring before September 1, 1999. See supra note 27 and infra p. 63.

The OIP also asserts that, during the same period, Carley and Zacharias violated, and Gould willfully violated, Section 16(a) of the Exchange Act and Rule 16a-3 thereunder by failing to file with the Commission reports on Forms 3, 4, and 5. The OIP further alleges that the reports Carley and Zacharias did file were false.

The Commission does not always address reporting violations of this sort when reviewing Initial Decisions. See Weeks, 81 SEC Docket at 1340 n.41 (declining to reach charges that respondents violated Sections 13(d) and 16(a) of the Exchange Act); L.C. Wegard & Co., 53 S.E.C. 607, 617 (1998) (declining to reach issue of whether respondents violated Section 13(d) of the Exchange Act), aff'd, 189 F.3d 461 (2d Cir. 1999).

Reports Required Pursuant to
Section 13(d) of the Exchange Act

Section 13(d)(1) of the Exchange Act and Exchange Act Rules 13d-1 and 13d-2 provide that persons or groups who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class that is registered pursuant to Section 12 of the Exchange Act, are directly or indirectly the beneficial owners of more than 5% of the class must file a disclosure statement with the Commission. The implementing rules require that such statements must be filed on Schedule 13D within ten days of the date on which the person's or group's beneficial ownership exceeded 5%.

For purposes of Section 13(d) of the Exchange Act, a person will be deemed a beneficial owner of a security if he has direct or indirect "investment power" over the security. See Exchange Act Rule 13d-3(a). "Investment power" includes the power to dispose, or to direct the disposition, of the security. Id. Beneficial ownership extends to any person who acquires direct or indirect investment power through any contract, arrangement, understanding, relationship or otherwise. Id. Rule 13d-3 is crafted broadly and sweeps within its purview informal, even oral, arrangements that confer upon a person investment power. See Herbert Moskowitz, 77 SEC Docket 481, 484 & n.15 (Mar. 21, 2002).

The purpose of Section 13(d) is to alert the marketplace to "large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control." SEC v. Savoy Indus., 587 F.2d 1149, 1165 (D.C. Cir. 1978) (quoting GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971)). Section 13(d) acts as the "pivot" of a regulatory scheme that permits issuers and their shareholders to evaluate possible effects of a change in control. SEC v. First City Fin. Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1980). Violations of Section 13(d) and Rule 13d-1 do not require proof of motive or scienter. Savoy, 587 F.2d at 1167; Moskowitz, 77 SEC Docket at 495 & n.48.

When two or more persons agree to act together for the purpose of acquiring, holding, voting, or disposing of equity securities of an issuer, the group formed thereby is deemed to have acquired beneficial ownership, for purposes of Section 13(d) of the Exchange Act, as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons. See Section 13(d)(3) of the Exchange Act and Rule 13d-5(b)(1) thereunder. A group need not be formally organized, nor memorialize its intentions in writing. Savoy, 587 F.2d at 1163. All that

is required is that its members combine in furtherance of a common objective. Wellman v. Dickinson, 682 F.2d 355, 362-63 (2d Cir. 1982); SEC v. Levy, 706 F. Supp. 61, 68-69 (D.D.C. 1989).

Group activity may be demonstrated by circumstantial evidence, such as a pattern of coordinated stock purchases. See Hallwood Realty Partners, L.P. v. Gotham Partners, L.P., 286 F.3d 613, 618 (2d Cir. 2002); Savoy, 587 F.2d at 1162; Bath Indus., Inc. v. Blot, 427 F.2d 97, 111-12 (7th Cir. 1970).

Zacharias observes that Section 13(d) was enacted as part of the Williams Act Amendments of 1968 and was designed to give notice of possible takeover activity that could change control of a publicly held corporation. He cites Scott v. Multi-Amp, 386 F. Supp. 44 (D.N.J. 1974), as holding that the reporting requirements of Section 13(d) do not apply to the existing management of an issuer (Zach. Trial Br. at 10-11; Tr. 11-12; Zach. Br. at 14-15). I agree with the Division that nothing in Section 13(d) or the Commission's implementing rules suggests that members of management are exempt from reporting their participation in a trading group (Div. Reply Br. at 7). Section 13(d) was not applied to management in Scott because the information had already been disclosed in the issuer's periodic report and press releases. In contrast, the alleged trading group here included persons who were not part of Starnet's management, and the information was not disclosed in Starnet's periodic filings.

Reports Required Pursuant to Section 16(a) of the Exchange Act

Section 16 of the Exchange Act applies to every person who is the beneficial owner of more than 10% of any class of equity securities registered under Section 12 of the Exchange Act and each officer and director of the issuer of such securities. Section 16(a) of the Exchange Act requires such persons to file initial reports with the Commission disclosing their beneficial ownership of all equity securities of the issuer. To keep this information current, Section 16(a) also requires such persons to report changes in their ownership involving such equity securities. Exchange Act Rule 16a-3 provides that an initial statement should be made on Form 3. Subsequent statements of changes in beneficial ownership should be made on Forms 4. Annual statements should be made on Forms 5. Rule 16a-3(j) requires that, where more than one person subject to Section 16 is deemed to be a beneficial owner of the same equity securities, all such persons must report as beneficial owners of the securities, either separately or jointly.

For purposes of determining whether a person is a 10% beneficial owner of securities under Section 16(a) of the Exchange Act, Rule 16a-1(a)(1) adopts the definition of "beneficial owner" found in Section 13(d) of the Exchange Act and Rules 13d-3 and 13d-5.

Assuming That Aggregation Is Appropriate, the Weight of the Evidence Fails to Show that the Group's Aggregate Ownership Exceeded 5% or 10% on Any One Day

The OIP alleges that Starnet's officers, Peeper, Le Fond Mondial, and Gould beneficially owned a large percentage of Starnet's common stock between February 1999 and November

2000. Under the Division's theory, these persons acted together in the acquisition and disposition of Starnet stock, and constituted a group for purposes of Sections 13(d) and 16(a) of the Exchange Act. The Division argues that the group's collective holdings should have been aggregated for purposes of determining each member's obligation to file Schedules 13D and Forms 3, 4, and 5. Finally, the Division asserts that Carley and Zacharias had a continuing duty to report the group's beneficial ownership, even after they had resigned as Starnet officers and directors. It is undisputed that no such group beneficial ownership reports were filed.

This is a plausible theory and there may be evidence somewhere to support it. However, the Division presented only conjecture and a jumble of data (Tr. 105-06).[37] The Division never explained what a properly filed Schedule 13D would have disclosed. It never presented an exhibit showing the specific number of securities beneficially owned by each member of the alleged group on each date between February 1999 and November 2000. In the absence of such an exhibit and a sponsoring witness who could be cross-examined about its content, the Division cannot meet its burden of proof merely by assuming that the decision maker will "eyeball" the data in DX 1, DX 2, and DX 318 and infer that the 5% and 10% thresholds had been crossed. Such an assumption is particularly unwarranted in proceedings subject to Commission-imposed deadlines for issuing Initial Decisions, as here.

For purposes of proving a Section 13(d) reporting violation, the Division's first task was to establish the quantity of outstanding Starnet securities on the relevant dates. The Division could not rely on the information set forth in Starnet's most recent quarterly or annual reports, because it knew that the information contained in those reports was not up to date. See Exchange Act Rule 13d-1(j). I conclude that DX 318 is more accurate than Starnet's periodic reports for these purposes.

The Division's next task was to identify the Starnet members of the group and the quantity of Starnet securities held by each of them. Although the OIP identifies four Starnet officers who were allegedly part of the group, there is no evidence about the number of Starnet shares that Dohlen and Giles, as individuals, beneficially owned between February 1999 and November 2000.[38] In other words, any shares owned by Dohlen and/or Giles cannot be aggregated because the Division has not even computed them. The Division does not claim that

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[37] In the leading cases involving failure to report the aggregate holdings of a group under Section 13(d), the parties alleging violations have presented detailed evidence computing the number of shares of the issuer outstanding, the number of shares beneficially owned by the group on the date(s) in question, and the percentage of the issuer's shares beneficially owned by the group on the dates in question. See Wellman, 682 F.2d at 359 & n.7, 364 & n.11; Milstein, 453 F.2d at 713; Levy, 706 F. Supp. at 71 n.16; Moskowitz, 77 SEC Docket at 486 & n.18, 488 & n.28; William A. Wilkerson, 81 SEC Docket 1826, 1828-29 (Oct. 27, 2003) (settlement). The Division needed a summary exhibit on this issue, but it elected not to provide one.

[38] The Division's posthearing pleadings do not identify the misconduct that Giles committed to merit inclusion in the group.

Zacharias or Carley, as individuals, ever reached the 5% or 10% reportable level of beneficial ownership.[39]

The Division's theory as to Gould is unclear. It has not explained if shares Gould held from time to time under irrevocable proxies for Starnet's employees should or should not be deemed to be held by Gould himself. Gould argues, with some justification, that his control of these shares was transitory and should not be counted (Gould Br. at 33).

The evidentiary gaps as to the Starnet officers and Gould would not be dispositive if the Starnet shares held by Peeper and Le Fond Mondial were to be aggregated, and if those shares exceeded the reportable threshold by themselves. In those circumstances, if Carley, Zacharias, and/or Gould were deemed to be members of a group that included Peeper and Le Fond Mondial, then, theoretically, their individual ownership of even a single Starnet share would render them liable for the group's failure to file Schedules 13D and Forms 3, 4, and 5.

However, the Division has not made this abbreviated showing. There is no basis for treating the Peeper entities as a group before December 1998. See supra p. 11. The Division has not identified the number of shares each of the Peeper accounts beneficially owned on any given date between February 1999 and November 2000. The absence of such evidence is significant. LaSalle had sold the last of its original Regulation S shares by December 23, 1998, and Eur-Am had sold the last of its original Regulation S shares by January 15, 1999 (DX 1 at 2, 4). Eur-Am and LaSalle did not exercise their first Regulation S warrants until March 9 and April 13, 1999, respectively (DX 1 at 2, 4). Thus, between mid-January 1999 and early March 1999, these two Peeper accounts did not beneficially own any Starnet shares and they had not yet exercised any Starnet warrants. The Division was obliged to show why Eur-Am and LaSalle should be deemed part of a reportable group during an interval when they had flat positions.

During 1999, the Peeper accounts turned over their shares quickly (DX 1, DX 2, DX 67). For its part, Starnet did not issue S-8 shares to its officers or employees until after the Peeper accounts had already sold a corresponding amount of Regulation S shares (DX 67). Even

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[39] Paragraphs II.E.2 and II.E.3 of the OIP allege Respondents failed to report their ownership of Starnet "stock." This is confusing terminology, because unexercised option and warrant positions are also reportable for purposes of Schedule 13D, as long as there is a right to exercise within sixty days. See Exchange Act Rule 13d-3(d)(1)(i). It would not be fair to broaden the scope of the OIP at this late date to include unexercised options as reportable. In any event, the Division has not identified when the sixty-day period arose for the S-8 options held by Starnet's officers.

The same is true as to any unexercised Regulation S warrants and piggyback warrants held by each of the Peeper entities. According to the subscription agreements, shares of stock obtained on the exercise of the warrants were supposed to go into escrow for forty days (DX 211 at 4). The piggyback warrants did not even exist until the warrants had been exercised. Given the narrow wording of the OIP, I specifically decline to count the unexercised warrants and piggyback warrants to determine whether the Peeper entities exceeded the 5% and 10% thresholds.

assuming that Peeper, Le Fond Mondial, Gould, Carley, and Zacharias were acting as a group during 1999 and 2000, the hearing exhibits and posthearing pleadings do not identify data to support the Division's claim that the group's position exceeded the 5% and 10% reporting thresholds for the entire nineteen month period, or on any specific dates during that period. As noted, such evidence may be buried in the Division's investigative file. The Division has not satisfied its burden of presenting the data in a logical and coherent fashion.

I dismiss the charge that Carley, Zacharias, and Gould violated a duty to file Schedules 13D or Forms 3, 4, or 5 concerning the aggregate number of Starnet shares held by a reportable group between February 1999 and November 2000.

Without Proof that the Group's Aggregate Ownership Exceeded 10%, the Weight of the Evidence Shows One Reporting Violation Under Section 16(a) of the Exchange Act

Apart from the alleged group reporting violation, the Division has essentially declined to participate on the issue of whether there are other Section 16(a) reporting violations. It asserts only that Carley and Zacharias failed to file "at least one" of the required Forms 3, 4, or 5 before their respective resignations from Starnet (Div. Prehearing Br. at 25; Div. Br. at 38). Respondents and the decision maker should not have to guess which specific reports may have been missing.[40]

Zacharias resigned as a Starnet officer and director on August 12, 1999. He continued to function as Starnet's in-house general counsel until February 14, 2000. Carley resigned as a Starnet officer and director on December 23, 1999. He continued to function as an officer of EFS Caribbean, a Starnet subsidiary, until April 3, 2000.

Exchange Act Rule 16a-1(f) provides that officers of an issuer's subsidiaries can be deemed officers of the issuer if they exercise policy-making functions for the issuer. The Division has not argued that Zacharias and Carley exercised such policy-making functions after the dates of their respective resignations. Exchange Act Rule 16a-2(b) provides that transactions in an issuer's securities are not subject to Section 16 of the Exchange Act following the cessation of officer or director status, except in specific circumstances. The Division has not argued that any of Zacharias's or Carley's post-resignation transactions met the specific circumstances of Rule 16a-2(b).

Carley filed Forms 3 and 4 with the Commission reflecting the acquisition and sale of 200,000 shares of Starnet (DX 434). I find that these Forms 3 and 4 described the material terms of the transactions. Any discrepancies were due to differences between the trade dates and the

[40] All litigants in the administrative forum are obliged to present their arguments in a timely and focused manner. Cf. Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 553-54 (1977) ("Administrative proceedings should not be a game . . . by making cryptic and obscure references to matters that 'ought to be considered' and then, after failing to do more to bring the matter to the agency's attention, seeking to have the agency's determination vacated on the ground that the agency failed to consider matters 'forcefully presented.'").

dates when Carley was paid, and to the differences between gross proceeds and net proceeds. Notwithstanding these minor discrepancies, I find that the Forms 3 and 4 that Carley filed were materially accurate.

There is some evidence that Carley sold at least 50,000 shares of Starnet in October 1999 (DX 2 at 39, DX 328). He was an officer and director at the time, and no Form 4 was filed with the Commission. However, Brovarone and Gould would not permit Carley to withdraw funds from "his" trust account at the end of October 1999. See infra note 47. The weight of the evidence supports Carley's claim that these transactions were not his.

The Division assumes that Carley was also responsible for filing Section 16(a) reports because Madison Park Trust acquired Starnet stock in September 1999 and sold the stock between January and September 2000 (Div. Reply Br. at 14-16). Carley contends that, if a reporting duty existed, it belonged to the trustee of Madison Park Trust, an individual in Barbados, West Indies, and not to him, as beneficiary of the trust (Carley Prehearing Br. at 7-9; Carley Br. at 12).

Exchange Act Rule 16a-8(b), which governs trust transactions, provides that holdings and transactions in an issuer's securities held by a trust are usually reported by the trustee on behalf of the trust. There are two exceptions to the general rule. First, if a trust beneficiary subject to Section 16 of the Exchange Act shares investment control with the trustee with respect to a trust transaction, then the transaction is attributed to and must be reported by both the beneficiary and the trustee. See Exchange Act Rule 16a-8(b)(3)(i). Second, if a trust beneficiary has investment control with respect to a trust transaction without consultation with the trustee, then the transaction is attributed to and must be reported by the beneficiary only. See Exchange Act Rule 16a-8(b)(3)(ii).

In other words, Exchange Act Rule 16a-8(b)(3) requires a trust beneficiary subject to Section 16 to report in his individual capacity trust transactions over which the beneficiary has or shares investment control. The existence of such investment control is analyzed in light of all the facts and circumstances.

Carley relies on Madison Park Trust's deed of trust, which states that the trustee exercised sole investment control of transactions on behalf of the trust (DX 113, DX 328). He also observes that the trustee executed all of Madison Park Trust's account opening documents at Spencer Edwards, and received the proceeds of transactions in Barbados (DX 113, DX 328). The Division does not discuss Rule 16a-8. Nor has it pointed to any evidence that Carley, as beneficiary, shared investment control with Madison Park's trustee. The weight of the evidence does not support the Division's claim that Carley had a duty to file Section 16(a) reports on behalf of Madison Park Trust.

Zacharias honored most of his reporting obligations as a Starnet officer and director (DX 438). The record demonstrates only one instance in which Zacharias failed to file a Form 4 while he was an officer and director. That lapse occurred after a July 21, 1999, transaction in which Zacharias acquired 10,000 shares of Starnet (DX 2 at 41; DX 438; Carley Ex. 36 at 7487).

Gould had no duty to file Section 16(a) reports. He was never an officer or director of Starnet. He was not proven to be a 10% beneficial owner of Starnet.

I dismiss the charge that Carley and Gould breached a duty to file Section 16(a) reports. I conclude that Zacharias failed to file one required report under Section 16(a).

C. False Filings and Antifraud Violations.

Paragraph II.F.1 of the OIP alleges that, from December 1997 through August 1999, Starnet violated Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1, 13a-11, and 12b-20 by filing current and annual reports with the Commission that were materially false and misleading. The allegedly misleading and/or omitted material information involved control, related-party transactions, executive compensation, and beneficial ownership of stock. Paragraph II.F.2 of the OIP alleges that Carley and Zacharias caused Starnet's violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 12b-20.[41]

Paragraph II.D of the OIP alleges that Carley and Zacharias violated the antifraud provisions of the federal securities laws by engaging in the same conduct that caused Starnet's violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, and 12b-20. Paragraphs II.D.5 and II.D.7 of the OIP allege that Gould, Geiger, and Kaufmann willfully aided and abetted and caused Carley's and Zacharias's violations of the antifraud provisions.

Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-11 thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act to file annual and current reports with the Commission. Exchange Act Rule 12b-20 further requires that such reports include any additional material information that is necessary to make required statements, in light of the circumstances under which they are made, not misleading. Implicit in these provisions is the requirement that the reports be accurate. SEC v. Kalvex, Inc., 425 F. Supp. 310, 316 (S.D.N.Y. 1975). Proof of scienter is not required to establish violations of the Commission's reporting provisions. See Savoy, 587 F.2d at 1167; SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

Section 17(a) of the Securities Act proscribes fraudulent conduct in the offer or sale of securities and Section 10(b) of the Exchange Act and Rule 10b-5 proscribe fraudulent conduct in connection with the purchase or sale of securities. These provisions prohibit essentially the same type of conduct. See United States v. Naftalin, 441 U.S. 768, 773 n.4 (1979). To prevail under Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5, the Division must show: (1) misstatements or omissions of material facts or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that Respondents acted with scienter. See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). No scienter requirement exists for violations of Sections 17(a)(2) or 17(a)(3) of the Securities Act; negligence alone is sufficient. Aaron v. SEC, 446 U.S. 680, 701-02 (1980); Pagel, Inc. v. SEC, 803 F.2d 942, 946 (8th Cir. 1986).

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[41] All the alleged false filings and alleged antifraud violations occurred more than five years before the Commission issued the OIP. See supra note 27 and infra p. 63.

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision and would view disclosure of the omitted fact as having significantly altered the total mix of information made available. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1466 (2d Cir. 1996).

Scienter is defined as "a mental state embracing intent to deceive, manipulate, or defraud." Hochfelder, 425 U.S. at 193 n.12. It may be established by a showing of recklessness. David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997) (citing Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990) (en banc)).

1. Primary Liability.

The OIP does not claim that Starnet, Carley, or Zacharias made any misrepresentations or material omissions about Starnet's business, financial results, or prospects. Nor is there any claim that the price of Starnet's stock was improperly inflated through fraud. Rather, the alleged fraud is the failure to disclose the existence of the scheme to sell unregistered securities in violation of Section 5 of the Securities Act.

Peeper's Undisclosed Control
of "Seven Separate Sophisticated
Foreign Investment Groups"

Paragraph II.C.3.a of the OIP alleges that Peeper controlled the seven foreign groups that purchased Starnet's stock under Regulation S. Paragraph II.D.4.a of the OIP alleges that Carley and Zacharias defrauded investors and prospective investors by failing to disclose Peeper's control.

Starnet disclosed its sale of Regulation S stock and warrants, and its extension of the warrant expiration date, in three current reports (DX 442-DX 444). The reports were dated December 11, 1997, December 17, 1998, and March 18, 1999, respectively. In each of these reports, Starnet identified the Regulation S purchasers as "seven separate sophisticated foreign investment groups" (DX 442-DX 444).

The Commission requires issuers to report unregistered sales of equity securities within fifteen days of their occurrence. Periodic Reporting of Unregistered Equity Sales, 62 SEC Docket 3059, 3060 (Oct. 10, 1996). Under this requirement, an issuer must file a mandatory current report on Form 8-K that discloses, among other things, "the person or class of persons to whom the securities were sold." In adopting this requirement, the Commission explained:

> Several commenters opposed the requirement that the names of persons to whom the securities were sold be disclosed. Item 701 [of Regulation S-B, 17 C.F.R. § 228.701(b)] would continue to provide companies with an option to describe the person or persons to whom the securities were sold by class (for example, to an accredited investor), as opposed to the names of the individual investors.

Id., 62 SEC Docket at 3060. Starnet was not required to identify Oriental New Investment, Orienstar, Orpac, Eur-Am, La Salle, Le Fond Mondial, Rial Equity, or Peeper by name in its mandatory current reports. To the extent that OIP ¶ II.D.4.a alleges otherwise, the charge has not been sustained.

However, under Rule 12b-20, Starnet was also required to include in its current reports any additional material information that was necessary to make required statements, in light of the circumstances under which they were made, not misleading. The Division's theory is that the statement Starnet made ("seven separate sophisticated foreign groups") (emphasis added) was misleading because the seven groups were affiliated with each other and Peeper controlled them all.

Exercising Starnet warrants and piggyback warrants was a lawful act for a legitimate market purpose. However, the Peeper accounts sold the stock acquired through the warrants to fund the exercise of S-8 options by Starnet's officers and employees. On that basis, the weight of the evidence supports an inference that Peeper operated the seven foreign entities as a single enterprise during 1999 and 2000. After being reimbursed with S-8 stock, the Peeper accounts then resold the S-8 stock into the public market, as well. By April 1999, Gould was urging Kaufmann and Brovarone to commingle the proceeds from Starnet trades by the Peeper accounts ((DX 82) ("it doesn't really matter which account it comes from as long as the amounts are correct"), (DX 83) ("if insufficient funds are in the accounts, request them from Tom or take them from another account as it should all balance out in the end")). By June 1999, Kaufmann was also commingling shares of Starnet stock in accounts for which Peeper and Gould exercised trading authority ((DX 346) ("cancelled trades moved to Celestine, Mondial out of stock"), (DX 369) ("Orienstar correction from Rial")). With Peeper's permission, Brovarone also commingled the funds belonging to the seven foreign entities (Tr. 615, 902-03, 974-75). Between February 1999 and March 2001, Oriental and Orienstar paid $351,000 for the benefit of Geiger (DX 3 at 3, 6, 11). If these two entities had their own business strategies and were truly independent of Peeper, there is no apparent reason why they would fund Peeper's generosity to Geiger.

However, such evidence offers no assistance in deciding whether Zacharias and Carley committed scienter-based antifraud violations in connection with the Forms 8-K. To prevail on that issue, the Division must make a particularized showing of what Zacharias and Carley knew about Peeper's control of the seven foreign entities and when they knew it.

Brovarone's testimony was not helpful on this issue. Brovarone assumed that Peeper owned and controlled the seven foreign entities, and he conceded that they might have been nominees for Peeper (Tr. 388, 1044). However, Brovarone admitted he had no facts to support such speculation (Tr. 641, 975-76, 1043-44).

When Zacharias reviewed and signed Starnet's first Form 8-K in December 1997, he knew that Peeper had signed all the bridge financing agreements in May 1997 (DX 450). He also knew that the subscription agreements were evenly divided (350,000 shares to each subscriber) and that Starnet would acquiesce in Peeper's preferred practice of using an escrow

agent, rather than restrictive legends on certificates. Zacharias says he did not consider that information to be relevant for purposes of the Form 8-K, and he asserts that Brovarone told him the seven foreign groups were not affiliated (Tr. 1120-22). While I did not find Zacharias's testimony on these points to be particularly compelling, even an adverse inference would be insufficient to support a finding that Zacharias knew of Peeper's control in December 1997 and acted with scienter to conceal it.[42]

There is no evidence that Zacharias knew or should have known in December 1997 that the Regulation S shares would be resold into the American markets. There is no evidence that Zacharias or Peeper knew in December 1997 that Starnet, then focused on its adult entertainment business, would later find success in Internet gambling. The Division has shown even less about what Carley knew in December 1997. Moreover, the seven foreign groups followed individualized and differentiated trading/investment strategies with respect to Starnet through November 1998, and some of them did not even open Spencer Edwards trading accounts until early 1999. See supra p. 11. The weight of the evidence does not support the charge that Zacharias and Carley committed an antifraud violation in connection with Starnet's December 1997 Form 8-K.

Matters had changed significantly by December 1998, when Zacharias signed the second Form 8-K. Starnet had extended the warrants for one year. Zacharias and Gould had discussed the exchange of S-8 stock for Regulation S stock. In addition, Reed had questioned Zacharias about whether the seven foreign accounts were really separate, and Zacharias had assured him they were. Carley had opened his United Capital/First Marathon account. Because Carley reviewed Starnet's public filings, it is reasonable to infer that he reviewed the December 1998 and March 1999 Forms 8-K.

The weight of the evidence supports the charge that Zacharias recklessly omitted material information when he signed Starnet's December 1998 and March 1999 Forms 8-K. The weight of the evidence fails to show that Carley acted recklessly in connection with these two current reports. However, in reviewing these Forms 8-K and failing to object to material omissions, Carley acted negligently.

False Representation of Compliance with Section 16(a)

Paragraph II.D.4.d of the OIP alleges that Carley and Zacharias falsely represented that they, Dohlen, and Giles had complied with Section 16(a) of the Exchange Act by filing all required forms to report changes in their beneficial ownership of Starnet stock. See supra note 18. The weight of the evidence does not sustain this charge.

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[42] An adverse inference may be employed to complete a chain of reasoning on a point partially established by direct evidence, but it cannot be used to fill a void where there is otherwise no evidence. See Stanojev v. Ebasco Servs., Inc., 643 F.2d 914, 923-24 n.7 (2d Cir. 1981) (holding that an adverse inference cannot supply the missing element of a prima facie case). The Division assumes that Starnet and Peeper reached an understanding in December 1997 or earlier, but it has offered little proof of that fact. Without testimony from Dohlen, Peeper, and Giles, the Division's case against Carley and Zacharias has faltered on this issue.

Carley filed all the Section 16(a) beneficial ownership reports that he was required to file as a Starnet officer and director during fiscal year 1999. The Division claims that Carley was also responsible for filing beneficial ownership reports on behalf of Madison Park Trust. However, Madison Park Trust did not acquire Starnet stock until September 1999. See supra pp. 18, 24. Its transactions did not occur during fiscal year 1999, and thus are irrelevant to representations made in Starnet's fiscal year 1999 annual report.

Zacharias failed to file one Section 16(a) beneficial ownership report that he was required to file as a Starnet officer and director. However, the relevant transaction occurred on July 21, 1999. It did not take place during fiscal year 1999, and thus is irrelevant to representations made in Starnet's fiscal year 1999 annual report. See supra note 17. The record does not show whether Dohlen and Giles failed to comply with the beneficial ownership reporting requirements of Section 16(a) during fiscal year 1999.

The weight of the evidence also fails to sustain the charge that a group's holdings exceeded the 10% threshold during fiscal year 1999.[43]

Failure to Disclose Related-Party Transactions

Paragraph II.D.4.b of the OIP alleges that Carley and Zacharias failed to disclose related-party transactions resulting from an agreement between Peeper, Le Fond Mondial, Gould, and Starnet's officers to share the proceeds from unregistered sales of Starnet stock. See supra note 19.

Starnet did not disclose in its 1999 annual report the nature and extent of the related-party transactions between its officers and directors, Gould, Peeper, and Le Fond Mondial. Starnet was a party to the transactions because it issued stock on the exercise of both Regulation S warrants and Form S-8 options between January and April 1999. The information about these related-party transactions was material and should have been disclosed.

Zacharias and Carley were both aware of the relevant transactions. Zacharias negotiated the structure of the transactions with Gould in December 1998 and processed the warrant exercises by the Peeper entities in and after January 1999. Carley opened a brokerage account at United Capital/First Marathon in December 1998 and the Peeper entities paid him $2.48 million through that account in connection with his exercise of stock options and his sale of stock, beginning in February 1999. Despite this knowledge, Carley and Zacharias failed to ensure that the related-party transactions were disclosed in Starnet's 1999 annual report.

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[43] The evidence introduced to support the charge in OIP ¶ II.D.4.d related solely to Starnet's fiscal year 1999 (May 1998 through April 1999). The period at issue in OIP ¶ II.E.2 was different (February 1999 through November 2000). The Division failed to meet its burden of proof with respect to both periods.

The weight of the evidence supports the charge that Zacharias and Carley committed scienter-based antifraud violations in Starnet's 1999 annual report in the manner described.

False Representations About Dohlen's Executive Compensation

Paragraph II.D.4.e of the OIP alleges that Carley and Zacharias committed fraud by materially underreporting Dohlen's executive compensation. Starnet's annual report, which Zacharias prepared and signed, and its amended annual report, which both Carley and Zacharias signed, made certain representations about Dohlen's executive compensation (Tr. 1189-90; DX 445 at 37-39, DX 446 at 41-42).

The weight of the evidence fails to show that these representations were inaccurate (Tr. 2133-36). To be sure, Dohlen received substantial sums from the Peeper entities during fiscal year 1999 (Tr. 81-82; DX 3 at 3, 5, 10, 18). However, there is no basis to infer that such payments related to Starnet or were part of Dohlen's executive compensation (Tr. 2133-36). The Division has not shown that Carley and Zacharias knew, or even should have known, that Dohlen received compensation for services beyond that which was disclosed in Starnet's 1999 annual report.

Failure to Disclose Non-Compliance with Section 13(d)

Paragraph II.D.4.e of the OIP alleges a failure to disclose in the 1999 annual report a group's failure to file Section 13(d) reports. The alleged failure to file Schedule 13D reports covered the period from February 1999 through November 2000 (OIP ¶ II.E.2). In contrast, the alleged antifraud violation is limited to non-disclosure in Starnet's fiscal year 1999 annual report. As I understand the OIP, the alleged non-disclosure relates only to the period from February 1999 through April 1999. Because the underlying reporting violation has been dismissed, the related non-disclosure violation will also be dismissed.

2. Secondary Liability.

Aiding and Abetting

To show that one respondent willfully aided and abetted the violation of another, the Commission requires the Division to establish three elements: (1) another party has committed a securities law violation; (2) the accused aider and abetter has a general awareness that his or her role was part of an overall activity that was improper or illegal; and (3) the accused aider and abetter knowingly and substantially assisted the principal violation. See Orlando Joseph Jett, 82 SEC Docket 1211, 1256 n.46 (Mar. 5, 2004); Abraham & Sons Capital, Inc., 75 SEC Docket 1481, 1492 (July 31, 2001) (citing Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000)); Donald T. Sheldon, 51 S.E.C. 59, 66 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995).

The Commission has held that a showing of recklessness will satisfy the "substantial assistance" prong of the aiding and abetting test. See Sharon M. Graham, 53 S.E.C. 1072, 1084-85 & n.33; Russo Sec., Inc., 53 S.E.C. 271, 278-79 & n.16 (1997). The reviewing courts have required more. See Howard v. SEC, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (holding that

"extreme recklessness" may support aiding and abetting liability, but concluding that "aiding and abetting liability cannot rest on the proposition that the person 'should have known' that he was assisting violations of the securities laws.").

Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter. See Zion Capital Mgmt. LLC, 81 SEC Docket 3063, 3076-77 & n.35 (Dec. 11, 2003); Terence Michael Coxon, 80 SEC Docket 3288, 3300 n.32 (Aug. 21, 2003), aff'd, 2005 U.S. App. LEXIS 13186 (9th Cir. June 29, 2005); Kingsley, Jennison, McNulty & Morse, Inc., 51 S.E.C. 904, 911 & n.28 (1993).

The Division's theory of aiding and abetting liability is difficult to follow. As to Gould, the Division states: "Gould was the person controlling the stock sales scheme that rendered Starnet's disclosures false and misleading . . . . Though Gould was not involved in formulating Starnet's misleading disclosures, his conduct should be deemed sufficiently close to the disclosures to support aiding and abetting liability" (Div. Br. at 30 & n.19). This formulation confuses the securities registration provisions with the antifraud provisions. It suggests that any time there is a violation of the former, a violation of the latter also occurs. In so arguing, the Division glosses over the need to demonstrate that the primary antifraud violators and the alleged aider and abetter each acted with scienter. The weight of the evidence does not support the charge that Gould willfully aided and abetted the proven antifraud violations.

As to Kaufmann and Geiger, the Division states: "Geiger and Kaufmann had a duty to review Starnet's filings with the Commission, which would have revealed the issues raised by the Forms 8-K. . . ." (Div. Br. at 33 n.21). As to Geiger, the Division also states: "Because Geiger was intentionally working together with the Starnet officers and others to commit the securities [registration] violations, he caused and aided and abetted the Starnet officers' antifraud violations" (Div. Reply to Geiger at 5). It is unclear if the Division contends that this duty to review attached before Starnet made its filings with the Commission. If so, it is unclear how a registered representative in Denver could have policed the content of disclosure documents written by an issuer in Vancouver and transmitted electronically to the Commission in Washington, D.C. Geiger acknowledged that "from time to time" he would review Starnet's public filings on the Internet (Tr. 1699-1700). The Division cannot prevail on the theory that Geiger "should have known" that Starnet's filings were materially false and misleading (Div. Reply to Geiger at 5). See Howard, 376 F.3d at 1143 ("should have known" will not support aiding and abetting liability).

As with Gould, the weight of the evidence shows that Geiger and Kaufmann knowingly and substantially participated in the distribution of unregistered securities. However, the record fails to show that they knowingly and substantially assisted the antifraud violations of Zacharias and Carley.

Causing

Section 8A of the Securities Act and Section 21C(a) of the Exchange Act specify that a respondent is a cause of another's violation if the respondent knew or should have known that his or her act or omission would contribute to such violation.

The Commission has determined that causing liability under these statutory provisions requires findings that: (1) a primary violation occurred; (2) an act or omission by the respondent caused the violation; and (3) the respondent knew, or should have known, that his or her conduct would contribute to the violation. See Robert M. Fuller, 80 SEC Docket 3539, 3545 (Aug. 25, 2003), pet. denied, 2004 U.S. App. LEXIS 12893 (D.C. Cir. Apr. 23, 2004); Erik W. Chan, 77 SEC Docket 851, 859-60 (Apr. 4, 2002).

Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. Howard, 376 F.3d at 1141; KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 (2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002). Negligence is the failure to exercise reasonable care or competence. Byron G. Borgardt, 80 SEC Docket 3559, 3577 & n.35 (Aug. 25, 2003).

The Commission has not decided any contested cases in which it explicitly concluded that a respondent was a cause, by negligent acts or omissions, of securities law violations that require scienter to establish the primary violation. Howard, 376 F.3d at 1141, intimates that such a showing would be legally insufficient. I conclude that the Division must demonstrate scienter to show that a respondent has causing liability in those circumstances. See H.J. Meyers & Co., Inc., 78 SEC Docket 909, 945-46 (Aug. 9, 2002), aff'd on other grounds sub nom., Robert Setteducati, 81 SEC Docket 2223 (Nov. 7, 2003).

Starnet violated Section 13(a) of the Exchange Act in the following respects: (1) its December 1998 and March 1999 Forms 8-K failed to disclose material information about Peeper; and (2) its 1999 annual report failed to disclose related-party transactions resulting from an agreement between Peeper, Le Fond Mondial, Gould, and Starnet's officers (except Giles) to share the proceeds from unregistered sales of Starnet stock. I agree with the Division that Zacharias and Carley caused Starnet's violations of Section 13(a) by signing and reviewing these disclosure documents. I further agree with the Division that Zacharias and Carley were at least negligent and should have known that their conduct would contribute to Starnet's violations.

There is no proven nexus between the conduct of Gould, Geiger, and Kaufmann, on the one hand, and the antifraud violations of Zacharias and Carley, on the other. Accordingly, the weight of the evidence fails to show that Gould, Geiger, or Kaufmann caused Zacharias or Carley to violate the antifraud provisions of the federal securities laws.

D. Gould Acted As An Unregistered Broker.

Paragraph II.D.5 of the OIP alleges that Gould willfully violated Section 15(a) of the Exchange Act by engaging in business in the United States as an unregistered broker. The OIP

charges that Gould solicited Starnet business from Starnet employees, directed transfers of Starnet stock, the sale of Starnet stock, and the disbursement of proceeds from these sales.

Section 15(a)(1) of the Exchange Act makes it illegal for a broker to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker is registered with the Commission. Scienter is not an element of the violation. SEC v. Nat'l Exec. Planners, Ltd., 503 F. Supp. 1066, 1073 (M.D.N.C. 1980). Section 3(a)(4)(A) of the Exchange Act defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others." A person may be found to be acting as a broker if he or she regularly participates in securities transactions "at key points in the chain of distribution." Mass. Fin. Serv's., Inc. v. Sec. Investor Prot. Corp., 411 F. Supp. 411, 415 (D. Mass.), aff'd, 545 F.2d 754 (1st Cir. 1976).

Gould was never registered with the Commission as a broker or associated with any broker registered in the United States. His regular participation in Starnet transactions and use of jurisdictional means is demonstrated by the documentary evidence in the case (DX 66; Gould Ex. 8; facsimile and e-mail traffic). Gould's own testimony confirms that he directed transactions for the Peeper accounts and ordered disbursements of funds from stock sales.

Gould was not compensated on a transaction-by-transaction basis. Nor did Gould directly solicit securities business from Starnet's employees. Starnet management required the firm's officers and employees to open accounts at United Capital to exercise their stock options (Tr. 1258). Gould initially agreed to this plan because he hoped to market other investments to Starnet's officers and employees (Tr. 1258, 1402). However, most of the employees withdrew their stock sale proceeds quickly, and Gould did not receive the compensation he anticipated. Gould then asked Dohlen for a flat fee of approximately $1 million, and Dohlen readily agreed. Gould continued to perform these services between December 1998 and 2000 (Tr. 1404-05) ("I agreed to do it until there wasn't any more to do."). The work took Gould and United Capital's staff "an enormous amount of time" (Tr. 1419-20).

Gould observes that Spencer Edwards actually brokered securities transactions and received trading commissions in the United States. He contends that he performed only "ministerial tasks" and functioned "as a custodian," "a mere customer," "like a trust company," "as a bank," "as an escrow agent," and even as "an outside contractor/independent consultant extension of Starnet's Human Resources Department" (Gould Br. at 4, 15-18).

Gould's testimony demonstrates his regular participation in securities transactions for the accounts of others. He routed and coordinated orders and facilitated the exercise of securities transactions within the United States. Gould also exercised time and price discretion when directing the sale of stock for Starnet's officers, directors, and employees (Tr. 1434) ("I felt a fiduciary responsibility to these people."). Gould's role continued over a lengthy period of time, from December 1998 until well into 2000 (Tr. 1404-05).

I conclude that Gould functioned as an unregistered broker and willfully violated Section 15(a)(1) of the Exchange Act, as charged in OIP ¶ II.D.5.

E. Price and Spencer Edwards Failed to Supervise Geiger and Kaufmann.

Paragraph II.G of the OIP alleges that Price and Spencer Edwards failed reasonably to supervise Geiger and Kaufmann with a view to preventing and detecting Geiger's and Kaufmann's willful violations of the registration provisions of the Securities Act and their willful aiding and abetting of Carley's and Zacharias's violations of the antifraud provisions of the federal securities laws. It further alleges that Geiger was subject to Price's supervision from June 1998 through January 2001, and that Kaufmann was subject to Price's supervision from June 1998 through February 2001.

Section 15(b)(6) of the Exchange Act, in conjunction with Section 15(b)(4), provides that the Commission may sanction a supervisor for failure reasonably to supervise a person subject to his supervision, with a view to preventing violations of the Securities Act, the Exchange Act, or the Commission's implementing rules and regulations.

The relevant part of Section 15(b)(4)(E) of the Exchange Act provides that no person may be deemed to have failed reasonably to supervise any other person if:

> (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and
> (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

To demonstrate deficient supervision by Price and Spencer Edwards, the Division must prove that Geiger and/or Kaufmann willfully violated the registration provisions of the Securities Act and/or willfully aided and abetted violations of the antifraud provisions of the federal securities laws, that they were subject to Price's and Spencer Edwards's supervision, and that Price and Spencer Edwards failed reasonably to supervise one or both of them with a view to preventing or detecting the violations.

The fact that Price prevailed on failure-to-supervise charges in the Kirby proceeding has limited relevance here. This proceeding involves a different period of time and different supervisory behavior.

The weight of the evidence shows that Geiger and Kaufmann willfully violated the registration provisions of the Securities Act. See supra pp. 35-44. There is no dispute that Geiger and Kaufmann were subject to supervision by Price and Spencer Edwards at the time these violations occurred.

Spencer Edwards did not have acceptable procedures in place to prevent or detect unregistered transactions in Starnet stock. Price allowed Geiger to work away from the Spencer Edwards office more than half the time, a situation that made effective supervision of Geiger

impossible. Price allowed Geiger and Kaufmann to maintain a separate facsimile machine in their private office, and he made no effort to monitor such facsimile traffic. Price allowed Kaufmann to communicate with Spencer Edwards's customers through two private e-mail accounts. Although Kaufmann "registered" his private e-mail accounts with Spencer Edwards's compliance office, Price did not develop any controls that permitted the firm to monitor such e-mail traffic in a timely manner. Throughout 1999, Price knew that the Peeper accounts were exercising Starnet warrants, depositing large blocks of Starnet stock in their Spencer Edwards accounts, and reselling these shares almost immediately (Tr. 2025, 2028-30).

As early as September 1996, Price told Spencer Edwards's registered representatives that they needed to investigate the origin of stock certificates transferred to accounts at the firm. He also emphasized that Spencer Edwards could not rely on the absence of a restrictive legend as proof that shares were free-trading. In view of this advice, Price and Spencer Edwards cannot seriously rely on the fact that Fiserv, Spencer Edwards's clearing broker, never rejected a Starnet trade (Tr. 2068; Spencer Edwards Prop. Find. # 30).

Price also told Spencer Edwards's registered representatives to review legal opinions on Regulation S transactions. However, when Price questioned Geiger and Kaufmann about Starnet Regulation S transactions involving the Peeper accounts, he was content to ask if such opinions existed and if Geiger and Kaufmann were comfortable with the transactions.

Price acknowledged that he was ultimately responsible for compliance at Spencer Edwards. In light of this testimony, Price cannot absolve himself of culpability for inadequate supervision by claiming that he relied on Cole to supervise Geiger and Kaufmann after December 1998 (Tr. 2032-33, 2115-16; Spencer Edwards Prop. Find. ## 3, 8, 18, 20, 26, 38, 40).

One of the issues in the Kirby proceeding was that Kaufmann, without Price's knowledge, had submitted a broker-dealer representation letter to the transfer agent to support removal of a restriction on a stock certificate pursuant to Rule 144. Kirby Initial Decision, 73 SEC Docket at 3578 n.33. Price testified in Kirby that the Rule 144 paperwork contained inconsistencies and he would have questioned Geiger and Kaufmann if he had seen it. Id., 73 SEC Docket at 3572 n.22. However, in the present proceeding, when Price was presented with Rule 144 paperwork containing inconsistencies, his supervisory review consistently failed to catch them. I find that Price's supervisory review of the Rule 144 paperwork was cursory, at best.

Price offered generally incredible testimony on some key matters. For example, Price believed in September 1998 that Geiger had lied to him about unregistered transactions involving Golden Eagle stock in the Kirby proceeding. Having made this rather damaging admission against his own interest, Price attempted to talk his way out of it at the hearing. Price maintained that he had no reason to believe that Geiger would mislead him as to unregistered transactions in Starnet stock. I reject that testimony as incredibly naive. In addition, Price expressed concern that, if he had discharged Geiger in September 1998 after the Kirby hearing, Geiger might have commenced a wrongful discharge suit. This testimony was puzzling. The evidence suggests that Geiger was an "at will" employee who could be discharged at any time. Moreover, it is standard in the securities industry that a predispute arbitration agreement would channel any litigation

between a brokerage firm and a discharged employee to a management-friendly arbitration forum. See New York Stock Exchange Rule 347; NASD Rule 10101. Price's inaction cannot be explained by his purported fear of litigation. Finally, Price's testimony about mailing Forms 144 to the Commission at the "wrong" address was baffling. Form 144, as then in effect and as currently in effect, contains a heading identifying the Commission's address as "Washington, D.C., 20549" (official notice). No street address for the Commission was provided on Form 144, then or now. Moreover, it is doubtful that a responsible brokerage firm would fail repeatedly to obtain proof of delivery, whether an overnight delivery ticket from a private courier or a certified mail receipt from the Postal Service.

Peeper's accounts at Spencer Edwards were very active. Geiger and Kaufmann produced large amounts of commission income for the firm. Revenues were spiking at Spencer Edwards (from $3.0 million in fiscal 1998 to $10.0 million in fiscal 1999 to $8.0 million in fiscal year 2000). If Price had curtailed Geiger's travel, Geiger's rainmaking might have been limited and that could have harmed Spencer Edwards's bottom line. In short, Price had a motive to overlook Geiger's and Kaufmann's involvement in unregistered sales of Starnet stock.

I agree with the Division that Price failed to exercise reasonable supervision over Geiger and Kaufmann with respect to unregistered transactions in Starnet stock between December 1998 and February 2001. I also agree with the Division that Price's deficient supervision is attributable to Spencer Edwards. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988); A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977).

For the reasons discussed above, the Division has failed to demonstrate that Geiger and Kaufmann willfully aided and abetted the antifraud violations by Carley and Zacharias. In these circumstances, Price and Spencer Edwards have not been proven to be deficient supervisors with respect to the antifraud violations alleged in the OIP.[44]

SANCTIONS

The Division seeks cease-and-desist orders against Carley, Zacharias, Gould, Geiger, and Kaufmann. It also requests associational bars against Gould, Geiger, Kaufmann, and Price, and an order of censure against Spencer Edwards. The Division seeks orders requiring accountings and disgorgement of ill-gotten gains, plus prejudgment interest, from all seven Respondents. Finally, it requests civil monetary penalties against Gould, Geiger, Kaufmann, Price, and Spencer Edwards.

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[44] The underlying antifraud violations ended more than five years before the Commission issued the OIP. See supra note 41 and infra p. 63. Price and Spencer Edwards could not be sanctioned for supervisory deficiencies associated with those violations through civil monetary penalties, registration revocations or suspensions, or an order of censure.

A. 28 U.S.C. § 2462.

Respondents have raised the statute of limitations as an affirmative defense in their Answers and amended Answers. Many of the unregistered transactions in Starnet stock, some of the required ownership reports, and all of the antifraud violations identified in the OIP occurred more than five years before the Commission issued the OIP.

The Division is not relying on misconduct occurring before September 1, 1999, to obtain associational bars, orders of censure, or civil monetary penalties against any Respondent (Order of Oct. 26, 2004, at 3-4; Division's More Definite Statement, dated Nov. 8, 2004; Prehearing Conference of Nov. 18, 2004, at 13-15). See 28 U.S.C. § 2462 (as interpreted by Johnson v. SEC, 87 F.3d 484, 488-91 (D.C. Cir. 1996), and 3M Co. v. Browner, 17 F.3d 1453, 1456-61 & n.14 (D.C. Cir. 1994)); see also Terry T. Steen, 53 S.E.C. 618, 623-25 (1998) (holding that the Commission will look only to wrongful conduct within the five-year period before the OIP to establish liability, but stating that it may consider a respondent's earlier conduct, when relevant, to establish motive, intent, or knowledge). Conversely, the Commission has determined that the five-year limitation period of 28 U.S.C. § 2462 does not apply to cease-and-desist orders, see Coxon, 80 SEC Docket at 3314 n.60; Moskowitz, 77 SEC Docket at 500-02, or to disgorgement relief, see Feeley & Willcox Asset Mgmt. Corp., 80 SEC Docket 2075, 2101 n.65 (July 10, 2003); Joseph J. Barbato, 53 S.E.C. 1259, 1279 & n.27 (1999).

B. Cease-and-Desist Orders.

The Division seeks cease-and-desist orders against Carley, Zacharias, Gould, Geiger, and Kaufmann (OIP ¶¶ III.C-III.E; Div. Br. at 47-49). It does not seek such orders against Price or Spencer Edwards.

Section 8A(a) of the Securities Act and Section 21C(a) of the Exchange Act authorize the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Securities Act, the Exchange Act, or the rules and regulations thereunder. The Commission may also impose a cease-and-desist order against any person that "is, was, or would be a cause of [a] violation" due to an act or omission the person "knew or should have known would contribute to such a violation."

In KPMG, 54 S.E.C. at 1183-92, the Commission addressed the standard for issuing cease-and-desist relief. It explained that the Division must show some risk of future violations. However, it also ruled that such a showing should be "significantly less than that required for an injunction" and that, "absent evidence to the contrary," a single past violation ordinarily suffices to raise a sufficient risk of future violations. Id. at 1185, 1191.

Along with the risk of future violations, the Commission considers the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the respondent's opportunity to commit future violations. Id. at 1192. In addition, the Commission considers whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial

function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceeding. Id. The Commission weighs these factors in light of the entire record, and no one factor is dispositive.

The U.S. Court of Appeals for the District of Columbia Circuit has insisted that the Commission adhere to the standards it announced in KPMG. See WHX Corp. v. SEC, 362 F.3d 854, 859-60 (D.C. Cir. 2004) (rejecting the Commission's explanation of the risk of future violations and vacating a cease-and-desist order).

Addressing these factors here, I conclude that the proven violations were serious and recurrent. They also involved the reckless disregard of regulatory requirements. No Respondent has offered assurances against future violations or recognized the wrongful nature of his conduct. On the other hand, the violations are not recent, and the Division has not presented evidence of harm to specific investors or to the market in general. The last two factors are outweighed by the other factors previously discussed. See Robert W. Armstrong, III, Securities Exchange Act Release No. 51920, 2005 SEC LEXIS 1497, at *66 (June 24, 2005) (imposing a cease-and-desist order against a respondent for misconduct that ended ten years earlier).

Zacharias is now a self-employed consultant who assists firms in raising capital by issuing securities (Tr. 1083-85, 1087). He can be expected to have a lengthy career in financial consulting and could readily repeat the type of misconduct proven here. There is no evidence that Carley has been employed by an issuer after 2001. Kaufmann and Gould will be barred from associating with brokers and dealers as a result of this Initial Decision. Nonetheless, cease-and-desist orders will help to ensure that Carley, Kaufmann, and Gould will take greater care to obey the law if they become active in the financial markets in the future. Geiger has not been active in the securities industry since January 2001, although his departure was hardly an act of free will. He is already subject to an order to cease-and-desist from future violations of Sections 5(a) and 5(c) of the Securities Act. See Kirby Opinion, 79 SEC Docket at 1108. A second such order will create no additional hardship for Geiger. I will impose cease-and-desist orders for all proven violations.

C. Associational Bars, Order of Censure.

The Division seeks sanctions under Section 15(b) of the Exchange Act against Gould, Geiger, Kaufmann, Price, and Spencer Edwards (OIP ¶ III.B; Div. Br. at 47-49). It does not seek sanctions under Section 15(b) against Carley or Zacharias.

Section 15(b)(6) of the Exchange Act, in conjunction with Section 15(b)(4)(D) of the Exchange Act, empowers the Commission to impose sanctions against persons associated with brokers or dealers if such persons willfully violated the Securities Act, the Exchange Act, or the rules or regulations thereunder. Specifically, the Commission may censure a broker or an associated person, place limitations on the activities or functions of that person, suspend that person for a period not exceeding twelve months, or bar that person from being associated with a broker or dealer. The Commission must find, on the record and after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest.

Section 15(b)(6) of the Exchange Act, in conjunction with Section 15(b)(4)(E) of the Exchange Act, provides that the Commission may impose the same sanctions on a supervisor for failing reasonably to supervise a person subject to his supervision, with a view to preventing violations of the Securities Act, the Exchange Act, or the rules or regulations thereunder.

The public interest analysis requires that several factors be considered, including: (1) the egregiousness of the respondent's actions; (2) the isolated or recurrent nature of the infractions; (3) the degree of scienter involved; (4) the sincerity of the respondent's assurances against future violations; (5) the respondent's recognition of the wrongful nature of his or her conduct; and (6) the likelihood that his or her occupation will present opportunities for future violations. Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). Such sanctions are not intended to punish a respondent but to protect the public from future harm. Leo Glassman, 46 S.E.C. 209, 211-12 (1975).

The proven violations were egregious. Although they continued from December 1998 to February 2001, I have only considered the violations after September 1, 1999, for purposes of Section 15(b) of the Exchange Act. These violations can hardly be described as isolated infractions. Proof of scienter is not required for the relevant violations. However, Gould, Geiger, and Kaufmann recklessly disregarded the securities registration provisions and Gould recklessly disregarded the requirements of Exchange Act Section 15(a)(1). Price's and Spencer Edwards's supervision of Geiger and Kaufmann approached willful blindness. These Respondents have offered no assurances against future violations or future supervisory lapses. Nor has there been any acknowledgement of the wrongful nature of the underlying conduct. In fact, these Respondents have raised a series of bogus defenses, including reliance on counsel, reliance on the transfer agent, and reliance on the clearing broker. There has been a clear effort to deflect any and all blame to others. In the absence of remedial action under Section 15(b) of the Exchange Act, there would be an opportunity for future violations and a risk to the public.

Gould has no prior disciplinary record in Canada or in the United States (Tr. 1482-83, 1504-05). Geiger, Kaufmann, Price, and Spencer Edwards have disciplinary records of varying age and severity.

In January 2003, the Commission barred Geiger from associating with any broker or dealer and from participating in any penny stock offering. See Kirby Opinion, 79 SEC Docket at 1108. In consideration of Geiger's then-clean disciplinary record, the Commission afforded him an opportunity to apply for reinstatement after five years. Id. The Commission also ordered Geiger to disgorge $14,109 in ill-gotten gains, plus prejudgment interest, and to pay a civil penalty of $300,000. Id. at 1108-09. Geiger has not paid these financial sanctions.[45]

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[45] On November 30, 2004, the Commission filed a civil action in U.S. District Court for the District of Colorado seeking an order requiring Geiger to comply with its prior order to pay financial sanctions. SEC v. Geiger, No. 04-CIV-2463 (WYD) (D. Colo.). On March 2, 2005, the district court entered a default judgment against Geiger. See Litigation Release No. 19129, 2005 SEC LEXIS 553 (Mar. 9, 2005).

In 1983, the Securities Division of the Commonwealth of Massachusetts charged Kaufmann with transacting a securities business in Massachusetts without being registered as an agent of a broker or dealer (DX 431). Kaufmann defaulted after initially participating in the proceeding. As a sanction, Kaufmann was prohibited from transacting a securities business in Massachusetts until he was properly registered (DX 431). Kaufmann has been properly registered and in good standing in Massachusetts since 1985 (Tr. 1962-63). I have given this twenty-year-old disciplinary action minimal weight here. Spencer Edwards has placed Kaufmann on heightened supervision twice, most recently in 2002 (Tr. 2124, 2160-61). Kaufmann has not been sanctioned for misconduct by the NASD or the Commission, and there are no arbitration awards or court judgments against him (Tr. 2165).

The Commonwealth of Massachusetts also alleged that Price transacted a securities business in Massachusetts without being registered as an agent of a broker or dealer (DX 432). Price settled the proceeding in 1985, without admitting or denying the allegation. He consented to the entry of an order directing him to cease and desist from transacting a securities business in Massachusetts until he was properly registered (DX 432). He also agreed not to apply for registration for one month (DX 432). I have given this twenty-year-old disciplinary action minimal weight here.

The NASD has subjected Spencer Edwards to progressive discipline between 1999 and 2002. On June 30, 1999, the NASD censured Spencer Edwards and fined it $5,000 for violations of NASD Rules and Exchange Act Rule 15c2-11 (DX 426). On February 29, 2000, the NASD censured Spencer Edwards, fined it $7,000, and required it to pay $625 in restitution to customers for violations of NASD rules relating to transaction reporting (DX 425). On July 8, 2002, the NASD censured Spencer Edwards and fined it $10,000 for violations of NASD trade reporting rules (DX 424).

I have given due regard to Gould's cooperation in providing extensive financial records to the Commission's staff investigators. I have also given appropriate consideration to Kaufmann's mitigating evidence, including his efforts to inquire into the pedigree of a Gelato Brats certificate (TK Ex. 11), his initiative in developing an equity authentication form that has been helpful to others (TK Ex. 6), and his willingness to ask questions of a Commission inspector visiting Spencer Edwards. However, I believe these factors are outweighed by the gravity of Kaufmann's offenses and the duration of the scheme. Kaufmann's knowledge of compliance issues is an aggravating factor (Tr. 2072).

Based on the proven violations after September 1, 1999, I will bar Gould, Geiger, and Kaufmann from associating with any broker or dealer, and I will censure Spencer Edwards, as requested by the Division.

I agree with the Division that Price should be barred from acting in a supervisory capacity with any registered broker or dealer. However, I conclude that it is not appropriate to suspend or bar Price from association with any broker or dealer in a non-supervisory capacity. The evidence in this record was confined to Price's shortcomings as a supervisor. There is no evidence of his unfitness to continue in the industry as a non-supervisory registered representative. Price has not received any customer complaints for his work as a registered

representative over a thirty-five-year career (Tr. 2114). See George J. Kolar, 70 SEC Docket 3103, 3142 (Oct. 28, 1999), aff'd, 77 SEC Docket 3400 (June 26, 2002).

D. Accounting and Disgorgement.

Pursuant to Section 8A(e) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act, the Division seeks orders requiring accountings and disgorgement of ill-gotten gains by all seven Respondents (OIP ¶¶ III.B-III.D; Div. Br. at 47-49).

1. Disgorgement.

Disgorgement seeks to deprive the wrongdoer of his ill-gotten gains. See First City, 890 F.2d at 1230-32. It returns the violator to where he would have been absent the violations. An order to disgorge a certain amount need only be a reasonable approximation of the profits causally connected to the violation. Id. at 1231.

Once the Division shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden of going forward shifts to the respondent to demonstrate clearly that the Division's disgorgement figure is not a reasonable approximation. SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996); SEC v. Patel, 61 F.3d 137, 140 (2d Cir. 1995). Any risk of uncertainty as to the disgorgement amount falls on the wrongdoer whose illegal conduct created the uncertainty. First City, 890 F.2d at 1232.

Carley

The Division has shown that the Peeper entities paid Carley $2,489,740 through his United Capital account (Tr. 1301-03; DX 3 at 2, 20). The payments were in connection with Carley's exercise of Starnet options and the sale of the resulting stock. Carley will be ordered to disgorge this amount.

The record also shows that Fiserv wired Madison Park Trust $1,205,578.38 in connection with the sale of Starnet stock from Madison Park Trust's account at Spencer Edwards (DX 2 at 40; DX 113). In addition, Rial Equity paid Madison Park Trust $482,000 in connection with the sale of Starnet stock (DX 3 at 20). The total proceeds to Madison Park Trust from the sale of Starnet stock were thus $1,687,578.38. Carley and his wife were the beneficiaries of Madison Park Trust. Carley has failed to sustain his burden of showing that the Madison Park transactions were subject to the Rule 144 safe harbor. On that basis, I will order Carley to disgorge the amounts paid to Madison Park Trust, as well.[46]

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[46] Carley faults the Division for failing to show that he received the funds disbursed to Madison Park Trust. It was enough for the Division to prove that Madison Park Trust received the funds and that Carley and his wife were Madison Park Trust's only beneficiaries. At that juncture, the burden of going forward shifted to Carley to show that he did not receive the funds. Carley failed to meet this burden.

The weight of the evidence does not show that Carley received any additional funds from the trading account in his name at Spencer Edwards. The Division established that Fiserv wired funds from this Spencer Edwards account to a client trust account that Brovarone opened for the benefit of Carley (DX 2 at 38-39). Carley demonstrated that Brovarone's procedures for handling the funds in this account were inexcusably lax.[47] In these circumstances, the Division has not explained why Carley should disgorge funds that Brovarone disbursed to others.[48]

I find that Carley received ill-gotten gains of $4,177,318.38, and I will order him to disgorge that amount.

Zacharias

The Division has shown that the Peeper entities forwarded $1,451,128.55 to accounts under Zacharias's control at First Marathon (DX 3 at 2, 24; Zach. Prop. Find. # 27). Zacharias will be ordered to disgorge this amount.

The weight of the evidence does not show that Zacharias received any additional funds from the trading account in his name at Spencer Edwards. The Division established that Fiserv wired funds from this Spencer Edwards account to a client trust account that Brovarone opened for the benefit of Zacharias (DX 2 at 42-43).[49] The Division asks me to infer that Zacharias must have benefited from the transfers of funds out of this client trust fund (Div. Prop. Find. ## 453-55, citing DX 3 at 24-25; but see Tr. 180-81). I decline to draw the requested inference. I will

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[47] Brovarone opened a client trust account for the benefit of Carley on March 23, 1999 (DX 33 at 7251). He could not recall who asked him to do so (Tr. 499-500). Brovarone never provided Carley an accounting of these funds (Tr. 715-16, 727-28). Brovarone never billed Carley for the services he performed, but rather, deducted his fees from the account without notice to Carley (Tr. 716-17). Carley only learned of the account's existence in late October 1999. When Carley attempted to withdraw funds from "his" client trust account, Brovarone and Gould rebuffed him (Tr. 725-26; Carley Ex. 30). At that juncture, Carley authorized Brovarone to take instructions concerning the account from Gould (Carley Ex. 31).

[48] Brovarone used this client trust account to transfer $1,115,500 to Le Fond Mondial; $162,900 to Rial Equity; and $9,950 to Starnet (Tr. 65-66, 241; DX 3 at 22). The weight of the evidence does not show that these transfers benefited Carley or were made at Carley's direction.

[49] Brovarone opened a client trust account for the benefit of Zacharias on March 23, 1999 (DX 33 at 7251). He could not recall Zacharias asking him to open the account and conceded that someone else may have done so (Tr. 499-501, 940-41). Zacharias did not learn of the account's existence until November 1999 (Tr. 1154-55). At that time, Gould told Zacharias not to worry about the client trust account, because the funds did not belong to Zacharias (Tr. 1156-57). On November 8, 1999, Zacharias authorized Brovarone to accept instructions from Gould concerning this client trust account (Tr. 1154-57; DX 276). Brovarone had not asked Zacharias for such an authorization when he opened the account seven months earlier (Tr. 948).

not order Zacharias to disgorge these funds merely because Brovarone received them and disbursed them to others.[50]

Zacharias made a persuasive showing that he did not know of the client trust account until November 1999, more than seven months after Brovarone opened it. The weight of the evidence also shows that Zacharias did not direct transfers of funds to or from the client trust account, and did not personally benefit from transfers of funds that Brovarone initiated from the client trust account (Tr. 171, 949-54, 1225-29).[51]

Gould

Gould received a fee of $1,006,308 for coordinating the transactions at the heart of the OIP (Tr. 1401, 1404-05, 1522-24; Gould Ex. 25). Because Gould used jurisdictional means, I reject his claim that he performed all the relevant work in Vancouver. I will require Gould to disgorge this amount. Gould will not be allowed a credit for any income taxes he may have paid on this fee. See infra pp. 73-74.

The Division showed that Celestine's trading proceeds were $25,221,084.02 (DX 3 at 23). The Division concedes that Celestine transferred some of these trading proceeds to others. To reflect these transfers, the Division reduced its demand for disgorgement by $7,124,268.52 (Div. Br., Attachment A, Transfers with Some Support).[52] I conclude that Gould has presented sufficient credible evidence that Celestine transferred even more of these trading proceeds to others (Gould Br., Appendix 3).[53] I will therefore reduce the amount subject to disgorgement by

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[50] There is an unexplained discrepancy of $2,998 between the proceeds generated by Zacharias's trading account at Spencer Edwards ($1,148,633.60) and the funds Fiserv wired to the client trust account controlled by Brovarone ($1,145,635.60) (DX 2 at 42, DX 3 at 24). There is no evidentiary basis for requiring Zacharias to disgorge the difference.

[51] Fiserv wired $390,468 to the Zacharias client trust account on March 24, 1999, one day after Brovarone opened the account (DX 2 at 43). Brovarone then wired $230,433 to Knight International and $159,950 to Starnet on April 1, 1999 (Tr. 175; Zach Ex. B). No evidence links Zacharias to Knight International (Tr. 950, 1227-28, 1532-33).

Fiserv transferred $755,177 to the Zacharias client trust account on October 20, 1999 (DX 2 at 43; Zach. Ex. B). Brovarone then wired $755,200 to Le Fond Mondial on November 10, 1999 (Tr. 66, 172-74, 180-81, 949-54; DX 3 at 1, 25). The weight of the evidence does not show that Zacharias ordered these transfers or benefited from them.

[52] The Division is willing to give Celestine credit for several line items that Gould identified in his posthearing pleadings (Div. Br., Attachment A, Transfers with Some Support). This includes transfers to Denmans.com (Gould Prop. Find. ## 317-20), Healthnet International and Net-Force Systems (Gould Prop. Find. ## 321, 328, 351), Geneva Overseas Holdings, Ltd. (Gould Prop. Find. ##330-31); and C.M. Buckley (Gould Prop. Find. # 349).

[53] The Division identified twelve items in Attachment A to its Brief as "Transfers Lacking Support." Gould's Brief, Appendix 3, attempts to rebut the Division's statement that these

another $5,259,472.71.[54] The amount to be disgorged from Celestine's trading proceeds is thus $12,837,342.79.[55]

Gould insists that funds flowed through Celestine's accounts at United Capital and did not come to rest with him or any member of his family. He contends that most of Celestine's transactions at United Capital benefited Starnet's employees, rather than its officers (Gould Ex. 78, Gould Ex. 79). To the extent that Gould has been able to support this claim with probative documentary evidence, I have given Celestine credit for reductions. I decline to make further reductions that are based on Gould's uncorroborated testimony.

Gould faults the Division for failing to prove that Celestine retained certain funds, or for failing to prove that he owned or controlled the recipients of Celestine's wire transfers (Gould Br. at 34-35). However, the burden of going forward is Gould's. The burden is formidable, given Celestine's casual recordkeeping practices. This is a classic application of First City, 890 F.2d at 1232, which held that the risk of uncertainty as to the disgorgement amount should fall on the wrongdoer whose illegal conduct created the uncertainty.

I will order Gould to disgorge $13,843,650.79. This amount represents Gould's fee of $1,006,308 and Celestine's net trading proceeds of $12,837,342.79.

Spencer Edwards, Kaufmann, and Geiger

The Division presented a summary exhibit showing the commissions earned by Spencer Edwards, Kaufmann, and Geiger on all Starnet trades from January 1999 through February 2001

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transfers lack support. I agree with Gould as to items 1, 5, 6, 8, and 9 of his Appendix 3. I agree with the Division that the remaining items in Gould's Appendix 3 lack appropriate documentary support.

[54] I agree with Gould that there is appropriate documentary support for Celestine's payment of $2 million to Dohlen on November 1, 1999 (Tr. 222-24; Gould Prop. Find. # 235); $900,000 to Knight International on June 20, 1999 (Gould Prop. Find. # 316); $1,575,856.41 to Dohlen and the Coziers for United Capital account # 3P1757B (Tr. 1569-71, 1575-78, 1593-95, 1619, 1623-26; DX 3 at 2, 23; Gould Prop. Find. # 337, Gould Ex. 80, Section E, Tab 2); $617,065 to Angeliki Doxa on August 20, 1999; and $166,551.30 to Janice Dohlen on May 16, 2000. Collectively, these payments equal $5,259,472.71.

[55] The Division also proposed to reduce the sum Gould should disgorge to reflect that Gould was a 50% owner of Celestine (Div. Prop. Find. # 466). See supra note 3. Gould rejected this olive branch (Gould Br. at 36). Celestine's other two owners may have received half the proceeds from Celestine's sale of 287,500 shares of Starnet (Tr. 1474, 1515-16). However, the Division could not quantify these proceeds because Celestine commingled these shares with others and the record does not clarify when or at what price Celestine sold these specific shares (Tr. 122-24; DX 2 at 7-8). In these circumstances, there is no legitimate basis for the Division's proposed reduction.

(Tr. 54, 108; DX 4). In preparing the exhibit, the Division assumed that Spencer Edwards retained 30% of the gross commissions, and that Kaufmann and Geiger split the remaining 70%. The Division then calculated the net commissions attributable to Kaufmann and Geiger under two scenarios: first, assuming a 50%-50% split, and then, assuming 25% went to Kaufmann and 75% went to Geiger (Tr. 55, 163; DX 4). In its posthearing pleadings, the Division shifted gears. It now argues that 70% of the net commissions should be attributable to Geiger and 30% to Kaufmann (Div. Prop. Find. ## 470, 475).

Kaufmann challenged the Division's methodology on several grounds, and presented his own summary exhibits (TK Ex. 1, TK Ex. 2, TK Ex. 4, TK Ex. 8). Geiger joined in Kaufmann's arguments.

The first of these challenges is easily resolved. The Division assumed that Spencer Edwards retained 30% of the gross commissions (DX 4). This assumption was based on Kaufmann's investigative testimony (Tr. 54-55, 127-29, 154, 1831). I find that the Division made a "reasonable approximation" within the meaning of First City, 890 F.2d at 1231. Kaufmann waffled on this point at the hearing (Tr. 1831) ("It would be in the 30% to 35% range."). Geiger also injected uncertainty, explaining that Spencer Edwards retained 30% to 45% of the gross commissions (Tr. 1677-79). However, I find that Kaufmann's and Geiger's hearing testimony was insufficient to sustain Respondents' burden of going forward. The weight of the credible evidence does not show that the Division's approximation of 30% for the house was wrong.[56]

At the hearing, the Division contended that the gross commissions earned by Spencer Edwards, Geiger, and Kaufmann through trading in Starnet were $2,766,550.90 (DX 4). Kaufmann argued that the OIP limited the Division to seeking disgorgement of commissions on trades executed for the Peeper accounts and Respondents. Kaufmann identified $80,996.96 in commissions listed on DX 4 that, in his judgment, were unrelated to the allegations in the OIP (Tr. 126, 128; TK Ex. 8). In its posthearing pleadings, the Division has modified its position, in part. The Division no longer seeks disgorgement of commissions on transactions by sellers "unrelated" to Respondents (Div. Prop. Find. ## 467, 472, 484; Div. Reply Br. at 27). The Division calculates the appropriate reduction to be $235,869.11.[57] Making an adjustment for sell

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[56] Spencer Edwards faults the Division for failing to review its payroll records to obtain independent verification that the firm kept 30% of the gross commissions (Tr. 154; Spencer Edwards Prop. Find. # 67). The argument is exactly backwards. If Spencer Edwards wanted to challenge the Division's approximation, Spencer Edwards bore the burden of offering its own payroll records as an exhibit. Spencer Edwards failed to do so.

[57] The Division has not provided any work papers to show how it made its posthearing reduction of $235,869.11 in DX 4. In other words, the record contains nothing for Spencer Edwards, Kaufmann, and Geiger that is comparable to Appendix A of the Division's Brief, which explains the reductions the Division is willing to make in its request for disgorgement by Gould.

On the one hand, the absence of such work papers might be brushed off on the grounds that Kaufmann only sought a reduction of $80,996 (TK Ex. 8), and the Division is now stipulating to a reduction of $235,869.11 for commissions earned on trades by sellers unrelated

transactions by sellers unrelated to Respondents, the Division reduced the gross commissions sought to be disgorged to $2,530,681.79 (Div. Prop. Find. ## 467, 472, 484).

It is unfair to expect Spencer Edwards, Kaufmann, and Geiger to accept the Division's reduction without a sufficient explanation. Accordingly, I will order the Division to provide Spencer Edwards, Kaufmann, and Geiger with copies of the work papers relating to the $235,869.11 reduction in DX 4. If Spencer Edwards, Kaufmann, or Geiger believe the Division has been too miserly in making specific reductions, they may attempt to negotiate a stipulation with the Division. Failing that, they may appeal to the Commission.

I will order Spencer Edwards to disgorge $759,204.54, an amount equal to 30% of $2,530,681.79. This sum will be subject to reduction for the reasons identified in the immediately preceding paragraph.

I will order the remaining 70% of the relevant commissions to be disgorged by Kaufmann and Geiger. The amount is $2,530,681.79 x 70% = $1,771,477.25. The question is how to apportion this amount between these two Respondents.[58]

Kaufmann testified that he executed trades for Starnet's officers, while Geiger executed trades for the Peeper accounts and handled all the other transactions relevant to this proceeding. Kaufmann also presented exhibits showing that he earned commissions of no more than $32,527 or $33,397 on the relevant Starnet transactions (TK Ex. 1, TK Ex. 2). However, Kaufmann cannot disavow his joint account executive number that easily. I find Kaufmann's testimony about the division of labor incredible and give little weight to the exhibits that are based on it. Kaufmann and Geiger were partners, and they acted together on all the transactions at issue.

Kaufmann and Geiger also asserted that they split commissions on a sliding scale that varied from month to month (Tr. 1680-83, 1831, 1846-47, 2211-17; DX 458). During the investigation, Geiger testified that his split ranged from 50% to 70%, and Kaufmann's split

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to Respondents (Div. Prop. Find. # 467; Div. Reply Br. at 27). Presumably, the Division's cryptic reference to "unrelated" sellers excludes trades for Geiger's wife (Connie Geiger), mother-in-law (Carol Faulkner), and other in-laws (e.g., Mel Van Diest) identified in TK Ex. 8 (Tr. 1654; DX 4). I infer that the Division's position is the same for sellers who may be related to Kaufmann, such as customers Thomas E. Kaufmann and Kaufmann Trust, and for sellers who may be related to Michaels, such as customer Deb Michaels (TK Ex. 8). I reject Kaufmann's argument that such commissions should not be subject to disgorgement (TK Ex. 8).

[58] Because Kaufmann and Geiger were partners who shared a single account executive number, joint and several liability for any disgorgement amount may have been appropriate. See Card v. Stratton Oakmont, Inc., 933 F. Supp. 806, 816 (D. Minn. 1996) (confirming an arbitration award that held two respondents jointly and severally liable for damages because they were partners who split commissions); see also Colo. Rev. Stat. § 7-60-115(1)(a) (partners may be jointly and severally liable for partnership debts in Colorado). However, the Division stipulated that it would not seek joint and several liability against the seven actively defending Respondents (Order of Oct. 26, 2004, at 2-3; Division's More Definite Statement of Nov. 9, 2004, at 1).

ranged from 50% to 30% (Tr. 1680-83). At the hearing, Kaufmann presented an unsigned, handwritten contract showing that his monthly split ranged from 45% to 24%, and Geiger's monthly split ranged from 55% to 76% (DX 458). The contract also stated: "Expenses in same proportion" (DX 458).

I do not find Kaufmann's and Geiger's testimony about the sliding scale of commission splits credible. First, I find it doubtful that Kaufmann, the college-trained engineer with an MBA, subordinated himself to Geiger, the high school graduate nine years his junior. Peeper had been Kaufmann's customer since 1984, three years before Geiger even entered the securities industry. Second, there is no evidence that anyone in the Spencer Edwards back office even saw the unsigned, handwritten contract (Tr. 2215-16). Third, Kaufmann's claim that he paid half of Michaels's base salary must be harmonized with a contemporaneous document, DX 458, providing that Kaufmann and Geiger split their expenses in the same proportion as they split their commissions. Kaufmann's efforts to explain this apparent discrepancy were not persuasive (Tr. 2214). Finally, I note that the Kirby proceeding determined that Geiger generally received a 50% split of the joint commissions during 1996. See Kirby Initial Decision, 73 SEC Docket at 3555; Kirby Opinion, 79 SEC Docket at 1093 n.37.[59]

I conclude that Kaufmann's and Geiger's testimony, along with DX 458, are a ploy to shift the lion's share of the joint commission income to Geiger, so that Kaufmann's personal liability for disgorgement will be minimized. Geiger has yet to pay the financial sanctions imposed in the Kirby proceeding, and there is little reason to assume that he will promptly pay any financial sanctions imposed in this proceeding. Thus, the ploy is to shift most of the commission income away from Kaufmann and toward Geiger, and then to let Geiger ignore any order to disgorge it. The situation was exactly the opposite in Kirby: because Kaufmann was not a respondent in that proceeding, Geiger had an incentive to attribute a higher percentage of their joint commission income to Kaufmann. Consistent with Kirby, and with Kaufmann's claim that he paid 50% of Michaels's monthly base salary, I infer that Kaufmann and Geiger split the commission income earned under their joint account number on a 50%-50% basis at the times relevant to this proceeding.

Kaufmann also argued that the expenses he incurred, such as federal and state income taxes withheld by Spencer Edwards and the salary and bonuses he and Geiger paid to Michaels, their assistant, should be deducted from any amount ordered to be disgorged (Tr. 130-31; TK Ex. 1, TK Ex. 2). Geiger assumed that the employee's share of FICA withholding should also be excluded from any sum ordered to be disgorged (Tr. 1677-79). The case law holds otherwise. Respondents are not entitled to deduct taxes, business expenses, and overhead from their ill-gotten gains. SEC v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 16 (D.D.C. 1998); SEC v. Great Lakes Equities Co., 775 F. Supp. 211, 214-15 (E.D. Mich. 1991); SEC v. Benson, 657 F. Supp. 1122, 1134 (S.D.N.Y. 1987), SEC v. World Gambling Corp., 555 F. Supp. 930, 935 (S.D.N.Y. 1983); see also Laurie Jones Canady, 54 S.E.C. 65, 84 n.35 (1999) (Canady I), pet. denied, 230 F.3d 362 (D.C. Cir. 2000).

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[59] Kaufmann was not a party in Kirby, and the findings in that proceeding are not res judicata as to him. Geiger was a party in Kirby. He did not show by competent evidence that the commission split in effect during 1996 changed in subsequent years.

I agree with the Division that income taxes withheld should not be deducted in reaching an appropriate disgorgement figure. Kaufmann has offered no evidence of what income taxes he in fact paid or what rights he may have to offset disgorgement in future tax years.

It is somewhat surprising that the Division is willing to allow Kaufmann and Geiger a deduction for the estimated cost of Michaels's base salary ($3,000 per month x 26 months = $78,000) (Div. Prop. Find. ## 469, 474; Div. Reply Br. at 27).[60] Michaels had very little to do with Starnet (Tr. 1829). I find that Michaels's estimated monthly salary represented the full range of duties he performed for Spencer Edwards. In these circumstances, I find the Division's concession improvident, and I decline to be bound by it.

Net commissions earned by Kaufmann and Geiger on the relevant trades were $1,771,477.25. No further deduction will be allowed for Michaels's salary. Attributing 50% to Kaufmann and 50% to Geiger, I conclude that each should disgorge $885,738.62.

Price

The Division lacks a coherent or consistent theory as to disgorgement by Price. At the early stages of the proceeding, the Division maintained that it could not recommend a specific disgorgement amount until after Price had made an accounting (Div. Prehearing Br. at 30; Tr. 9-11). It also conceded that DX 4 would not be helpful in calculating the sum to be disgorged from Price (Tr. 357). In its posthearing pleadings, the Division requests that Price disgorge $379,602.27 (Div. Prop. Find. ## 481-82; Div. Br. at 49). But see Div. Br. at 44 ("Disgorgement . . . should be ordered against all respondents except Price.").

I agree with Price that the Division's posthearing pleadings create a disgorgement sum out of thin air. To make matters worse, the Division's posthearing theory involves punitive double counting, as both Price and Spencer Edwards would be required to disgorge the same amount.

In Kenneth L. Lucas, 51 S.E.C. 1041, 1046-47 (1994), the Commission reviewed a disciplinary action in which the NASD had held two officers of a broker-dealer liable for failing to supervise adequately certain employees who charged customers unfair, fraudulent markups on the sale of securities. The NASD ordered the deficient supervisors to disgorge $100,048 jointly and severally with the respondents who committed the primary violation. The Commission reversed and remanded, noting that the officers had failed to supervise and were not primary violators. It also observed that the transactions at issue did not account for a large percentage of the brokerage firm's overall business. Finally, the Commission found that the record did not

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[60] Kaufmann testified that he and Geiger paid Michaels a base salary plus a bonus, amounting to $2,400 to $3,500 per month (Tr. 1829). In contrast, Kaufmann's exhibits assumed that Michaels received $3,500 to $5,000 per month (TK Ex. 1, TK Ex. 2). Kaufmann's exhibits also stated that he and Geiger paid Michaels a base salary of $3,400 per month (Tr. 2193; TK Ex. 1 n.8). Kaufmann did not explain the discrepancies. Nor did Kaufmann offer any source documents, such as Spencer Edwards's payroll records, to support his claims.

reflect the amount, if any, by which the officers individually profited from the firm's trades in the security at issue. The current record has the same deficiencies as to Price.

At times, Price did not receive a salary for serving as president or compliance officer of Spencer Edwards (Tr. 2019). At other times, he drew a salary of $3,000 per month for performing supervisory duties (Tr. 2288-89). The record does not show how much salary, if any, Price may have received for performing supervisory duties between December 1998 and February 2001. Nor does it show how much of that supervisory salary, if any, was related to Spencer Edwards's Starnet business.[61] Finally, the record does not show whether Price executed any Starnet trades for his own account or for the accounts of his customers between December 1998 and February 2001. In these circumstances, the record will not support an order of disgorgement against Price.

2. Accountings.

Sections 21B(e) and 21C(e) of the Exchange Act permit the Commission to order an accounting and disgorgement. As a practical matter, there is a fork in the road. The Division can either ask for an accounting, to be followed by a request to disgorge a fixed sum, or it can ask for disgorgement of a fixed sum. Here, the Division wants to take both forks. It asks for fixed sum disgorgement, to be followed by post-proceeding accountings.

A post-proceeding accounting is little more than a belt-and-suspenders mechanism to ensure that the disgorgement ordered during the proceeding is accurate. See SEC v. Randy, 38 F. Supp. 2d 657, 674 (N.D. Ill. 1999). In theory, if a post-proceeding accounting shows that a respondent actually benefited by more than the disgorgement amount ordered in the underlying proceeding, then the Division may petition the Commission to reopen the proceeding and increase the amount of disgorgement. Id. Conversely, if a respondent provides evidence during a post-proceeding accounting that the amount of ill-gotten gains is less than the disgorgement award in the underlying proceeding, then, in theory, the respondent may petition the Commission to reopen the proceeding and decrease the amount of disgorgement. Id. Randy was a default case. After the district court issued its default order, the post-proceeding accounting never took place.

In practice, a post-proceeding accounting presents a case management nightmare. In Canady I, 54 S.E.C. at 84, the Commission ordered the respondent to disgorge a fixed sum, less specified set-offs as substantiated by an accounting. After the Commission's opinion was affirmed on judicial review, see 230 F.3d 362 (D.C. Cir. 2000), it took eighteen months to resolve the accounting issue, and another six months to complete payment on the installment plan. Canady made a first accounting in June 2001, and when the Division objected to its superficiality, she made a second accounting in October 2001. The matter was then the subject of a second Initial Decision. Laurie Jones Canady, 76 SEC Docket 1066 (Nov. 26, 2001) (Canady II). Canady then appealed to the Commission and, ultimately, settled the proceeding.

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[61] Although the Commission asserts authority to require disgorgement of salary, it has been cautious in exercising that authority. See Rita J. McConville, Securities Exchange Act Release No. 51950, 2005 SEC LEXIS 1538, at *57 n.64 (June 30, 2005).

Laurie Jones Canady, 77 SEC Docket 1384 (Apr. 19, 2002) (Canady III). The irony was that the modest amount by which Canady was able to reduce the sum to be disgorged was more than offset by the increase in interest she owed. The Commission authorized Canady to make installment payments, which added another six months to the collection process. Laurie Jones Canady, 79 SEC Docket 984 (Dec. 30, 2002) (Canady IV).

There are no Commission opinions setting standards for when a post-proceeding accounting is appropriate. I am aware of two judicial opinions denying requests for post-proceeding accountings by private parties in similar circumstances. See First Commodity Traders, Inc. v. Heinhold Commodities, Inc., 766 F.2d 1007, 1011 (7th Cir. 1985); Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co., 122 F. Supp. 2d 444, 465 (S.D.N.Y. 2000), rev'd in part on other grounds, 302 F.3d 18 (2d Cir. 2002).

If the Division believes that it should automatically obtain an order for a post-proceeding accounting every time it asks for one, it may urge the Commission to adopt such a policy. Bifurcated administrative proceedings (liability first, sanctions later) can then become the default rule.

In the absence of such a policy, and in light of Canady I, Canady II, Canady III, and Canady IV, I have considered the following factors: (1) whether the Division has made a particularized showing that there were reasonable grounds for failing to adduce the missing accounting evidence at the hearing, cf. Rule 452 of the Commission's Rules of Practice; (2) whether the Division had an opportunity to request access to the relevant financial records during its investigation; (3) whether the available financial data have been examined by the Division's staff investigators; (4) whether Respondents' accounts are so complicated that a normal request for disgorgement of a fixed sum is impractical; (5) how long the litigation has been pending; and (6) the need for finality.

Every one of these factors counsels against a post-proceeding accounting here. The Division has been less than forthcoming about its reasons for seeking a post-proceeding accounting, but its position boils down to an acknowledgement that it might have missed something and it wants a second chance. The Division never even asked Carley to testify during its investigation (Tr. 1234-35). Zacharias did not testify during the investigation, either (Tr. 1078). Kaufmann, Geiger, and Price each testified during the investigation; however, the Division never asked Geiger or Spencer Edwards to provide an accounting at that time (Tr. 138, 155-56). Non-party Celestine is the only entity whose financial affairs can fairly be characterized as complicated, and Gould voluntarily provided a partial accounting during the Division's investigation (Tr. 1578; Gould Ex. 80, Tab B). He also made an exhaustive accounting at the hearing. The Division is silent as to what, if anything, it expects a further accounting by Gould to show. Gould represents that his ability to make an accounting has reached an end. After reviewing his extensive exhibits and considering his testimony, I believe that Gould has provided everything that he is able to provide.

If the Division wanted additional financial data from Spencer Edwards about markups and markdowns on Starnet transactions, it could have asked for such information during the investigation. The events under scrutiny ended in February 2001. The Division began its

investigation on March 13, 2001 (Tr. 787). The need for finality is obvious. Moreover, a post-proceeding accounting would be pointless as to Spencer Edwards and Gould. Both have presented credible evidence of an inability to pay. See infra pp. 79-81. The Division's request for post-proceeding accountings is denied.

E. Prejudgment Interest.

Section 8A(e) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act provide that the Commission may order disgorgement, "including reasonable interest," in any administrative proceeding in which a cease-and-desist order is sought or a civil monetary penalty could be imposed. These statutory provisions also authorize the Commission to adopt rules and regulations and issue orders concerning rates of interest and periods of accrual. The Commission promulgated Rule 600 of its Rules of Practice, Interest On Sums Disgorged, in 1995.

The Division contends that the starting date for the computation of prejudgment interest should be March 1, 2001 (Tr. 266-67). Respondents do not challenge the Division's position.

I will enter an order requiring the Division to provide schedules showing the applicable rates of interest and the amount of prejudgment interest that has accrued on the sums ordered to be disgorged. The Division's schedules must show, on a Respondent-by-Respondent basis, the relevant data between March 1, 2001, and the date of this Initial Decision. Such schedules shall be filed and served within seven days after the date of the Initial Decision. If Respondents dispute the Division's calculations, they may raise the issue on appeal to the Commission.

F. Civil Monetary Penalties.

An order of disgorgement (even with prejudgment interest) merely requires the return of wrongfully obtained profits. Disgorgement does not result in any actual economic penalty or act as a financial disincentive to engage in securities law violations. See SEC v. Morgan, 944 F. Supp. 286, 296 (S.D.N.Y. 1996). The Division therefore argues that substantial monetary penalties, in addition to the disgorgement of ill-gotten gains, is necessary to punish Respondents and deter others from engaging in securities law violations that otherwise may provide significant financial returns to the violators.

Under Section 21B(a) of the Exchange Act, the Commission may assess a civil monetary penalty if a respondent has willfully violated or willfully aided and abetted any violations of the Securities Act, the Exchange Act, or the rules or regulations thereunder. It may also assess a civil monetary penalty if a respondent has failed reasonably to supervise another person who has committed such violations. The Commission must find that such a penalty is in the public interest. Six factors are relevant to the public interest determination: (1) fraud, or the deliberate or reckless disregard of a regulatory requirement; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) deterrence; and (6) such other factors as justice may require. See Section 21B(c) of the Exchange Act. Not all factors may be relevant in a given case, and the factors need not all carry equal weight.

Section 21B(b) of the Exchange Act specifies a three-tier system identifying the maximum amount of a penalty. All of the violations in this proceeding occurred after December 9, 1996, and nearly all of them occurred before February 3, 2001.[62] For each such "act or omission" by a corporation, the adjusted maximum amount of a penalty is $55,000 in the first tier; $275,000 in the second tier; and $550,000 in the third tier. For each such "act or omission" by a natural person, the adjusted maximum amount of a penalty is $5,500 in the first tier; $55,000 in the second tier; and $110,000 in the third tier. A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement. A third-tier penalty not only must have involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but also must have "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission."

The adjusted statutory maximum amount is not an overall limitation, but a limitation per violation. See Mark David Anderson, 80 SEC Docket 3250, 3270 (Aug. 15, 2003) (imposing a civil penalty of $1,000 for each of the respondent's ninety-six violations); cf. United States v. Reader's Digest Ass'n., 662 F.2d 955, 966, 970 (3d Cir. 1981) (holding that each individual mailing constitutes a separate violation of an FTC consent order).

The Division seeks third-tier civil penalties against Gould, Geiger, Kaufmann, Price, and Spencer Edwards (OIP ¶ III.B; Div. Br. at 48 n.27). No civil penalties are sought from Carley or Zacharias.

Addressing the six factors that guide the public interest analysis under Section 21B, I conclude that the proven violations involved the reckless disregard of the securities registration requirements. With the exception of Price, Respondents were unjustly and substantially enriched. Significant penalties are necessary to deter misconduct by others. There is no quantifiable harm to others. Prior violations have been summarized above.

Based on the proven violations occurring after September 1, 1999, I will impose third-tier civil penalties of $500,000 against Gould, $400,000 against Geiger, and $300,000 against Kaufmann. A second-tier penalty is appropriate against Price because his multiple supervisory failures involved reckless disregard of regulatory requirements by Geiger and Kaufmann. Cf. Kolar, 77 SEC Docket at 3410 & n.20 (citing Consol. Inv. Servs., Inc., 52 S.E.C. 582, 590 (1996)). The Division failed to make the required showing for a third-tier penalty against Price. A third-tier penalty is appropriate against Spencer Edwards, because its multiple supervisory failures also resulted in substantial pecuniary gains to the firm. I will impose a third-tier

[62] As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 9, 1996, and, again, for violations occurring after February 2, 2001. See 17 C.F.R. §§ 201.1001, .1002. For present purposes, I have only considered violations occurring after September 1, 1999.

penalty of $200,000 against Spencer Edwards and a second-tier penalty of $150,000 against Price.[63]

G. Inability to Pay.

Under Section 21B(d) of the Exchange Act, in any case in which the Commission may impose a civil penalty, a respondent may present evidence of the respondent's ability to pay the penalty. The Commission may, in its discretion, consider such evidence in determining whether a civil penalty is in the public interest. Such evidence may relate to the extent of the respondent's ability to continue in business and the collectability of the penalty, taking into account any other claims of the United States or of third parties on the respondent's assets and the amount of the respondent's assets.

The gravity of a respondent's violations may occasionally trump even undisputed evidence about the respondent's present inability to pay a penalty. See Charles Trento, 82 SEC Docket 785, 793 n.22 (Feb. 23, 2004).

Although no statutory requirement addresses inability to pay disgorgement or interest, the Commission may also consider evidence of ability to pay as a factor in determining whether a respondent should be required to pay disgorgement and interest. See Rule 630(a) of the Commission's Rules of Practice. As the Commission recognized in Comment (a) to Rule 601 of its Rules of Practice, "collection of disgorgement, interest, and penalties becomes increasingly more difficult the longer it is delayed."

Well before the hearing, I advised Respondents that, if they intended to claim inability to pay disgorgement, interest, or civil penalties, they were required to submit sworn financial statements, as well as supporting income tax returns, at the hearing (Prehearing Conference of Oct. 12, 2004, at 31-34; Order of Oct. 13, 2004, at 2). See Rule 630 of the Commission's Rules of Practice; Steen, 53 S.E.C. at 626-28 (holding that an ALJ may require the filing of sworn financial statements). Carley, Geiger, Kaufmann, and Zacharias did not submit sworn financial statements or income tax returns, and the Division did not have an opportunity to question them about their financial circumstances. I conclude that these four Respondents have waived any claim of inability to pay. Gould, Price, and Spencer Edwards did submit extensive evidence on this subject, and the Division cross-examined them (Tr. 2257-89).

Price's sworn financial statement shows a net worth of less than $1 million. He is sixty-three years of age, and his primary assets are his pension account and the equity in his house. The supervisory bar imposed in this Initial Decision is unlikely to have a significant adverse impact on Price's ability to earn an income as a non-supervisory registered representative. The civil penalty imposed in this Initial Decision equals approximately 16% of Price's reported net

[63] The Initial Decision in Steven E. Muth, 83 SEC Docket 3701, 3746 (Oct. 8, 2004), also imposed a third-tier civil penalty against a deficient supervisor. That sanction is under review by the Commission.

worth. The public interest does not warrant any reduction in that sanction on the grounds of inability to pay.

Spencer Edwards's sworn financial statement shows a net worth of $213,363. One of its major assets ($104,149) is a clearing deposit with Fiserv. That asset is not available to satisfy financial sanctions if Spencer Edwards is to remain in business. The firm's November 30, 2004, FOCUS report shows excess net capital of $31,093.[64] Spencer Edwards reported net losses in 2000, 2001, 2002, and 2004, and a net gain of $126,840 in 2003. The financial sanctions imposed in this Initial Decision include disgorgement of $759,204.54, four years of prejudgment interest, and a $200,000 civil penalty. I agree with Spencer Edwards that such financial sanctions are beyond its ability to pay, now or in the reasonably foreseeable future.

I have considered whether the owners of Spencer Edwards should simply be left to make any necessary infusions of capital so that the firm can satisfy the financial sanctions. Price is a 45% owner of the firm, and he has already been sanctioned once. The other owners of Spencer Edwards acquired their 55% interest in December 2002 (Tr. 2273). Justice does not require the other owners to infuse additional capital into the firm to pay sanctions for supervisory failures that occurred before their arrival.

By seeking only a censure against Spencer Edwards, the Division has signaled that it does not intend to drive the firm out of business. Having made that conscious and principled decision, the Division cannot suggest that it is in the public interest to drive Spencer Edwards out of business with crippling financial sanctions. It is in the public interest to waive Spencer Edwards's civil penalty and reduce its disgorgement and prejudgment interest to $25,000.

Gould's sworn financial statement reports a net worth of less than $2 million and an annual income in the low-to-mid six figures. Gould's personal financial records (unlike Celestine's) are in good order. There is no evidence that Gould has undisclosed assets hidden abroad.

This Initial Decision bars Gould from associating with brokers and dealers in the United States. Gould has not shown whether the associational bar will have adverse collateral consequences for his ability to remain in the securities business in Canada. He merely suggested that it "could" have such consequences (Gould Br. at 29-30). Gould is fifty-seven years of age. The financial sanctions imposed in this Initial Decision include disgorgement of $13,843,650.79, four years of prejudgment interest, and a $500,000 civil penalty. Such financial sanctions are beyond Gould's ability to pay, now or in the reasonably foreseeable future.

The Division focuses on the need for deterrence. It ignores the statutory issue of collectability. However, in First Securities Transfer Systems, Inc., 52 S.E.C. 392, 397 (1995), the Commission wrote:

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[64] In 1975, the Commission adopted the Financial and Operational Combined Uniform Single (FOCUS) report as part of an effort to streamline financial and operational reporting by brokers and dealers.

> We are cognizant of the inadvisability of assessing penalties so heavy that the persons against whom they are assessed are unable to pay them. Such a situation results in the expenditure of agency resources in unsuccessful attempts to collect the penalties. Moreover, the imposition of a sanction that cannot be enforced may ultimately render the deterrent message intended to be communicated by the sanction less meaningful.

The Government Accountability Office (formerly the General Accounting Office) has made the same point when advising Congress about the Commission's record of turning assessed penalties into cash:

> Levying fines is an important mechanism that regulators use to sanction those who violate securities . . . industry rules. However, for fines to be an effective means of ensuring adherence with the rules, regulators must collect them.

Report to the Ranking Minority Member, Committee on Energy and Commerce, House of Representatives, SEC and CFTC: Most Fines Collected, but Improvements Needed in the Use of Treasury's Collection Service 1 (GAO-01-900) (General Accounting Office, July 2001).

When a respondent properly invokes Section 21B(d) of the Exchange Act, two principles emerge from the Commission's First Securities opinion: (1) financial sanctions should be imposed with due regard for collectability, so as to avoid to the extent possible the imposition of sanctions that are likely to be uncollectible; and (2) the collection of financial sanctions is as much, if not more, of a deterrent to misconduct as the imposition of showplace sanctions. Consideration of collectability should not lead down a path to the assessment of financial sanctions that are so low that they lack any meaningful deterrent value. On the other hand, consideration of deterrence should not lead down a path to the assessment of financial sanctions that are so high that they lack any meaningful prospect of being turned into cash.

It is in the public interest to waive Gould's civil penalty and reduce his disgorgement and prejudgment interest to $1,000,000. That sum equals 54% of Gould's reported net worth, and takes into account his significant future earning capacity. See JCC, Inc. v. CFTC, 63 F.3d 1557, 1572 (11th Cir. 1995) (affirming a civil penalty that equaled 71% of a respondent's version of his net worth).

Reducing the financial sanctions against Spencer Edwards and Gould now also adds transparency to the Commission's processes. If the agency were to wait three or four years before writing off these uncollectible financial sanctions, that transparency would be lost. Financial sanctions may be imposed with fanfare, but, at present, they are written off without an equivalent level of public notice.

Gould, Price, and Spencer Edwards are reminded of the need to keep current their confidential financial disclosure statements in the event that the Commission reviews this Initial Decision. See Rules 410(c) and 630(b) of the Commission's Rules of Practice.

RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, I certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on March 31, 2005, as revised on April 19, 2005.

ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, John A. Carley shall cease and desist from committing or causing any violations or future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b) and 13(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 10b-5, 12b-20, 13a-1, and 13a-11;

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Christopher H. Zacharias shall cease and desist from committing or causing any violations or future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Sections 10(b), 13(a), and 16(a) of the Securities Exchange Act of 1934, and Exchange Act Rules 10b-5, 12b-20, 13a-1, 13a-11, and 16a-3;

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Roy E. Gould shall cease and desist from committing or causing any violations or future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 and Section 15(a)(1) of the Securities Exchange Act of 1934;

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933, Eugene C. Geiger and Thomas E. Kaufmann shall cease and desist from committing or causing any violations or future violations of Sections 5(a) and 5(c) of the Securities Act of 1933;

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Roy E. Gould, Eugene C. Geiger, and Thomas E. Kaufmann shall be barred from associating with any broker or dealer;

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Edward H. Price shall be barred from associating with any broker or dealer in a supervisory capacity;

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b) of the Securities Exchange Act of 1934, Spencer Edwards, Inc., shall be censured;

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Sections 21B and 21C of the Securities Exchange Act of 1934, John A. Carley shall disgorge $4,177,318.38; Christopher H. Zacharias shall disgorge $1,451,128.55; Roy E. Gould

shall disgorge $13,843,650.79; Spencer Edwards, Inc., shall disgorge $759,204.54; Eugene C. Geiger shall disgorge $885,738.62; and Thomas A. Kaufmann shall disgorge $885,738.62; each of these disgorgement amounts shall include prejudgment interest computed as set forth in Rule 600 of the Rules of Practice of the Securities and Exchange Commission, and prejudgment interest shall start to run on March 1, 2001;

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, Roy E. Gould shall pay a civil penalty of $500,000; Eugene C. Geiger shall pay a civil penalty of $400,000; Thomas E. Kaufmann shall pay a civil penalty of $300,000; Spencer Edwards, Inc., shall pay a civil penalty of $200,000, and Edward H. Price shall pay a civil penalty of $150,000;

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, the civil monetary penalty against Spencer Edwards, Inc., is waived and the disgorgement and prejudgment interest against Spencer Edwards, Inc., are reduced to $25,000 in view of Spencer Edwards, Inc.'s, demonstrated inability to pay;

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, the civil monetary penalty against Roy E. Gould is waived and the disgorgement and prejudgment interest against Gould are reduced to $1,000,000 in view of Gould's demonstrated inability to pay; and

IT IS FURTHER ORDERED THAT, within seven days after the service of this Initial Decision, the Division of Enforcement of the Securities and Exchange Commission shall file and serve (a) a chart showing its computation of prejudgment interest on the sums to be disgorged and (b) a chart showing how it arrived at its proposal to reduce disgorgement of commissions by $235,869.11 on transactions by sellers unrelated to Eugene C. Geiger and Thomas A. Kaufmann.

Payment of the civil penalties, disgorgement, and prejudgment interest shall be made on the first day following the day this Initial Decision becomes final. Payment shall be made by wire transfer, certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the Securities and Exchange Commission. The payments, and a cover letter identifying the Respondents and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and the instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after the service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision pursuant to Rule 111 of the Commission's Rules of Practice. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact.

The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact, or unless the Commission determines on its own initiative to review this Initial Decision as to any party. If any of these events occur, the Initial Decision shall not become final as to that party.

At any time following a notice of finality of this Order, the Division of Enforcement may petition the Commission to (1) reopen this matter to consider whether Spencer Edwards, Inc., and Roy E. Gould provided accurate and complete financial information at the time they made representations about their inability to pay financial sanctions, and (2) seek an order directing payment of disgorgement, prejudgment interest, and civil penalties up to the amounts specified in this Initial Decision. No other issue shall be considered in connection with such a petition other than whether the financial information provided by Spencer Edwards, Inc., and Roy E. Gould in support of their claims of inability to pay was fraudulent, misleading, inaccurate, or incomplete in any material respect.

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James T. Kelly
Administrative Law Judge