ADMINISTRATIVE PROCEEDING
FILE NO. 3-469

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
ROMAN S. GORSKI (801-2400)

INITIAL DECISION

Irving Schiller
Hearing Examiner

Washington, D.C.
October 19, 1966

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ROMAN S. GORSKI (801-2400)

BEFORE: Irving Schiller, Hearing Examiner

APPEARANCES: John J. McLoughlin, Esq.
for the Division of Trading and Markets

Lawrence C. Moore, Esq.
Attorney for Roman S. Gorski

These are proceedings pursuant to Section 203(d) of the Investment Advisers Act of 1940 ("Advisers Act") to determine whether Roman S. Gorski ("respondent") willfully violated Section 204 of the Advisers Act and Rules 204-1(b) and 2(a)(10) thereunder, whether registrant violated Sections 205(1) and (2) and 206(1) and (2) of the Advisers Act and whether any rememdial action is appropriate in the public interest pursuant to Section 203(d) of the Advisers Act.

The order for proceedings alleges in essence that respondent entered into and performed an investment advisory contract which provided for compensation on the basis of a share of capital gains upon and capital appreciation of the funds or a portion of the funds of a client and failed to provide, in substance, that no assignment of such contract shall be made without the consent of the other party to the contract in violation of Section 205(1) and (2) of the Advisers Act;[1/] that respondent directly and indirectly employed a device, scheme and artifice to defraud clients and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon clients in violation of Section 206(1) and (2) of the Advisers Act[2/] and that

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1/ Section 205(1) and (2) of the Advisers Act, as pertinent here, makes it unlawful for an investment adviser to enter into any investment advisory contract if such contract provides for compensation to the adviser on the basis of a share of the capital gains upon or capital appreciation of the funds of a client and fails to provide in substance, that no assignment be made by such adviser without the consent of the other party to the contract.

2/ Section 206(1) and (2) of the Advisers Act forbids an investment adviser from employing "any device, scheme, or artifice to defraud any client or prospective client"or from engaging in "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

respondent made false statements in an application for registration and Form ADV-SUP and willfully failed promptly to file an amendment correcting such information when it became untrue and concealed and failed to provide for inspection all written agreements (or copies thereof) entered into with clients in willful violation of Section 204 of the Advisers Act and Rules 204-1(b) and 2(a)(10).

After appropriate notice hearings were held before the undersigned Hearing Examiner. Proposed findings of fact and conclusions of law and briefs in support thereof were filed by the Division of Trading and Markets and a reply thereto by the respondent.

The following findings and conclusions are based on the record, the documents and exhibits therein and the Hearing Examiner's observation of the various witnesses:

Respondent is registered as an investment adviser pursuant to Section 203(c) of the Advisers Act and has been so registered since November 18, 1960.

Violations of Sections 205(1) and (2) of the Advisers Act

The record establishes that on March 26, 1963 respondent entered into a written investment advisory agreement with Harry Twine ("Twine") which authorized respondent to act as Twine's agent and to purchase or sell securities selected by respondent, for a fee of twenty-five (25%) per cent of the net profits, payable immediately upon completion of each transaction. The agreement further authorized respondent to

purchase or sell puts, calls or straddles [3/] for which Twine agreed to pay twenty-five (25%) per cent of monies received from such sales "immediately upon notification . . . . that such monies have been credited" to Twine's account.

On or about May 14, 1963 respondent entered into a joint agreement (hereinafter referred to as "joint agreement") with Twine and Twine's sister-in-law, Marjorie Irvin ("Irvin"), which was identical to the March 26, 1963 agreement with Twine. Respondent denies he ever had any adviser agreement with Irvin or that she was his client. Such denial, however, finds no support in the record. Respondent testified he was told by Twine that the latter wanted Irvin's name added to the account since his was getting old and wanted to save on inheritance taxes, that it was "all right" with him and thereafter ". . . they send some papers, they sign, and that is all I know about it."

Respondent also testified that the single account with Twine became a joint account with Irvin. The documentary evidence moreover demonstrates the existence of a joint agreement and respondent's recognition thereof. On May 15, 1963 respondent wrote to Twine, the subject matter of which was "Re: joint account" and the body of the letter included the following:

3/ Put and call options are negotiable contracts in which the writer of the option, for a certain sum of money called the "premium," gives the buyer of the option the right to demand within a specified time the purchase or sale by the writer of a specified number of shares of a stock at a fixed contract price. A straddle is a combination of a put and a call giving the holder the right to both buy and sell a specified number of shares of stock at a fixed price. An endorsed option is one in which performance of the option is guaranteed by a member firm of the New York Stock Exchange.

> ". . . as you requested I am enclosing the new papers. Miss. Irving (sic) and you should sign the two papers from the broker where I have marked in pencil, and the agreement with me where your names are typed in".
>
> "Please return all papers to me after you have both signed each paper, and I'll take care of the rest." (Underscoring supplied)

The record includes a copy of a letter dated May 17, 1963, addressed to duPont and signed by Twine and Irvin giving respondent full trading authorization with privilege to withdraw money and/or securities. Obviously this was one of the documents sent by respondent to Twine and Irvin which he referred to in his letter of May 15, 1963 as the papers from the broker to be signed by Twine and Irvin. The other document referred to in respondent's letter as a paper from the broker is a form entitled "joint account" and signed by both Twine and Irvin. Finally, the "agreement with me" to which he refers in his letter is obviously the May 14, 1963 agreement under which respondent was to be paid 25% of the net profits.

The Hearing Examiner finds that the March agreement with Twine and the joint agreement in May 1963, contrary to the prohibitions set forth in Section 205 of the Act, provided for compensation to the respondent, a registered investment adviser, on the basis of a share of the capital appreciation of the funds of respondent's clients and failed to provide, in substance, that no assignments of the contract could be made by the respondent without the consent of Twine or Irvin. Respondent contends that Section 205 of the Act is inapplicable since he is not an "investment adviser" within the meaning of the Advisers Act by reason of

Section 202(a)(11)(B) which excludes from the definition of investment adviser any teacher whose performance of such services is solely incidental to the practice of his profession. The record establishes that the respondent is employed as a teacher at Mars Hills College in North Carolina where he teaches courses in personal finance, investments and economics. The respondent, however, testified that the college pays "very little money," that he is "dependent" upon his investment adviser registration "in order to earn his livelihood," and that he "needs this business." There is no evidence as to the proportionate time spent by respondent in either type of activity nor any evidence concerning respondent's income income from teaching as against his remuneration from the advisory services. The Hearing Examiner finds the record fails to establish that respondent's investment advisory services is solely incidental to his teaching activities.

Respondent further contends that he is not subject to Section 205 of the Act because he is exempt from registration under Section 203(b)(3) since he has had only five (5) very small accounts during the preceding twelve months and does not generally hold himself out as an investment adviser. Respondent testified he had only 5 accounts in April 1965. Through the record does not establish that respondent had only 5 clients within the preceding twelve months, it is unnecessary to determine such fact since it is apparent from the evidence that registrant holds himself out generally to the public as an investment adviser. The record shows that from 1942 through 1960 respondent forwarded communications

to clients containing analysis of the market, together with recommendations concerning specific securities and from 1963 through June 1965, respondent, in communications to Twine and Irving, identifies himself on his letterhead as financial counsel, financial consultant and investment consultant. Moreover, the filing of a registration application which becomes effective is itself a holding out to the public that the registrant is an investment adviser registered under the Advisers Act, not exempt from its provisions. In 1961 respondent filed Form ADV-SUP as a supplement to his effective registration statement, and in 1965 and 1966 filed amendments to such application. Each of such amendments is again a public declaration that respondent is an investment adviser subject to the Act.

The Courts have held that the burden of proving a claimed exemption from the provisions of the Securities Act of 1933 is upon the person asserting the exemption. Gilligan Will & Co. v. Securities and Exchange Commission, 267 F. 2d 461 (C.A. 2); S.E.C. v. Culpepper, 270 F. 2d 241. Similarly under the Advisers Act the burden of establishing an exemption from such Act rests with respondent. In the instant case respondent failed to discharge this burden. Thus the respondent failed to establish that his investment advisory service is solely incidental to his teaching and the record contains ample evidence supporting the conclusion that respondent is holding himself out generally to the public as an investment adviser. The Hearing Examiner concludes that by entering into the Twine agreement in March 1963 and the Twine and Irvin agreement in May 1963, respondent willfully violated Section 205(1) and (2) of the Advisers Act.

Violations of Section 206(1)(2) of the Act

Following the March 26, 1963 agreement between respondent and Twine, noted above, a cash account was opened at Francis I. duPont & Co. ("duPont") by respondent. On April 3, 1963 the sum of $2,958.63 was deposited therein to cover the first security transaction. Two days later a margin account was opened for Twine at the same brokerage firm. By letter dated April 10, 1963 Twine authorized respondent to act as his attorney in fact, giving him full trading authorization with privilege to withdraw money and/or securities in the account maintained for him at duPont. Thereafter, Twine who was then over 90 years old persuaded his sister-in-law Irvin to participate in his account. She was then 76 years old, acted as Twine's housekeeper, and had a joint checking account with him. Between April 5 and June 24, 1963, Irvin deposited a total of $11,000 in the account, which funds represented money she had received as a result of an accident. As noted above, on May 14, 1963 a joint investment advisory agreement was entered into between respondent and Twine and Irvin. By letter dated May 17, 1963 Twine and Irvin authorized respondent to act as their attorney in fact, giving him full trading authorization with privilege to withdraw moneys or securities in their account at duPont. The following week Twine and Irvin signed a joint account agreement with duPont which was approved by the brokerage firm on May 24, 1963. For reasons which do not appear in the record the transfer of funds and securities in the Twine account did not commence until April 29, 1964 and was not completed until September of that year.

The joint account at duPont was maintained until May 26, 1965.

The evidence shows that respondent placed all orders for the purchase and sale of securities for Twine and for the joint account. Copies of all statements and notices from the brokerage firm were sent to respondent. To portray the manner in which respondent managed the Twine and the joint accounts, an analysis of respondent's trading in the account was prepared by a securities investigator of the Commission from the books and records of duPont and received in evidence without objection. The analysis discloses that 54 round turn transactions were effected involving 124 separate transactions. These transactions included two short sales of securities and the sale of nine endorsed straddles. The capital turnover was 7.7 times the amount invested. The analysis further discloses that both of the short sales resulted in losses and of the nine endorsed straddles sold, five resulted in losses. Two straddles resulted in profits only by including the premium received upon the sale of the straddle.[4/] The remaining two straddle transactions were profitable. As a result of the operations in the account Twine and Irvin sustained a loss of approximately $8,332. In addition to such loss Twine and Irvin paid respondent $2,040 in fees for his advisory services.

4/ Thus the record shows in one instance the straddle transaction resulted in a loss of $36 but when the premium of $275 received upon the sale of the option was applied to the transaction it resulted in a profit of $239. In the other instance a loss of $202.66 occurred in the straddle transaction and by applying the premium of $500 received upon the sale of the option a profit of $297.34 resulted.

The loss in the account, in large part, was attributable to the sale of an endorsed straddle. Since the transaction is illustrative of the speculative nature of the transactions which respondent effected for the accounts it bears scrutiny. On July 28, 1964 respondent sold an endorsed straddle for 100 shares of the common stock of Rollins Broadcasting Co. having an expiration date of February 2, 1965. In the period the straddle was outstanding the company declared a 200% stock dividend payable to the holders of record on January 26, 1965. From the inception of the option the price of the stock steadily increased. There was no Rollins stock in the account and respondent made no effort to acquire such stock when the market price exceeded the option call price notwithstanding the liability outstanding to make delivery of the stock if such call was exercised. On February 2, 1965 the call was exercised and the account was thereupon requested to deliver 300 shares plus accrued dividends of 25 cents a share. On May 25, 1965 duPont purchased 300 shares for the Twine and Irvin account as a result of which a loss in excess of $8,000 was realized.

In addition to the highly speculative type of transactions for which respondent was responsible, the record shows that respondent sent false statements to Irvin, failed to advise Twine and Irvin of losses occurring in the account and ignored requests from them for explanations of how their money was being invested. Thus the record shows and the respondent does not refute that in December 1963 he incorrectly informed Irvin that there were no losses in the account and that in March 1965 respondent forwarded a statement of profits for the year 1963 which reflected a net profit of $4,718.98 when, in fact, the account had some

losses during the period and the profit for the year was approximately $1,611.96. Moreover, the statement indicated as a profit the money received from the sale of endorsed straddles despite the fact that the option dates had not expired and no determination could be made as to profit or loss on such transactions. In addition respondent offered no explanation to refute that in the same month he sent another letter to Irvin enclosing a statement of capital gains and losses for year 1964 which indicated a net loss of $749.21 when,in fact, a profit of $701 had been realized.

From the period June 25, 1964 to May 19, 1965 duPont sent 19 demands for additional margin to Twine and Irvin. Upon receipt of the first of such notices Irvin telegraphed respondent inquiring as to the reason for receipt of such demand. Respondent advised Twine it was "all right" and he would handle the matter. He furnished no proof of how he handled such matter. It is apparent from the documentary evidence that in response to further efforts to ascertain information concerning the account and the reason for the margin requests respondent either ignored such requests or informed his clients that duPont was making mistakes.

The record discloses and respondent does not dispute he received 25% of profits realized from purchases and sales of securities without regard to transactions which resulted in losses. In connection with respondent's sale of endorsed straddles, respondent does not dispute that he received 25% of the moneys received on the sale of such straddles

regardless of whether such transaction finally resulted in a profit or loss. On one occasion when a profit was realized at the termination of the straddle respondent received an additional 25% of the moneys received in excess of the premium. In addition respondent does not dispute that on one occasion he received 25% of an indicated profit of $312.14 when, in fact, a profit of only $20.62 was realized and on another occasion he received a fee on an indicated profit of $156.74 when a loss of $970.28 had been incurred. The Hearing Examiner finds that respondent's activities in the operation of the Twine and the joint account constitutes a willful violation of Section 206(1) and (2) of the Act.

Failure Promptly to File Amendments to Registration Application

On September 7, 1961 respondents filed Form ADV-SUP stating, among other things, that his compensation is based on a sliding percentage basis depending upon the size of the account supervised, that he does not have authority to obtain custody or possession of the securities or funds of any investment advisory client and that he does not have discretionary authority to make any of the following determinations without obtaining the consent of the investment advisory client before the transition is effected, (a) whether securities are to be bought or sold, (b) which security is to be bought or sold or (c) the total amount of the security to be bought or sold. The Hearing Examiner finds that respondent failed to file a correcting amendment to reflect the written arrangements with Twine and Irvin pursuant to which respondent was to be paid on the basis of 25% of the net profits realized immediately upon

completion of each transaction and that he failed to file a correcting amendment to reflect that he had authority to obtain custody and possession of the funds and securities held by duPont for Twine and Irvin. Respondent testified that in April 1963 Twine deposited $700 in the Chemical Bank New York Trust Company in an account entitled "Dr. Roman S. Gorski I/T/F Harry L. Twine" from which account he subsequently withdrew funds for fees due him. The Hearing Examiner finds that no correcting amendment was filed by respondent to disclose such facts until March 1966. In addition the record discloses that in November 1963 another one of respondent's investment advisory clients gave him authority to purchase and sell securities and commodities without such client's prior consent. The Hearing Examiner finds that no correcting amendment was filed by respondent to disclose the existence of such agreement until March 1966.

In June 1965 a securities investigator of the Commission made a routine inspection of respondent's activities during the course of which respondent,when asked to produce copies of agreements with clients, produced only a sample form which apparently conformed with the answers in his registration application but failed to produce at least one written agreement giving him discretionary authority over a client's account. A correcting amendment was finally filed in March 1966. The Hearing Examiner finds that respondent failed promptly to file appropriate amendments to his registration application as an investment adviser in willful violation of Section 204 of the Act and Rule 204.1(b) thereunder and willfully violated the same Section and Rule 204.2(a)(10) thereunder

by failing to produce for inspection all written agreements (or copies thereof) entered into with clients.

Public Interest

The sole remaining question is what, if any, remedial action is appropriate in the public interest. Neither at the hearing nor in his brief does respondent controvert the facts set forth above regarding the type of securities transactions he effected for Twine and the joint account, the fees he received for his services, nor the false statements he sent his clients. Respondent urges he should not be held accountable for all of the transactions since he advised Twine by letter in October 1964 that he terminated his agreement and in December of the same year, again by letter reaffirmed his resignation. The fact that respondent terminated his agreement with Twine, however, does not exculpate him for the manner in which he managed the account of his clients or relieve him of his duty to act in his client's best interest and deal fairly with them.[5/] In fact, terminating the agreement to act as investment adviser in October 1964 raises serious questions concerning not only respondent's ethical standards but his good faith in carrying out the fiduciary responsibilities and duties which an adviser has toward his client. At the time respondent terminated his agreement there were outstanding liabilities by Twine and Irvin by reason of straddles which respondent sold for their account at least one of which had a termination date in February 1965. Respondent made no mention of such facts to his clients at the time he terminated the agreement nor did he make any effort to liquidate the account or at least protect

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5/ See Norris & Hirshberg v. Securities and Exchange Commission, 177 F. 2d 228 (D.C. Cir. 1949).

it so as to limit the outstanding liability. Twine and Irvin suffered a huge loss as a result of such outstanding liability.

Respondent also urges that he tried to help Twine, a friend of long standing, by agreeing to take his account only after repeated urging by Twine who respondent says wanted to speculate and who in the twilight of his declining years (he was then 90) was seeking an interest in life which Twine purportedly told him he would get by looking in the papers at night to see if his stocks were going up or down. Irvin testified that at the time respondent opened Twine's account the latter's vision was very dim, that he could not see to write or read, that she had to read to him and take care of his correspondence.

Respondent contends that there are no standards established under the Act concerning suitability of investments and if Twine wished to speculate it was his privilege to do so. The question is not whether the clients are free to speculate but rather whether respondent having complete discretionary authority to buy and sell securities for Twine and Irvin exercised such authority properly and acted in the best interests of his client. The relationship which exists between an investment adviser and his client is a fiduciary one.[6/] The Supreme Court clearly enunciated the standards applicable to such a fiduciary in Securities and Exchange Commission v. Capital Research Bureau, 375 U.S. 180 (1953), when it stated at p. 194:

6/ Loss, Securities Regulation (2 Ed. 1961), 1412.

> "Nor is it necessary in a suit against a fiduciary, which Congress recognized the investment adviser to be, to establish all the elements required in a suit against a party to an arm's-length transaction. Courts have imposed on a fiduciary an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading his clients."

In the instant case the record discloses that Twine and Irvin were uninformed as to securities matters, placed full faith and confidence in respondent in the management of their funds, sought unsuccessfully on a number of occasions to be advised of the status of their account and were furnished false statements concerning such account. Moreover, the sale of straddle transactions, which at best are highly speculative in nature and not readily understood by the average investor, in the manner respondent effected such transactions, is hardly suitable for clients who were elderly and unsophisticated in market activities. The Hearing Examiner finds that respondent failed to exercise reasonable care in the management of the Twine and Irvin account.

Respondent pleads that he is a respected teacher and college professor in the field of economics and finance, has written and published numerous articles in his field, has been an investment adviser and consultant of upwards of thirty years and has not previously been in any difficulty with the Commission or other regulatory body. He also requests that we weigh the fact that the Twine and Irvin agreement is the only one of its type he has ever had, that he had not previously or since engaged in put and call transactions, that he entered into

the Twine agreement at constant urging of Twine who told him that his (Twine's) nephew "made a lot of money in puts and calls," that he voluntarily terminated the contract and that his registration application is presently in compliance with the Advisers Act and the Rules thereunder. Apparently the amendment filed March 1966 appears to be in order. The Hearing Examiner has given careful consideration to these matters and has also considered all of the facts relating to the Twine and Irvin agreement. In light of respondent's activities the Hearing Examiner is of the view that the public interest requires the imposition of a sanction. The Hearing Examiner finds it is in the public interest to suspend respondent for a period of six months. 7/ Accordingly,

IT IS ORDERED that the registration as an investment adviser of Norman S. Gorski be and the same is hereby suspended for a period of six months effective from the date of this order.

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

Petition for review of this initial decision may be filed by a party in accordance with Rule 17(b) of the Commission's Rules of Practice within fifteen days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission unless a party files a petition for review in compliance with Rule 17(b)

7/ To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are rejected.

or the Commission under Rule 17(c) determines on its own initiative to review. If a party timely files a petition to review or the Commission takes action to review, this initial decision shall not become final.

Irving Schiller
Hearing Examiner

Washington, D.C.
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