ADMINISTRATIVE PROCEEDING
FILE NO. 3-4495

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

DELTA STEEL CORPORATION :

(24SF-4052) :

Securities Act of 1933 - :
Section 3(b) and Regulation A

FILED
1974
SECURITIES & EXCHANGE COMMISSION

# INITIAL DECISION

Washington, D.C.
December 3, 1974

Max O. Regensteiner
Administrative Law Judge

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APPEARANCES: David P. Goss and Carl B. Noelke, of the Commission's San Francisco Branch Office, for the Division of Corporation Finance.

Hal Howard, for Delta Steel Corporation.

BEFORE: Max O. Regensteiner, Administrative Law Judge

On May 29, 1974, the Commission issued an order, pursuant to Rule 261 under the Securities Act of 1933 (17 CFR 230.261), temporarily suspending a Regulation A exemption from registration under that Act with respect to a proposed public offering by Delta Steel Corporation of 500,000 shares of its common stock at $1 per share. The order alleged that the notification and offering circular filed by Delta to obtain the exemption were materially deficient in that they failed to disclose that James N. Concannon is Delta's manager and controlling person and that the designated officers and directors are not active in the company's management, and that the offering circular falsely stated that certain persons were engaged in providing technical advice to Delta.[1/] The order further alleged that the terms and conditions of Regulation A had not been met because Concannon was not listed as an affiliate of Delta, and that the offering would be made in violation of Section 17 of the Securities Act.

A request for a hearing was filed by Polaris International Metals Corporation ("Polaris") and Concannon in their capacity as promoters of Delta, and Delta filed an answer denying the allegations. Thereafter hearings were held, at which Delta and the Division of Corporation Finance were represented. At the outset of the hearings, the Division moved to amend the order to add an allegation that Delta's notification was further misleading in failing to name a certain attorney as co-counsel for Delta in connection with the proposed offering. The motion

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1/ This recital reflects the response of the Division of Corporation Finance to an order requiring it to make the allegations more definite.

was granted. Following the hearings, the parties filed proposed findings and conclusions and briefs.

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

The Company

Delta is an Arizona corporation which was organized in November 1972 to engage in the production of various types of steel products using a patented process known as REDOX OTS (reduction-oxidation, ore to steel). Under the terms of an agreement executed shortly after Delta's inception, Edward M. Van Dornick, inventor of the process, and Polaris, which had previously been licensed to use it, granted Delta a non-exclusive license to use the process in a steel plant with a maximum annual capacity of 30,000 tons.[2/] In exchange, Delta was required to provide $400,000 to finance the construction and operation of a prototype plant designed to determine the commercial feasibility of the process. Delta was also obligated to make available to Van Dornick and Polaris all information obtained in the operation of the prototype plant -- which in any event was to be under Van Dornick's direction -- and to pay specified percentages of its income to them as royalties.

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2/ A corporation controlled by Van Dornick was also a party to the agreement.

The principal purpose of Delta's proposed stock offering was to raise the funds needed for the prototype unit. If that unit proved successful, additional funds estimated at $2.5 million would be needed to build a commercial plant. It was hoped that those funds could be obtained through industrial revenue bond financing. As the offering circular explained, Polaris had attempted to obtain financing for development of the Redox process, but those attempts had proved unavailing. It was felt that Delta, as a new company, would have a greater chance of success with a public offering than Polaris which already had about 9.5 million shares outstanding.

Delta has no assets, aside from the license, and it has no liabilities or outstanding securities.

## Concannon's Relationship to Delta; Activities of Officers and Directors

Delta's notification and offering circular list Concannon as a promoter, along with Polaris, Van Dornick and a corporation controlled by the latter. Six persons are listed as directors and four of these also as officers, including Frederick W. Heydinger as president and Dr. Walter W. Walker as vice president. In addition, the notification lists those six persons as "affiliates" of Delta.[3/] The major issue in this proceeding is whether, as alleged, those disclosures -- particularly in conjunction with certain other representations in the offering circular -- present a materially misleading picture regarding the control and management of Delta.

3/ Rule 17 CFR 230.251 defines an "affiliate" of an issuer as including a person controlling such issuer.

The record, which includes the testimony of Concannon and each of the six directors,[4/] shows that Concannon, who is the president and a controlling stockholder of Polaris, conceived of and initiated Delta's creation and was the moving force behind every step the company has taken in its brief existence. It was he who devised the modus operandi for Delta, i.e., the construction initially of a prototype unit, to be followed by a commercial plant if the prototype operation proved successful, the use of a Regulation A offering to finance the first stage, and the projected financing for the commercial plant. To implement his plan, Concannon determined the terms and caused execution of the license agreement. He selected the incorporators, filed the articles of incorporation with the state authorities and retained an attorney for Delta, who was also Polaris' attorney. He recruited Delta's directors and officers as well as several technical advisers. Although Delta's office is in Tucson, Arizona -- at the same address as Polaris' office -- Concannon selected Heydinger, a Dayton, Ohio resident, who is married to Concannon's niece, as president. On behalf of Delta, Concannon engaged in discussions with the agent of an Oklahoma port authority concerning the possibility of industrial revenue bond financing for any commercial plant to be constructed. And Concannon prepared a notification and offering circular, together with related exhibits, to be filed with the Commission. In addition to the proposed plan of

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4/ One of the designated directors, Lawrence Subrin, resigned as treasurer and a director of Delta shortly before the hearings.

operation for Delta and the planned use of the proceeds of the offering, those documents, among other things, reflected the terms and manner of the proposed offering.

The record indicates that in recruiting the directors and officers, Concannon explained in general terms the proposed business of Delta and the fact that a public stock offering was contemplated. Walker and Arthur Lewis, Delta's secretary-designate, served as incorporators and also signed the license agreement on behalf of Delta. In addition, it appears that prior to the first board of directors meeting, Concannon kept the directors advised to some extent regarding the progress of the company. He discussed portions of the offering circular which were of a technical nature with Walker, a metallurgical engineer who had been a consultant to Polaris on the Redox process.

The first meeting of the board of directors took place on December 14, 1972 at the office of Delta's attorney. The meeting was called by Concannon who also prepared the agenda. Heydinger and Lewis were absent. In addition to the four remaining directors, Concannon and the attorney were in attendance. Walker presided, but could not recall who had asked him to do so. Concannon presented each director with a complete copy of the proposed Regulation A filing, including a copy of the license agreement. As reflected in the minutes of the meeting, the board elected officers and adopted a series of resolutions which, in the main, (1) approved the by-laws, (2) ratified the license agreement, (3) granted conditional stock options to the directors, and

(4) authorized the officers of the company to prepare a notification under Regulation A and to file it with the Commission.

Concannon testified that at the meeting Walker and the attorney went through the Regulation A material "step by step" and that his participation consisted of answering questions addressed to him. Although he testified that a number of questions were asked, the only item he could recall on which there was discussion or disagreement concerned the directors' options. Certain of the directors thought the options should be for 10,000 shares each rather than 5,000 shares, but they were persuaded to retain the 5,000-share plan as spelled out in the offering circular. Concannon's testimony concerning the meeting is substantially corroborated by that of Walker, although the latter's recollection as to what transpired was hazy.

The board did not meet again until April 23, 1974. That meeting was prompted by the Division's investigation of Delta's filing which led to these proceedings. During the period between the two meetings, the company's activities were confined to matters related to the Regulation A filing. Promptly after the December 1972 board meeting, Concannon filed the Regulation A material on Delta's behalf with the Commission's Fort Worth office. The notification was signed by Walker. Following receipt of an extensive comment letter from that office, Delta withdrew its filing in April 1973. Walker signed the withdrawal letter, but the record indicates that it was Concannon who caused it to be prepared. Concannon subsequently revised the notification and

offering circular to reflect the staff comments and caused the revised documents, which are the subjects of this proceeding, to be filed with the Fort Worth office in December 1973.[5/]

The April 1974 board meeting, which was called by Concannon and attended by him and the same directors who attended the earlier meeting, was devoted to a discussion of questions which the Division had apparently raised with the directors.

Following issuance of the temporary suspension order, the request for a hearing was filed, as noted, by Concannon and Polaris. An answer and motion for more definite statement filed on behalf of Delta were prepared by an attorney whom Concannon asked to do so. The attorney who represents Delta in this proceeding was also retained by Concannon.

The Division contends that Concannon was and is a controlling person (and as such an affiliate) and manager of Delta, and that Delta's officers and directors are not active in the company's management and had in fact abdicated their responsibilities. Delta's position, on the other hand, is that the actions which Concannon took and activities which he engaged in were those which are normally performed by a promoter and do not render him a controlling person. Delta further contends that the officers and directors of the company were active in its management, consistent with the stage of development which Delta has reached.

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5/ The filing was thereafter transferred to the San Francisco branch office, as of March 22, 1974.

There is no question that Concannon was a promoter, indeed the principal promoter, of Delta. He fits squarely within the definition of that term in Rule 17 CFR 230.251 under the Securities Act as including any person who, "acting alone or in conjunction with one or more other persons, directly or indirectly takes the initiative in founding and organizing the business or enterprise of an issuer." But it does not follow that Delta is on solid ground in arguing that because everything Concannon has done is within the scope of a promoter's functions, he cannot also be found a controlling person.

The Commission has defined control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 6/ There is no basis in law, logic or the Commission's rules for the contention that the promoter of a corporation, acting *qua* promoter, 7/ cannot at the same

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6/ This definition is found in Rule 17 CFR 230.405 under the Securities Act. While that Rule pertains to registration statements filed under the Act, the Commission has relied on it in other contexts, including Regulation A proceedings. See Telescript - CSP Inc., 41 S.E.C. 664, 667 (1963).

7/ In my view of the case, there is no need to fix the bounds of promotional activity. Delta has cited a number of state court decisions defining the term "promoter," which indicate that that role may extend beyond the formation of the company to the point where "it is fully launched in business " (Bigelow v. Old Dominion Copper Mining & Smelting Co., 74 N.J. Eq. 457 (Ch.), 71 A.153, 171 (1908)) or at which he has attracted the investment of capital and provided the company with the "commercial breath of life," (Hifler v. Calmac Oil and Gas Corporation, 10 N.Y.S. 2d 531, 541 (Sup. Ct. 1939)).

time be a controlling person of that corporation once it has acquired a legal existence,[8/] nor for the view that activities which may be within the normal scope of a promoter's functions cannot be considered in determining whether the promoter is also a controlling person.

In my opinion, the record compels the conclusion that Concannon was, and is, a controlling person and as such an "affiliate" of Delta. There is no merit to Delta's argument that the board made the basic decisions, i.e., that Concannon proposed and the board disposed. That was true only in form, not in substance. As noted, there was only one "regular" board meeting. Heydinger and Lewis, whose selection as president and secretary, respectively, was given board sanction at that meeting, were absent. While Heydinger testified that he was in frequent contact with Concannon and was kept informed regarding developments, he could recall no instance in which his opinion was solicited. It is clear that neither he nor Lewis has had any part in the decision-making process.

The recollections of the four officers and/or directors who attended the board meeting concerning what transpired there were hazy, to say the least. Some of that haziness can be attributed to the lapse of over 1 1/2 years from the date of the meeting to the time of the hearings. But in my judgment it derives principally from

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8/ See e.g., Great Northern Management Co., Inc., 43 S.E.C. 960, 962 (1968), where a prospectus was found misleading because, among other things, it failed to disclose that a certain individual was a parent (i.e., controlling person) and promoter of the issuer from its inception through the effective date of its registration statement.

the fact that those persons -- as did the absent directors -- relied on Concannon for leadership and guidance and had neither been given nor had they sought the detailed information necessary to permit them to make any informed determinations. When presented at the meeting with a package of material ready to be filed with the Commission, which most of them were seeing for the first time, they were not in a position to question the decisions regarding Delta's business and fund-raising program which had already been made by Concannon.

Subsequent to the board meeting, Concannon continued to make decisions basic to Delta's existence on his own responsibility. Without consulting the designated management officials, he acted for Delta in taking the steps referred to above in connection with the processing of the Regulation A filing and the suspension proceeding. The conclusion is inevitable that during this entire period Concannon, like the individual found to be the controlling person of the issuer in Profile Mines, Inc., 9/ "effectively govern[ed] the affairs of [the issuer] without need of consulting the board."

The offering circular contains just a single reference to Concannon, as one of four promoters. Only the officers and/or directors are listed under the caption "Management". The obvious implication of that presentation, that the persons so listed are actively managing Delta,

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9/ 38 S.E.C. 533, 536-7 (1958).

is further buttressed by a number of statements in the offering circular representing that various determinations had been made by the board of directors. By way of example, it was stated that the board had determined the offering price of the shares and had determined to proceed with the Delta "project" in two stages.

In light of the above findings, this presentation is materially misleading. It may well be that, as the testimony of several of the directors and officers suggests, they intended in good faith to assume an active managerial role once Delta had passed the embryonic stage and was actually engaged in the steel business. But disclosure should have been made that as of the time of filing, Concannon controlled and managed Delta and that the designated officers and directors were not active in its management.[10/] Concannon's affiliation with Polaris, which stood to be a principal beneficiary of Delta's stock offering, made it all the more important to provide full disclosure regarding his relationship with Delta.

Technical Advisers

The temporary suspension order, as made more definite by the

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10/ Because the temporary suspension order did not allege that the affirmative statements in the offering circular concerning the directors' determinations were false or misleading, I cannot adopt the Division's proposed conclusion to that effect. However, these were among the statements rendered misleading by the failure to disclose that the directors have not been active in Delta's management. The presence in the offering circular of such affirmative representations concerning the participation of the directors in Delta's affairs also serves -- among other factors -- to distinguish this case from Franchard Corporation, 42 S.E.C. 163 (1964) where the Commission held (at pp. 175-178) that, in the absence of representations of that nature, the prospectuses there under scrutiny were not deficient in failing to disclose the apparent subservience of the directors to the company's chief executive and their relatively inactive role in its management.

Division, alleges that the offering circular falsely states that Joseph Herz and Walter J. Grace, III were engaged in providing technical advice to Delta. The circular lists a total of five technical advisers, including Herz, Grace and Van Dornick, the inventor of the Redox process. At the end of the list appears the following statement:

> "The Company is heavily relying upon the knowledge and expertise of its technical advisors and consultants, and any alteration or severance of the present working relationship would have a severe adverse effect on the business and operations of the Company."

Grace, an attorney with an engineering background, testified that he had agreed to be a consultant, although he had not yet been called on to give technical advice. Under the circumstances, it was proper for Delta to include him in its list of technical advisers. The Division contends that the above-quoted statement implies that there is an existing relationship during which advice has been or is being given. However, in the context of the offering circular which clearly disclosed the incipient nature of the enterprise, I cannot find the representations concerning Grace to be materially misleading.

The situation with respect to Herz is entirely different. Herz testified on direct examination that he is not a technical adviser to Delta, to his recollection had not been asked to be a technical adviser and never consented to serve in that role. On cross-examination, Herz testified that he was familiar with the Redox process and would be competent to be a technical adviser concerning it, but that his

willingness to serve would depend on the company that asked him. He also acknowledged that if Van Dornick, with whom he is acquainted, were to be involved in the building of a pilot plant to test out the process, he would consult with him "personally as a colleague." Herz further testified that it was possible that he had had a telephone conversation with Concannon which he had forgotten. Concannon testified that in 1967 Herz had agreed to be a consultant to Polaris; that at the time he (Concannon) was lining up technical advisers for Delta he asked Van Dornick whether he thought Herz would act in that capacity and Van Dornick replied that he thought Herz would be willing but it would be best if Concannon contacted him; that he then called Herz and told him "we were forming" Delta and wanted to use him as a technical adviser; that Herz said he had some people with him and was in a rush and gave no answer; and that Concannon then indicated to Herz they would discuss the matter further.

The inference most favorable to Delta that can be drawn from the above testimony is that Herz had not refused to become a technical adviser to Delta. It does not show that he had consented to serve in that capacity. Accordingly, the offering circular was false in listing him -- and his impressive credentials -- among the company's technical advisers.

Counsel

At the outset of the hearings, I granted the Division's motion to amend the temporary suspension order by adding the further allegation that the notification was materially deficient in failing to list

Grace as co-counsel for Delta in connection with the proposed offering.[11/] However, the preponderance of the evidence does not support that allegation.

Grace is a friend of Concannon's and had served as an officer of and attorney for Polaris. The record -- which as relevant to this issue comprises the testimony of Concannon and Grace -- shows that, as already noted, Concannon prepared both the original and the revised notification and offering circular and that he presented the documents to Grace in essentially finished form for the latter's perusal of typographical accuracy, spelling, punctuation and grammar.[12/] Concannon recalled that in addition to performing those tasks, Grace suggested a way in which the intended meaning of a certain item in the original filing could be more clearly stated, and that Concannon made the suggested revision. Furthermore, Concannon consulted with Grace concerning one disclosure comment in the Fort Worth office's comment letter which seemed puzzling to him. And Grace's testimony indicated that he intended to bill Delta for his services if and when the company acquired funds. Based on this testimony, I cannot find that Grace performed services in connection with preparation of the documents filed with the Commission which were of such a nature as to constitute him counsel for Delta. I recognize, as stressed by the Division, that in interviews with Division counsel prior to the hearings, both Concannon and Grace, and particularly the former, made statements indicating that Grace played a more substantial role in connection with preparation of the Regulation A material than that portrayed in their

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11/ The attorney that was listed was the one whom Concannon had retained at the inception of the company.

12/ Concannon testified that he is a "notoriously poor speller," an appraisal corroborated by Grace.

testimony. And their explanations of these prior statements are not wholly convincing. However, I have determined to credit their unequivocal testimony before me on this issue.

Following issuance of the temporary suspension order, Grace did act as counsel for Delta when, at Concannon's behest, he drafted the answer and motion for more definite statement which Delta filed. In and of itself, this has no relevance to the question whether the notification was inaccurate when filed or at the time the order was issued. While Grace's later legal services for Delta could conceivably shed some light on the nature of his earlier services, they are also consistent with the inference that Concannon deemed the answer and motion, unlike the notification and offering circular, beyond his competence to prepare.

Conclusions

It follows from the foregoing findings that Delta's notification and offering circular are materially misleading in failing to disclose that Concannon has been and is the company's manager and controlling person and that the designated management group has not been active in the company's management. The offering circular also includes the materially untrue statement that Herz is a technical adviser of Delta. Moreover, the terms and conditions of Regulation A have not been met in that the notification fails to list Concannon as an affiliate of Delta. And because of the above false or misleading statements, the offering would be made in violation of Section 17 of the Securities Act.

Under Rule 17 CFR 230.261, ample grounds thus exist for a permanent suspension of Delta's exemption. Delta asks, however, that it be given the opportunity to amend the notification and offering circular to correct any deficiencies found in these proceedings, 13/ and it expresses a willingness to make any other amendments deemed necessary by the Division and the Commission. 14/

Few concepts in the field of securities law are as well established as the principle that the exemption provided by Regulation A is a conditional one based on strict compliance with express provisions and standards, and that a permanent suspension is appropriate where such compliance has not been effected. 15/ It is true, as Delta points out, that there have been instances where the Commission has permitted an issuer to amend its filing after issuance of a temporary suspension order or even vacated such an order notwithstanding the existence of deficiencies. Delta urges that such treatment is warranted here because, unlike the cases cited by the Division where suspensions were made permanent, no investor has been misled or lost money, the company is not yet engaged in business, and a good faith effort was made to make full disclosure, as evidenced by the "negative tone" of the notification and offering circular.

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13/ At the outset of the hearings, Delta, while adhering to its denial of the allegations, offered to amend the notification and offering circular to disclose Concannon as manager and controlling person, to delete Herz and Grace from the list of technical advisers and to list Grace as co-counsel.

14/ In view of the findings made, there is no need to discuss Delta's contention that the suspension should be vacated because the notification and offering circular provide a true picture of Delta's control, management and technical advisers.

15/ For a recent reaffirmation by the Commission of that principle, which received judicial approbation, see Tabby's International, Inc., (continued)

In my opinion, the circumstances here do not warrant a departure from the normal consequence of a failure to comply with the provisions of Regulation A. As the Commission pointed out in General Aeromation, Inc., 16/

> "While we have, upon a showing of good faith and other mitigating circumstances, permitted withdrawal or amendment of deficient filings after commencement of suspension proceedings in certain limited situations, we have emphasized that a careful and honest preparation is an absolute prerequisite to the exercise of our discretion in this area. We cannot countenance a practice of deliberate or even irresponsible submission of inadequate material by permitting the correction of deficiencies found by our staff in the examination of such material." 17/

The principal deficiencies here relate to the very basic and vital items of control and management of the issuer. And the record does not in my judgment warrant the finding that a diligent and careful effort was made to present an accurate filing, which the Commission has deemed a prerequisite to the withholding of a permanent exemption in the face of a serious deficiency. 18/

Accordingly, IT IS ORDERED, pursuant to Rule 261 of Regulation A under the Securities Act of 1933, that the exemption of Delta Steel Corporation under Regulation A be, and it hereby is, permanently suspended.

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15/ (Continued)
Securities Act Release No. 5283 (July 21, 1972), aff'd per curiam on Commission opinion, 479 F.2d 1080 (C.A. 5, 1973).

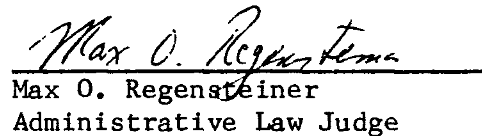
16/ 41 S.E.C. 219, 228 (1962).

17/ To the same effect, see, e.g., Illowata Oil Company, 38 S.E.C. 720, 723 (1958); Inspiration Lead Company, 39 S.E.C. 108, 114 (1959); American Television & Radio Co., 40 S.E.C. 641, 650 (1961); Jackpot Exploration Corp., Securities Act Release No. 5061, p. 5 (April 22, 1970).

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

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

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



Max O. Regensteiner
Administrative Law Judge

Washington, D.C.
December 3, 1974.