ADMINISTRATIVE PROCEEDING
FILE NO. 3-8257

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	)
	)
JAY HOUSTON MEADOWS	)
	)

INITIAL DECISION

Washington, D.C.
September 19, 1994

Glenn Robert Lawrence
Administrative Law Judge

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APPEARANCES: T. Christopher Browne, Karen M. Lundskow, Katherine S. Addleman for the Division of Enforcement.

Robert F. Watson, H. Allen Pennington, Jr.,Todd P. Kelly of Law, Snakard & Gambill, for Jay Houston Meadows.

BEFORE: Glenn Robert Lawrence, Administrative Law Judge.

These public proceedings were instituted by an order of the Commission dated January 11, 1994, ("Order") issued pursuant to Sections 15(b) and 19(h), 21B and 21C of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether allegations of misconduct made by the Division of Enforcement ("Division") against Jay Houston Meadows ("Respondent" or "Meadows") are true and what, if any, remedial action would be appropriate in the public interest.

In substance, the Division alleges that from 1986 to the present, Jay Houston Meadows has been a registered representative associated with a broker dealer in Fort Worth, Texas, and that Meadows, from about October 1990 to May 1991, willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in connection with fraudulent conduct in the sale of $1,000,000 in securities of Mundiger International, Inc. ("Mundiger") and Mira Golf International, Inc. ("Mira Golf").

By answer dated March 2, 1994, Meadows essentially denied any fraudulent conduct and that he was involved in the sale of securities. Rather, he alleged that he was not acting as a broker, salesman or underwriter of securities but was merely acting in the capacity of an investor. On May 18, l994, a final judgment of permanent injunction and other equitable relief was entered by consent against Marc W. Gunderson and William Craig Harriger, who were co-founders with Meadows of Mundiger and Mira Golf.

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon my observation of the various witnesses that testified at the hearing that was held in Fort Worth, Texas from May 11 through May 14,1944 as well as the briefs, arguments and proposals of facts and law of the parties and the relevant statutes and regulations.

From April 1986 to the present, Meadows was employed as a registered representative associated with the Fort Worth, Texas office of Rauscher Pierce Refsnes, Inc. ("RPR"), a broker-dealer registered with the Commission. (Stipulation of Facts by and between The Division of Enforcement and Respondent Jay Houston Meadows (Hereinafter "Stip.") A; B) The record does not reflect that he has been the subject of any inquiry by the NASD or any exchange or state securities department or the SEC other than the instant proceeding. (Tr. 637-638)

The record also reflects that he has never been the subject of a customer complaint, other than in connection with the instant proceeding. (Tr. 637) Larry Shafer described Meadows as honest, hardworking and having an excellent reputation for integrity. (Tr. 604) Charles Dominy described Meadows as honest, hardworking and responsible. (Tr. 585) Richard Griffin described Meadows as sharp, providing good service, and reputable. (Tr. 570) John Derrick has had no problems with Meadows as his stockbroker, and Meadows, he testified, never made a speculative recommendation to him. (Tr. 518, 497) Despite the pendency of this administrative proceeding, RPF has placed no restrictions on Meadows activities. (Tr. 749)

Meadows was a co-founder[1] of Mundiger and Mira Golf. (Stip. C; Tr. 34; Division Exhibit 27 (Hereinafter "Div. Ex.")) Gunderson and Harriger initially conceived a venture in which a single company would engage in recycling golf balls and drilling gas wells. (Tr. 395, 642) The name of the original venture, and subsequently the gas drilling company,

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[1]Respondent argues in his Proposed Findings of Fact and Conclusion of Law (RPFF) that Gunderson and Harriger conceived the venture and later invited Meadows to join. (RPFF 2) This appears to be a correct assertion. (Tr. 395, 641-642)

was Mundiger, an acronym for the original three shareholders' names.[2] (Div. Ex. 10; Tr. 29, 230) Shortly after the companies were formed, a fourth principal, Brian Catlin, joined. (Tr. 34, 400)

Meadows sought permission from his RPR branch manager to participate as a shareholder, officer and director of the venture but was informed that he could not be an officer of an entity that would raise capital through the sale of interests in gas wells. (Tr. 654) As a result, the principals formed two separate companies, Mira Golf to recycle golf balls and Mundiger to drill and operate gas wells, although the companies shared office space. (Stip. C, E, F). RPR gave Meadows permission to be a shareholder and officer in Mira Golf and was permitted to be a shareholder of Mundiger, but was specifically denied permission to be an officer of Mundiger. (Tr. 654-655) Further, Meadows was specifically denied permission to participate in raising funds from investors for either company. (Stip. C; Tr. 654) Meadows understood that he was not to sell, suggest or recommend these securities, regardless of whether he received a commission, and that RPR did not want him contacting investors. (Tr. 707-708)

Meadows completed a written request to engage in outside business activity with Mira Golf on January 30, 1991. (Stip. D) On that document, Meadows indicated that he would not be engaged in capital raising activity. (Div. Ex. 35) By the date he completed the form, much of the money already had been raised from the Mira Golf investors. (Div. Exs. 11, 16, 18)

Meadows invested $10,000 and received ten percent of Mundiger's stock and eight and one half percent of Mira Golf's stock. (Tr. 655-656) From October 1990 through May

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[2]"M" for Meadows, "und" for Gunderson, and "iger" for Harriger.

1991, Meadows was a director and treasurer of Mira Golf. (Tr. 655; Stip. K). Further, it was testified that Meadows had signature authority, together with Harriger and Gunderson, over the checks for Mira Golf. (Tr. 520)

Meadows testified that it was initially necessary to obtain outside capital for Mira Golf. (Tr. 702) In fact, the principals invested only $100 each toward the corporation's capital. (Div. Ex. 27) Meadows did not recall disclosing to RPR that there was a need to seek additional investors for Mira Golf. (Tr. 703; Div. Ex. 35) Mundiger and Mira Golf raised nearly $900,000 from twenty-seven investors for the common stock of Mira Golf and the working interests of Mundiger. (Stip. I, J).

Meadows was a member of a group called the "Masterminds," along with Alan Pursley, David Forbess, John Derrick, Harriger and Phil McCrury (a mentor). (Tr. 526) The members of the Mastermind group were offered the opportunity to participate in various investment opportunities such as the Mundiger and Mira Golf. (Tr. 152)[3]

Mundiger offered four two-well and two single-well drilling programs. (Div. Ex. 27) Investors who participated in the first Mundiger program were offered the opportunity to participate in the next program. (Tr. 305) However, if an investor failed to participate in one of the program offerings, he could potentially lose the opportunity to invest again. (Tr. 305-306) The Division has conceded that the Respondent did not obtain investors

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[3]Respondent argues, in substance, that it was the relationships that were an outgrowth of the social activities of the Mastermind group and the Mira Vista Country Club that were the efficient agents that caused the sales in this case. More likely Meadows used the Mastermind group and the country club to develop his business including promotion of the sale of securities that are the subject of this proceeding.

acting as a salesman through RPR.[4]

No prospectus or written offering materials were used in the sale of either security. (Stip. G) The means and instruments of interstate commerce were utilized in the offer, purchase and sale of the common stock of Mira Golf and the Mundiger working interests. (Stip. H)

Meadows agreed to introduce some of his RPR clients to Gunderson. In doing so, Meadows contemplated that they might invest in the Mundiger wells.[5] (Tr. 712) Meadows views Gunderson as being very persuasive and testified that Gunderson can "sell ice to eskimos." (Tr. 713)

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[4]There has been a dispute between the parties as to the magnitude of the concession made by the Division. Respondent argues, in substance, that Division by its concession has effectively divorced Meadows from his identity as a registered representative and salesman of stock. The transcript suggests that the concession was of a more limited nature:

JUDGE LAWRENCE: Now, just so I can understand before we hear from Mr. Watson, you're saying that he was acting in the capacity of a registered representative when he sold these shares in these two companies to the investors, is that --

MR. BROWNE: No, Your Honor, we're not suggesting to the Court that he was acting in his capacity as a registered representative. What we are suggesting to the Court was that he in fact was a registered representative of a New York Stock Exchange member broker/dealer and his customers looked to him in that capacity as a securities professional and relied upon him in that capacity. I think it would be unrealistic to expect investors to know which hat Mr. Meadows was wearing at any given time. They looked to him as Jay Meadows. They looked to him as their broker. They looked to him as a securities professional.

JUDGE LAWRENCE: Now, did this pass through the entity that he worked for as a trade?

MR. BROWNE: No, Your Honor. (Tr. 14-15)

[5]Meadows argues that he did not contemplate that the introductions would produce investments. (RPFF 3) However, Meadows testified to the affirmative. (Tr. 713)

Additionally, Meadows refers to himself as a terrific salesman and admits that it may be enough to trigger a sale for him to tell a customer that he likes a certain investment or that he bought a certain stock. (Tr. 762-763) In that regard, it was testified that Meadows told several people that he had invested in Mundiger and Mira Golf.[6] (Tr. 152, 355, 709-710) and he characterized the potential investments to investors as a "sure thing"..."hugh plum" (Tr. 248), "slam dunk" deals. (Tr. 296)

Meadows did not create a due diligence file for either Mundiger or Mira Golf. However, he claims that he made a due diligence investigation. (Tr. 723) However, Meadows did not make any independent inquiry to verify the information he received from Gunderson or Harriger and relayed to investors.[7] (Tr. 738-739, 740-741, 744, 746)

The Division's witnesses included four investors. John Kane, a client of Meadows at RPR, invested a total of $48,161.45 between November 15, 1990 and January 20, 1991 in three Mundiger well packages and Mira Golf common stock. (Tr. 220, 228-229, 243, 254; Div. Exs. 12, 14, 15, 27) Alan Pursley maintained an individual retirement account with Meadows at RPR to invest in mutual funds. (Tr. 149-150) Pursley invested $5,100 in Mira Golf stock and invested $5,000 for a three percent working interest in the first Mundiger well program. (Tr. 151-152; Div. Exs.17, 27) Lewis Williams was a client of Meadows at RPR who previously traded options with Meadows. (Tr. 292-293) Beginning in November 1990, Meadows recommended investments in Mundiger and Mira Golf to

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[6]Respondent argues that the testimony results from leading and argumentative questions. (RPFF 3) These arguments are not timely. The purportedly offensive questions were not objected to by the Respondent during the trial.

[7]Respondent argues that this finding is overly broad citing to Wallace and Hawkins. (RPFF 3) This objection lacks specificity.

Williams.[8] (Tr. 294-295, 304) Williams invested in four Mundiger well programs for a total investment of $99,922.90. (Tr. 297; Div. Exs. 21, 22, 24, 25, 27) He also purchased shares of Mira Golf for $15,000. (Tr. 297; Div. Ex. 27) Sidney Poynter, who was not one of Meadows' RPR clients, invested $21,900 in March 1991 in one Mundiger well program. (Tr. 354-355; Div. Ex. 27)

Gunderson was the chief operating officer, a director and shareholder in Mundiger and was an officer, a director and shareholder in Mira Golf. (Div. Exs. 3, 19, 27, 34, 55) Harriger served as president, a director and shareholder of Mundiger and as the president, director and shareholder of Mira Golf. (Div. Exs. 3, 19, 27)

Gunderson and Harriger forced Meadows to resign his positions with Mundiger and Mira Golf in May 1991. According to a Stock Purchase Agreement signed by Meadows on May 24, 1991, Meadows retained three percent of the stock in Mira Golf and six and one half percent of Mundiger's outstanding stock and was to receive payment of $10,000 plus $1,000 per month for twelve months thereafter. Meadows received $11,000 on or about June 1, 1991 and received two additional payments of $1,000 for selling one-half of his stock back to the companies. (Stip. L, M; Div. Ex. 34) The Stock Purchase Agreement, pursuant to which Meadows sold a portion of his stock back to the companies, contains a provision conditioning the payment of funds on Meadows' refraining from disclosing information about the companies, including the companies' financial condition. (Div. Ex. 34)

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[8]Respondent objects to the Division's proposed finding on the grounds that Meadows only told Williams that Meadows purchased the securities but not that he recommended the purchase. (RPFF 3) Notwithstanding the Respondent's testimony, it is considered that when Meadows stated to a prospective investor that he purchased the stock under the circumstances here, it was obviously a solicitation to sell the securities. (Tr. 685)

The ventures collapsed in August 1991. In September 1991, Catlin assumed responsibility for operating Mundiger and began recalculating the production proceeds which had been paid to investors. (Tr. 39) Catlin ascertained that the investors had been paid more than their pro rata portion of the production from the wells in which each person invested. (Tr. 80) Catlin sent statements to each investor showing the amount of overpayment which was due to Mundiger or to be off-set against future production proceeds. (Tr. 53-54; Div. Ex. 8) Catlin determined that most of the wells were not commercially productive.[9] (Tr. 68-69)

Catlin discovered that, throughout the operations of Mundiger and Mira Golf, Gunderson and Harriger misappropriated corporate funds for personal uses and converted funds for unauthorized business purposes. (Div. Exs. 29, 30, 31, 32; Respondent's Exhibit 14)

Despite his firm's admonitions, Meadows participated in raising capital for both Mundiger and Mira Golf. The testimony of investors and documentary evidence demonstrates that Meadows' role was to obtain investors and that he solicited the investments from some of the investors. (Tr. 150-151, 230-231, 238, 294-295, 371, 398, 407; Div. Ex. 55) Meadows' assertion that his role was solely to invest any "excess capital" for Mundiger and Mira Golf is wholly unsupported.

Each of the four principals brought expertise to the enterprises: Gunderson had business experience in both ventures, Harriger, an attorney, would handle administrative and legal matters, Meadows had contacts with people with money for investment, and

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[9]The respondent argues that only one of the wells was unproductive. (RPFF 3-4, citing to Div. Ex. 33) However, the use of the word unproductive alone without a qualifier such as "commercially" is not understood from this record.

Catlin, a certified public accountant ("CPA"), would perform accounting duties.[10] (Tr. 36, 225, 230, 333, 397-398, 402)

At the outset of the ventures, Meadows bragged that, given two days, he could sell all the interests in the Mundiger well packages. (Tr. 403) Harriger testified that after Meadows learned from his branch manager that he should not participate as originally planned, Meadows was less active for a couple weeks. However, Meadows quickly resumed his participation in both companies and approached potential investors about investing in Mira Golf and Mundiger. (Tr. 403-404)

Meadows denies that he participated in selling Mundiger and Mira Golf interests but his testimony on this point is not credible. Meadows testified that, if RPR concluded that he had engaged in capital raising activities for Mundiger and Mira Golf, he would be dismissed. (Tr. 704-705)

In approximately April 1991, during a discussion of proposed salaries, Meadows claimed that he had intrinsic value to the companies and that he had raised $750,000 from investors. (Tr. 404-405). He wanted a salary commensurate with the amount he raised. (Tr. 407) Harriger disputed Meadows' claim because, at that time, only $680,000 had been raised by the two companies. (Tr. 406) However, Harriger credits Meadows with having raised between $400,000 and $500,000. (Tr. 405-407)

Four investors testified that Meadows recommended investments in one or both of these companies to them. Three were Meadows' clients at RPR. Meadows presented the investments singly and in concert with Gunderson and Harriger. Meadows independently made representations, was present when Gunderson and Harriger made

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[10]The Division has not alleged that Catlin made representations to investors or participated in raising capital for the ventures.

representations about the companies, and supported the representations made by Gunderson and Harriger. (Tr. 150-172, 222-252, 294-323, 355-362)

The investors understood that Meadows' role was to raise money.[11] Two investors testified that they believed Meadows did not receive a commission for selling interests in Mundiger, but rather benefitted by his ownership interest in Mundiger, which retained an interest in each of the wells. (Tr. 271-272, 230, 333-334, 336, 362).

Kane testified that Meadows initially presented the investments to him and recommended that he invest. (Tr. 222-223, 226). At this presentations Meadows made representations and a "sales pitch." (Tr. 231) Kane attended two meetings with Meadows at the RPR offices during which Meadows solicited or participated in soliciting Kane's investment. (Tr. 239, 241) On four of the five occasions Kane invested, he delivered his investment checks to Meadows at RPR or left them with RPR's cashier to deposit into a Mundiger account maintained at RPR. (Tr. 238)

Meadows recommended that Kane sell securities out of his RPR brokerage account to purchase interests in Mundiger and Mira Golf. (Tr. 236-237) Meadows recommended that Kane sell a Sara Lee option contract and use the $5,000 profit to purchase 20,000 shares of Mira Golf. (Tr. 226) Kane delivered a check for the Mira Golf investment to Harriger. Harriger gave Kane a stock certificate to evidence the investment which Kane took to the RPR offices for Meadows' signature. (Tr. 238)

In late January 1991, Meadows solicited Kane's second purchase of 20,000 Mira

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[11]Similar testimony was provided by Harriger: "Jay had the contacts and knew the people in town to raise money." (Tr. 398) Respondent makes a broad brush attack on Harriger's credibility while attempting to suggest that he was under FBI investigation. (RPFF 10) The Division argues persuasively that the attack is unfounded and that there is no current FBI investigation. Further, I found Harriger a credible witness without any reason to prevaricate.

Golf shares stating that Mira Golf needed more capital to purchase golf balls and fill the company's outstanding orders. (Tr. 250-251) Meadows told Kane that he had built some of the equipment used to operate Mira Golf's business. (Tr. 249) Meadows explained that the value of the company had doubled[12] within the approximately one month since Kane's prior investment and that the same number of shares would cost $10,000. (Tr. 251-252) Kane delivered his second investment check to Meadows at RPR. (Tr. 238, 250-251)

Kane testified that Meadows' participation added credibility to the investments and that he spoke to Meadows on a daily basis to discuss trading in his RPR account and these investments. (Tr. 231, 272) Kane relied on Meadows' recommendation to purchase these securities as advice from his stock broker.[13] (Tr. 237, 290)

Pursley testified that Meadows, along with Harriger, presented him information regarding Mundiger and Mira Golf and recommended the investments. (Tr. 150-151) Prior to investing, Pursley attended four meetings during which Meadows solicited his investment. (Tr. 151, 160, 164-165, 169-170) During one meeting, Pursley told Meadows that he knew nothing about either business. (Tr. 166) Pursley informed Meadows, prior to investing, that the funds Pursley had available for investing was set aside to pay his income tax obligation in April 1991. (Tr. 173) Meadows told Pursley that there was a six month payback, so Pursley would have his money back in time to pay his taxes. (Tr.

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[12]There is no proof supporting this prediction.

[13]Reliance is not an element that the Division must prove to establish a violation of the anti-fraud provisions. Hanly v. SEC, 415 F.2d 589, 596 n. 9 (2d Cir. 1969). Nevertheless, investor reliance upon Meadows' representations is evidence that Meadows participated in the selling process for these ventures and was an important factor in convincing investors to purchase these securities.

174)[14] Pursley delivered his investment checks to Meadows and Gunderson after the fourth meeting. (Tr. 171-172) As he was leaving, Pursley heard Meadows remark: "I wish all my sales were that easy." (Tr. 172) Pursley testified that it added credibility to the investment recommendation that Meadows was Pursley's stock broker. (Tr. 174)

Williams testified that Meadows recommended investments in Mundiger and Mira Golf to him beginning in September 1990. (Tr. 294-295, 297-298) Meadows approached Williams about each of these investments and Williams dealt almost exclusively with Meadows, often calling Meadows at his office at RPR. (Tr. 294-295, 303-305, 308, 312, 318) Meadows provided Williams with virtually all of the specific information about the well programs. (Tr 299, 303, 305-316) Meadows told Williams that people were lined up to invest in the wells. (Tr. 306) Meadows represented that he had all his clients in these investments and that he personally had an interest. (Tr. 321) Williams believed Meadows received an interest in both companies for raising money. (Tr. 321) In soliciting Williams' investment in Mira Golf in March 1991, Meadows stated that the company oversold its

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[14]Respondent argues that "Pursley does not specifically remember Meadows ever telling him that there was a high probability of hitting on the gas wells; that the payback was going to be very good; that you could make your money back even if one of the wells didn't produce; or that by becoming involved in two wells you could cut your risks significantly. Tr. 155, line 17; 156, line 2. Pursley does not specifically remember Meadows ever telling him about a 6-month payback; that investment money for Mira Golf would be used to buy old golf balls for $.25 that would retail at $.65; or that after all golf balls were sold once or twice all of the stockholders would get their initial investments back. Tr. 159, line 16 - 160, line 2. When he invested, Pursley believed Meadows to be an investor just like the other investors. He never had information suggesting otherwise until four or five months thereafter. Tr. 168." RPFF page 5. It is considered that these cites to the record, purportedly contradicting the main thrust of Pursley's testimony that Meadows induced the purchases by extravagant and unproven claims, are strained. Even though Pursley did not recall with exact precision who was present at all the promotional meetings, the record supports the view that Meadows was heavily involved in selling to Pursley, as was Gunderson, and that he made the extravagant claims upon which Pursley predicated his purchases.

inventory and needed money to purchase more balls. (Tr. 318-319) Meadows said he was at the factory and personally watched over the business. (Tr. 319)

Meadows calculated the book value of the shares at the time Williams invested and offered Williams a three percent interest for $15,000. (Tr. 319; Div, Ex. 27) As a result, Williams paid more for his shares than other investors. (Div. Ex. 27) Williams talked almost exclusively to Meadows regarding Mira Golf. (Tr. 320) Williams financed each of his investments by transferring funds from either his RPR brokerage account or trust account into Mundiger's RPR account. (Tr. 304, 307) Meadows knew that Williams borrowed money from his trust account on a line of credit to make his later investments. (Tr. 309-310) Williams testified that it lent credibility that his stock broker recommended these investments and he would not have invested absent Meadows' recommendation.[15] (Tr. 323)

Poynter, who was not a client of Meadows at RPR, testified that, in the spring of 1991, Meadows mentioned that he had invested in Mundiger. Meadows later contacted Poynter to advise him that an interest was available in a well package. (Tr. 355-357) Poynter asked why an interest was available and whether the investments were successful. Meadows explained that the programs were successful but that an interest was available because not all of the investors were "strong enough" financially to continue investing. (Tr. 356-357)

Meadows arranged a meeting between Poynter and Gunderson at which

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[15]Respondent argues that Williams had some expertise in gas. (RPFF 9) However, this expertise did not extend to gas drilling. (Tr. 335) Additionally, Respondent contends that Aiken influenced the sales to Williams. In reading Respondent's cite to the record it appears that Meadows advised Williams that Aiken's bought an interest - not that Aikens affirmatively tried to interest Williams. (Tr. 323)

Gunderson explained the details of the drilling program. (Tr. 357) Poynter called Meadows to inform him of Poynter's decision to invest. (Tr. 358-359) Meadows then picked up the investment check from Poynter's home. (Tr. 359)

Poynter relied on Meadows as a licensed stock broker. Poynter testified that he made his decision to invest based upon his relationship and confidence in Meadows and that Meadows sold him the security. (Tr. 362-363, 371) Had Meadows not recommended the investment, Poynter never would have gotten involved.[16] (Tr. 362-363)

Davis Forbess, a brokerage customer since 1989 of Meadows and a friend testified in his behalf. (Tr. 529) He was present at a Mastermind meeting when Gunderson made a presentation. (Tr. 529). Some weeks prior to the presentation he made an investigation of Gunderson. (Tr. 545). One informant advised the witness with respect to Gunderson that to enter into a transaction with him he had "to be careful; I needed to cover all the bases; I needed to make sure I had an ironclad deal, from a business judgment perspective." (Tr. 546) Another informant advised "that I choose not to do business from his prior experience as an attorney representing Marc's father-in-law and they left it at that. They didn't want to go any further. But that was enough for me." (Tr. 546) Based on this information, Forbess did not invest.[17]

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[16]Respondent argues, in substance, that he did not try to sell Poynter. (citing to Tr. 367) However, the record reflects that Meadows communicated his excitement to Poynter having made the investment himself. It is fair to assume that this was merely a sales tactic.

[17]The record is contradictory as to whether he communicated this information to the Respondent and at one point the witness claimed he didn't recall. (Tr. 542-543) There was an effort to question the witness on this and it is noted that there were extended objections raised by the Respondent. Considering the long and friendly relations between the Respondent and the witness it seems very likely that the negative information was communicated to Meadows and he withheld the information from his customers who bought an interest.

Meadows made numerous false representations and failed to disclose information to investors while soliciting investments in both companies. Meadows misrepresented the risks associated with the investments, the likelihood that the ventures would be profitable, and the time periods required for return of their investments. Meadows falsely represented that the investment in each company was a "sure thing" and that investors would receive full return on their investment within six to 18 months. (Tr. 154-156, 224, 232-233, 247-248, 296)

Meadows also failed to disclose material facts in his promotion of Mundiger and Mira Golf. Meadows knew that investors' funds were commingled among the Mundiger well programs. (Tr. 734) Further, he knew that investment funds were commingled with corporate funds. (Tr. 734) Meadows knew that Catlin, as a CPA, recommended at the inception of these ventures the use of separate bank accounts for the well programs. (Tr. 737) Meadows testified that he recognized the risks to investors of not having the funds segregated, if the funds are improperly handled. (Tr. 736) Meadows did not disclose that the funds from all of the programs would be commingled into one bank account. (Tr. 173, 235, 301, 361)

Meadows failed to disclose that he made no inquiry to verify the information provided to him by Gunderson and Harriger, thus, that he had no reasonable basis for recommending investment in the securities. Further, he never reviewed the corporate bank records. (Tr. 723, 738-739) Meadows also did not disclose that either company was insolvent. (Tr. 302, 361)

Meadows failed to investigate and therefore failed to disclose information he received suggesting that Gunderson had misappropriated bonds totalling $200,000. (Tr. 726-728)

Kane believes he lost his investment because Meadows failed to conduct a due diligence search. (Tr. 287) Pursley believed that, in recommending the investments in Mundiger and Mira Golf, Meadows had a reasonable basis for the recommendation. (Tr. 212)

Meadows misrepresented that, in the Mundiger well programs, there was a very high probability of hitting gas. (Tr. 155, 296) Further, Meadows stated, with no reasonable basis in fact, that there was only a six percent chance of a well not "coming in" and that risk was due solely to human error. (Tr. 155-156)

In soliciting investments in the second, third and fourth Mundiger well programs, Meadows misrepresented the success of the prior well programs. Meadows stated that the earlier wells had hit and were very successful and he provided investors with specific production figures. (Tr. 239-240, 298, 305-308, 311-312, 316, 356) Meadows told investors that the first well was a big producer and investors would receive a full return on their investment in only six to eight months. (Tr. 232-233)

Investors relied on Meadows' representations that the prior wells were successful in deciding to invest in later programs. (Tr. 243, 309, 313, 356-357) Meadows stated that based upon the flow of the first two wells, the investors would receive their money back within a year. (Tr. 232-233, 245) The figures provided were represented as production rates, as opposed to open flow rates. (Tr. 316) In reality, most of the Mundiger wells were not economically viable and at least one was a "dry hole." (Div. Ex. 33)

While soliciting investments in the third well program, Meadows represented that the program involved re-opening a well which was already producing large quantities of gas and was a "sure thing." (Tr. 239-240, 247-248) Meadows provided specifics of the current production of the re-entry well, the production history and what was anticipated.

(Tr. 247-249, 276) According to the production records on file with the Texas Railroad Commission, which Meadows never made an effort to check, the re-entry well had not produced in several years and, then, produced only nominally. (Tr. 70-72)

Meadows failed to disclose that certain wells were losing money or were likely to be unproductive, and that investors would not receive the return they were led to expect. Meadows did not disclose that he failed to contact the Texas Railroad Commission to verify the production of the re-entry well or of any other well. (Tr. 746) Meadows never contacted the well operator or engineer, who were known to Meadows, to verify the information provided to him by the defendants. (Tr. 741, 746) One investor who called the purchaser of gas from the Mundiger wells received production flow information that was lower than represented by Meadows. (Tr. 342)

Meadows misrepresented his role in Mundiger. Prior to investing, Meadows stated that he did not have any reason, different from Pursley, to be enthusiastic about the investments. (Tr. 167) As a result, Pursley believed Meadows was an investor in the well programs. (Tr. 167) Meadows did not disclose that he was a shareholder in Mundiger who retained an interest in all the wells. (Tr. 167-168)

Meadows failed to disclose information he had about the use of investor funds. Investors understood that their investment funds would be used to drill the wells in which they invested. (Tr. 156, 234-235, 299) They also understood that their return on investment would be paid based upon their pro-rata share of production proceeds. (Tr. 233-234, 299-300) Instead, both the investment funds and production proceeds were commingled such that investor funds from a later program were used to pay purported production revenue from an earlier program. (Tr. 58-60, 80)

The investors did not receive the promised returns and the ventures were not

successful. Investors received less from their Mundiger investments than Meadows led them to expect although their initial production payments were substantially more than actual production proceeds. (Tr. 158, 175-177, 245-246, 252-254, 321-324, 360-362; Div. Exs. 8, 9, 20, 48, 54) None of the investors in Mundiger received a return of their investment. (Respondent's Exhibit 31)[18]

When Pursley received his first revenue check, it was much smaller than he was expecting. Pursley called Meadows and asked how to calculate how much his check should be. Meadows told Pursley that given a six month payback on his investment, he should just divide the amount invested by six to determine the monthly return. (Tr. 178-179) Meadows method of calculating investment returns was unrelated to production.

In reality, some investors were initially overpaid based upon the actual production from their respective wells. Thus the funds initially paid to investors were not derived solely from the sale of gas from the wells in which they invested. Ultimately, investors did not receive the return they were promised. (Tr. 158, 175-177, 245-246, 252-254, 321-324, 360-362; Respondent's Exhibit 31)

Based upon Meadows' representations, Kane expected approximately $3,000 per month as a return on his Mundiger investments. However, Kane received between $600 and $800 per month for approximately six months, for a total of less than $5,000. He has lost approximately $45,000 from his investments.[19] (Tr. 245-246, 252-254)

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[18]Respondent argues that the investors could receive the benefit of 100% or more on their investment. RPFF page 19. This claim misconstrues the tax law as discussed in the record. Tr. 782. If an investor is in the 39% bracket and he loses $ 1000 and the lose is deductible he would receive the benefit of $390 not $1,000.

[19]As noted by the Division during the hearing, the tax benefits, if any, claimed by the investors should not be considered in determining the amount of investor losses. See Randall v. Loftsgaarden, 478 U.S. 647, 663-64 (1986) (holding that damages in a private

Pursley expected to receive about $800 per month based on the information he received from Meadows. Pursley began receiving checks in the spring of 1991. The largest check he received was approximately $300. Pursley invested a total of $10,100 and lost approximately $9,000. (Tr. 158, 175-177)

Williams made his last Mundiger investment in March of 1991 and started receiving revenue checks in April of 1991. Of the $115,000 Williams invested in these two ventures, he lost over $100,000. (Tr. 321-324)

Poynter invested $21,900 and received less than $900 return on his investment. Thus, Poynter lost over $21,000 on the investment. (Tr. 360-362)

Meadows similarly misrepresented and failed to disclose the risk and return associated with investing in Mira Golf. Meadows stated that the funds invested in Mira Golf would be used to purchase golf balls and that the investments would be secured by the company's inventory in golf balls. (Tr. 157, 317-320) Meadows and the defendants told investors that after the balls "turned over" once or twice, they would get their initial investment back. (Tr. 159) Meadows represented that Mira Golf had a two tier structure to provide that the investors would receive full return of their investments before he, Gunderson, Harriger or Catlin received any distributions. (Tr. 167)

Meadows provided information to investors regarding the margin the company would receive on the golf balls. (Tr. 159, 318-319) Meadows represented that he worked at the factory and personally watched over the business. (Tr. 319) Further, Meadows represented that Gunderson's father was in the golf ball recycling business and was making money "hand over fist." (Tr. 320)

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action under Section 10(b) of the Exchange Act should not be reduced by the amount of tax benefits to effectuate the deterrent purpose of the Exchange Act).

In reality, investors only received one disbursement from their Mira Golf investment, amounting to five percent of their total investment. (Tr. 177) Pursley received $250, losing nearly $5,000. (Tr. 177) Kane received $800, losing over $14,000 on his investment in Mira Golf. (Tr. 254) Williams received $750, losing over $14,000. (Tr. 297, 320-321)

Meadows was aware that Mira Golf obtained a bank loan shortly after the company's inception. Meadows and the three other principals guaranteed the loan. (Tr. 61-62) However, Meadows did not disclose the Mira Golf bank loan to investors.

Meadows never disclosed that he and the other principals only paid $100 for their interests in Mira Golf, and therefore contributed only $400 total toward the company's capital. (Tr. 179, 660, 702; Div. Ex. 27)

There were numerous red flags which indicated problems in the ventures. While Gunderson and Harriger conducted the day to day operations of the companies, the four principals conducted meetings once or twice each month to discuss the management of the companies. During these meetings, there was a free flow of information among all the principals. (Tr. 63-64)

Meadows guaranteed the Mira Golf bank loan which was obtained shortly after the company's inception. (Tr. 61-62) The fact that the company took out a loan soon after inception and after raising funds from investors was a red flag to indicate that the investors' and company's funds were not sufficient to capitalize the venture.

During the formation of Mundiger, the four principals discussed creating separate bank accounts for each Mundiger gas program. Meadows was aware that Catlin, as a CPA, recommended the separation of funds and, in fact, Meadows concurred in that recommendation. Nevertheless, all of the funds from the Mundiger programs were placed

into one bank account. (Tr. 58-60, 737)

Meadows failed to disclose to investors the commingling of funds. (Tr. 235, 301, 361) Meadows was aware that there were different investors in each of the programs and that each of the programs was independent of the others. At any given time, each company had one or two accounts, however, the accounts were used for all purposes. (Tr. 59) Mundiger had an account at RPR, Meadows' brokerage firm. (Div. Ex. 28) Meadows deposited investment funds into that account. (Tr. 238, 304) Further, Meadows received investment funds directly from some investors. (Tr. 171, 238, 304, 359) The commingling of funds should have alerted Meadows that investors' interests were not being adequately protected.

Meadows testified that he later learned that the $10,000 he invested for his interest in both companies was used entirely for Mundiger. (Tr. 660) In December of 1990, the defendants changed the lock on the corporate offices, thereby prohibiting Meadows from entering after business hours.[20] (Tr. 409-410, 660-662)

In April 1991, the principals had a meeting during which salaries for Gunderson and Harriger were discussed. Originally, only Gunderson was to receive a salary. Meadows was extremely displeased that Harriger was also planning to draw a salary from the companies. Further, Meadows thought the proposed salaries were too high. (Tr. 64-65, 404-405, 663-664)

Meadows testified that he believed Gunderson was independently wealthy. Meadows also stated he was aware that Gunderson was unemployed at the time the

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[20]Harriger and Meadows both testified that Gunderson and Harriger changed the lock because Meadows was sneaking into the office at night. Harriger was concerned about Meadows looking at personal and client information that Harriger kept in the office.

companies were formed, that he was making $4,000 per month salary from the companies and that Gunderson never had much money in the brokerage account he kept with Meadows at RPR. Furthermore, Meadows knew he could not trust Gunderson. Meadows viewed Gunderson as being a "big storyteller" and a "loose cannon" in his personal life. (Tr. 723-724, 728-730)

Meadows knew, or as a stockbroker should have known, that there was inadequate documentation to support investing in Mundiger and Mira Golf. One witness for Respondent testified that he was dissatisfied with the lack of documentation, especially pro-forma and other financial documents, supporting the solicitation for these investments. He so informed Meadows and decided not to invest in these ventures. (Tr. 162-163)

In May 1991, Gunderson and Harriger forced Meadows out of the businesses. (Stip. L) This should have alerted Meadows of problems within the companies. Meadows failed to disclose the circumstances under which he was ceasing his involvement with the companies and the defendants. (Tr. 236) Further, he failed to disclose that he received more than his original investment in exchange for only a portion of his shares in each company. (Tr. 667)

Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, prohibit the employment of a fraudulent scheme or the making of material misrepresentations and omissions in and in connection with the offer, purchase or sale of any security. In proving a violation of these provisions, the Division must show: (1) that a misrepresented or omitted fact was made in an offer, attempt to induce a purchase or sale, or an actual purchase or sale of a security; (2) that the misrepresented or omitted fact was "material;" and (3) that the respondent acted with the requisite "scienter." Basic, Inc. v. Levinson, 485 U.S. 224, 240 (1988); Aaron v. SEC, 446 U.S. 680,

701-702 (1980).[21]

"[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information." Basic, Inc. v. Levinson, 485 U.S. at 240. Information is deemed material upon a showing that there is a substantial likelihood that the omitted facts would have assumed actual significance in the investment deliberations of a reasonable investor. A statement is misleading if the information disclosed does not accurately describe the facts or if insufficient data is revealed. Basic, Inc. v. Levinson, 485 U.S. at 232; see also United States v. Koenig, 388 F. Supp. 670, 700 (S.D.N.Y. 1974).

Misrepresentations and omissions of material fact regarding the risks involved in an investment, the expected return, and prior operating results of company drilling programs are factors in the basic criteria for valuing gas wells and, thereby, for evaluating an investment in such gas wells. Thomas J. Fittin, Jr., 50 S.E.C. 544 (1991).

Predictions of substantial earnings or of substantial price rises with respect to securities are material and are actionable absent a reasonable basis for the prediction. See, e.g., SEC v. R.A. Holman & Co., 366 F.2d 456, 458 (2d Cir. 1966), cert. denied, 389 U.S. 991 (1967); SEC v. Wellshire Securities, Inc., 737 F. Supp. 251, 256 (S.D.N.Y. 1990); SEC v. Rega, Fed. Sec. L. Rep. (CCH) ¶ 95,222 at 98,148 (S.D.N.Y. 1975).[22]

If no adequate basis existed for making the statement, the fraud is not ameliorated even where the positive prediction about the future performance of securities is cast as opinion or possibility rather than as a guarantee. See, e.g., Hiller v. SEC, 429 F.2d 856,

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[21]The parties have stipulated as to the use of interstate commerce. (Stip. H)

[22]Charles P. Lawrence, 43 S.E.C. 607, 610 (1967), aff'd 398 F.2d 276 (1st Cir. 1968) ("We have repeatedly held that a specific prediction of the future value of a speculative or unseasoned security is inherently fraudulent"). See also Merrill Lynch, Pierce, Fenner & Smith, Inc., 13 SEC Docket 646 (1977).

858 (2d Cir. 1970); Alexander Reid & Co., Inc., 40 S.E.C. 986, 990 (1962).

The "in connection with" requirement of Section 10(b) has been construed broadly. See Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 12 (1971). Courts have held that in using the phrase "in connection with," Congress intended "only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities." SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968), cert denied, 394 U.S. 976 (1969).

Any statement that is reasonably calculated to influence the average investor, satisfies the "in connection with" requirement. SEC v. Hasho, 784 F. Supp. 1059, 1106 (S.D.N.Y. 1992); see also SEC v. Savoy Industries, Inc., 587 F.2d 1149, 1171 (D.C. Cir. 1978); SEC v. Texas Gulf Sulphur Co., 401 F.2d at 860-61. When statements made are "meant to persuade customers to purchase various securities" they are made in connection with the purchase or sale of a security. SEC v. Hasho, 784 F. Supp. at 1106.

A showing of scienter is required to prove violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. Aaron v. SEC, 446 U.S. 680, 701-702 (1980). Scienter has been described as "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n. 12 (1976).

The Fifth Circuit, where the hearing was held and where Meadows' conduct occurred, has held that scienter is established by a showing that the defendant acted intentionally or with severe recklessness. See Broad v. Rockwell Int'l Corp., 642 F.2d 929 (5th Cir.), cert. denied, 454 U.S. 965 (1981); see also Warren v. Reserve Fund, Inc., 728 F.2d 741, 745 (5th Cir. 1984); Hackbart v. Holmes, 675 F.2d 1114, 1118 (10th Cir. 1982);

Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1039 (7th Cir.), cert. denied, 434 U.S. 875 (1977). Recklessness has been defined as highly unreasonable conduct involving not merely simple or excusable negligence, but an extreme departure from the standards of ordinary care. SEC v. Carriba Air, Inc., 681 F.2d 1318, 1324 (11th Cir. 1982); SEC v. Tome, 638 F. Supp. 596, 622 (S.D.N.Y. 1986).

Proof of recklessness may be inferred from circumstantial evidence. Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir.), cert. denied, 439 U.S. 1039 (1978).

Registered representatives who offer and sell securities owe a special duty of fair dealing to their clients. A securities salesman cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Hanly v. SEC, 415 F.2d at 597; SEC v. Hasho, 784 F. Supp. at 1107.

A registered representative may not rely solely upon a company's principals for information concerning the company but must make independent inquiry. Hanly v. SEC, 415 F.2d at 597. More thorough investigations are required when the securities are offered by smaller companies of recent origin. Id.

A registered representative's duties are not ameliorated when his customers learned about the company from someone else, had conversations with others, or did not rely on the representative in making purchases. James E. Cavallo, 49 S.E.C. 1099 (1989). "Furthermore, a registered representative is not shielded from liability if he actually believed the representations which he had no adequate basis to make." SEC v. Hasho, 784 F. Supp. at 1107, (citing, Alexander Reid & Co., Inc., 40 S.E.C. 986, 990-91 (1962)).

The Respondent moved for dismissal and argues that "the Division did not prove a violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act or Rule 10b-5 promulgated thereunder. To have violated Section 17(a), Meadows must have been a seller of securities. SEC v. Hasho, 784 F. Supp. at 1105, Farlow v. Peat Marwick Mitchell & Co., 666 F. Supp. 1500, 1508 (W.D. Okla. 1977) (citing Aaron v. SEC, 446 U.S. 680, 687 (1980)). Pinter v. Dahl, 486 U.S. 622 (1988).[23]

Respecting Section 10(b) and Rule 10b-5, Respondent argues that to have violated these provisions he must have been a principal, and he must have acted with scienter — which, even using a recklessness standard, requires "severe recklessness," amounting to "a state of mind equivalent to an intent to deceive." Tuchman v. DSC Communications Corp., 14 F.3d 1061, 1067 (5th Cir. 1994); Huddleston v. Herman & MacClain, 640 F.2d 534, 545 (5th Cir. 1981), aff'd in part and rev'd in part, 459 U.S. 375 (1983).

The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. at 193 n. 12 (1976). Severe recklessness is "'limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that

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[23]Meadows quotes the following passages from Pinter: "When a person who urges another to make a securities purchase acts merely to assist the buyer, not only is it uncommon to say that the buyer 'purchased' from him, but it is also strained to describe the giving of gratuitous advice, even strongly or enthusiastically, as 'soliciting.'" Id. at 647; A crucial element is direct personal financial benefit resulting from the sale. Id. at 647, 654; "The person who gratuitously urges another to make a particular investment decision is not, in any meaningful sense, requesting value in exchange for his suggestion . . . ." Id. at 647; Thus, one who is "motivated entirely by a gratuitous desire to share an attractive investment opportunity with his friends and associates" is not a "seller" as that term is used in Section 12 or Section 17(a). Id. at 655.

the defendant must have been aware of it.'" Tuchman, 14 F.3d at 106 (quoting Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961-62 (5th Cir. 1981) (en banc), cert. denied, 454 U.S. 965 (1981)).

Following Hochfelder, the Fifth Circuit in Section 10(b) cases has approved of requiring proof of "conduct which is so extreme as to be a form of intentional conduct or behavior equivalent to an intent to deceive, manipulate or defraud." Huddleston, 640 F.2d at 545 (quoting jury charge of the trial court). "Rather than being 'merely a greater degree of ordinary negligence,' recklessness is closer to a 'lesser form of intent.'" Vucinich v. Paine, Webber, Jackson & Curtis, Inc., 739 F.2d 1434, 1435 (9th Cir. 1984). Fraud by hindsight, moreover, is not sufficient to establish the mental state required for a violation of Section 10(b). See e.g., Borow v. nVIEW Corp., 829 F. Supp. 828, 840 (E.D. Va. 1993) (striking pleadings on the grounds of failure "to state the facts suggesting that defendants knew they were making false statements or adopting any allegedly false predictions of others . . . [thus pleading] fraud by hindsight, which is insufficient for purposes of stating a claim under Rule 10b-5"); see also Crummere v. Smith Barney, 624 F. Supp. 751 (S.D.N.Y. 1985) (requiring causal connection between misstatements or omissions and purchase or sale, and noting there can be no such connection when misstatement occurs after purchase).

The Respondent further argues that Meadows certainly was not a principal, and the Division's case failed to establish scienter. "The Supreme Court recently concluded that there is no secondary or aiding and abetting liability for violations of Section 10(b) and rule 10b-5. Central Bank of Denver v. First Interstate Bank of Denver, 114 S. Ct. 1439 (1994).

Meadows further argues, by implication, that his role in Mira Golf and Mundiger was minimal inasmuch as he

> held no office in Mundiger. He was the nominal Treasurer and a nominal director of Mira Golf, but he did not engage in any operational or managerial activities. He was not a member of the Mira Golf Executive Committee. He did not have experience or information with respect to the operations of Mundiger or Mira Golf. He relied on the expertise of Gunderson and Harriger, and the blessing of Bob Akin, Sr. He had no role in the pricing of securities. He sold no securities. He was excluded from company offices. Accordingly, Meadows was not a principal of Mundiger or Mira Golf, and he had no control over the operations of either company. Because Meadows (1) was not a principal of either company, (2) had no control over the operation or management of either company, and (3) sold no securities of either company, he could not have been a primary violator of Section 10(b) or Rule 10b-5. Because there is no secondary or aider and abettor liability for violations of Section 10(b) and Rule 10b-5, and Meadows could not be a primary violator, there is no jurisdiction for proceeding against him thereunder.

(RPFF pages 4-32)

Respondent argues, by inference, that he did not have a full and fair hearing (RPFF pages 19-22) and that based on the failure of the Division to prove its case no sanction is warranted. Additionally, Respondent argues that the actual production from the Muniger wells has not been provided. (RPFF page 33)

Final Conclusion and Discussion

Based upon the foregoing findings of fact, conclusions of law and the following discussion it is determined that the Respondent, a registered representative in the employ of a broker dealer, wilfully violated Section 17(a) of the Securities Act and 10(b) of the Exchange Act and Rule 10b-5 thereunder. Notwithstanding Meadow's protestations and testimony to the contrary, which I don't find credible, it is found that for pecuniary gain and in violation of the law he was instrumental in effecting the fraudulent sale of a substantial number of shares in Mundiger and Mira Golf to the detriment of numerous investors who incurred large loses.

The threshold question raised by Respondent is whether the Division's case under Section 17(a) of the Exchange Act should be dismissed on account of Respondent not

being a seller. From a factual standpoint it is considered that respondent was a seller. Second, it does not appear, as Respondent argues, that the Division stipulated that the Meadows was not a seller as defined by Section 17(a) of the Securities Act and the cases that interpreted that section. Finally, even if he was not a seller it appears that the case is still cognizable under Section 17(a). As set out in the findings, the Division stipulated that Meadows was not acting as a registered representative for the broker dealer who employed him at the time of the critical transactions. But he was nevertheless a registered representative at all significant times and the public viewed him in that capacity and were encouraged to buy securities from him because of that status. As the Division stated in substance Meadows could not remove his registered representative status like a hat. The record makes it obvious that Meadows was a seller.

Respondent places principal reliance on the Pinter case which defines a seller under Section 12 of the Securities Act. The Division argues that Section 12 is limited to private rights of action, which are not at issue in this case. However, there is no showing that the Pinter court ever intended such a limitation and it is considered that the Pinter definition of sales is applicable here under Section 17(a) of the Securities Act: "The language and purpose of § 12(1) suggests that liability extends only to the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the security owner. If he had such a motivation, it is fair to say the buyer 'purchased' the security from him and to align him with the owner in a rescission action." Pinter, 486 U.S. 645, 647.[24]

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[24]The Division plausibly argues that the Court in Pinter "interpreted the term seller as it applies only to a private action for recision under Section 12(1) of the Securities Act." Division's Reply brief, page 12.

In the instant case Meadows was a co-founder and a principal in both corporations and an officer of Mira Golf. When the discussion of salaries came up he indicated that he was entitled to a substantial salary based on the amount of investment money he had procured. Accordingly, it is considered that Meadows violated Section 17(a) of the Securities Act inasmuch as the record shows that he was motivated for financial gain when he solicited the investments for both corporations and is therefore a seller or offerer as defined by Pinter. The transparent scheme of telling some buyers[25] that he can't sell to them and turning them over to Gunderson to consummate the transactions does not save Meadows from liability under Section 17(a).

Assuming arguendo that the Division is correct in that Pinter is inapplicable as it relates only to Section 12(1), it is considered that Meadows is still liable under Section 17(a). In U.S. v. Dukow, 330 F. Supp. 360 (W.D. Pa. 1971) the court held that even though the defendant was not be a party to sales made by brokerage personnel, he was part of the scheme and was not exonerated from charges of securities fraud. Similarly in Fund of Funds Ltd. v. Arthur Andersen & Co., 545 F. Supp. 1314 (S.D.N.Y. 1982), the court held that "securities laws include as a seller entities which proximately cause the sale ... or whose conduct is a 'substantial factor in causing a purchaser to buy a security.'" 545 F. Supp. at 1353 (quoting Lawler v. Gilliam, 569 F.2d 1283, 1287 (4th Cir. 1978))[26] Of similar import is John R. Brick, 46 S.E.C. 43 (1975), where the Commission rejected the notions that there is magic in the term "seller" and that a registered representative

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[25] In some cases such as that of investor Poynter, Meadows picked up the purchase check at Poynter's home after Poynter called Meadows indicating he would like to invest.

[26] Arguably, Pinter eliminates the proximate cause theory that Fund of Funds depends on. However, if Pinter is limited to 12(1) cases, as argued by the Division, then the proximate cause theory of liability under 17(a) is still viable.

could avoid liability by advising clients to make there own investment decisions. See also SEC v. American Commodity Exchange, Inc., 546 F.2d 1361 (10th Cir. 1976)

Lower court cases relied on by Respondent are SEC v. Hasho, 784 F. Supp. 1059 (S.D.N.Y. 1992), and Farlow v. Peat Marwick Mitchell & Co., 666 F. Supp. 1500 (W.D. Okla. 1987). The Hasho decision turned on the point that a "registered representative is not shielded from [securities fraud] liability if he actually believed representations which he had no adequate basis to make." 784 F. Supp. at 1107. This point is applicable to the instant case assuming one were to believe the respondent had no inkling of the falsity of his representations, which seems most unlikely.[27] Affirming the idea that you need a sales or offer under Section 17(a) could be considered dicta in Hasho. The main point of Farlow was that the plaintiff must do more than allege that the defendant was a substantial factor in the sale but must also allege facts which tend to show that the defendant participated in the buy/sell transaction. The Division has shown that Meadows did participate in the buy/sell transactions here. Based on the foregoing considerations, Respondents renewed motion to dismiss under Section 17(a) on the contention that failing to show that Meadows was a seller is denied. It is considered that Meadows was a fraudulent seller or offeror or the proximate cause of fraudulent sales and is liable under 17(a) of the Securities Act.

The Respondent attempts to avoid liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by contending that the Division has not proved scienter. It is considered that Meadows has amply demonstrated scienter in soliciting investors for these speculative and unseasoned enterprises using such expressions to prospective

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[27]Meadows' reference to the investments as a "sure thing" makes it very doubtful that he believed his representations.

investors referring to the investments as "sure thing," "slam dunk" and "low risk." Additionally, it is noted that Meadows had no reasonable basis to use such superlatives in attempting to effect a sale. See Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969). In Hanly it was indicated that earnings predictions with respect to a speculative security are inherently misleading without disclosing the basis and uncertainties. Further, it is considered that the use of such adjectives in the context of this case reflects that Meadows willfully committed the fraudulent acts complained of herein.[28]

Meadows was reckless within the meaning of Rule 10b-5 inasmuch as his acts were "so highly unreasonable and such a departure from the standard of ordinary care as to present a danger of misleading [investors] to the extent that the danger was either known to the [Respondent] or so obvious that he must have been aware of it." Hoffman v. Esterbrook & Co., 587 F.2d 509, 517 (1st Cir. Mass. 1978) (quoting Sanders v. John Nuveen Co, 554 F.2d 790, 793 (7th Cir. 1977).

It is additionally noted that Meadows was a principal inasmuch as he was a director and treasurer of Mira Golf and a founder and substantial shareholder in both corporations. Accordingly, the limitations set out in the Central Bank of Denver case on indirect liability is inapplicable here as Meadows directly defrauded the investors as a principal and violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Meadows claims that he had no duty to investigate Mundiger or Mira Golf prior to recommending them to investors. This view is predicated on the notion that he received

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[28]Meadows claims that Ratzlaf v. U.S., 510 U.S. __, __, 114 S. Ct. 655, 659, changes the meaning of wilfulness so that intent versus mere knowledge of what one is doing must be shown. (RPFF page 29) It is considered that the Division's response is correct that Ratzlaf is limited to criminal cases involving anti-structuring provisions of currency reporting requirements and is inapplicable here. (Division's Reply brief, page 11)

no commission and that RPR did not execute the trades. The Division's cite to Pinter to the effect that a financial benefit may involve either a brokerage commission or a "share of the profits" is applicable to this case and it is considered that Meadows is in the same position as if he received a commission. As the court indicated in Hanly, "It is clear that a salesman must not merely avoid affirmative misstatements when he recommends the stock to a customer; he must also disclose adverse facts of which he is or should be aware." 415 F.2d at 592 (quoting Richard J. Buck & Co., 43 S.E.C. 998, 1006 (1968)). In the context of the instant case, this would have required Meadows to have made an investigation at least to the level made by Forbess, a prospective investor, discussed supra. He would then have been a position to advise the investors of the very doubtful reputation of Gunderson, the main promoter of both corporations. As discussed supra, it appears likely that Meadows had adverse information which he received from Forbess and other sources and he withheld it from the investors.

The Respondent raises the issue that he did not secure a fair hearing inasmuch as he disagrees with evidentiary and other rulings that were adverse to its position. Such an objection was not raised at the hearing and a fair reading of the transcript does not support the claim.

A sampling of the items Respondent cites reflect obvious justification for each of the rulings. For instance he complains that an objection was sustained during Respondent's opening remarks. (Tr.16) The nature of the objection was that Respondent's opening statement went beyond the probable record. Respondent didn't deny this contention. (RPFF page 16) An objection was sustained to the Respondent's offering evidence on a stock purchase which was not in issue in the case. (Tr. 193) There was no showing that the evidence was relevant. Similarly, an objection was sustained in

connection with a question that had been asked and answered previously. (Tr. 269-70) The Respondent did not deny that the question was repetitive.

An objection was sustained in connection with a clearly leading question: "Did Gunderson make the entire presentation at the meeting." (Tr. 269-270) It should be kept in mind that whether Meadows participated in the presentation at the meeting was in issue. A proper series of opening questions would have been: "Were there presentations made at the meeting? Who made them?" Respondent complains that he was limited in inquiring as to whether the investors at the Mastermind Club were speculators. (RPFF page 20) The Respondent's lawyer acquiesced in the ruling of the administrative law judge: "If the judge has heard enough that these are speculative investors, that is fine." (Tr. 499) These examples are representative of the rulings that Respondent complains of and that were made in this case. Respondent's contention that he did not receive a fair hearing appears baseless.

Sanctions

Imposition of administrative sanctions requires consideration of:

> ...the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that his occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir., 1979), aff'd on other grounds, 450 U.S. 91 (1981). The amount of a sanctions depends on the facts of each case and the value of the sanction in preventing a recurrence. Berko v. SEC, 316 F.2d 137, 141 (2d Cir. 1963); Leo Glassman, 46 S.E.C. 209, 211 (1975); Richard C. Spangler, Inc., 46 S.E.C. 238, 254 n. 67 (1976).

Considering Meadows' repeated willful violations of the anti-fraud provisions of the

federal securities laws and his persistent denial of any wrongdoing in his participation in the offer and sale of Mundiger and Mira Golf interests, his failure to acknowledge his professional responsibilities as a registered representative, his breach of his understandings with his broker-dealer RPR, his present employment as a registered representative with RPR, and the likelihood that he will engage in further fraudulent activity in the future, upon careful consideration of the record, the arguments and contentions of the parties, it is concluded that it is in the public interest that Meadows be sanctioned as follows:

ORDER

IT IS ORDERED that Jay Houston Meadow be barred from association with any broker or dealer under Section 15(b)(6) of the Exchange Act with a right to reapply in two years to the appropriate regulatory agency or, where there is none, to the Securities and Exchange Commission. Meadows is ordered under Section 21C of the Exchange Act to permanently cease and desist from committing or causing any violation and committing or causing any future violation of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Meadows is ordered under Section 21B of the Exchange Act to pay to the Commission, on behalf of the United States Treasury a civil money penalty of $100,000.[29]

This order shall become effective in accordance with and subject to the provisions

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[29]Payment should be by certified check payable to the Securities and Exchange Commission, bearing on its face the caption: "Jay Houston Meadows, Administrative Proceeding Number 3-8257." The check should be sent to the Office of the Controller, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington D.C. 20549, within 30 days of the issuance of this decision.

of Rule 17(f) of the Rules of Practice.

Pursuant to Rule 17(f) of the Rules of Practice, 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.

Glenn Robert Lawrence
Administrative Law Judge

Washington, D.C.
September 19, 1994