

INITIAL DECISION RELEASE NO. 273
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11179

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of :
:
IFG NETWORK SECURITIES, INC., :
WILLIAM KISSINGER, KISSINGER : INITIAL DECISION
ADVISORY, INC., BERT MILLER, : February 10, 2005
GLENN WILKINSON, and :
DAVID LEDBETTER :

APPEARANCES: M. Graham Loomis, William S. Dixon, and William P. Hicks for the
Division of Enforcement, Securities and Exchange Commission

Alexander D. Bono, Timothy D. Katsiff, and Evan H. Lechtman of Blank
Rome LLP for Respondents William Kissinger and Kissinger Advisory,
Inc.

Edwin J. Tomko of McManemin & Smith, P.C. for Respondent Bert
Miller

Thomas A. Ferrigno, Roberta Koss, and Hebba M. Hassanein of Hughes
Hubbard & Reed LLP for Respondent Glenn Wilkinson

Peter J. Anderson, Brian L. Rubin, Rebecca L. Burnaugh, Lawrence A.
Dany, and Olga Greenburg of Sutherland Asbill & Brennan LLP for
Respondents IFG Network Securities, Inc., and David Ledbetter

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision dismisses charges brought against a broker-dealer, its president, and three of its registered representatives. The charges concerned sales practices in selling Class B shares of mutual funds.

I. INTRODUCTION

A. Procedural Background

The Securities and Exchange Commission (Commission) initiated this proceeding by an Order Instituting Proceedings (OIP) on July 15, 2003. The proceeding was authorized pursuant to: Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act) against IFG Network Securities, Inc. (IFG), and David Ledbetter (Ledbetter); Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (Advisers Act) against Kissinger Advisory, Inc. (Kissinger Advisory); Section 8A of the Securities Act of 1933 (Securities Act), Sections 15(b) and 21C of the Exchange Act, and Sections 203(f) and 203(k) of the Advisers Act against William Kissinger (Kissinger); and Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act against Bert Miller (Miller) and Glenn Wilkinson (Wilkinson). Subsequently, the Commission dismissed Kissinger Advisory, which no longer exists, as a party to the proceeding. IFG Network Sec., Inc., 83 SEC Docket 1103 (July 13, 2004).

The undersigned held a twenty-two day hearing between October 27 and December 12, 2003. Hearing sessions were held in Baltimore, Maryland (October 27-30), Houston, Texas (November 3-5), Wilmington, North Carolina (November 12-14), and Washington, D.C. (November 17-20, December 3-5, and December 8-12). A large number of witnesses testified, including Respondents, customers, representatives of mutual funds, and expert witnesses, and a vast number of exhibits were admitted into evidence.¹

The findings and conclusions in this Initial Decision are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 97-104 (1981). Pursuant to the Administrative Procedure Act, 5 U.S.C. § 557(c), the following posthearing pleadings were considered: (1) the Division of Enforcement's (Division) February 25, 2004, Proposed Findings of Fact and Conclusions of Law and Post Hearing Brief; (2) IFG and Ledbetter's March 17, 2004, Proposed Findings of Fact and Conclusions of Law; (3) Kissinger and Kissinger Advisory's March 17, 2004, Proposed Findings of Fact and Conclusions of Law; (4) Miller's March 17, 2004, Proposed Findings of Fact and Conclusions of Law and Post Hearing Brief and Response to the Division's Brief; (5) Wilkinson's March 17, 2004, Counter Statement of Proposed Findings of Fact and Conclusions of Law and Opposition to Enforcement's Post-Hearing Brief; and (6) the Division's May 24, 2004, Reply. All arguments and proposed findings and conclusions that are inconsistent with this Initial Decision were considered and rejected.

¹ Citations to the transcript will be noted as "Tr. ___." The Division's exhibits will be noted as "Div. Ex. ___," IFG and Ledbetter's as "IFG Ex. ___," Kissinger's as "K. Ex. ___," Miller's as "M. Ex. ___," and Wilkinson's as "W. Ex. ___."

B. Allegations and Arguments of the Parties

This proceeding concerns the sale of Class B mutual fund shares to retail customers by three registered representatives – Kissinger, Miller, and Wilkinson – associated with IFG, a broker-dealer that operates through registered representatives and small branch offices that are independent contractors. The OIP alleges that, between July 1, 1998, and December 31, 2000 (the relevant period), they recommended to customers that they invest \$250,000 or more in Class B shares of mutual funds “without disclosing . . . [t]hat Class A shares of the mutual funds that they were purchasing would have produced materially higher returns than Class B shares of the same mutual funds” because of the availability of breakpoints and lower annual expenses for Class A shares, and “[t]hat the investments in Class B shares as opposed to Class A shares of the same mutual funds significantly increased the commissions paid.” Additionally, the OIP alleges that Kissinger and Kissinger Advisory failed to disclose to the customers that investments of \$250,000 or more in Class A shares of the same mutual funds would have entitled them to breakpoints and that comparable discounts on sales charges were not available for investments in Class B shares of \$250,000 or more. Thus, the OIP alleges that Kissinger, Miller, and Wilkinson willfully violated Securities Act Section 17(a), and Exchange Act Section 10(b) and Rule 10b-5; and that Kissinger Advisory (an investment adviser operated by Kissinger) willfully violated Advisers Act Sections 206(1) and 206(2) and Kissinger willfully aided and abetted or caused those violations.

The OIP charges that IFG and its president, Ledbetter, failed reasonably to supervise Kissinger, Miller, and Wilkinson with a view toward detecting and/or preventing violations of the securities laws. The OIP alleges that IFG’s supervisory system was inadequate because it failed to: designate supervisors for Kissinger, Miller, and Wilkinson; require regular review of their customer files by anyone other than themselves; and adequately ensure that they properly disclosed material facts regarding multiple-class shares of mutual funds to their customers. The OIP charges that Ledbetter failed to: take reasonable steps to supervise their transactions; effectively delegate their supervision to anyone else; and recognize or respond to red flags, such as exception reports, a deficiency letter from Commission staff, and a customer complaint.

Respondents Kissinger, Miller, and Wilkinson do not dispute that they did not tell their customers that investments of \$250,000 or more in Class A shares would have produced materially higher returns than Class B shares of the same mutual funds. The Respondents argue that, in fact, depending on variables, Class B shares sometimes outperform Class A shares, and Class A shares sometimes outperform Class B shares. Kissinger states that he did not discuss breakpoints with customers who were not interested in purchasing Class A shares. Respondents Kissinger, Miller, and Wilkinson do not dispute that they did not tell their customers that they would receive higher commissions for the sale of Class B shares than for the sale of Class A Shares. The Respondents point out that the prospectuses that they provided to the customers describe the features of each share class, including the expense ratios of Class A and B shares, breakpoints available in the purchase of Class A shares and the ways to obtain breakpoints through combining purchases in different funds in the same family or over time, and the dealer concessions and commissions paid on Class A and B shares. The Respondents argue that if there

is a need for greater disclosure, new requirements should be adopted prospectively by rule making, rather than imposed retroactively through enforcement action.

The Division requests that Kissinger, Miller, and Wilkinson be barred from association with any broker-dealer, that Kissinger also be barred from association with any investment adviser, and that Ledbetter be barred from association in a supervisory capacity with any broker-dealer. The Division also requests that Kissinger, Miller, and Wilkinson be ordered to cease and desist from violations of the antifraud provisions. The Division also requests disgorgement of ill-gotten gains, reflecting excess commissions from the sale of Class B shares, of \$44,904 from Kissinger, \$59,992 from Miller, \$35,346 from Wilkinson, and \$9,495 from IFG. The Division also requests that each of the individuals be ordered to pay a civil penalty of \$100,000 and IFG be ordered to pay \$300,000. The Respondents request that the proceeding be dismissed.

II. FINDINGS OF FACT

A. MUTUAL FUNDS²

1. Sales Charges, Fees, and Commissions

A mutual fund (also referred to as an open-end investment company) is a company that pools money from many investors and invests in a portfolio of various securities. The mutual funds at issue in this proceeding, like many others, offered “Class A” and “Class B” shares in the same underlying investment portfolio.³ As is typical, each class, however, was subject to

² The findings of fact in this section are based on: information concerning mutual funds that is publicly available on the Commission’s Web site (www.sec.gov), of which official notice is taken pursuant to 17 C.F.R. § 201.323; and prospectuses, statements of additional information (SAIs), and testimony of representatives of the specific funds at issue in this proceeding in the AIM, Oppenheimer, Kemper, MFS, and Putnam families of funds. Prospectuses and SAIs are found at: Div. Exs. 165-233, IFG Ex. 206A, W. Exs. 17, 19, 24, 27, 29, 34, 51-52, 54, 56, 58, 65, 67-68, 70, 73-74, 77-80, 96, 98, 100, 103-04, 107, 114-16, 122-23, 132-38, 151-53, 165-66, 168-74, 184-92, 206, 230-31, 251, 273, 387 (AIM); Div. Exs. 236-247b (Kemper); Div. Exs. 248-279 (Oppenheimer); Div. Exs. 309-15, 327-50 (Putnam); Div. Exs. 316-26, 351-62 (MFS). Additionally, representatives of the funds testified concerning their features. Tr. 1201-71 (AIM), 2587-2649 (MFS), 2757-2834 (Putnam), 2994-3106 (Kemper), 4102-84 (Oppenheimer). Additionally, Lee Pickard, who was accepted as an expert in industry practice, testified concerning disclosures about compensation. Tr. 4550, 4558-59.

³ Funds offering multiple share classes became common after the April 1995 effective date of Rule 18f-3 under the Investment Company Act of 1940 (Investment Company Act), which permits mutual funds to issue multiple classes of shares representing interests in the same portfolio. See 17 C.F.R. § 270.18f-3. Previously, funds seeking to issue multiple classes of shares were required to obtain exemptive orders from the Commission’s staff. The Commission had permitted such arrangements on a case-by-case basis dating back to 1985. See Exemption for Certain Open-End Management Investment Companies to Impose Contingent Deferred Sales Loads (Final Rule), 58 SEC Docket 2487, 60 Fed. Reg. 11887 (Mar. 2, 1995); Exemptions for

different sales charges and expenses, which would cause their performance results to differ. The funds at issue were marketed to investors through broker-dealers, and the classes also differed as to the commissions paid to brokers who sold them.

The commissions brokers receive when they sell fund shares are paid by purchasers of Class A and Class B shares in different ways. The investor who buys A shares pays an initial sales charge, or front-end load, at the time of purchase, most or all of which is paid to the broker. The initial sales charge reduces the amount of the investor's money available to purchase shares. No sales charge is assessed when Class B shares are purchased, so all of the investor's money purchases shares. The commission paid up-front to the broker is, in essence, financed over a period of time by two means: (1) a charge, known as a contingent deferred sales charge (CDSC),⁴ imposed on the redemption of shares that declines over time, and (2) a portion of an ongoing, asset-based, fee known as a 12b-1 fee.⁵ Under NASD rules, the portion of such 12b-1 fees used to pay marketing, or sales, ("distribution") expenses cannot exceed 0.75% of a fund's average net assets per year. See NASD Conduct Rule 2830. The funds at issue all charged the 0.75% maximum. The front-end load and CDSC are paid directly by the investor while the 12b-1 fees are paid by the fund out of fund assets – indirectly by, and less noticeable to, the investor.⁶

As is typical, the funds at issue offered discounts that reduced or eliminated the initial sales charge for larger investments in Class A shares. The investment amounts at which a fund offers these discounts are referred to as "breakpoints." The maximum front-end load on the A shares of the funds at issue was between 4.75% and 5.75%, depending on the fund. At the \$250,000 breakpoint, the charge dropped to between 2% and 3%, depending on the fund. At \$500,000 the sales charge was usually 2%, and at \$1 million, zero.

An investor can achieve a breakpoint by aggregating multiple purchases over a specified period through the exercise of the investor's "rights of accumulation." In addition, an investor

Certain Registered Open-End Management Investment Companies to Impose Deferred Sales Loads (NPRM), 42 SEC Docket 257, 259-60 & n.16, 53 Fed. Reg. 45275, 45277-80 & n.16 (Nov. 9, 1988).

⁴ The CDSC is also referred to as a back-end sales load. It is more accurately referred to as "spread-load," but this term has fallen out of usage.

⁵ The 12b-1 fee is authorized by Rule 12b-1 under the Investment Company Act. See 17 C.F.R. § 270.12b-1. As adopted in 1980, the rule permits a fund to pay "distribution" expenses, including broker's commissions, and shareholder service expenses from fund assets. For a concise history of the rule, see William P. Dukes and James B. Wilcox, The Difference Between Application and Interpretation of the Law as It Applies to SEC Rule 12b-1 Under the Investment Company Act of 1940, 27 New Eng. L. Rev. 9 (1992).

⁶ In addition to the sales charges and marketing fees, additional operating expenses, such as management fees paid to the fund's investment adviser for investment portfolio management, are paid out of fund assets and are, thus, ultimately borne by shareholders of both classes.

can sign a “letter of intent,” pursuant to which the investor represents to the fund that he or she will purchase over a set period of time an amount of fund shares that equals or exceeds the amount required to obtain a breakpoint discount.

The CDSC for the funds at issue started at 4% or 5%, depending on the fund, and declined to zero after six years. After six or eight years, depending on the fund, the B shares converted to A shares, thus eliminating the difference in expenses resulting from the 0.75% 12b-1 “distribution” fees imposed on B shares. As is typical, breakpoint discounts were not available for purchases of Class B shares. However, as is typical, the CDSC for the funds at issue was not imposed on all redemptions: It was not imposed on appreciation, as it was calculated on the lower of the original purchase price or the current market value of the shares being redeemed. Nor was it imposed on shares purchased with dividends or capital gains distributions.⁷ Additionally, the CDSC was not imposed on redemptions made according to a plan of systematic withdrawal of up to 10% or 12% per year, depending on the fund. The CDSC was not imposed on the required minimum distribution from a retirement account after age seventy and one half. Finally, the CDSC was waived in case of death or disability after the purchase of the fund.

The commission, also referred to as “dealer concession” or “reallowance,” that brokers received for customer purchases at the \$250,000 level for the funds at issue was as follows:

	Class A	Class B
AIM Category II	2%	3.75% (plus an advance of the first year’s 0.25% “service fee,” also referred to as a “trail commission”)
Category I	2.5%	
Oppenheimer	2%	3.75% (plus an advance of the first year’s 0.25% service fee)
Kemper	2.25%	3.75% (plus an advance of the first year’s 0.25% service fee)
Putnam	2%	4%
MFS	2.25%	3.75% (plus an advance of the first year’s 0.25% service fee)

It was not industry practice during the relevant period for brokers to disclose to customers the differential compensation they received for selling A and B shares. Tr. 4558-59; IFG Ex. 203A at 4-5.

⁷ Investors earn money from their mutual fund purchases in several ways, including dividend payments and capital gains distributions. Funds usually give investors a choice as to how these payments or distributions are made: the fund can send the investor a check or other form of payment; or the investor can have his or her dividends or distributions reinvested in the fund to purchase more shares.

Mutual funds are required to have prospectuses and statements of additional information (SAI). The prospectus contains information about the fund's fees and expenses, investment objectives, investment strategies, risks, performance, and pricing, among other things. The SAI conveys information about the fund that is not necessarily needed by investors to make an informed investment decision. It allows the fund to expand on the information described in the prospectus and includes information about the fund's officers and directors, tax matters, and brokerage commissions. Funds are not required to provide investors with the SAI, but they must furnish investors with it upon request and without charge.

During the relevant period AIM and Putnam limited a customer's purchases of Class B to \$250,000 per order per day; Kemper and Oppenheimer had a \$500,000 limit.⁸ MFS prospectuses did not indicate any limit on Class B purchases during the relevant period.⁹

2. Relative Performance of Class A and B Shares

The OIP alleges that Kissinger, Miller, and Wilkinson recommended that customers invest \$250,000 or more in Class B shares of mutual funds "without disclosing . . . [t]hat Class A shares of the mutual funds that they were purchasing would have produced materially higher returns than Class B shares of the same mutual funds" because of the availability of breakpoints and lower annual expenses for Class A shares. Much space in the record is devoted to the issue of whether Class A shares produce materially higher returns than Class B shares at the \$250,000 level. Tr. 1937-2089, 2218-2379, 4519-4545 (testimony of Edward S. O'Neal [O'Neal] and exhibits referred to therein); Tr. 3873-3950, 3974-4072, 4094-4101 (testimony of Carl J. Santillo [Santillo] and exhibits referred to therein).¹⁰

The record shows that an investment of \$250,000 in Class A shares will outperform an investment in Class B shares in many, but not all, circumstances. Variables that affect the relative performance of each class include: the holding period, tax considerations, withdrawal rate, and rate of return. Systematic withdrawals may make an investment in Class B shares more financially advantageous, especially if started soon after the investment is made. Also, a waiver of the CDSC in case of death or disability will make an investment in Class B shares more

⁸ Some AIM and Putnam prospectuses set the limit at more than \$250,000, others, at \$250,000 or less. Div. Exs. 312 at 10, 336 at 10, 330 at 9; W. Exs. 17 at 3, 51 at A-1, 133 at A-1. Kemper and Oppenheimer set the limit at \$500,000 or less. Div. Exs. 236 at 39, 241 at 33, 270 at 15, 275A at 26, 275B at 17.

⁹ MFS had a guideline limiting Class B purchases to less than \$1 million because, at \$1 million, customers could purchase Class A shares without any up-front sales charge. Tr. 2621, 2628.

¹⁰ O'Neal testified for the Division, and Carl Santillo, for Wilkinson. Each was accepted as an expert for the purpose of opining on the relative returns of A shares and B shares. Tr. 2001, 3885-86. The undersigned did not rely on the testimony of a third expert witness, Ross Tulman. Tr. 2864-2965, 3107-3213, 3250-3432.

financially advantageous if such an event occurs within the first several years of the investment. These generalizations are supported by the evidence presented by both O’Neal and Santillo. O’Neal summarized his view by testifying that A shares will generally outperform B shares at the \$250,000 investment level, unless the investor starts a systematic withdrawal plan shortly after making the investment, dies, or becomes disabled. Tr. 2347-48. Santillo summarized his view by testifying that B shares perform best on early account closure where the CDSC is waived; when there are major early withdrawals where a CDSC is avoided, whether in accordance with a plan of systematic withdrawal or because the CDSC is not applied to dividends, capital gains, and appreciation; with lower rates of return; with higher withdrawal rates; and with higher taxes. Class A shares perform best with no withdrawals, high investment yields, and ignoring taxes. Tr. 3934.

B. Respondents

1. IFG and Ledbetter

a. IFG

IFG was, and is, a broker-dealer that operates through registered representatives and branch offices that are independent contractors. Div. Ex. 161 at IFG62692. Thus, its form of organization contrasts with that of a broker-dealer such as Merrill Lynch that has numerous large branches and employees and is self-clearing. Other than mutual fund transactions that were submitted by application directly to the fund company, IFG cleared through Pershing, a division of Donaldson Lufkin & Jenrette Securities Corporation. Tr. 2527, 2532; Div. Ex. 109. During the relevant period IFG had about 100 Offices of Supervisory Jurisdiction (OSJs)¹¹ and about 100 additional branch offices affiliated with the OSJs.¹² Tr. 2657-58. It had about 400 to 600 registered representatives. Tr. 2658. Kissinger, Miller, and Wilkinson were each a principal and manager of his own OSJ. Tr. 2411.

The sale of mutual funds was a major portion of IFG registered representatives’ business. Tr. 2465, 2472. IFG retained 8% of the commissions received from such sales in return for the “back-office” services it performed. Tr. 57, 856, 1390.

¹¹ OSJs and branch offices are defined in NASD Conduct Rule 3010. The NASD, formerly known as the National Association of Securities Dealers, is a self-regulatory organization, operating under Commission supervision, of firms in the over-the-counter market. One of its basic purposes is to establish and enforce fair and equitable rules of securities trading.

¹² IFG’s processes of acquiring and terminating OSJ principals were unstructured. Tr. 2675-81. Generally, someone in IFG would sponsor someone who had been in the business awhile as a prospective OSJ principal, and IFG marketing and other employees would interview the candidate. Tr. 2444, 2675-78. No one person could retain a new OSJ principal without the consent of others, but the president, director of compliance, and others could veto a candidate. Tr. 2675-78. Likewise, an OSJ principal might be terminated by a process of consensus, usually for low production. Tr. 2679-81.

IFG's home office had several departments headed by general securities principals, who reported to Ledbetter in connection with compliance matters. Tr. 4446-48; Div. Ex. 161 at IFG62678-79. Supervision of the supervising principals of the OSJs was diffused among the home office principals, including the business review principals, trading officer, operations officer, and advertising review principal, depending on the functional area. Tr. 2417-18, 2440-43, 2445-47, 2661, 4446-47. IFG's president was ultimately responsible for supervision of OSJ principals such as Kissinger, Miller, and Wilkinson. Tr. 2417-18, 2451, 4446-48.

Wilkinson understood Ledbetter, IFG's president during much of the relevant period, to be his ultimate supervisor, but not direct supervisor responsible for supervising his transactions, advertising, or seminars, as Ledbetter had delegated these responsibilities to others within the organization. Tr. 1531-32. He considered the chain to run from those individuals through compliance to Ledbetter. Tr. 1539-42. Miller considered Don Gilbert, a business review principal, to be his immediate supervisor during the relevant period. Tr. 930-31. Kissinger considered Julie Ann Sullivan (Sullivan) or Ledbetter to be his immediate supervisor. Tr. 291.

Sullivan was IFG's chief compliance officer during part of the relevant period. Tr. 2403-04. Edward Woll (Woll) also worked in compliance at IFG during part of the relevant period, reporting to Sullivan. Tr. 2526-31, 2562. Patricia Ann Elebash (Elebash) worked as a business review principal during part of the relevant period. Tr. 2836-41. All three have since left IFG. Tr. 2403, 2562, 2835.

The Commission's Atlanta District Office staff sent a deficiency letter to Ledbetter on January 13, 1999, following its June 24, 1998, examination of IFG. Div. Ex. 162. The letter addressed a number of topics, including "numerous instances where customers purchased quantities of class B shares that exceeded, equaled or came close to the quantity limits permitted by the mutual funds." Div. Ex. 162 at 3. The letter also noted "some investors were purchasing large quantities of class B money market fund shares." Div. Ex. 162 at 3. The letter stated, "[T]he economic benefit to these investors is not apparent given the alternative classes and fee structures available." Div. Ex. 162 at 3-4. IFG responded in a March 26, 1999, letter from Ledbetter. Div. Ex. 123. The compliance department obtained information from the representatives involved in the questioned investments and helped prepare the reply. Tr. 2479-80. IFG did not contact the customers who made the questioned investments. Tr. 2432. The reply explained that the money market purchases were merely the first step, as an administrative convenience, in a plan of allocations into various mutual funds and that the investments remained in the money market fund for very short periods. Div. Ex. 123 at 3. The reply analyzed each of the Class B mutual fund purchases cited in the staff letter, noted that each fell within prospectus limits and explained each customer's reasons for selecting the investment. Div. Ex. 123. IFG further responded to the deficiency letter by sending its May 10, 1999, Compliance Alert to its registered representatives. Tr. 2467-68; Div. Ex. 43.

NASD letters of caution to IFG dated February 10, 1999, and December 1, 2000, referenced a concern, in general terms, that the firm's written supervisory procedures did not adequately address the sale of mutual funds. Div. Exs. 66, 88. The letters of caution did not mention Class B shares. Div. Exs. 66, 88.

IFG's method of supervising the adequacy of disclosures by OSJ representatives included review of sales literature by IFG's advertising review principal, review of all transactions by business review principals,¹³ exception reports,¹⁴ information updates, annual training sessions, a compliance procedures manual, a bridge book, Compliance Alerts, a mutual fund multiple class disclosure form (multi-class disclosure form), and customer complaints. Tr. 2406-13, 2426-30, 2444-45, 2455, 2460-61, 2464-72, 2532-36, 2670-74, 4452-63, 4488-89; Div. Exs. 43, 44, 115, 118, 119, 161; IFG Exs. 222, 228. A mutual fund coordinator answered representatives' questions about mutual funds. Tr. 2683. The compliance department conducted annual audits of branch offices and OSJs that included reviewing customer files of OSJ principals. Tr. 2418, 2420, 3737-38. Additionally, OSJ principals, including Kissinger, Miller, and Wilkinson, had frequent contact with home office principals. Tr. 1447, 2423-25, 3840. No specific procedure guaranteed 100% disclosure, but IFG had no indication that registered representatives failed to furnish prospectuses to investors. Tr. 2438-39, 2846.

The business review principals reviewed transactions for such issues as suitability and sales practice violations, e.g., mutual fund switching and breakpoint violations. Tr. 2661-70, 2691. In evaluating suitability, they considered data from the customer's new account form, including the customer's objectives, net worth, tax status, and the type of account. Tr. 2841-42, 4460-61. In reviewing an application for an investment of \$250,000 or more in Class B shares, they looked for, but did not require, the multi-class disclosure form to document the registered representative's disclosure. Tr. 2842-44, 2851-52. They reviewed transactions for compliance with prospectus limits of \$250,000 or \$500,000 for B shares, per fund per day. Tr. 2847, 4462-64. They considered whether Class A shares would be more suitable if there was some reason for concern.¹⁵ Tr. 2686-90.

¹³ OSJ principals reviewed the transactions of registered representatives in their offices before sending the new account forms and applications to IFG. Tr. 2411-12, 2861-62. IFG's business review principals reviewed those transactions as well as OSJ principals' own transactions. Tr. 2661, 2861-62.

¹⁴ IFG had an exception report, using data from Pershing, that selected trades over a specified size that were executed through Pershing. Tr. 2532-33. The exception report was reviewed by business review principals. Tr. 2535-36.

¹⁵ For example, in one instance where IFG detected a large sale of Class B shares, the client, when contacted by Ledbetter, was insistent on the transaction. In another, IFG detected sales that were to the registered representative's family members, and the transactions were changed to drop all sales charges. Tr. 2483-84. In a third, IFG sent a letter, signed by Ledbetter, to two IFG customers concerning their wish to invest \$8 million in Class B shares in \$240,000 purchases of twenty different mutual funds. The letter detailed the sales charges and fees applicable to investments in Class A and B shares of various amounts, stressing that there is no sales charge for an investment of \$1 million in Class A shares. The letter asked the customers to acknowledge reading and understanding the description of these features. Tr. 2721-28; Div. Ex. 163.

Business review principals referred transactions about which they had concerns to compliance, rather than contacting the customer directly. Tr. 2447, 2844, 2853. Elebash believed that the compliance personnel took their responsibilities seriously. Tr. 2854. Compliance had the authority to cancel trades, and business review did not. Tr. 2860. In Sullivan's experience, if compliance thought a transaction should be reversed, it would be reversed. Tr. 2486.

The multi-class disclosure form explained to the prospective investor, in general terms and in plain English, the features of Class A and B shares. Div. Ex. 44 at 2-3. It stated that each fund had its own schedule of fees, set forth in its prospectus, which the registered representative was required to provide prior to purchase. Div. Ex. 44 at 2. It urged the investor to read the prospectus carefully and ask his representative to explain any part that was not clear. Div. Ex. 44 at 2. The form stressed that Class A shares are especially advantageous for investors who can invest enough to reach a reduced commission breakpoint and noted that, for this reason, many funds will not accept a Class B investment over \$500,000.¹⁶ The form contained a block, which the customer signed, in which he listed his investment choices, confirmed that he had received and reviewed the prospectuses, understood the sales charges associated with the class of shares he had selected, and that he had had an opportunity to discuss all issues with his registered representative. Div. Ex. 44 at 3. IFG developed the multi-class disclosure form at the end of 1998, and recommended, but did not require, its use for investments over \$250,000.¹⁷ Tr. 2433-34, 2463, 2843, 2851, 4500-03; Div. Ex. 44 at 1.

IFG audits reviewed the books and records, blotters, complaint files, and advertising files. Tr. 2472. The auditor also chose a sample of customer files that had recent transactions to look for undisclosed complaints, signed blank documents, checks, indications of selling away, or documentation that did not make sense. Tr. 2472. Sampling, rather than a review of all client files, was in accordance with industry practice. Tr. 2472-73. IFG audits included a checklist with a section on mutual funds that was developed with the help of a consulting firm. Tr. 2436-37, 2472-76; IFG Ex. 171.

IFG had ten or fewer complaints per year related to mutual funds, and none concerned the adequacy of disclosures with respect to the relative performance of Class A and B shares at the \$250,000 level. Tr. 4482-83. The only significant complaint concerning the sale of mutual funds during the relevant period was that of Kissinger customer Myrna Moran. Tr. 4482. During the relevant period IFG had mutual fund sales of about \$1.5 billion. Tr. 4482.

¹⁶ Some mutual fund companies accepted Class B investments up to \$500,000, and others, up to \$250,000. The form mentioned \$500,000 to be inclusive. Tr. 2542-43, 2576.

¹⁷ Wilkinson began using the form in June 1999. Tr. 1416, 1524, 3855-56. Miller never used the form. Tr. 886, 920-21, 939-40. Kissinger used the form with some of his customers. Tr. 228, 383-85, 1901.

Sullivan and others attended professional meetings, such as quarterly meetings of an organization of financial planners, NASD meetings, and meetings of an association of compliance professionals. 2452-54. Multi-class share disclosure was discussed at the meetings. Tr. 2452-53. IFG's method of attempting to ensure that all material facts were disclosed to customers – training, review of transactions, customer complaints, audits, and exception reports – was consistent with industry practice. Tr. 2443, 2454. During the relevant period no one in the industry had a requirement that the customer sign a document similar to IFG's multi-class disclosure form before Class B trades over \$250,000 could be approved. Tr. 2858. Based on NASD training and information, Elebash believed that IFG was acting consistently with other firms regarding Class B shares. Tr. 2854-55.

Woll became interested in comparing the total returns of Class A and B shares. Tr. 2546-51. He compared actual past performance using CDA Weisenberger software, but found the results hard to interpret; the performance of Class A and B shares was more similar than he had expected. Tr. 2546-47. He understood that there were factors other than the higher 12b-1 fees associated with Class B shares affecting performance, but never understood what those additional factors were or how they affected relative performance. Tr. 2548-51, 2565-66. Woll participated in drafting the multi-class disclosure form. Tr. 2541-43.

b. Ledbetter

Ledbetter, born in 1941, was at one time a certified public accountant and worked at the Price Waterhouse accounting firm between 1965 and 1976. Tr. 2650-52, 4445. Subsequently, he entered the securities business and became a registered representative. Tr. 2652-54. He became president of IFG in November 1989 and held that position until May 2000, when he was demoted, without explanation, to vice president, a position he holds now.¹⁸ Tr. 2654-56. During the relevant period his annual salary was \$125,000 to \$135,000. Tr. 4446.

Ledbetter understood that he had ultimate responsibility for compliance while he was president of IFG. Tr. 4493-95. The IFG department heads reported to Ledbetter in connection with compliance. Tr. 4448. His management technique was “management by walking around”; daily, on arrival, he went to the office of each department head and discussed concerns of the day. The entire route took two hours. Tr. 4448-52. This was his method of verifying that they were supervising adequately and were on top of all issues that had arisen. Tr. 4452. In the early 1990s Ledbetter was also IFG's chief compliance officer; Sullivan succeeded him in that position. Tr. 2657. Ledbetter was always involved in compliance issues; while the compliance department handled less important matters without consulting him, Ledbetter was very accessible. Tr. 2445, 2456, 2737-38.

The deficiency letter, the NASD letters of caution, and Myrna Moran's complaint did not indicate to Ledbetter that IFG had a problem with adequacy of disclosure. Tr. 4468-77; Div. Exs. 66, 88. These events were discussed at IFG, however, and IFG issued the May 1999

¹⁸ In his present position Ledbetter assists registered representatives but has no supervisory responsibilities over them. Tr. 2656-57.

Compliance Alert strongly recommending use of the multi-class share disclosure form for B share purchases over \$250,000. Tr. 2704-08, 2711-16; Div. Ex. 43. During the relevant period when Ledbetter was president, it was not his understanding that A shares could outperform B shares at various investment levels.¹⁹ Tr. 2740. He did not task anyone at IFG to compare the performance of A and B shares after receiving the deficiency letter. Tr. 2701-02; Div. Ex. 162. Ledbetter's understanding of the activities of the business review principals in reviewing transactions for possible improprieties was anecdotal, based on conversations with them over the years. Tr. 2688-92. Ledbetter did not know whether the review for breakpoint violations included Class B share sales. Tr. 4517-18.

Sullivan, who worked for Ledbetter for ten years, considers him to be of the highest integrity. Tr. 2484-85. Woll considers Ledbetter to be very concerned with compliance with the securities laws. Tr. 2568. Elebash considers that he is one of the nicest, kindest people she has ever met and that he has a reputation of unquestioned integrity among the people who worked with him. Tr. 2855-56. He also has a reputation of being very thorough, very analytical, and looking in great detail at all sides of an issue. Tr. 2856. This was consistent with his demeanor and testimony at the hearing.

2. Wilkinson

Wilkinson was born in 1952. Tr. 1380. After high school he volunteered for the draft. Tr. 3690-91. He is a graduate of the U.S. Military Academy, to which he received an appointment after a year as an enlisted man, and also has an MBA from the Florida Institute of Technology. Tr. 1380, 3691. He retired from the U.S. Army as a lieutenant colonel on November 1, 1993, after twenty years of active duty. Tr. 1381, 3691, 3695. For the last ten years of his Army career, he served in the comptroller field. Tr. 3692. He served at Fort Bragg as budget officer of the Special Operations Command and, later, as comptroller for the Delta Force. Tr. 1380-81, 3691-93. As comptroller, he controlled the funds of the unit and was also unit tax advisor and internal controls officer. Tr. 3693. He began working as a registered representative, with the permission of his superiors, in 1991, while he was still in the Army. Tr. 3693-95.

Wilkinson was registered with IFG from 1992 to July 1, 2001.²⁰ Tr. 1381, 3697. During the relevant period he had four staffed offices, with two to five employees, in Wilmington, N.C., Fayetteville, N.C., Myrtle Beach, S.C., and Charleston, S.C. Tr. 1381-84. The Fayetteville office was the OSJ, and the others were branch offices. Tr. 1384-85. The staff included additional registered representatives: Robert Penn, Jason Wheeler, Rod Adelstone, Chris St. John, Pam Tormey, and Shannon Umana. Tr. 1385-89. During the relevant period about 80% of

¹⁹ Woll has a vague, general recollection of discussing \$250,000 Class B transactions with Ledbetter. Tr. 2537-41. Ledbetter does not have a recollection of such discussions. Tr. 2700-01, 4464-68. There is no meaningful conflict in their testimony because the recollection of both was vague. Tr. 2537-41, 2700-01.

²⁰ Wilkinson is now registered with Morgan Stanley. Tr. 3697-98.

Wilkinson's revenue was derived from commissions from mutual fund sales. Tr. 1390-92. Revenues for Wilkinson's fiscal years ended June 30, 1998, were \$700,000 to \$900,000; June 30, 1999, about \$1.1 million; and June 30, 2000, about \$2.2 million. Tr. 1390-91.

Wilkinson no longer sells mutual funds. Tr. 3699. He has abandoned his previous buy-and-hold strategy for an active management approach and seeks a different clientele for his business. Tr. 3699.

Wilkinson has no previous disciplinary history. Tr. 3700. The investigation and proceeding have had a devastating impact on him, financially and personally. Tr. 3786-87.

Richard Hayford, presently the civilian Director of Facility Management at the Joint Special Operations Command at Fort Bragg, North Carolina, retired as an Army Colonel in 1996. Tr. 1727. His military career brought him to Fort Bragg in 1989 as executive officer of the special operations unit in which Wilkinson was a comptroller. Tr. 1727-28. When Hayford was Wilkinson's supervisor, Wilkinson was responsible for oversight of various funds, including training, research and development, procurement, and special mission funds, which spent money in non-standard ways. Tr. 1730-32. Audits showed Wilkinson to be above reproach, and Hayford considers him professional, competent, conscientious, trustworthy, and honest, and considers his character above reproach. Tr. 1731-33. Wilkinson founded and actively supports a scholarship fund for dependents of members of his old Army unit and manages its investment portfolio. Tr. 1729-30, 1733-34, 3700. Since Wilkinson's retirement from the Army, Hayford sees him in connection with the scholarship fund. Tr. 1729-30, 1733-34.

Rodney Adelstone was employed as a registered representative with Wilkinson in Myrtle Beach, from November 1998 to April 2000. Tr. 1796-97. He considers Wilkinson to be very energetic and intelligent and to have a high degree of integrity. Tr. 1803-04. He also considers Wilkinson to be conscientious about compliance, noting that he contacted IFG on any compliance questions that arose. Tr. 1807-08.

During the relevant period Wilkinson did not believe that, as a general rule, A shares would materially outperform B shares at the \$250,000 level. Tr. 3859. He had been introduced to B shares by the AIM distributor in 1994. Tr. 1511. Wilkinson then sought information on which class was appropriate at different investment levels and found no guidance from the NASD or the Commission. Tr. 1512-13. In 1995, based on simple calculations from figures contained in AIM's marketing materials, Wilkinson concluded that A shares would not outperform B shares until a 2% breakpoint was reached, at the \$500,000 level. Tr. 1424-26, 1512-13, 1802, 1806-07, 3728-33. He found that withdrawals and the rate of return each had an impact on the comparative performance of A and B shares.²¹ Tr. 3728-29. Scenarios he ran on Morningstar Principia software, which he obtained in 1997, confirmed his conclusions.²² Tr.

²¹ The impact of systematic withdrawals on the relative performance of A and B shares was less the later the customer started the withdrawals. Tr. 3872-73.

²² The Morningstar Principia product could be used to compare the historical performance of A and B shares. Tr. 1418. The Morningstar reports did not, however, compare redemption values.

1513-15. He relied on his calculations in making recommendations to his clients. Tr. 3859. For an investment of \$500,000 or more, Wilkinson recommended Class A shares; below \$250,000 he recommended Class B shares. Tr. 1472-73, 3228-30, 3238-45, 3833. The record also shows that Wilkinson recommended Class B shares for investments between \$250,000 and \$500,000.²³ Tr. 1396, 1472-73, 3724, 3833.

Wilkinson shared his analysis with Sullivan, IFG's compliance officer. Tr. 3733. No one ever told him his analyses were wrong. Tr. 3734. IFG's business review received copies of all of Wilkinson's trades and never reversed or contacted him about any of his customers' B share purchases over \$250,000. Tr. 1501-04, 3736-37.

Wilkinson primarily recommended funds in the AIM family of funds. Tr. 1393-96, 3703. Wilkinson understood that AIM's only limit on B share investments was to restrict B share purchases to \$250,000 per customer per day. Tr. 1426, 1515. Wilkinson's opinion about Class B shares was not shaken by the \$250,000 limit. Tr. 1426-36, 1529. No one at AIM ever cautioned him against using B shares for investments over \$250,000. Tr. 3734. If a client was to invest more than \$250,000 in Class B shares, Wilkinson structured the investment to take place on more than one day. Tr. 1484-86, 1491-92. Wilkinson informed such clients that AIM limited Class B investments to \$250,000 a day. Tr. 1491-92.

Wilkinson was aware that IFG was recommending use of the multi-class disclosure form from IFG's November 2, 1998, Compliance Alert, which he discussed with Sullivan; as a result he believed that, rather than limiting Class B investments to \$250,000, IFG was recommending full disclosure, which included having the client acknowledge the disclosure by signing the form. Tr. 1440-42. Wilkinson provided information for IFG's response to the January 13, 1999, deficiency letter, which noted two of Wilkinson's customers' investments in Class B shares. Tr. 1443-47; Div. Ex. 162. Wilkinson began using the multi-class disclosure form with clients investing \$250,000 in June 1999 after receipt of IFG's May 1999 Compliance Alert and a phone call with Sullivan in which she strongly recommended that he use the form. Tr. 1416-17, 1474, 1524, 3855-56; Div. Ex. 43; W. Exs. 105, 183, 359, 360, 362. Wilkinson telephoned Sullivan almost weekly to discuss compliance matters, including questions related to Class B shares. Tr. 1447, 2434-35, 2437, 2497, 3734, 3739-41, 3840-46. She never suggested a limit on B shares.

Tr. 1536. Also, Wilkinson contacted AIM in 2001, after the relevant period when B shares had been in existence long enough to convert to A shares, and asked for a comparison based on historical data of \$250,000 investments in A and B shares, with a 9% withdrawal; the CDA Weisenberger analysis showed B shares performed slightly better than A shares. Tr. 3735-36, 3796-3807, 3830, 3858-59.

²³ During the relevant period the sales charge for an investment of \$250,000 through \$499,999 in Class A shares was 3% for an AIM Category I fund and 2.5% for a Category II fund. Tr. 1204. The difference in expense ratios for A shares and B shares was attributable to the different 12b-1 fees. Tr. 1205. During the relevant period Class A shares were charged between 25 and 50 basis points for a 12b-1 fee, depending on the fund, whereas B shares were charged 100 basis points. Tr. 1205, 1207.

Tr. 1537. Instead, she stressed that he should provide full disclosure and use the multi-class disclosure form. Tr. 3741.

IFG audited Wilkinson annually. Tr. 1521-22, 3737-38. Wilkinson made all his customer files available, and IFG's auditor selected twenty to forty files for review. Tr. 3846-47, 3866. Also available to the auditor were notes of all meetings with customers.²⁴ Tr. 1404-07, 1520-22, 1799-1800. Wilkinson discussed B shares with the auditor, who never indicated any concern with his transactions. Tr. 3738, 3866-67.

Most of Wilkinson's clients during the relevant period were at or near retirement and were buy-and-hold mutual fund investors. Tr. 1392-93, 3730. The waiver of the CDSC on death or disability is an important consideration for persons in this age range.²⁵ Tr. 3730-31. Also, for many customers the plan for their mutual fund purchases included withdrawals to supplement their Social Security or pensions.²⁶ Tr. 3741-42. Most of Wilkinson's clients who invested less than \$500,000 purchased Class B shares of AIM funds. Tr. 1396. During the relevant period he had about 1,000 customers, and a majority had less than \$500,000 to invest. Tr. 1396. About 83% of Wilkinson's mutual fund customers made investments of less than \$100,000 in Class B shares. Tr. 3784. For an investment below \$100,000, Wilkinson received a higher commission for Class A than Class B shares. Tr. 3784.

²⁴ In addition to the meetings preceding an initial investment, Wilkinson or one of the other registered representatives conducted an annual review with each client. Tr. 1403. They discussed whether the client's goals had changed, obtained current information on the client, reviewed the performance of the portfolio, and then discussed whether any changes should be made. Tr. 1404.

²⁵ Of the seven customers who testified on behalf of the Division, Harry Stone has obtained a CDSC waiver based on disability and Joan Carlson has applied for one. Tr. 3782.

²⁶ Of the seven B-share customer witnesses, three, Paul Ruckelshaus, Boyd Hammersley, and James Brenton, took planned systematic withdrawals. Tr. 1545, 1566, 1580, 3773; Div. Ex. 106 at IFG84402-02.1 (Ruckelshaus); Tr. 1671, 1697-98, 3764; W. Ex. 303 (Hammersley); Tr. 3752; W. Ex. 311 (Brenton). They also took additional withdrawals. Tr. 3774-76; Div. Ex. 106 at IFG84379-81, IFG84396-401 (Ruckelshaus); Tr. 1698-99, 3764-68; W. Exs. 304-08 (Hammersley); Tr. 3752-53; W. Ex. 310, 312 (Brenton).

Six (of seven) customers – Paul Ruckelshaus,²⁷ James L. Mitchell,²⁸ Boyd Hammersley,²⁹ Thurl Balderson,³⁰ James Brenton,³¹ and Joan Carlson³² – who testified on behalf of the Division invested between \$250,000 and \$400,000 in Class B shares through Wilkinson.³³ Tr. 1544,

²⁷ Ruckelshaus, seventy, retired in 1992 after thirty-seven years as an engineering designer in the drafting department at Westinghouse in the Baltimore area. Tr. 1543. He attended college, as did his wife, Charlotte. Tr. 1557, 1579. Mrs. Ruckelshaus taught school for thirteen years, stayed home to raise their children, and then was a real estate agent for ten years before they retired to North Carolina. Tr. 1578-79. A relative recommended Wilkinson, and they ultimately invested all of their money, about \$273,000, which had come from Ruckelshaus's lump-sum retirement payment, with Wilkinson in AIM funds. Tr. 1544, 1551, 1579-80.

²⁸ Mitchell, sixty-three, retired in 1995 as deputy superintendent of the Indiana State Police Department, after thirty-one years of service. Tr. 1601-02. His educational background included an associate's degree from Indiana University and a one-year management-training course at Northwestern University. Tr. 1602. He invested about \$300,000 in AIM funds in 2000 through Wilkinson. Tr. 1602-03, 3769-71; W. Exs. 215, 218. Most of the funds came from investments through AARP with Scudder Investments. Tr. 1603. Knowing that he would have to retire at a relatively early age, he had saved as much as possible during his working years. Tr. 1605-06.

²⁹ Hammersley, sixty, retired in 1998 as a warehouse supervisor for Philip Morris after thirty-three years with the company. Tr. 1669. He is a high school graduate with two years of college. Tr. 1669. He invested over \$300,000 in AIM funds through Wilkinson; the funds came from his profit-sharing account at Philip Morris. Tr. 1669-1671.

³⁰ Balderson, sixty-six, retired as a district manager in 1992 after thirty-six years with Giant Food, Inc. (Giant), in Landover, Maryland. Tr. 1710-11. He has a high school education. Tr. 1711. He invested about \$264,000 with Wilkinson in AIM funds in April 1999. Tr. 1711. The funds derived from the investments built up in his 401(k) plan during his years with Giant. Tr. 1711-12. After Giant was taken over by Royal Ahold, he became dissatisfied with the changed management of his 401(k) plan. Tr. 1713-14.

³¹ Brenton, sixty-three, retired in 1998 after thirty-seven years with Giant, in Landover, Maryland. Tr. 1736. In 2000 he invested about \$358,000, which had derived from his Giant 401(k) plan, in AIM funds through Wilkinson. Tr. 1736.

³² Carlson, sixty-nine, retired from teaching business subjects in college and high school in Connecticut in 1995. Tr. 1772-73. After moving to South Carolina, she determined she needed a local financial adviser and ultimately decided to transfer her investments to Wilkinson. Tr. 1774-75. She invested all of her available capital, \$400,000. Tr. 1774-75.

³³ A seventh customer, Harry Stone, invested \$170,000 in Class B shares in March and May 1999. Tr. 3778-79; Div. Ex. 137(c) at 3-4. Stone did not plan to invest more unless Wilkinson proved himself to Stone's satisfaction. Tr. 1767. After a few months Stone's account was transferred to Robert Penn. Tr. 1770, 3777-78. Ultimately, Stone invested an additional amount

1551, 1579-80, 1602-03, 1669-71, 1711, 1736, 1774-75, 3769-71; Div. Ex. 137(c); W. Exs. 215-218. All six customers at issue would have qualified for a 2 1/2% or 3% breakpoint. Tr. 1452-59. The funds for the customers' investments came from lump sum retirement payments, IRAs, 401(k) plans, and other retirement savings of the customers. Tr. 1544, 1551, 1579-80, 1603, 1669-71, 1711-14, 1736, 1774-75. None of the customers demonstrated any degree of financial sophistication, but most had sufficient education and cognitive skills to study and understand the mutual fund prospectuses had they made the effort.³⁴ Tr. 1545-50, 1556-58, 1576, 1581-85, 1587-88, 1605-09, 1612-13, 1615-16, 1678-1710, 1717-23, 1737-45, 1777-78. However, as Carlson, a retired teacher, stated, she considered herself a novice and felt it would be advisable to employ an expert to advise her. Tr. 1781. Mitchell, a retired state police superintendent, articulated a similar thought. Tr. 1605-09, 1615.

Wilkinson presented seminars as a marketing tool.³⁵ Tr. 1505-09. He obtained most of his clients from the seminars, which he encouraged prospective clients to attend.³⁶ Tr. 1505, 3704. The seminars included a presentation on mutual funds, including systematic withdrawals. Tr. 1505-06, 3705-06. Wilkinson explained that AIM had Class A and B shares, that there was an up-front sales charge to invest in A shares, and that there was a redemption charge for B shares if a customer redeemed his shares too soon. Tr. 3708. He also stated that the fund family paid him a commission. Tr. 3708-09. The materials provided to the attendees included a cassette tape, approved by IFG, that provided information on Wilkinson's services and how he was compensated. Tr. 1506. The materials also included a data form on which they could list their assets, liabilities, income, and objectives. Tr. 1507.

If interested, attendees scheduled a meeting with Wilkinson's firm, bringing the completed data form. Tr. 1507-08. Generally, there were two meetings before clients actually invested their money.³⁷ Tr. 1397, 1509, 1559. Each meeting lasted an hour and a half. Tr. 1510, 1559, 1788. At the first meeting the prospective client revealed his assets, investment goals, and

through Penn in December 2000, nineteen months after his initial investment. Tr. 3779-80; Div. Ex. 137(c) at 5.

³⁴ Hammersley did not sufficiently understand some of the questions that counsel asked him to answer responsively. Tr. 1678-1710. Mitchell, however, during the year before the hearing, after the relevant period, studied the AIM materials closely and gained a good understanding of the funds he was invested in and features such as breakpoints. Tr. 1614-15.

³⁵ AIM provided some reimbursement for the expenses of the seminars. Tr. 3785. AIM would have provided a higher rate of reimbursement had Wilkinson sold more A shares rather than B shares. Tr. 3785. The difference in reimbursement was not quantified in the record.

³⁶ Each of the Division's seven customer witnesses attended one or more seminars. Tr. 1544, 1612, 1674, 1713, 1743-44, 1762, 1774-75.

³⁷ Wilkinson's testimony to this effect was consistent with customer testimony. Tr. 1554-59, 1592-93, 1612, 1618, 1713-15, 1775.

risk tolerance. Tr. 1397. If he was interested in doing business with Wilkinson, there was a second meeting at which Wilkinson recommended various AIM funds or other investments, provided prospectuses, and answered the client's questions. Tr. 1397-99. After discussing the prospective client's life situation and risk tolerance, Wilkinson selected one of three model portfolios – conservative, moderate, or aggressive. Tr. 3709-10. He gave the client a notebook for that portfolio that included the prospectuses for the funds that Wilkinson was recommending. Tr. 3710-11. Wilkinson explained the funds he was recommending by reviewing the marketing materials in the notebook with the client and referring to the prospectuses. Tr. 3712-16. Almost all the clients needed income and took systematic withdrawals from their investment. Tr. 3525-27.

Wilkinson routinely explained the features of A and B shares at the second meeting with prospective clients. Tr. 1407-11, 1461-1500, 1511, 1571, 1583, 1610, 1674, 1804-05, 3744, 3857. Also, he used the multi-class disclosure form with customers who invested after May 1999. Tr. 1573, 1610, 1643-45, 1738-39, 1782-83, 1790, 3723-24, 3758-59, 3776-77; Div. Ex. 103 at IFG79637-38, Div. Ex. 106 at IFG84276-77, Div. Ex. 133 at IFG83099-83100; W. Ex. 359. Specifically, Wilkinson testified that he told prospective clients that A shares have a front-end charge, B shares have a declining back-end charge, that B shares have higher expenses than A shares, and that his estimate was that A shares would catch up to B shares after five or six years; he testified that he told them about breakpoints available on purchases of A shares. Tr. 1407-11, 1461-1500, 3717-22. Customers, however, recalled that Wilkinson explained that A shares have a front-end charge and B shares have a declining back-end charge; none recalled a discussion of breakpoints available for Class A purchases or of higher annual expenses associated with Class B investments.³⁸ Tr. 1552-54, 1571-72, 1583, 1674, 1702, 1706-07, 1718-20, 1780. It is found that Wilkinson's discussion of the difference between Class A and B shares focused on the difference in sales charges, consistent with the customers' testimony and consistent with his conclusion that Class B shares were preferable for investments between \$250,000 and \$500,000.

Wilkinson informed customers that AIM paid him a commission on their purchases. Tr. 1506, 1553, 1583, 1613, 1638, 1784, 3708-09. Wilkinson did not disclose that he would earn higher commissions on a client's purchase of Class B than A shares, unless asked. Tr. 1415, 1553, 1613, 1780. The AIM prospectuses disclosed that the dealer concession or sales commission paid to dealers, in this case IFG, was higher for B shares than for A shares at the \$250,000 level. Div. Exs. 166 at A-3-A-4, 168 at A-3-A-4.

Assuming a dealer concession of 2.5% on A shares (applicable to Category I shares) and 3.75% on B shares, Wilkinson received \$21,983, and IFG received \$1912, more in commissions from the six customers' purchases of Class B shares than they would have received had the

³⁸ Mitchell, however, told Wilkinson that he did not want to invest in funds that had a front load. Tr. 1606, 1631. The Brentons met with Adelstone, not Wilkinson, at the meeting at which the investment proposal took place. Tr. 1516-17, 1801-02. Thus, Adelstone would have been responsible for detailing the differences between the A shares and B shares. Tr. 3750. Harry Stone, who invested \$170,000, was adamant about not paying a front load. Tr. 1761.

customers purchased Class A shares. The figures would be as high as \$30,776 and \$2676, respectively, for Wilkinson and IFG, if the customers purchased only Category II shares.

Wilkinson believed that he was providing full disclosure by giving copies of the prospectuses to the clients, explaining share classes, and reviewing the multi-class disclosure form with clients. Tr. 3741. Wilkinson is aware of no Commission or NASD rule or industry practice, as of 1998 or today, that required him to tell clients that A shares would outperform B shares at the \$250,000 level or that he received a higher commission when a client purchased B shares. Tr. 1526-28.

Dollar cost averaging is putting money into one fund, such as a money market or cash reserves fund, and then routinely transferring it monthly into a planned selection of other funds. Tr. 1400. When investors put money into AIM cash reserves, Wilkinson did not receive a commission immediately; rather, the commission was paid when the money was transferred into A or B shares. Tr. 1478.

3. Miller

Miller was born in 1945 and graduated from Texas A&M in 1967 with a major in accounting. Tr. 850. He worked for Ernst & Ernst from 1967 to 1974 as an auditor. Tr. 851. From 1974 to 1983 he worked for several companies in financial and accounting positions. Tr. 851-52. He entered the securities business in 1983 and eventually started Miller Green Financial Group (Miller Green), which operated as an OSJ of IFG from 1994 to 2001.³⁹ Tr. 853-55. Miller also started Miller Green Financial Services, Inc., which was a registered investment adviser during the relevant period.⁴⁰ Tr. 854-55. He was located in Houston, Texas. Tr. 852. During the relevant period he had twenty registered representatives under his supervision. Tr. 855. Miller had the largest OSJ group in IFG, which set aside a dedicated team to handle operations and business review of his transactions. Tr. 2851-52. During 2000 Miller Green had commission revenues of about \$6 million; Miller's own production resulted in about \$1 million in commission revenues, most of which came from mutual fund sales. Tr. 856-57. During the relevant period Miller had about 100 brokerage customers and about 200 advisory clients.⁴¹ Tr. 857. These clients were generally long-term investors seeking help with their retirement income, not active traders. Tr. 859.

³⁹ Miller is now registered with Sanders Morris Harris. Tr. 855.

⁴⁰ The OIP does not charge Miller with any violations under the Advisers Act.

⁴¹ Miller described a brokerage customer as someone who made a one-time investment and an advisory client as someone who had a sum, perhaps from a retirement plan, to be invested and managed over a period of time. Tr. 857-58. Advisory clients during the relevant period did not pay a fee during their first year; they were informed orally about the fees that would be charged after the first year, at which time they signed a form authorizing collection of the fees. Tr. 858-59.

During the relevant period Miller recommended funds in the Putnam, MFS, AIM, American, and Kemper families of funds. Tr. 867-68. Miller's clients' mutual fund transactions were executed through Pershing. Tr. 2570, 2581, 3477.

During the relevant period Miller did not believe that Class A shares would produce materially higher returns at the \$250,000 level. Tr. 3511. Miller did not investigate this. Tr. 862, 870-92. Rather, he assumed that since the funds all accepted orders at \$250,000, the difference in performance at that level was materially insignificant. Tr. 871. Accordingly, Miller did not tell clients that A shares were "likely" to outperform B shares at the \$250,000 level. Tr. 866, 934-35. Miller never used the multi-class disclosure form. Tr. 886, 920-21. It was not required, and he considered his oral presentation to be better. Tr. 920-21, 939-40. Miller did not tell customers who were investing in Putnam or AIM funds that those funds had a \$250,000 limit per order for Class B shares. Tr. 866-67. Miller provided information for IFG's response to the January 13, 1999, deficiency letter, which noted three of Miller's clients. Tr. 2480; Div. Ex. 127.

Miller customers – Jan Adelman,⁴² Robert T. Overton, III,⁴³ Brian L. Taranto,⁴⁴ Robert L. Brown,⁴⁵ James K. Nordin,⁴⁶ Ronald J. Hethershaw,⁴⁷ Guy Wirth,⁴⁸ Jerome C. Simon, Jr.,⁴⁹

⁴² Adelman, sixty, retired from Exxon Chemical in 1999 as a community awareness and emergency response manager after thirty-four years. Tr. 949-50, 993. He has an undergraduate degree in advertising and a master's degree in marketing. Tr. 950. He invested about \$2.7 million (including Exxon stock that he retained) through Miller. Tr. 972-75; M. Ex. 50. The funds came from his 401(k) plan and a lump sum he took in lieu of an annuity. Tr. 950. His investments through Miller included \$250,000 in Class B shares of several funds in the Putnam family of funds. Tr. 950; Div. Ex. 137(b) at 1.

⁴³ Overton, sixty-seven, retired from Texaco in 1999 as an engineering project manager after forty-one years. Tr. 1020-21. He has a bachelor's degree in mechanical engineering. Tr. 1021-22. Overton invested about \$1.5 million in various funds through Miller. Tr. 1022, 1035-36. The funds came from his Texaco savings plan and a lump sum in lieu of an annuity. Tr. 1022-23. His investments through Miller included \$250,000 in Class B shares of MFS funds. Tr. 1022; Div. Ex. 137(b) at 3.

⁴⁴ Taranto, sixty-three, retired from Exxon-Mobil in 2000 as an environmental engineer after thirty-three years. Tr. 1067. He has a master's degree in civil engineering. Tr. 1068. He invested about \$2 million through Miller. Tr. 1069, 1080. The funds came from his Exxon-Mobil thrift fund, retirement benefit, and a lump sum in lieu of an annuity. Tr. 1069. His investments through Miller included \$250,000 in Class B shares of AIM funds. Div. Ex. 137(b) at 3.

⁴⁵ Brown, sixty, retired from Exxon-Mobil in 1998 as an engineer after thirty-three years. Tr. 1097. He has a bachelor's degree in engineering physics. Tr. 1098. He invested about \$2.7 million through Miller. Tr. 1107. The funds came from his company savings plan and a lump sum in lieu of an annuity. Tr. 1098. His investments through Miller included a total of \$1

Ewell Echols,⁵⁰ Thomas A. Steck,⁵¹ and Neil Dougharty⁵² – who testified on behalf of the

million in Class B shares – \$250,000 in each of four families (AIM, Kemper, MFS, and Putnam) of funds. Tr. 1098; Div. Ex. 137(b) at 1.

⁴⁶ Nordin, sixty, retired from Exxon after nineteen years as an engineer. Tr. 1118-19. He has a bachelor's degree in chemistry. Tr. 1119. He invested at least \$900,000 through Miller after he retired. Tr. 1120; Div. Ex. 293; M. Ex. 132. The funds came from his Exxon thrift account and retirement funds. Tr. 1119. His investments through Miller included \$290,000 in Class B shares of Kemper funds. Tr. 1119; Div. Ex. 137(b) at 2.

⁴⁷ Hethershaw, sixty-four, retired from Exxon in 1999 after thirty-seven years as a safety advisor. Tr. 1136-37. He has a bachelor's degree in industrial engineering. Tr. 1137. He invested about \$2.5 million through Miller. Tr. 1153-54. The funds came from his Exxon retirement accounts. Tr. 1138-39. His investments through Miller included \$251,000 in Class B shares of AIM funds and \$315,000 in Class B shares of Putnam funds. Div. Ex. 137(b) at 2.

⁴⁸ Wirth's wife, Darlene Wirth, testified in the Division's case, while Miller called Wirth and examined him on calculations that he had done to compare Class A and B shares. Tr. 1162-1200. Wirth retired from Exxon in 2000 after thirty-two years. Tr. 1163. He has a Ph.D. in chemical engineering. Tr. 1180. He invested over \$1.125 million in addition to about \$250,000 in Exxon stock through Miller. Tr. 1174, 1189; M. Ex. 179. The funds came from Wirth's retirement from Exxon. Tr. 1164. His investments through Miller included \$250,000 in Class B shares of AIM funds. Div. Ex. 137(b) at 3-4.

⁴⁹ Simon, sixty, retired from Exxon-Mobil in 2000 after thirty-three years as an engineer. Tr. 1272. He has a master's degree in chemical engineering. Tr. 1272. He invested about \$2.68 million through Miller. Tr. 1286-89; M. Ex. 166 at BM0110, BM0112. The funds came from his Exxon thrift plan and a lump sum in lieu of an annuity. Tr. 1274. His investments through Miller included \$250,000 in Class B shares of AIM funds. Div. Ex. 137(b) at 3.

⁵⁰ Echols, sixty-three, retired from Exxon in 2000 after thirty-seven years as a research technician. Tr. 1305-06. He has a bachelor's degree in chemistry. Tr. 1306. He invested about \$1 million through Miller. Tr. 1317; M. Ex. 11. The funds came from his Exxon thrift plan and a lump sum in lieu of an annuity. Tr. 1307. His investments through Miller included \$251,000 in Class B shares of MFS funds. Tr. 1306; Div. Ex. 137(b) at 1-2.

⁵¹ Steck, sixty-three, retired from Exxon in 1995 after thirty-one years of working in financial and information systems management. Tr. 1330-31, 1338. He has a bachelor's degree, and two years of graduate study, in mathematics. Tr. 1331. Steck's investments originated with his Exxon retirement and thrift funds, which he placed with a local investment adviser, Cigna Financial Group, before moving them to Miller in 1998. Tr. 1333, 1339. At the time Steck moved his business to Miller he had about \$800,000 in mutual funds; Miller-recommended changes included \$275,000 in Class B shares of Kemper funds. Tr. 1331, 1344-47, 1353; Div. Ex. 137(b) at 3; M. Ex. 187 at BM0095, BM0103.

Division invested in Class B shares through Miller as part of a plan for each that included cash, U.S. Treasury securities, Class A shares, and general securities (mostly stock of their former employer that had accumulated in their thrift plans). Adelman, Overton, Taranto, Wirth, Simon, and Dougharty each invested \$250,000 in Class B shares of a single fund family, and Brown invested \$250,000 in Class B shares in each of four fund families; the four other customers each invested between \$251,000 and \$315,000 in Class B shares of individual fund families. Div. Ex. 137(b). Each customer also purchased Class A shares at a \$250,000 or \$500,000 breakpoint.⁵³ Tr. 944-45, 3468-75.

Miller's plan for each customer took into account anticipated income needs, diversification, tax considerations associated with retirement plans, the basis of stock held in retirement plans, and the like. Tr. 3463-79. Their former employer's stock, which they had in their retirement plans, was retained with an eye to tax considerations. Tr. 3462-63. Miller planned for two years' worth of cash and cash equivalents (no cost to the client) to meet anticipated income needs so that the client did not have to liquidate assets during unfavorable market conditions.⁵⁴ Tr. 3463. Actual systematic distribution was a last resort. Tr. 3464-65, 3496. Miller planned for an equivalent using "free dollars" – from redemption, without a sales charge, of B shares that were acquired through capital gains distributions, interest and dividends, as well as appreciation. Tr. 3464-65, 3476-79. "Free dollars" were used to replenish the cash,

⁵² Neil Dougharty, sixty-five, retired from Exxon in 1998 after twenty-five years as a chemical engineer. Tr. 1913-14. He has a Ph.D. in chemical engineering. Tr. 1914. He invested about \$1 million through Miller. Tr. 1917. The funds came from his savings, Exxon savings plans, and a lump sum in lieu of an annuity. Tr. 1915. His investments through Miller included \$250,000 in Class B shares of Kemper funds. Tr. 1914; Div. Ex. 137(b) at 1.

⁵³ Adelman invested \$500,000 at the \$500,000 breakpoint in Class A shares of several funds in the American family of funds. Tr. 958, 975, 3474; M. Ex. 196. Overton invested \$625,000 at the \$500,000 breakpoint in American funds. Tr. 1040; M. Ex. 193. Taranto invested \$500,000 at the \$500,000 breakpoint in American funds as well as investing at the \$250,000 breakpoint in Putnam funds. Tr. 1081-82; M. Ex. 198. Brown invested \$600,000 at the \$500,000 breakpoint in American funds. Tr. 1099, 1109, 3471-72; M. Ex. 30 at BM0247. Nordin invested in Class A shares at a \$250,000 breakpoint. Tr. 3475. Hethershaw invested \$440,000 at the \$500,000 breakpoint in American funds; the breakpoint was attained through IFG and Miller's foregoing any commission on the purchase. Tr. 3472-74; M. Ex. 195 at BM0762. Wirth invested \$500,000 at the \$500,000 breakpoint in Putnam funds. Tr. 1165, 1176, 3474; M. Ex. 197 at BM0791. Simon invested \$500,000 at the \$500,000 breakpoint in Putnam funds. Tr. 1290-91, 3472; M. Ex. 194 at BM0749. Echols invested \$280,000 at the \$250,000 breakpoint in Putnam funds. Tr. 1325-26; M. Ex. 190 at BM0698. Dougharty invested \$305,000 at the \$250,000 breakpoint in American funds. Tr. 1923.

⁵⁴ Miller asked the clients for their expected outlay for living expenses and matched it against their take-home pay as a test for reasonableness. Tr. 3464.

starting about fourteen to eighteen months into the two-year period.⁵⁵ Tr. 3465. Miller considered that the pieces of the plan fit together like pieces of a puzzle and could not be considered separately apart from their place in the plan. Tr. 3476-77. Miller's goals for each customer's plan included: low net out-of-pocket up-front cost, diversity across funds and fund families, and cash and cash equivalents to be available for the first year or two if the client needed income distribution. Tr. 903. Miller considered it important to diversify among families of funds as well as among funds within families. Tr. 3502; Div. Ex. 127 at IFG060421-22.

Miller had at least two face-to-face meetings with clients before they invested.⁵⁶ Tr. 860. At the first meeting Miller gained an understanding of the client's financial position and investment goals. Tr. 860. At a later meeting, using a standard presentation, he discussed specific investments, including specific mutual funds, and provided a copy of the relevant prospectuses. Tr. 860-66. He described the difference in expenses between Class A and B shares by using a car analogy: buying a car for cash is equivalent to Class A shares, while financing the same car over a period of years costs more and is equivalent to Class B shares.⁵⁷ Tr. 861-63, 936-37. He told clients that A shares have a front-end sales load, while B shares have a back-end sales charge, which declines over a period of years to zero, and higher operating costs.⁵⁸ Tr. 865-66. Miller also told the customers that with B shares all of their money would

⁵⁵ Some of the customers at issue did not take such withdrawals during the relevant period. Tr. 3487-3500.

⁵⁶ Before reaching his investment decision Adelman met with Miller two or three times over a period of several months for one to two hours each time and asked many questions, which Miller answered to his satisfaction. Tr. 952, 960; M. Exs. 32, 44, 50. Overton and his wife met with Miller three times over a period of time. Tr. 1025, 1033-40. Taranto and his wife met with Miller three times. Tr. 1070, 1077-78. Brown and his wife went through a lengthy process of choosing a financial advisor at the time of his retirement. Tr. 1099, 1104-06. Nordin and his wife met with Miller three or four times. Tr. 1125-26. Hethershaw met with Miller three or four times over a period of time. Tr. 1140, 1146-48. Wirth and his wife met with Miller three or four times over a year, and Wirth asked many questions, which Miller answered. Tr. 1170-74, 1187; M. Exs. 179, 180.

Most of the customers also attended a seminar on financial planning for retirement that Miller gave after-hours at their worksites. Tr. 1025 (Overton); Tr. 1070-71 (Taranto); Tr. 1105 (Brown); Tr. 1146 (Hethershaw); Tr. 1164 (Wirth); Tr. 1312 (Echols).

⁵⁷ Some of the customers recalled the car analogy. Tr. 965-66 (Adelman); Tr. 1082-83 (Taranto); Tr. 1144-46 (Hethershaw); Tr. 1176-77 (Wirth). Some did not. Tr. 1123 (Nordin); Tr. 1280-81 (Simon); Tr. 1309 (Echols). Taking into account the passage of time and the fact that some customers did recall the car analogy, the undersigned finds that it was part of Miller's standard presentation.

⁵⁸ As with the car analogy, some customers recalled Miller's discussion of the difference between A and B shares as to sales charges and operating expenses, and others did not. The fact that some customers recalled his discussion corroborates Miller's testimony that he included this

be invested immediately, which would be a benefit in a rising market. Tr. 894, 897, 899, 901-03, 905, 907, 910, 912, 919-20, 923, 925-26. Miller discussed breakpoints, rights of accumulation, and letters of intent applicable to A shares.⁵⁹ Tr. 863-65.

Concerning financial sophistication, all the customers at issue were highly educated professionals well able to ask questions and to study and understand mutual fund prospectuses had they made the effort. Tr. 949-1354 passim, Tr. 1913-29 passim. However, each was more or less unknowledgeable about financial matters.⁶⁰ Thus, each felt it was advisable to employ an expert, Miller, for advice.⁶¹ Generally, the customers went through a lengthy and careful process of evaluating options for managing their money before settling on Miller.⁶² Miller did not have blanket discretionary authority over any account of any of the customers at issue; however, he

in his standard presentation. Adelman recalled the discussion but not the details. Tr. 953, 962. Taranto, Brown, and Dougharty understood the difference in sales charges and operating expenses before investing in B shares with Miller. Tr. 1080-81, 1114, 1919-20, 1924, 1927-28. Wirth recalled the discussion of the difference in sales charges and operating expenses. Tr. 1198-99. Hethershaw recalled Miller's discussion, but it was not until a subsequent meeting after his investment in B shares that he gained a clear understanding of the difference between A and B shares. Tr. 1149-50. Simon and Steck recalled a discussion of the difference in sales charges; Steck did not understand that higher expenses would affect the presumed benefit of not paying an up-front sales charge to any significant extent. Tr. 1275-76, 1280, 1335, 1342, 1354. Overton and Echols did not recall whether Miller discussed the difference between A and B shares. Tr. 1028, 1053, 1308. Nordin was not aware that he had invested in B shares until contacted by Commission staff in 2001. Tr. 1120.

⁵⁹ Miller's testimony to this effect is corroborated by the fact that the customers all purchased Class A shares at a breakpoint of \$250,000 or \$500,000. Additionally, some of the customers recalled either a discussion of breakpoints or knowing what breakpoints were. Tr. 954 (Adelman); Tr. 1039-40 (Overton); Tr. 1184 (Wirth); Tr. 1278 (Simon); Tr. 1340 (Steck); Tr. 1926 (Dougharty). Each customer had a letter of intent with at least one mutual fund. Tr. 3512-13, 3518.

⁶⁰ Tr. 950, 954-55, 981-82 (Adelman); Tr. 1022-23, 1027, 1050-51 (Overton); Tr. 1069, 1071 (Taranto); Tr. 1101 (Brown); Tr. 1119-20, 1122 (Nordin); Tr. 1143-44 (Hethershaw); Tr. 1171 (Wirth); Tr. 1273 (Simon); Tr. 1306, 1310 (Echols); Tr. 1331-32 (Steck); Tr. 1917-18 (Dougharty).

⁶¹ Tr. 956 (Adelman); Tr. 1023-24, 1031-32, 1042 (Overton); Tr. 1101-02 (Brown); Tr. 1122 (Nordin); Tr. 1143, 1151 (Hethershaw); Tr. 1277 (Simon); Tr. 1310 (Echols); Tr. 1333 (Steck); Tr. 1918 (Dougharty).

⁶² Tr. 952, 995-96, 1008-09 (Adelman); Tr. 1024-25 (Overton); Tr. 1084 (Taranto); Tr. 1099, 1104-05 (Brown); Tr. 1288 (Simon).

had discretion to make exchanges (that incurred no commission) within fund families to react quickly to market conditions.⁶³ Tr. 3466-67.

Miller did not tell clients who were investing at the \$250,000 level that he would receive higher commissions by selling B shares rather than A shares because he was not aware that he was required to make that disclosure. Tr. 866, 935. If Miller's customers had asked about the commissions he would earn from selling A and B shares, he would have told them that he earned more from selling B shares and less from selling A shares. Tr. 936.

Miller received \$54,443, and IFG received \$4734, more in commissions from the eleven customers' purchases of Class B shares than they would have received had the customers invested the same amount in Class A shares. These figures assume a 2.5% breakpoint on Class A shares of AIM funds that the customers purchased. The figures would be as high as \$60,197 and \$4934, respectively, for Miller and IFG, if the customers who purchased AIM funds purchased only Category II funds.

Sullivan and another employee from the home office audited Miller's office in December 1998. Tr. 2473. Miller did not affirmatively choose his auditors, but IFG accommodated his unfavorable opinion of two specific auditors and did not send them to Miller's office. Tr. 2473, 2502-03. Based on experience, Miller considered the two auditors substandard and asked for Sullivan because he expected to learn from an audit conducted by her. Tr. 3513-14. He went through a sample client presentation with them and ran some programs to show how he monitored funds and their performance. Tr. 2473. His books and records were comprehensive. Tr. 2473. Sullivan was impressed with Miller's thoroughness and with the way he transacted business. Tr. 2473-74. Ledbetter knew that Sullivan was satisfied with the types of disclosures Miller made. Tr. 2717-20. Ledbetter did not require Miller to start using the multi-class form or task anyone with calling Miller's customers. Tr. 2703-04, 2718-19.

Based on her experience with Miller and the fact that he did not have any customer complaints, Sullivan did not question the information Miller supplied concerning his customers' transactions for IFG's response to the deficiency letter. Tr. 2480-81.

4. Kissinger

Kissinger was born in 1944. Tr. 3531. He has a B.S. in accounting and worked as a certified public accountant for a Maryland accounting firm from 1966 until 1982, when he entered the securities industry. Tr. 43-48. Kissinger is heavily involved in the activities of his church and various charitable endeavors in the Baltimore area. Tr. 3532-36.

⁶³ Tr. 986-87; M. Ex. 91 (Adelman); Tr. 1046; M. Ex. 113 (Overton); Tr. 1078-80; M. Ex. 94 (Taranto); Tr. 1111; M. Exs. 101, 112 (Brown); Tr. 1129-30; M. Ex. 114 (Nordin); Tr. 1154-55; M. Ex. 92 (Hethershaw); Tr. 1183 (Wirth); Tr. 1277-78, 1290 (Simon); Tr. 1307, 1311, 1321-24; M. Ex. 98 (Echols); Tr. 1924 (Dougharty).

During the relevant period Kissinger was the president and controlling owner of Kissinger Financial Services, the parent corporation of Kissinger Advisory, an investment adviser, and of Kissinger Securities, through which the brokerage business associated with IFG was conducted.⁶⁴ Tr. 47-51; K. Ex. 60. The enterprise had fifteen employees and was located in Timonium, Maryland, outside of Baltimore. Tr. 52-53; K. Exs. 39, 40. Several of the employees had securities licenses, but Kissinger was the only commission-producing staff. Tr. 53. The enterprise had about \$2 million in annual revenues, of which about 70% was commissions from mutual fund sales, and 30% was advisory fees. Tr. 57-58. There were 350 advisory clients and about 700 non-advisory clients. Tr. 3577-78. The clients were long-term, buy-and-hold investors. Tr. 59. In 2000, B shares were 11% of the \$300 million that Kissinger had under management. Tr. 94-95, 3578.

During the relevant period Kissinger recommended Franklin Templeton, Fidelity, Kemper, Phoenix, Putnam, and Oppenheimer funds; Franklin Templeton and Fidelity were the first and second most recommended. Tr. 71. The Class B share purchases at issue were in the Kemper and Oppenheimer funds. Div. Ex. 137(a). Kemper and Oppenheimer limited Class B purchases to \$500,000.⁶⁵ Tr. 1853, 4143, 4156.

During the relevant period Kissinger did not believe that A shares would produce materially higher returns than B shares at the \$250,000 level. His opinion was not based on mathematical analysis or any investigation. Tr. 148, 721. Instead, Kissinger relied on the limits for B share investments in the funds' prospectuses. Tr. 669-70, 721. That is, he considered a particular fund family's limit of \$500,000 or \$250,000 for Class B share purchases to indicate that B shares were preferable up to that limit. Tr. 75, 85, 93, 136, 721. Otherwise Kissinger and his staff did a great deal of study to determine the appropriate investments for each client. Tr. 60-70, 670, 676-716, 720, 3626-29. For instance, Kissinger used CDA Weisenberger software to provide a client with historical returns for the assets he was recommending as compared with the client's present assets. Tr. 90-91, 684. Breakpoints can be entered as a variable in a CDA Weisenberger analysis. Tr. 735-36. Kissinger never ran a CDA Weisenberger analysis or performed any other mathematical analysis to compare performance of Class A and B shares. Tr. 148, 721.

Kissinger conceded that fund prospectuses did not show the relative performance of A and B shares at the \$250,000 level. Tr. 75-84. He conceded that an Oppenheimer prospectus in

⁶⁴ Kissinger was registered with IFG from 1994 until April 5, 2001, and is now registered with Sanders Morris Harris. Tr. 51, 55. Kissinger Advisory went out of existence when it merged with Sanders Morris Harris's federally-registered investment adviser entity, SMH Advisory, Inc. Tr. 308.

⁶⁵ Kemper prospectuses stated that orders for Class B shares for \$500,000 or more would be declined. Div. Exs. 236 at 39, 241 at 33. Oppenheimer prospectuses stated that normally it would not accept purchase orders of \$500,000 or more of Class B shares. Div. Exs. 270 at 15, 275A at 26, 275B at 17. Kissinger had interpreted these limits as "up to \$500,000." Tr. 196-98, 204.

effect in 1998 appeared to state that A shares outperformed B shares over the \$100,000 level. Tr. 158-67; Div. Ex. 275A at 26. Subsequent Oppenheimer prospectuses did not have this statement. Tr. 200; Div. Exs. 270 at 15, 275B at 17. Kissinger conceded that charts in various prospectuses comparing A and B shares did not take account of breakpoints. Tr. 3632-43. Kissinger knew that A shares had lower expenses than B shares. Tr. 3641. During the relevant period Kissinger did not ask the fund companies or IFG compliance which share class offered higher returns. Tr. 3630-31, 3643. Kissinger's opinion that he could rely on a fund's \$500,000 or \$250,000 limit was not shaken by IFG's Compliance Alert. Tr. 151-56; Div. Ex. 43.

Kissinger customers – Mary Ann Cline (a/k/a Hohenberger),⁶⁶ Mary Jane Daley,⁶⁷ Myrna Moran,⁶⁸ Lucie Portier,⁶⁹ Satwant Chona,⁷⁰ Barry Hart,⁷¹ and William A. Moulyn⁷² – who

⁶⁶ Cline, sixty-six, retired in 1999, after forty years as a Registered Nurse. Tr. 449. She invested \$423,000, her retirement funds, in Class B shares of Kemper funds in 1999. Tr. 449-50; Div. Ex. 137(a) at 2-3.

⁶⁷ Daley, fifty-eight, is an educator, with master's degrees in American studies and in instructional technology. Tr. 397-98. She invested \$326,000 in Class B shares of Kemper funds in January 2000. Tr. 222, 398; Div. Ex. 137(a) at 3.

⁶⁸ Moran, fifty-six, is a Registered Nurse with a master's degree in nursing. Tr. 2090, 2153. She invested about \$2 million through Kissinger, including \$500,000 in Class B shares of Kemper funds, purchased in April 1999. Tr. 141, 697, 2090; Div. Ex. 137(a) at 3. The funds came from her divorce settlement. Tr. 2090.

⁶⁹ Portier, seventy, retired from the U.S. Department of Veterans Affairs as a social worker; she has master's degrees in literature and in social work. Tr. 1881. She invested \$327,701 in Oppenheimer funds in 2000. Div. Ex. 137(a) at 3-4; Div. Ex. 307. The money came from her U.S. Government Thrift Savings Plan and from her TIAA/CREF account. Tr. 1882.

⁷⁰ Chona, sixty-six, is an architect and was educated in India. Tr. 364. He invested \$500,000 in Class B shares of Oppenheimer funds in June 2000. Tr. 364; Div. Ex. 137(a) at 2. The funds came from his employer's profit-sharing plan. Tr. 365.

⁷¹ Hart, fifty-seven, is a self-employed disk jockey, and, for the past eight years, has run a business supplying language interpreters for courts in Maryland. Tr. 469-70. The company for which he had worked for thirty-two years was sold and he had to take his investments out of his retirement plan. Tr. 471, 488. He invested almost \$426,000 in Class B shares of Oppenheimer funds on January 24, 2000. Tr. 225, 471; Div. Ex. 137(a).

⁷² Moulyn, fifty-eight, a college graduate, is a computer specialist for a U.S. Government agency in Washington. Tr. 418-19. He invested \$250,000 in Class B shares of Oppenheimer funds in December 1999. Tr. 419; Div. Ex. 137(a) at 3.

testified on behalf of the Division invested between \$250,000 and \$500,000 in Class B shares through Kissinger. Div. Ex. 137(a). Some also invested in Class A shares at a breakpoint.⁷³

Kissinger obtained most of his clients from referrals. Tr. 60. Some came from his seminar at Towson University.⁷⁴ A potential client was asked to fill out a financial inventory to bring to his first appointment, which Kissinger calls the concept interview. Tr. 60-61. At the concept interview Kissinger explained his services and how he is paid – by advisory fees to prepare a financial plan, by commissions, by an ongoing fee for periodic monitoring reports and meetings if the client desires, and by referrals from satisfied clients. Tr. 61, 311-12. If the client expressed interest in a financial plan, Kissinger inquired of his life circumstances, objectives, and tolerance for risk and evaluated his personal business affairs, such as investments, retirement plans, insurance policies, home mortgage, budget, tax returns, and wills. Tr. 62-64. If the client decided to go ahead with a financial plan, Kissinger reviewed the written contract that the client was to sign, which specified a fee of \$750 to \$2,500.⁷⁵ Tr. 64-65. The agreement specified the advisory services that Kissinger Advisory was to provide and stated that the client was free to select any brokerage firm to implement any advisory recommendations that the client decided to follow; it also stated that broker-dealers and their registered representatives are paid with commissions from such transactions. Tr. 64-65, 3566-73; K. Exs. 60, 71, 75.

After the client decided to go ahead with a financial plan, staff members prepared a plan to be presented at a second meeting to be held within thirty days. Tr. 66-68. The plan, which Kissinger refers to as a generic plan, addressed the client's goals and objectives, concentration of assets, diversification, taxes, cash flow, education of children, retirement, and estate planning. Tr. 304. The plan compared the client's existing situation with a recommended model of percentages devoted to cash, bonds, and various categories of equities. Tr. 306. At the second meeting, Kissinger explained the various action recommendations of the plan and the client signed the contract and was presented with the invoice for the advisory fee. Tr. 67-68. Thereafter, at the same meeting, Kissinger transmuted from an associated person of an investment adviser to an associated person of a broker-dealer.⁷⁶ Tr. 65, 69, 3568, 3570. At that

⁷³ Daley invested in Class T shares, which are similar to A shares, of Fidelity funds, and received a breakpoint. Tr. 223, 411. Moran invested \$1 million in Class T shares of Fidelity funds for no commission at the \$1 million breakpoint. Tr. 3597.

⁷⁴ For many years, Kissinger has presented a paid seminar monthly on financial planning at Towson University (donating the tuition to the school). Tr. 60, 675, 3536-37, 3540-41. Towson University, located in Towson, Maryland, is a member of the University System of Maryland. <http://www.towson.edu>.

⁷⁵ Advisory fees for a financial plan ranged from \$1,000 (\$750 for government employees or those who had taken the Towson seminar) to \$2,500. Tr. 60, 311.

⁷⁶ Kissinger testified that he tells the client that he is taking off his adviser hat and putting on his salesman hat to alert the client to the conflict of interest. Tr. 65, 69, 3568, 3570. Customer Lucie Portier recalled the two-hats metaphor. Tr. 1899. However, she did not connect the difference in his remuneration to a conflict of interest and did not consider that he was less

point he recommended specific asset repositioning, including the purchase of mutual funds. Tr. 69-70.

The recommendations typically included a recommendation for A shares or B shares. Tr. 85. Kissinger's discussion of the difference between A and B shares focused on the difference in sales charges; with A shares there was an up-front charge, and with B shares 100% of the client's money was invested immediately but there was a penalty if the client withdrew before six years had elapsed.⁷⁷ Tr. 95-107. Kissinger testified, "[M]y general discussion is an A share carries an up-front commission, a B does not. All your money is going to work. Do you want to pay an up-front commission? The client says, no, I don't want to pay an up-front commission."⁷⁸ Tr. 453. Kissinger did not discuss the difference in expenses between A and B shares. Tr. 107. Kissinger did not discuss breakpoints unless the client chose to invest in A shares. Tr. 153-54. If the client stated that he did not want to pay an up-front sales charge, Kissinger did not discuss Class A shares, unless they were clearly in the client's best interest, for example, for an investment of \$1 million. Tr. 276. He provided the client with prospectuses in which breakpoints, expenses, and other differences between Class A and B shares were disclosed.⁷⁹ Tr. 281-86 (Moran, Moulyn, and Portier), 565-66. The client was then told to wait before making a decision. Tr. 86. If the client decided to implement the recommendations, Kissinger scheduled periodic meetings to discuss the performance of his investments. Tr. 87-90.

trustworthy when wearing his salesman hat. Tr. 1909-10. Customer Matthew Regan, who testified on behalf of Kissinger, also recalled the two-hats metaphor. Tr. 795.

⁷⁷ To the extent that the customers recall any discussion concerning classes of shares, this is consistent with their recollections. Tr. 1889-92, 1900-01, 1907 (Portier); Tr. 369, 394 (Chona); Tr. 475-77, 483-84, 495-96 (Hart). The fact that Moulyn sent an e-mail to Kissinger on January 20, 2000, complaining about the tax consequences of his investment in "Oppenheimer Income Fund B" does not mean that he understood the significance of "B." Div. Ex. 95 at IFG76729.

Kissinger opined that the CDSC was a beneficial preventative against churning. Tr. 104-05.

⁷⁸ Hart affirmatively did not want to pay a front load. Tr. 475. He was not concerned about the CDSC because he intended to hold the shares for the long term. Tr. 476. He understood that there would be a small maintenance fee. Tr. 476-77. Hart believed that because the investor was locked into B shares for a number of years they would be cheaper than A shares. Tr. 477, 495-96.

⁷⁹ The customers recalled receiving prospectuses. Tr. 462 (Cline); Tr. 2094 (Moran); Tr. 1897 (Portier); Tr. 389-90 (Chona); Tr. 488-89 (Hart); Tr. 447 (Moulyn). However, some did not read them. Tr. 463 (Cline); Tr. 389-90 (Chona); Tr. 488-89 (Hart); Tr. 447 (Moulyn). Portier read the prospectuses she was given, made notes, and asked questions, to which Kissinger responded to her satisfaction. Tr. 1897-98. Moran glanced through the prospectuses she was given but did not read them carefully. Tr. 2127-35.

Some of the customers signed multi-class disclosure forms. Tr. 1901 (Portier); Tr. 383-85; K. Ex. 94 (Chona); Tr. 228; Div. Ex. 74 at IFG18680; K. Ex. 87 (Hart). Others – Cline, Daley, and Moulyn – did not. Kissinger’s explanation for this was that IFG had not required or suggested it. Tr. 3574. However, while Cline’s April 1999 investment antedated IFG’s May 1999 Compliance Alert, Daley’s and Moulyn’s investments postdated it. Div. Ex. 137(a) at 2-3. Moran was Kissinger’s largest customer, investing about \$2 million, so Kissinger consulted with Sullivan about appropriate disclosure. Tr. 254-57, 335-38, 697-99; K. Exs. 65, 66. As a result of that consultation, Moran signed a forerunner of the multi-class disclosure form, which emphasized the absence of a front-end charge for Class B shares (and for her \$1 million Class T purchase) and did not address breakpoints or the differences in expenses between A and B shares. Tr. 3597; K. Ex. 66. In fact, Sullivan suggested disclosure of the estimated expenses of the funds to be purchased, but Kissinger urged that this would be an inappropriate projection of future performance. Tr. 254-56, 336-38; K. Ex. 65.

Some of the customers at issue were advisory clients. Tr. 213 (Cline), 221 (Daley), 251 (Moran), 272, 274 (Portier). Some were not. Tr. 199 (Chona), 225-26 (Hart), 268 (Moulyn). Concerning financial sophistication, all the customers at issue had sufficient education and cognitive skills to ask questions and to study and understand mutual fund prospectuses had they made the effort. Tr. 363-500, passim, 1880-1912, passim, 2089-2157, passim. However, each was more or less unknowledgeable about financial matters.⁸⁰ Thus, each felt it was advisable to employ an expert, Kissinger, for advice.⁸¹ The customers relied on Kissinger’s advice⁸² – as Daley expressed it, she relied on his advice much as she relies on anyone whose advice she seeks in an area in which she is not an expert. Tr. 400, 414-15. Hart articulated a similar thought. Tr. 473, 489, 496-97.

The clients knew that Kissinger received a commission on their mutual fund purchases.⁸³ Tr. 3570. Kissinger did not tell clients who were investing at the \$250,000 level that he would

⁸⁰ Tr. 450, 453-54 (Cline); Tr. 398-99, 403-05 (Daley); Tr. 2092 (Moran); Tr. 1884-87 (Portier); Tr. 366-75, 388-89 (Chona); Tr. 471-500, passim (Hart); Tr. 424 (Moulyn).

⁸¹ Tr. 453, 466 (Cline); Tr. 400, 414-15 (Daley); Tr. 2093-95, 2098 (Moran); Tr. 1884 (Portier); Tr. 366, 377 (Chona); Tr. 473, 489, 496-97 (Hart); Tr. 424 (Moulyn).

⁸² Tr. 400, 414-15 (Daley); Tr. 2093-95, 2098 (Moran); Tr. 1884 (Portier); Tr. 366, 377 (Chona); Tr. 473, 489, 496-97 (Hart). Moulyn, however, engaged in extensive discussions concerning recommendations of various investment advisers, investments in individual equities, and the expenses of the Oppenheimer funds as compared with no-load funds. Tr. 429-30, 434-42, 445. Kissinger eventually fired Moulyn as a client because Moulyn started calling daily and wanting to trade daily, which was inconsistent with Kissinger’s business strategy of buy-and-hold with adjustments after periodic reviews done in an orderly manner. Tr. 3592.

⁸³ Tr. 404 (Daley); Tr. 463 (Cline). A few months after investing, Moran became dissatisfied with the performance of her investments compared to her friends’ investments and accused Kissinger of recommending investments that were not in her interest solely to increase the commissions he received. Tr. 260-67, 2102-03, 2105-06; Div. Exs. 11, 12, 13, 14.

receive higher commissions by selling B shares rather than A shares. Tr. 138. Kissinger believed it to be a win-win situation, in which investing in B shares was better for the customer and better for him, as well. Tr. 138-39.

Kissinger received \$41,446, and IFG received \$3604, more in commissions from the seven customers' purchases of Class B shares than they would have received had the customers invested the same amount in Class A shares.

The Division argues that three additional considerations – Moran's complaint, Oppenheimer's telephone call about Hart's transaction, and a 1996 letter from Commission staff – should have alerted Kissinger to question Class B investments at the \$250,000 level. Moran chose Kissinger after consulting three other investment advisers and met with him several times before deciding to invest. Tr. 2109-11. Kissinger initially made recommendations for investments in various mutual funds in June 1998. Tr. 2117-18. The investments were made, based on a new recommendation, when she received her divorce settlement, in April 1999. Tr. 258-59, 3597-98. Moran ceased being Kissinger's customer after a few months, in 1999, because she was unhappy with the performance of her investments compared to her friends' investments. Tr. 2101-03. She conceded, however, that her first concern was preservation of capital. Tr. 2112. After conferring with a friend, she contacted the fund companies in which she was invested and obtained information leading her to believe that Kissinger was investing so as to maximize his commissions. Tr. 2105-06; Div. Ex. 13. Eventually the dispute was resolved through mediation; her B shares were converted to A shares and her legal expenses were paid by IFG. Tr. 3599-600. Kissinger considered that Moran expected returns that were inconsistent with a conservative investment profile; he did not take the incident as a warning against B shares. Tr. 81, 3595, 3646-48.

A representative of Oppenheimer telephoned Kissinger's office in early 2000 and spoke to Christopher Pollitt, director of client administration during the relevant period; she asked that IFG compliance approve Hart's \$426,000 trade before Oppenheimer processed it. Tr. 232, 523, 529-32; Div. Ex. 74 at IFG018657. Pollitt telephoned IFG compliance and spoke to Richard Dunston, who requested he forward the multi-class disclosure form that Hart had signed; Pollitt did so, and subsequently the transaction was completed. Tr. 529-30.

In 1996, following an examination, Commission staff sent Kissinger a letter questioning twelve customers' transactions, including some in which B shares were purchased; as to one customer, Kissinger was asked why B shares were selected for an investment of \$312,000. Tr. 602-03, 625-26; Div. Ex. 90. The main thrust of the letter was mutual fund switching. Div. Ex. 90. Kissinger's response concerning the \$312,000 was that the client needed income, but not more than the 10% withdrawal allowed annually by that fund, and that with B shares all of her payment would be invested from day one. Div. Ex. 91. The letter did not spur Kissinger to do a comparative analysis between the returns of A and B shares. Tr. 625-27, 3648-49.

Kissinger's office executed transactions by sending applications to the mutual fund: the client's new account form was sent to the mutual fund company with the check or transfer paperwork, a copy was sent to IFG, and a copy was retained in Kissinger's customer files. Tr. 561-62. The mutual fund company or IFG could stop a trade. Tr. 524-25, 563. If the transaction

went through, the mutual fund company paid its commission to IFG, which eventually forwarded Kissinger's share. Tr. 525, 563.

IFG audited Kissinger annually. Tr. 584-85. The auditor sampled client files for review, reviewed Kissinger's books, and interviewed staff. Tr. 585. At the end of the day-and-a-half audit, the auditor held an exit interview. Tr. 586. The auditor reviewed every transaction for several months preceding the audit, including several transactions at issue in this proceeding. Tr. 638-643; IFG Exs. 169, 170, 171. If an auditor concluded changes were needed, this would be put in writing and sent to Kissinger; in some cases a reply was required. Tr. 585, 587. Woll was the auditor in the 1999 audit; his January 2000 letter did not raise any questions concerning Hart's Oppenheimer transaction or any other Class B transaction. Tr. 589-90; K. Ex. 39.

No one at IFG questioned Kissinger or his office about Cline's, Daley's, Hart's, Moulyn's, or Portier's transactions. Tr. 219, 225, 237, 287. No one at IFG contacted Kissinger about Moran's \$500,000 Kemper transaction before she complained. Tr. 288-90. No one at IFG contacted the other customers about their Class B share purchases. Tr. 372 (Chona), 402 (Daley), 421 (Moulyn), 452-53 (Cline), 479 (Hart), 1883 (Portier).

III. CONCLUSIONS OF LAW

In this section it is concluded that the three registered representatives did not violate the antifraud provisions. Accordingly, the failure to supervise charge against IFG and Ledbetter fails as well.

A. Antifraud Provisions

Exchange Act Section 10(b) and Rule 10b-5 make it unlawful "in connection with the purchase or sale of any security," by jurisdictional means, to:

- 1) employ any device, scheme, or artifice to defraud;
- 2) make any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading; or
- 3) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Similar proscriptions are contained in Section 17(a) of the Securities Act and Sections 206(1) and 206(2) of the Advisers Act.

Scienter is required to establish violations of Securities Act Section 17(a)(1), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Section 206(1). It is "a mental state embracing intent to deceive, manipulate, or defraud." Aaron v. SEC, 446 U.S. 680, 686 n.5, 695-97 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976); SEC v. Steadman, 967 F.2d 636, 641 (D.C. Cir. 1992). Recklessness can satisfy the scienter requirement. See David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997); Steadman, 967 F.2d at 641-42; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is conduct which

is “‘highly unreasonable’ and represents ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2d Cir. 1978) (quoting Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977)).

Material misrepresentations and omissions violate Securities Act Section 17(a) and 17(a)(3), Exchange Act Section 10(b) and Rule 10b-5, and Advisers Act Sections 206(1) and 206(2). The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest. See Steadman, 967 F.2d at 643; Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 240 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

An investment adviser is a fiduciary. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-92, 194, 201 (1963); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17 (1979). As such, investment advisers and their associated persons are held to a higher standard than broker-dealers and their associated persons.

Kissinger Advisory is accountable for the actions of its responsible officers, including Kissinger. See C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988) (citing A.J. White & Co. v. SEC, 556 F.2d 619, 624 (1st Cir. 1977)). A company’s scienter is imputed from that of the individuals controlling it. See SEC v. Blinder, Robinson & Co., 542 F. Supp. 468, 476 n.3 (D. Colo. 1982) (citing SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972)). As an associated person of Kissinger Advisory, Kissinger’s conduct and scienter are also attributed to the firm. See Section 203(e) of the Advisers Act.

1. Aiding and Abetting; Causing

In addition to being charged with “committing” violations of the antifraud provisions of the Securities and Exchange Acts, Kissinger is charged with “aiding and abetting,” and with “causing,” primary violations of Advisers Act Sections 206(1) and 206(2) by Kissinger Advisory.

For “aiding and abetting” liability under the federal securities laws, three elements must be established: (1) a primary or independent securities law violation committed by another party; (2) awareness or knowledge by the aider and abettor that his or her role was part of an overall activity that was improper; also conceptualized as scienter in aiding and abetting antifraud violations; and (3) that the aider and abettor knowingly and substantially assisted the conduct that constitutes the violation. See Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000); Woods v. Barnett Bank, 765 F.2d 1004, 1009 (11th Cir. 1985); Investors Research Corp. v. SEC, 628 F.2d 168, 178 (D.C. Cir. 1980); IIT v. Cornfeld, 619 F.2d 909, 922 (2d Cir. 1980); Woodward v. Metro Bank, 522 F.2d 84, 94-97 (5th Cir. 1975); SEC v. Coffey, 493 F.2d 1304, 1316-17 (6th Cir. 1974); Russo Sec. Inc., 53 S.E.C. 271, 278 & n.16 (1997); Donald T. Sheldon, 51 S.E.C. 59, 66 (1992), aff’d, 45 F.3d 1515 (11th Cir. 1995); William R. Carter, 47 S.E.C. 471, 502-03 (1981). A person cannot escape aiding and abetting liability by claiming he was ignorant of the securities laws. See Sharon M. Graham, 53 S.E.C. 1072, 1084 n.33 (1998), aff’d, 222 F.3d 994 (D.C. Cir. 2000). The knowledge or awareness requirement can be satisfied by recklessness when

the alleged aider and abettor is a fiduciary or active participant. See Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990); Cornfeld, 619 F.2d at 923, 925; Rolf, 570 F.2d at 47-48; Woodward, 522 F.2d at 97.

For “causing” liability, three elements must be established: (1) a primary violation; (2) an act or omission by the respondent that was a cause of the violation; and (3) the respondent knew, or should have known, that his conduct would contribute to the violation. Robert M. Fuller, 80 SEC Docket 3539, 3545 (Aug. 25, 2003), pet. denied, No. 03-1334 (D.C. Cir. 2004). A respondent who aids and abets a violation also is a cause of the violation under the federal securities laws. See Graham, 53 S.E.C. at 1085 n.35. Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. See KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1175 (2001), recon. denied, 74 SEC Docket 1351 (Mar. 8, 2001), pet. denied, 289 F.3d 109 (D.C. Cir. 2002), reh’g en banc denied, 2002 U.S. App. Lexis 14543 (July 16, 2002). It is assumed that scienter is required to establish secondary liability for causing a primary violation that requires scienter. Id.

2. Willfulness

The Division requests sanctions pursuant to Sections 8A of the Securities Act; 15(b)(6), 21B, and 21C of the Exchange Act; and 203(f), (k), and (i) of the Advisers Act. The Commission must find willful violations to impose sanctions under Sections 15(b) and 21B of the Exchange Act and 203(f) and (i) of the Advisers Act. A finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation. See Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Steadman v. SEC, 603 F.2d 1126, 1135 (5th Cir. 1979); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965).

B. Antifraud Violations

The three registered representatives, Kissinger, Miller, and Wilkinson, were charged with willfully violating Exchange Act Section 10(b) and Rule 10b-5 and Securities Act Section 17(a). Additionally, Kissinger, as an associated person of an investment adviser, was charged with willfully aiding and abetting and causing violations of Advisers Act Sections 206(1) and 206(2). Specifically, they were alleged to have committed the violations by recommending to customers that they invest \$250,000 or more in Class B shares of mutual funds “without disclosing . . . [t]hat Class A shares of the mutual funds that they were purchasing would have produced materially higher returns than Class B shares of the same mutual funds”⁸⁴ because of the availability of breakpoints and lower annual expenses for Class A shares, and “[t]hat the investments in Class B shares as opposed to Class A shares of the same mutual funds significantly increased the commissions paid.” Thus, in brief, the three registered representatives

⁸⁴ The post-hearing pleadings also discuss whether the B share purchases of each individual customer in fact proved less advantageous in hindsight, with the Division concluding that nineteen out of twenty-five customers would have been better off with A shares. This is, however, outside of the charges in the OIP.

were charged with failing to disclose that, at the \$250,000 level: (1) A shares outperformed B shares (OIP ¶¶ III.D.2.-3., F.); and (2) they received higher commissions for selling B shares (OIP ¶¶ III.D.4). Additional allegations relate to alleged fiduciary obligations arising out of Kissinger’s status as an associated person of an investment adviser and of the registered representatives’ alleged de facto control of customer accounts.

1. Performance

The alleged fact that Kissinger, Miller, and Wilkinson omitted to disclose at the point of sale, that with investments of \$250,000 or more “Class A shares of the mutual funds [their customers] were purchasing would have produced materially higher returns than Class B shares of the same mutual funds” is unproven. As found above, an investment of \$250,000 in Class A shares will not outperform an investment in Class B shares in all circumstances. Back-of-the-envelope computations of sales charges, including 12b-1 marketing fees, applicable to A and B shares that appear to show that A shares always outperform B shares at the \$250,000 level do not take account of some significant factors that can affect performance, including B share redemptions that are free of CDSC for a variety of reasons.⁸⁵ In sum, it is unproven that A shares always outperform B shares at the \$250,000 level. Therefore, the registered representatives’ failure to inform customers that Class A shares of the mutual funds they were purchasing would have produced materially higher returns than Class B shares of the same mutual funds was not an omission to state a material fact. Nor was it an omission to state a material fact necessary to make statements made by any of the registered representatives “regarding the relative performance of Class A and Class B shares” not misleading, as alleged in OIP ¶ III.F.

The Division argues, with reference to OIP ¶ III.F., that by recommending B shares, the registered representatives represented that B shares were preferable to A shares and that they omitted to state material facts in that, “[t]he complete story required disclosing that Class A shares would likely outperform Class B shares at the \$250,000 investment level because of the reduced sales charges and lower monthly expenses.”⁸⁶ Post Hearing Brief at 55 (emphasis added). This interpretation contrasts with the allegations in OIP ¶ III.D. that Respondents committed violations by recommending to customers that they invest \$250,000 or more in Class B shares of mutual funds “without disclosing . . . [t]hat Class A shares of the mutual funds that they were purchasing would have produced materially higher returns than Class B shares of the same mutual funds” (emphasis added) because of the availability of breakpoints and lower annual expenses for Class A shares. The Division’s interpretation of OIP ¶ III.F. is strained. Had the Commission intended to adopt an OIP alleging that Class A shares at the \$250,000 level

⁸⁵ The Division’s argument that Class A shares would have produced higher returns for nineteen of twenty-five customers at issue is consistent with the conclusion that A shares do not always outperform B shares at the \$250,000 level.

⁸⁶ Similar statements appear in the Division’s Post Hearing Reply Brief at 34, 66-67: “[The registered representatives] were thus required to disclose that, based on the conditions under which the investments at issue were made, A shares would likely deliver higher returns than B shares.” (emphasis added).

would “likely” outperform Class B shares, the OIP would have articulated it forthrightly.⁸⁷ Thus, the undersigned understands OIP ¶ III.F. to be based on the alleged fact that A shares outperform B shares at the \$250,000 level because of breakpoints and lower annual operating expenses. The record shows that Respondents defended the proceeding based on this understanding.

Essentially, the Division interprets OIP ¶ III.F. to allege that the registered representatives did not fully disclose the comparative marketing costs of investing in A and B shares.⁸⁸ While the CDSC and the front-end sales charge for Class A shares (including the reduced sales charges at breakpoints), are clearly visible and easily understood by customer and broker alike, the 12b-1 asset-based marketing fee is much less so. As the Commission has recognized, transactional fees, such as the front-end sales charge and CDSC, are relatively visible, while ongoing asset-based charges such as 12b-1 fees are less evident because they are deducted from fund assets and are reflected in reduced account balances rather than being separately stated. Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, Final Rule, File No. S7-51-02, 82 SEC Docket 1040, 1041, 69 Fed. Reg. 11244, 11245 (Mar. 9, 2004).

Respondents urge that any problems with the marketing of A and B shares should be addressed through prospective rule making rather than through enforcement. It is axiomatic, however, that “the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency.” SEC v. Chenery, 332 U.S. 194, 203 (1947). Nonetheless, the Commission has, in fact, considered, but has yet to adopt, rule changes that would mandate transparency of marketing charges applicable to A and B shares. In 2004, after the events in question, the Commission adopted a Notice of Proposed Rule Making (NPRM), Prohibition on the Use of Brokerage Commissions to Finance Distribution, File No. S7-09-04, 82 SEC Docket 986, 69 Fed. Reg. 9726 (Mar. 1, 2004) (S7-09-04). Among other things, the NPRM requested comment on whether the Commission should propose to rescind, or amend, Rule 12b-1 in light of the current practice of using 12b-1 fees as a substitute for a sales load. The NPRM suggested an approach that would refashion the rule to deduct distribution costs directly from shareholder accounts rather than from fund assets, such

⁸⁷ For example, the OIP in Michael Flanagan alleged, in ¶ III.B.2., that the respondents in that proceeding recommended to customers that they invest \$100,000 or more in Class B shares of mutual funds without disclosing, among other things, that “class A shares generally produce materially higher returns than class B shares of the same mutual fund for long-term investors making purchases large enough to take advantage of the breakpoints available for purchases of Class A shares.” Admin. Proc. No. 3-9784 (Dec. 9, 1998) (emphasis added). Ultimately, the Commission dismissed that proceeding. Michael Flanagan, 80 SEC Docket 2766 (July 30, 2003).

⁸⁸ As found above, Miller discussed breakpoints and annual operating expenses with the customers at issue, and Kissinger did not. Wilkinson’s discussion of the difference between A and B shares focused on the CDSC and front-end sales charge and did not focus on breakpoints and annual expenses, consistent with his conclusion that B shares were preferable for customers investing less than \$500,000.

that an investor would have the choice of paying a sales load up front or paying the same, known amount, over time, with interest. 82 SEC Docket at 991-93, 69 Fed. Reg. at 9731-33. The NPRM noted that this approach would make the 12b-1 distribution fees completely transparent to the investor and eliminate conflicts of interest and sales practice problems associated with separate fund classes. However, when the Commission adopted the final rule amendments, it declined to amend Rule 12b-1 in regard to distribution costs or to propose a further NPRM on this issue. Final Rule, S7-09-04, 83 SEC Docket 2491, 2493-94; 69 Fed. Reg. 54728, 54730-31 (Sept. 9, 2004).

Also in 2004, the Commission adopted another NPRM, Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, File No. S7-06-04, 82 SEC Docket 6, 69 Fed. Reg. 6438 (Feb. 10, 2004) (S7-06-04). Among other things, the NPRM proposed “point of sale” (i.e., before the customer decides to invest) requirements that the broker-dealer inform the customer about distribution-related costs, including front-end sales loads, deferred sales loads, and estimated asset-based charges as well as the dealer concession or other sales fees it would receive and payment of differential compensation to associated persons, differing as to whether, for instance, A or B shares are sold. That rule making remains pending.

In light of the conclusion that A shares do not always outperform B shares at the \$250,000 level and in light of the Commission’s rule making proceedings regarding sales loads and disclosure, it is concluded that none of the registered representatives violated the antifraud provisions in regard to disclosure about the relative performance of A and B shares.

OIP ¶ III.E. alleges that the three registered representatives recommended investments without providing the customers with an adequate opportunity to study and understand the alternatives. As found above, each of the three met with customers multiple times, provided them with materials for study at home, and otherwise afforded ample time for customers to make unpressured investment decisions. As the undersigned previously ruled, OIP ¶ III.E. is a factual allegation of the context of the alleged material omissions and does not state a legal requirement in itself.⁸⁹ IFG Network Securities, Inc., Admin. Proc. No. 3-11179 (A.L.J. Sept. 12, 2003) (unpublished).

2. Higher Commissions Received for Selling Class B Shares at the \$250,000 Level

⁸⁹ In its August 19, 2003, Response to Respondents’ Motions for More Definite Statement, the Division cited a 1969 settlement, Paine, Webber, Jackson & Curtis, 43 S.E.C. 1052, 1054 (1969), to support the existence of such a requirement. A settlement, however, is not precedent, as the Commission has stressed many times. See Richard J. Puccio, 52 S.E.C. 1041, 1045 & n.7 (1996) (citing David A. Gingras, 50 S.E.C. 1286, 1294 (1992), and cases cited therein); see also Kelley ex rel. Mich. Dep’t of Natural Res. v. FERC, 96 F.3d 1482, 1489-90 (D.C. Cir. 1996), and cases cited therein; Robert F. Lynch, 46 S.E.C. 5, 10 n.17 (1975) (citing Samuel H. Sloan, 45 S.E.C. 734, 739 n.24 (1975); Haight & Co. Inc., 44 S.E.C. 481, 512-13 (1971); Security Planners Assocs., Inc., 44 S.E.C. 738, 743-44 (1971)).

As found above, none of the three registered representatives informed customers that he would receive a higher commission for selling Class B than Class A shares at the \$250,000 level. The Division argues that this was a failure to disclose a material fact, citing SEC v. Capital Gains Research Bureau, 375 U.S. 180, 196 (1963). Respondents argue that there was no duty to disclose such differential compensation and that there is no rule or precedent that supports the existence of such a duty during the relevant period. Certainly, it was industry practice for registered representatives not to disclose the differential compensation they received. Additionally, during the relevant period there was no specific case precedent or rule that required such disclosure by broker-dealers. United States v. Alvarado, 2001 U.S. Dist. LEXIS 21100 at *29 (S.D.N.Y. Dec. 17, 2001), aff'd 84 Fed. Appx. 162 (2d Cir. 2003) (unpublished). There is now pending, however, a rule making, S7-06-04, in which the Commission has proposed such a rule. The Commission has chosen to address this as a policy matter. If it decides to adopt such a rule, then going forward, the problem sought to be addressed in this case will be addressed globally, and all industry participants, including Kissinger, Miller, and Wilkinson, will have fair notice that they must disclose differential compensation. If the Commission decides not to adopt such a rule, then, a fortiori, registered representatives' past nondisclosure cannot, in fairness, be a violation of the antifraud provisions. At this point, for the undersigned to decide whether or not their nondisclosure was fraud would be to usurp the Commission's policy and rule making function.

3. Fiduciary Obligations

a. Kissinger

In addition to being an associated person of a broker-dealer, Kissinger was also an associated person of an investment adviser.⁹⁰ Thus, he owed a higher duty, as a fiduciary, to his advisory clients, Cline, Daley, Moran, and Portier, than an associated person of a broker-dealer owes to brokerage clients. The Division argues that his fiduciary obligations continued when he sold these clients specific investment products in his role as an associated person of a broker-dealer.⁹¹ Kissinger was aware of the fiduciary obligations of investment advisers and attempted to warn advisory clients who also became brokerage customers that, in that role, he was a salesman with the self-interest that role implies. His advisory contracts specified that the client was free to select any brokerage firm to carry out Kissinger Advisory's recommendations and, in meetings with the clients, Kissinger attempted to convey the difference between the advisory and brokerage services he provided. There is no case precedent that holds that an associated person of an investment adviser cannot change hats, to use Kissinger's metaphor, and act in the capacity

⁹⁰ There is no indication in the record or otherwise that offering co-located advisory and brokerage services is illegal or inappropriate.

⁹¹ If so, his failure to disclose to the advisory clients the higher commissions he was receiving for selling Class B shares would be a violative failure to disclose a conflict of interest. Capital Gains Research Bureau, 375 U.S. at 191-196. His failure to disclose that breakpoints were available on Class A purchases but not on Class B purchases would be another way of failing to disclose the same conflict of interest.

of an associated person of a broker-dealer without the higher obligations of an adviser. In light of the Division's burden of proof, and Kissinger's efforts to differentiate between his roles as investment adviser and as salesman, it is concluded that no violation of Sections 206(1) and 206(2) of the Advisers Act occurred.

The Division cites Marc Geman, 54 S.E.C. 1226, 1240-42 (2001), for the proposition that Kissinger's fiduciary obligations to Cline, Daley, Moran and Portier continued when he recommended specific transactions in Class B shares, notwithstanding his claim that he acted only as a broker in recommending specific transactions to them. In Geman, an investment adviser and broker-dealer (PMC) violated the antifraud provisions of the Securities, Exchange, and Advisers Acts in its operation of a "wrap fee" program under which customers paid an all-inclusive fee for brokerage, advisory, and custodial services.⁹² In contrast to Geman, however, Kissinger differentiated between his advisory and broker-dealer services. As he explained to the customers, he charged a fee for advisory services and was paid by a commission for brokerage services when he sold mutual funds to them.

b. De Facto Control

The Division argues that all three registered representatives had fiduciary obligations toward their brokerage customers, urging that they exercised de facto control over the accounts of the customers, who were not especially financially sophisticated and routinely followed their advice.

Cases in which de facto control of an account has been addressed have involved the flagrant violative sales practices of churning or excessive trading. See, e.g., Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980); Donald A. Roche, 53 S.E.C. 16, 22-23 & n.14 (1997) (citing Mihara, 619 F.2d at 821); Newburger, Loeb & Co. v. Goss, 563 F.2d 1057, 1069-70 (2d Cir. 1977), cert. denied, 434 U.S. 1035 (1978); Follansbee v. Davis, Skaggs & Co., Inc., 681 F.2d 673, 676-77 (9th Cir. 1982) (citing Mihara, 619 F.2d 814); Eugene J. Erdos, 47 S.E.C. 985, 989-90 (1983), aff'd, 742 F.2d 507 (9th Cir. 1984); Carras v. Burns, 516 F.2d 251, 258-59 (4th Cir. 1975). The fact that a customer follows the advice of his broker does not in itself establish control. If the customer, based on the information available to him and his ability to interpret it, can independently evaluate his broker's recommendations, the customer, not the broker, has control of the trading. Follansbee, 681 F.2d at 677 (quoting Carras, 516 F.2d at 258-59; Newburger, 563 F.2d at 1070).

Each of Miller's and Wilkinson's customers, as well as Kissinger's advisory and non-advisory customers, considered himself or herself more or less unknowledgeable about financial matters and felt it advisable to employ an expert for advice. However, each also had sufficient education and cognitive skills to ask questions and to study and understand mutual fund prospectuses had he or she made the effort. In short, each customer, based on the information available to him or her and his or her ability to interpret, could have independently evaluated his

⁹² PMC switched from agency to principal transactions and failed to disclose the reason to customers – that it expected to profit thereby at their expense.

or her broker's recommendations. Thus, it is concluded that none of the registered representatives had de facto control of any customer account at issue, and accordingly, none had enhanced, fiduciary obligations.⁹³

In sum, it is concluded that no violation alleged in the OIP against Kissinger, Miller, or Wilkinson was proved.

C. Failure to Supervise

Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act authorize sanctions against a broker-dealer or any associated person who "has failed reasonably to supervise, with a view to preventing [securities] violations . . . , another person who commits such a violation, if such other person is subject to his supervision." Since the alleged violations of the three registered representatives are unproved, it must be concluded that the failure to supervise charge against IFG and Ledbetter is also unproved.

IV. ULTIMATE CONCLUSIONS

It is concluded that Kissinger did not willfully aid and abet or cause violations of Sections 206(1) and 206(2) of the Advisers Act, and that Kissinger, Miller, and Wilkinson did not violate Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Further, IFG and Ledbetter did not fail reasonably to supervise within the meaning of Sections 15(b)(4) and 15(b)(6) of the Exchange Act. Accordingly, the proceeding will be dismissed as to all five Respondents.

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the revised record index issued by the Secretary of the Commission on August 16, 2004.

VI. MOTION TO STRIKE

Respondents Kissinger, Miller, and Wilkinson moved to strike the Division's proposed findings of fact 20, 27, and 28, urging that they constituted a new mathematical formula that had not been introduced at the hearing and subjected to cross-examination. In view of the decision herein, the motion is moot.

VII. ORDER

⁹³ The fact that Miller customers gave him discretion to make exchanges that incurred no commission within fund families in which they were already invested is not an indication that he had de facto control of their accounts, especially not de facto control over their initial selection of investments.

Based on the findings and conclusions set forth above:

IT IS ORDERED that this administrative proceeding IS DISMISSED as to IFG Network Securities, Inc., William Kissinger, Bert Miller, Glenn Wilkinson, and David Ledbetter.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Carol Fox Foelak
Administrative Law Judge