INITIAL DECISION RELEASE NO. 293
ADMINISTRATIVE PROCEEDING
FILE NO. 3-11012

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
	:	INITIAL DECISION
JAMES F. GLAZA, D/B/A FALCON FINANCIAL SERVICES, INC.	:	July 21, 2005

APPEARANCES: Polly Atkinson and Robert Fusfeld for the Division of Enforcement, United States Securities and Exchange Commission

Martin Berliner for James F. Glaza

BEFORE: Robert G. Mahony, Administrative Law Judge

INTRODUCTION

The Securities and Exchange Commission (Commission) issued an Order Instituting Proceedings (OIP) on January 21, 2003, pursuant to Section 8A of the Securities Act of 1933 (Securities Act) and Sections 15(b) and 21C of the Securities Exchange Act of 1934 (Exchange Act) against James F. Glaza (Glaza) d/b/a Falcon Financial Services, Inc. The OIP charged that from August 1999 through May 2000 (the relevant period) Glaza, as a registered representative, willfully violated Sections 5(a), 5(c), and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in connection with the offer, purchase, and sale of shares of OnLine Power Supply, Inc. (OnLine or the company.)

Glaza filed his Answer on April 2, 2003. A hearing was scheduled for July 7, 2003. However, on July 3, 2003, Glaza and the Division of Enforcement (Division) agreed to submit the matter for decision based on stipulations of fact. On September 8, 2003, the undersigned issued an Initial Decision finding Glaza in violation of the registration and antifraud provisions of the Securities Act and Exchange Act. James F. Glaza, 81 SEC Docket 245 (Sept. 8, 2003). Thereafter, Glaza sought Commission review of the decision, asserting that the findings and conclusions were

based on stipulations that his hearing attorney had fraudulently induced him to sign. On September 30, 2004, after considering Glaza's argument and proffer of evidence, the Commission remanded the proceeding for further inquiry. James F. Glaza, 83 SEC Docket 3101 (Sept. 30, 2004).

Pursuant to the Order of Remand, I held a hearing in Denver, Colorado, on November 8, 2004, to inquire into the circumstances surrounding the submission of the matter on stipulations of fact. At the conclusion of the hearing, I determined that Glaza was neither fully advised nor did he fully understand the legal consequences of submitting the case on stipulations. I ordered that the proceeding be reopened and the matter be considered de novo. See Order Following Remand Hearing, Administrative Proceedings Rulings Release No. 615 (November 17, 2004). On remand, a hearing was held in Denver, Colorado, during February 1-4, 2005. The Division and Glaza filed posthearing briefs on April 1, 2005, and April 4, 2005, respectively. The Division and Glaza also filed reply briefs on April 11, 2005.[1]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The findings and conclusions herein are based on the entire record made at the February 1-4, 2005, hearing. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments and proposed findings and conclusions that are inconsistent with this Initial Decision.

The Division called Glaza as a witness.[2] He became a registered representative in 1982. (Tr. at 103.) He held Series 7, 22, and 63 licenses. (Tr. at 103.) Initially, he worked for EF Hutton & Co., and successor firms until 1990. (Tr. at 104.) He then went to D.E. Frey & Co. until 1995, when he became associated with Dominion Capital Corp. and its successor firms, Northstar Securities, Inc. (Northstar), and Rushmore Securities, until 2000. (Tr. at 104-105.)

Glaza served as president and part owner of Falcon Financial Services, Inc. (Falcon), from approximately 1991 to 2001. (Tr. at 107.) Falcon was a Sub-Chapter S Corporation with two shareholders, Glaza and his wife, Jeannette Glaza, each of whom owned 50 percent. (Tr. at 104-105, 107, 120-21.) Falcon was primarily a financial planning firm. (Tr. at 108.) Falcon performed financial planning services for 90 percent of its clients. The firm primarily sold shares of OnLine private placements to the other 10 percent, who were referred to the firm with a specific interest in that stock. (Tr. at 109.) During the relevant period, Jeannette Glaza, Teresa Kelly (Kelly), and Rick Parsons worked with Falcon and held Series 7 licenses. (Tr. at 110, 122-123.)

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[1] Citations to the transcript of the hearing will be noted as "(Tr. at __.)." Citations to the Division's and Glaza's exhibits will be noted as "(Div. Ex. __.)," and "(Resp. Ex. __.)," respectively. Citations to the Division's and Glaza's posthearing briefs will be noted as "(Div. Post-Hearing Br. at __.)," and "(Resp. Post-Hearing Br. at ___.)," respectively.

[2] Glaza is sixty-seven years old. He received his bachelor's degree in aeronautical engineering from the Air Force Academy in 1960. He received a master's degree in behavioral science and education from Sacramento State University in 1987. In addition, he attended graduate school at the University of Michigan and the University of Oklahoma. He served on active duty with the Air Force from 1960 to 1981 and retired at the rank of Lieutenant Colonel. (Tr. at 383-384.)

OnLine was a Nevada corporation based in Englewood, Colorado, and the successor to OnLine Entertainment, Inc., which was a successor to Roth Financial Fitness, Inc. (Div. Ex. 33 at 192-193, 996-998.) During the relevant period, OnLine stock traded on the Over-the-Counter Bulletin Board (Bulletin Board) and was a penny stock. (Div. Ex. 6 at 18141; Div. Ex. 24 at 25864; Div. Ex. 25 at 25879.) The company filed for bankruptcy in May 2004, and the assets were sold to Saturn Electronics and Engineering in August 2004. (Tr. at 543-544.)

OnLine's business involved the design and sale of "AC to DC" power supply systems for electronic devices. (Div. Ex. 33 at 193-194, 996-998.) During the relevant period, the company focused its operations on three product lines: the Glitch Master, the Power Factor Corrected Front End module (PFCFE), and the 48 Vdc power supply (48-volt power supply). (Div. Ex. 6 at 18142, 18145-18147, 18150-18152.) The Glitch Master was a "product designed to protect and maintain the power supply for direct current (DC) circuitry," such as personal computers and workstations. (Div. Ex. 6 at 18151.) OnLine discontinued production of this line at the end of 1999. (Div. Ex. 33 at 1012.)

The company believed the new technology (PFCFE and 48-volt power supply) provided an alternative to other power supply systems because it was smaller and more efficient. (Div. Ex. 6 at 18146.) The PFCFE was a modular power supply that converted AC power from the wall into DC power for electrical equipment with memory supplied by a chip. (Div. Ex. 6 at 18146.) OnLine did not complete the PFCFE until late 2000. (Div. Ex. 33 at 1000.) OnLine also developed the 48-volt power supply, which incorporated the PFCFE technology and would operate as a device that distributed power across a varying set of voltages. (Tr. at 302; Div. Ex. 33 at 1002.) The company believed the PFCFE and the 48-volt power supply would form the basis for approximately 30 other product lines. (Div. Ex. 6 at 18146.)

The company needed the proceeds of the offerings to operate and to bring the new technology to the market. (Tr. at 237-238, 376.) Kris Budinger (Budinger) was associated with OnLine from approximately 1994 through 2002. (Tr. at 235.) In 1999 and 2000, he held the position of chief operating officer. (Tr. at 236.) According to Budinger, the company did not earn a net profit during any of the years that he was associated with the company. (Tr. at 246.) In fact, the annual report on Form 10-KSB for the year ending December 31, 1999, showed a net loss of $1,449,530 for 1998 and a net loss of $1,588,355 for 1999. (Div. Ex. 33 at 225.) The annual report on Form 10-KSB for the year ending December 31, 2000, also showed a net loss of $3,786,372. (Div. Ex. 33 at 1023.)

This proceeding is based on the private placement of OnLine stock. The private placement memoranda are dated July 1999, November 12, 1999, and April 5, 2000. (Div. Exs. 6, 24, 25.) For all three private placements, Glaza's team sold about 65 percent of the shares, which totaled about 5 million shares to approximately 300 clients. (Tr. at 129-131.) Each private placement memorandum (PPM) offered OnLine stock at $2.00 per share. (Tr. at 129-31; Div. Exs. 6, 24, 25.)

SECTION 5 - REGISTRATION PROVISIONS

Section 5(a) of the Securities Act prohibits the sale of unregistered securities or deliveries for the purpose of sale. Section 5(c) prohibits any person to "offer to buy" or "offer to sell" any security, unless a registration statement has been filed.

The PPM for each offering stated the stock was offered pursuant to an exemption from the registration requirements of Section 5 of the Securities Act. The July 1999 PPM stated the offering was made pursuant to Section 4(6) of the Securities Act. (Div. Ex. 6 at 18135.) The November 1999 and April 2000 PPMs stated the offerings were made pursuant to Rule 506 of the Securities Act. (Div. Ex. 24 at 25861; Div. Ex. 25 at 25875.)

The PPMs also stated the requirements for each exemption. All three PPMs stated that "[s]hares will be sold to accredited investors only, as that term is defined in Regulation D. Generally, accredited investors are those individuals with net worth exceeding $1,000,000 or annual net income over $200,000." (Div. Ex. 6 at 18135-18136; Div. Ex. 24 at 25861; Div. Ex. 25 at 25875.) Further, all three PPMs stated that "[n]o advertising or any other form of general solicitation will be used in connection with this offering." (Div. Ex. 6 at 18135; Div. Ex. 24 at 25861; Div. Ex. 25 at 25875.) The PPMs also stated each offering amount, which was $5,000,000 for the July 1999 offering, $2,500,000 for the November 1999 offering, and $8,500,000 for the April 2000 offering. (Div. Ex. 6 at 18134; Div. Ex. 24 at 25861; Div. Ex. 25 at 25874.) Glaza and Kelly, the Falcon Branch Manager, testified that each investor received a copy of the PPM. (Tr. at 394, 414, 468-470.)

Steven Rounds (Rounds), an experienced securities lawyer, began serving as OnLine's attorney during the summer of 1999.[3] (Tr. at 529.) Rounds confirmed that the offerings were not registered. (Tr. at 533.) He advised OnLine on the requirements for claiming an exemption from registration under Section 4(6) and Rule 506 of the Securities Act. (Tr. at 533-534.) Rounds believed that OnLine was ultimately responsible for determining whether the prospective investor met the net worth or income requirements of the exemptions. (Tr. at 534.) He also believed that OnLine was the decision maker on compliance with the exemption. (Tr. at 534-535.)

Rounds was one of the attorneys who represented OnLine during the investigation that led to this proceeding. (Tr. at 536.) He testified that during the investigation, the Division questioned whether the private placements were exempt from registration. (Tr. at 535-536.) At that time, Rounds analyzed the matters raised by the Division and expressed his opinion in a letter sent to the Division attorneys that he continued "to believe the three post mid-July 1999 offerings complied with section 5." (Tr. at 536-537; Resp. Ex. 16.) During the hearing, Rounds testified that he still believed the offerings qualified for the exemptions. (Tr. at 537.)

Kelly served as the compliance officer for Falcon. (Tr. at 405.) Kelly testified that she determined whether the investor was accredited before sending the PPM and subscription

[3] Rounds testified that he has practiced securities law for twenty-five years, representing issuers in private placements and public offerings. (Tr. at 529.)

agreement to the investor. (Tr. at 393.) According to Kelly, all Falcon clients who participated in the OnLine offerings completed a subscription agreement. (Tr. at 394-395.) She reviewed the completed subscription agreement returned by the client to assure that the client was accredited. (Tr. at 395.) On one occasion, she rejected a subscription agreement because the client refused to provide his net worth information. (Tr. at 396.) Kelly sent a copy of each subscription agreement to Northstar and the original to OnLine. (Tr. at 395-396.) She believed that OnLine ultimately decided whether a subscription agreement was accepted for the offering. (Tr. at 396.)

Budinger testified that each investor who purchased shares through the private placements completed a subscription agreement, which indicated the investor met the net worth or income requirements. (Tr. at 294; Resp. Ex. 18; Resp. Ex. 21.) According to Budinger, he and Larry Arnold, the chief executive officer at the time, approved the subscription agreements. (Tr. at 294.)

The investors who testified met the net worth and/or net income requirements at the time they purchased shares of the private placements. The subscription agreements and the testimony show that Kathleen Madison (Madison), David Helmreich (Helmreich), and Ronald Murchison (Murchison) were accredited investors at the time of their purchases.[4] George Bracksieck (Bracksieck) testified that he was accredited at the time of his purchase.[5] Donald Halley (Halley) testified that he thoroughly read the July 1999 PPM, which stated the offering would be sold only to investors that met the net worth or net income requirements. (Tr. at 571; Resp. Ex. 3.) Glaza also provided copies of the new account forms, which required net income and net worth information, for Madison and Helmreich. (Tr. at 57; Resp. Ex. 18; Resp. Ex. 21.)

Glaza testified that he contacted Northstar and OnLine and they confirmed the offerings were exempt from registration because the sales were made only to accredited investors. (Tr. at 132-133, 137, 139-140.) Glaza maintains that he talked only to accredited investors about the OnLine private placements. (Tr. at 201.) Glaza asserts that he did not make general solicitations.[6] (Tr. at 492-493.)

Section 4(2) of the Securities Act states the provisions of Section 5 shall not apply to "transactions by an issuer not involving any public offering." Rule 506 provides that an offer or sale of securities shall be deemed a transaction not involving any public offering, within the meaning of Section 4(2) of the Securities Act, if the offer satisfies all the terms and conditions of

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[4] Madison (Tr. at 58-59; Resp. Ex. 18.); Helmreich (Tr. at 94-95; Resp. Ex. 21.); and Murchison (Tr. at 318-319.)

[5] Bracksieck testified that at the time he purchased shares of the private placements his net worth was more than $1,000,000. (Tr. at 328-329.)

[6] In a July 23, 1999, Compliance Alert, Northstar addressed the requirements for participating in the OnLine private placement. The compliance alert stated that representatives may not use general advertising or solicitation for this offering, which included "seminar notices or letters to your investors." The compliance alert also warned that the private placement could be offered only to accredited investors. (Div. Ex. 7.)

Rules 501 and 502 and there are no more than thirty-five non-accredited purchasers. Rule 501(a) provides that the term "accredited investor" includes any natural person "whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000" or "who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year." Rule 502(c) further provides that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation."

Section 4(6) of the Securities Act provides that Section 5 shall not apply to transactions involving offers or sales by an issuer solely to accredited investors, if the aggregate offering price of the issue does not exceed $5,000,000 and there is no advertising or public solicitation by the issuer or anyone acting on the issuer's behalf.

A broker who claims an exemption from registration, similar to that of the issuer, has the burden of proving the exemption applies. SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953). Accordingly, Glaza has the burden of showing that Section 4(6) and Rule 506 applied to the OnLine offerings to avoid a violation of Section 5.

Rounds believed that all three offerings were exempt from registration. He counseled OnLine on the requirements for exemption under Section 4(6) and Rule 506. He then continued to represent OnLine during the investigation of this matter and expressed his opinion to the Division attorneys that he believed the offerings were exempt based on the information he analyzed. During the hearing, he reiterated his belief that an exemption applied to these offerings.

The PPMs stated that only accredited investors could purchase shares of the offerings and the subscription agreements indicated that the investor was accredited. The testimony of Bracksieck, Helmreich, Madison, and Murchison indicates that each met the accreditation requirements. Halley testified that he thoroughly read the July 1999 PPM, which specified that only accredited investors could purchase shares.

Glaza asserts that he contacted Northstar and OnLine about the legality of the transactions and they confirmed the offerings were "legally sufficient." (Tr. at 132.) Kelly reviewed each subscription agreement to determine whether the individual provided the required information and evaluated whether the investor was accredited. Budinger also testified that he and Larry Arnold approved the subscription agreements completed by investors. Glaza testified that he did not use any general solicitation to offer or sell shares of OnLine.[7] Further, the PPMs stated that no general solicitation would be used in connection with the offerings.

[7] Although Murchison testified that he met Glaza at one of his retirement planning seminars, there is no evidence that Glaza or anyone else discussed the OnLine private placements at the seminar.

I find the testimony of Glaza, Kelly, Rounds, and Budinger to be credible as to compliance with the requirements of Rules 501, 502, and 506 of the Securities Act.[8] Rule 506(b)(2)(i) states the issuer must have a reasonable belief that there are no more than thirty-five non-accredited investors. Although Glaza did not provide copies of signed and completed subscription agreements for each investor, I find the procedure followed by Falcon and OnLine, as well as the testimony of Glaza, Kelly, Rounds, and Budinger, establishes that all investors were accredited. The executed copies of the subscription agreements admitted as evidence and the testimony of the investor witnesses further supports this finding. The Division has not introduced evidence to rebut the existence of the claimed exemptions.

For these reasons, I find that the evidence establishes that the July 1999, November 1999, and April 2000 offerings met the requirements of Rule 506 of the Securities Act. Accordingly, the charge that Glaza violated Section 5 of the Securities Act must be dismissed.

ANTIFRAUD PROVISIONS – SECTION 17(a) OF THE SECURITIES ACT AND SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5

A. Background

1. Stock Price Projections

The Northstar compliance documents specifically prohibited registered representatives from making stock price projections. The Northstar Annual Registered Representative Disclosure Package for 1999 listed the "prediction/projection of future results other than as presented in offering materials" as a prohibited practice. (Div. Ex. 3 at 18591.) Further, the July 1999 Northstar Compliance Alert addressed the OnLine offering and acknowledged that OnLine may not perform as projected and warned that representatives should "not get carried away in our enthusiasm." (Div. Ex. 7.)

a. Glaza's Projected Stock Price Calculations

Despite these warnings from Northstar, Glaza frequently offered OnLine stock price projections to his clients.[9] He told investors that the projected stock price for OnLine would be

[8] Rule 502(a) states that "[a]ll sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D." The rule also provides a safe harbor under which offers or sales made more than six months before or after the Regulation D offering will not be considered part of that Regulation D offering. The Note to Rule 502(a) states that when the safe harbor is unavailable, the five-factor test set forth in Securities Act Release No. 33-4552, shall be used to determine whether the offerings are integrated. Applying these factors, the Section 4(6) exemption is not available for the July 1999 offering because the three offerings are integrated and the total amount exceeds the $5,000,000 limit. However, because I find that all investors were accredited and there was no general advertising or solicitation, the Rule 506 exemption is available for the July 1999 offering.

[9] Glaza believes that price projections are necessary. (Tr. at 180.) However, he has no expertise in analyzing stocks and he primarily sold other investments, such as mutual funds, annuities,

approximately $70 per share by the end of 2000 and $120 per share by the end of 2001. (Tr. at 47-48; Div. Ex. 13 at 85; Div. Ex. 14 at 48.) He calculated the projected OnLine stock price by multiplying a projected earnings per share (EPS) by the price to earnings ratio (P/E ratio) for other companies in the power supply industry.[10] (Tr. at 476-477; Div. Ex. 10 at 19074.)

Glaza believed it was reasonable to use a P/E ratio of 30 because that was the ratio for other companies in the power supply industry.[11] He believed that OnLine would be competitive with other companies in that industry. (Tr. at 476.) However, he conceded that other companies with this ratio were listed on the New York or American Stock Exchanges. (Tr. at 523.)

The July 1999 PPM contained revenue, net income, and EPS projections for 2000 and 2001. (Div. Ex. 6 at 18160.) The PPM stated the projected revenue was "based on the assumption that 40% of the 'requests for specifications' received to date result in contracts for manufacture of OPS products." (Div. Ex. 6 at 18159.) Glaza believed it was reasonable to obtain the projected EPS from the July 1999 PPM, which showed EPS of $2.29 for 2000 and $4.08 for 2001. (Tr. at 475, 477; Div. Ex. 6 at 18160.) The PPM indicates these numbers were calculated by dividing the projected net income by the outstanding number of shares. (Div. Ex. 6 at 18160.)

Glaza believed the projections in the July 1999 PPM were taken from a report prepared by Richard Lintz (Lintz). (Tr. at 471-475.) Lintz's wife, a portfolio manager considering an investment in OnLine, suggested that her husband could prepare a business plan for OnLine. (Tr. at 471-472.) Although he was not engaged for his services, Lintz prepared a business plan for the company titled, "OnLine Entertainment, Inc., Business Plan and Financial Projections, July 1999."[12] (Tr. at 586; Div. Ex. 39.) Lintz's report included revenue and income projections for 2000 and 2001, which he derived from discussions with management and from his own judgment of expenses. (Tr. at 589.) Lintz did not conduct an independent investigation of the information provided by the company. (Tr. at 589-590.) Further, he did not believe the information would be included in a private placement memorandum. (Tr. at 594-595.)

According to Glaza, Budinger told him that the Lintz projections would be reduced by 60 percent. (Tr. at 473.) At the hearing, neither Glaza nor Budinger could explain why the

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insurance products, and shares of partnerships. (Tr. at 104, 385-386.) He testified that he was "not a stock guy" and that he did not "like to do stocks and bonds." (Tr. at 104, 172-173.)

[10] According to Glaza, the P/E ratio for the power supply industry was 30 or 36. (Tr. at 476-477.) He used a P/E ratio of 30. (Div. Ex. 13 at 85; Div. Ex. 14 at 63-64.)

[11] In 1997, he used a P/E ratio of 20. The fall 1997 newsletter stated, "[n]et earnings are very conservatively estimated to be $1.20 per share in 1998 and over $3.00 per share in 2000. Using a price-to-earnings multiple of 20, those earnings equate to a $24 and $60 stock respectively." (Div. Ex. 10 at 19074.)

[12] Lintz was a consultant with Cap Gemini, formerly Ernst & Young Consulting, at the time he prepared the report. (Tr. at 583.)

projections were reduced by 60 percent. (Tr. at 272, 522.) Further, Glaza did not review the report before the hearing and he did not know what Lintz assumed or did to prepare his report. (Tr. at 473, 521.) The summer 1999 newsletter told Falcon clients: (Div. Ex. 10 at 19091.)

> an outside group who was interested in placing capital in OnLine engaged Ernst & Young to update OnLine's business plan. Within that resulting plan are revenue projections that are very high. Suffice it to say ONLN discounted these projections by 60% and still came up with possible earnings per share of $2.29 by end of the year 2000.

Thomas Glaza, an OnLine board member and Glaza's brother, refused to rely on the information in the pro forma income projection that existed in July 1999. (Tr. at 604-605.) Thomas Glaza was appointed to the OnLine board of directors in July 1999. (Div. Ex. 33 at 255.) He testified that at or about the time he came to the board, he saw a pro forma income projection prepared by the company. (Tr. at 604.) He understood that "some consultant" prepared a report showing the total potential business and the company calculated the pro forma income projection by assuming it would earn a percentage of that potential business. (Tr. at 604-605.) However, he believed that the pro forma income projection was too high and there was no logic behind the whole projection. (Tr. at 604-605.) He asked for a more specific projection, "based on actual prospects with numbers and closing dates and all that kind of thing" and received that information about six months after he joined the board. (Tr. at 605.) He believed that the company needed to stop using "some percentage of potential and boil it down to who you're talking to, when you expect it to close, what is the volume, how much you're going to sell it for, and how much you're going to realize over time." (Tr. at 606-607.)

b. Glaza Gives Projected Stock Prices for 2000 and 2001 to Investors

The National Association of Securities Dealers (NASD) required Northstar Securities to begin taping telephone conversations with existing or potential customers. This became effective on October 5, 1999, and was to continue for two years, unless modified by the NASD. (Div. Ex. 11.) Pursuant to this requirement, Glaza taped telephone conversations with all his clients. (Tr. at 126-127.) Glaza testified that he believed the taped phone conversations, which were transcribed and admitted as Division Exhibits 13 and 14, took place in the fall or late 1999.[13] (Tr. at 144; Div. Ex. 13; Div. Ex. 14.)

Glaza made OnLine stock price projections to almost every client. (Tr. at 471.) He explained that "the first thing that virtually every client asked was where you thought the company and the stock might go. They want to know what the upside potential is." (Tr. at 471.) When the July 1999 PPM was released, which included pro forma net income and EPS projections, Glaza believed it was reasonable to project the OnLine stock price from that information. (Tr. at 471-477; Div. Ex. 6 at 18160.)

Glaza told Dr. Bruce Haughey, a Falcon client: (Div. Ex. 13 at 63-64.)

[13] The conversations are undated in the transcript. (Div. Ex. 13.)

Glaza: You bought the stock at two bucks. It's now at 30 and we're projecting 120. Would you sell it at 30? If you did, I would personally come down there and break your arm.
Haughey: Okay.

Glaza told Jackie Barondeau, a Falcon client: (Div. Ex. 13 at 122-125.)

Barondeau: Okay. I want you to make that other stuff [OnLine] stock.
Glaza: It's at 5.75 today.
Barondeau: Yeah, but when is it really going to go up.
Glaza: In the next year. I expect it to reach -- we are projecting a minimum price of 70 bucks or thereabouts.
Barondeau: I have [unintelligible]. That still won't do me any good if it doesn't make me any money, because we're not going to sell any of it, right?
Glaza: We'll start coming out, in my opinion, somewhere around -- somewhere north of 70.
Barondeau: Uh-huh.
Glaza: Let's say at 100, we start coming out. So at 100, you got quite a bit of it. So you got two, four -- you know, about 7000 shares. That's worth about $700,000 at 100 bucks a share, which would give you a 10 percent cash flow, which would give you about $70,000 a year cash flow. It would make your retirement very imminent.
Barondeau: So I could retire immediately when that happens?
Glaza: Precisely. . . .
Barondeau: Okay. So my sister has some and she's looking at funding a college education here in the next year.
Glaza: She might have to get out earlier than what she wants to if she needs to have that money.
Barondeau: I'll talk to her.
Glaza: But I would only take out what she absolutely needs, because the company -- I personally see the company potentially going to several hundred dollars a share. . . . Yeah, the OnLine is doing extraordinarily well.
Barondeau: Okay.
Glaza: I remain as excited as I've ever been and it's growing. In fact, I'm going to Comdex with it in two weeks. . . . Tell [your sister] to sit tight and it's looking exceptionally -- well, you're saying you're up what, 1000 percent already.
Barondeau: I know. I'm so broke. You know me.
Glaza: But this is not the time to sell it out.
Barondeau: I know that. I know that.

Glaza had the following discussion with Carol Porter, a Falcon client, in late 1999: (Tr. at 171-173; Div. Ex. 13 at 84-87.)

Glaza: . . . And OnLine of course is -- you watch what it's doing. It's up to -- roughly six bucks now.
Porter: Okay. 5 ¾ the last time.
Glaza: But don't do anything.
Porter: Oh, no.

Glaza: Don't cash out. That guy is going north. It's just barely started.
Porter: That's what we got our fingers crossed.
Glaza: Your value right now, you have 4000 shares there, so that's 24,000 at the moment roughly. But it's going -- I think that's worth 400,000 before it's done.
Porter: Yeah. Well, that would be good. That would be very good.
Glaza: I'm planning on it.
Porter: How long do you project that it's going to --
Glaza: Chris took 40 percent -- Chris being the president of the company.
Porter: Uh-huh.
Glaza: Took 40 percent of the existing orders that we have on the desk and projected that to the end of next year and that's $70 stock, with using an average 30 -- price to earnings ratio, which is less than the S and P 500 average --
Porter: Uh-huh.
Glaza: --and projected it to $120 a share by the end of the following year.
Porter: Uh-huh.
Glaza: And that 40 percent of the orders -- those orders come from two of the 14 distributors. We haven't even opened our doors to the other 12 distributors.
Porter: Wow.
Glaza: So you can see the enormous potential for the stock. It could be several hundred dollars a share.
Porter: So you expect in the next couple of years it's going --
Glaza: We should be well over 100 in the next two years.
Porter: Should be --
Glaza: Yeah. That's your 400,000.
Porter: Uh-huh.
Glaza: And that will give you -- reinvested properly, that will give you a 10 percent cash flow, so that will give you about 40,000 a year -- even at that level, about $40,000 a year of income.
Porter: Okay. That sounds very good.
Glaza: And it's not -- you don't have to wait a lifetime for it.
Porter: Right.
Glaza: I mean, you know, it should be relatively soon. . . . And we haven't opened our doors overseas too. We have distributors over there as well. . . . We're probably going to do that in this next quarter, during this quarter.
Porter: Yeah.
Glaza: . . . So things are moving forward very, very quickly at this juncture.

Helmreich testified for the Division. He is fifty-seven and sells real estate for a living. (Tr. at 82-83.) Prior to his OnLine investment, he purchased equity securities in "little bits and pieces" for 20 or 30 years. (Tr. at 87.) Helmreich contacted Glaza specifically about OnLine stock. Glaza told him the price of OnLine stock would reach $70 to $120 using a P/E ratio of 30. (Tr. at 83-86.) Helmreich's first OnLine investment in October 1999 totaled $140,000. About six weeks later, he invested another $70,000. Prior to investing, he did not call the company or speak to anyone about OnLine. (Tr. at 88-91.) He received a PPM and saw the risk factors, including that the company did not have any orders or appreciable income. (Tr. at 89-90.)

Madison testified for the Division. Madison is fifty-seven years old and holds a bachelor's degree in business and psychology. During the relevant period, she worked as a real estate broker. (Tr. at 40, 55.) She had no prior experience investing in private placements. (Tr. at 40.) Her investments prior to her participation in the OnLine private placement were conservative. (Tr. at 41.) Madison was referred to Glaza in October 1999 by Helmreich. (Tr. at 41-42.) Prior to her initial conversation with Glaza, Madison had purchased almost 3,000 shares of OnLine for about $12,000 in the open market. (Tr. at 53-54, 61-62.)

During an October 1999 conversation with Madison, Glaza projected the stock price to reach $70 by the end of the first year and $120 by the end of the second year. (Tr. at 47-48; Div. Ex. 14 at 48.) Glaza called this an ultra conservative estimate. (Tr. at 76.) In October 1999 Madison purchased $50,000 of the OnLine private placement and an additional $25,000 in January 2000. (Tr. 51-53.) In February 2000, she bought 600 for about $29 per share in the open market on her father's behalf. (Tr. at 52-53.)

Glaza began sending newsletters to all his clients in the fall of 1997. **(**Tr. at 190; Div. Ex. 10 at 19073.) Glaza was ultimately responsible for the content of the newsletters. (Tr. at 188.) Kelly testified that she sent the newsletters to Budinger, which were returned with his initials and with few proposed changes. (Tr. at 409-410.) Budinger only recalled reviewing one newsletter. (Tr. at 293.) From that point, Kelly sent the newsletters to the Northstar compliance officer for review before Falcon sent them to clients. (Tr. at 405, 410.) According to Kelly, the letters were returned to Falcon with the initials of the compliance officer and quite often the letters included changes. (Tr. at 405.)

On one occasion, Northstar required the omission of a specific stock price projection. (Tr. at 406-408.) The original version of the summer 1999 newsletter read: (Resp. Ex. 29.)

> Suffice it to say ONLN discounted these projections by 60% and still came up with expected earning per share of $2.29 by year end 2000 and of $4.08 by year end 2001. <u>If you use the average power supply company's P/E ratio of 30, this gives a potential stock value of $122.00 by 12/31/01</u>. (emphasis added).

The final version of the summer 1999 newsletter read as follows:[14] (Div. Ex. 10 at 19091.)

> In the meantime an outside group who was interested in placing capital in OnLine engaged Ernst & Young to update OnLine's business plan. Within that resulting plan are revenue projections that are very high. Suffice it to say ONLN discounted

[14] The summer and fall 2000 newsletters began with a discussion of how to predict OnLine stock prices. After employing some hypothetical calculations involving OnLine, the newsletters stated: "Participate in the excitement. Use stock analysis fundamentals to forecast the price of [OnLine]." The newsletters also included the following information from the company's June 30, 2000, quarterly report: "Since the company had very little income during this period, OnLine lost money overall. . . . Management is estimating that volume sales will occur during the fourth quarter of the year 2000." (Div. Ex. 10 at 19101-19102, 19105-19106.)

these projections by 60% and still came up with possible earnings per share of $2.29 by the end of the year 2000. If projections are realized, the stock could increase significantly in the next two years. But do not forget, however, that these are only projections and we have yet to see actual sales potential; we "always consider Murphy to be an optimist."

Although the PPMs disclosed the risk factors associated with the company and the offerings, Glaza discounted these risks in conversations with clients. (Div. Ex. 6 at 18138-18141; Div. Ex. 24 at 25862-25865; Div. Ex. 25 at 25877-25879.) He told Hank Maas (Maas) and Madison that he believed his estimates were very conservative, and he told Madison that the investment was a "slam dunk." (Tr. at 44; Div. Ex. 14 at 48, 64.) Further, Glaza only recalls telling two investors that he believed the investment in OnLine was risky, because it was a start-up company with no revenue and no sales. (Tr. at 198-200.)

c. Actual Stock Prices for 1999 and 2000

The stock prices Glaza projected did not materialize. In 1999, the price for OnLine stock ranged from a low of $1.87 on January 13, 1999, to a high of $6.25 on October 19, 1999. (Div. Ex. 32 at 1-6.) The highest closing stock price for OnLine in 2000 was $32.37.[15] (Div. Ex. 32 at 6.)

2. Revenue Projections

Christie Maxwell (Maxwell) was the OnLine director of sales and marketing during the relevant period. (Tr. at 546.) Maxwell was responsible for marketing the new technology for design into the buyer's products. (Tr. at 548.) She and her partner compiled lists of potential buyers based on verbal expressions of interest. (Tr. at 550-551.) According to one list compiled around mid-1999, Lucent Technologies was interested in 25,000 units of the PFCFE module, if OnLine could "build this product and it met this form factor, this size, this efficiency percentage." (Tr. at 553-554; Resp. Ex. 25.) The "Estimated Request Date" for the Lucent Technologies request was "ASAP." (Resp. Ex. 25.) This list also stated that Qualcomm was interested in 10,000 units for a total of $1,725,000 with an "Estimated Request Date" of October 1, 1999. (Resp. Ex. 25.) Maxwell testified that $225,580,000 was a reasonable estimate of the total expressions of interest as of mid-1999, provided that the product met the buyer's requirements. (Tr. at 553-554.) The company disseminated information about the expressions of interest to broker-dealers and potential investors. (Tr. at 554.)

Glaza regularly projected the amount of orders OnLine would secure for the PFCFE module. Glaza maintains he received the information about the status of OnLine's operations on a regular basis from Budinger, Arnold, and other OnLine employees. He also stated that he drove to the company and talked to the staff and observed the operation.[16] (Tr. at 478-479.)

[15] In 1998, the net loss per share equaled $.13. In 1999, the net loss per share equaled $.13. (Div. Ex. 33 at 225.)

[16] An undated letter on Falcon letterhead and directed " To Our OnLine Entertainment Investors" stated:

The summer 1999 newsletter contained the following information, in part, about OnLine: (Div. Ex. 10 at 19091.)

> As stated previously, progress continues across virtually every area of the company. . . . OnLine plans to begin manufacturing around the first of September and hopes to have their first order soon thereafter. . . . The 48 volt power supply is projected to go to UL on the first of September, with manufacturing anticipated around mid-September. . . . OnLine has established 14 distributorships for its product lines. Only two of these have been activated to date, but have, incredibly, sent in 45 potential customer companies who have provided specifications, numbers of units wanted and pricing, totalling [sic] over $230 million in gross revenue.

The fall 1999 newsletter gave the following information about OnLine: (Div. Ex. 10 at 19095.)

> OnLine Entertainment Inc. (NASDAQ Electronic Bulletin Board symbol: ONLN) successfully concluded a $5 million private offering. . . . Several PFC evaluation units are already in the hands of potential buyers, all performing as advertised.
>
> Saturn Electronics and Engineering Inc. of Auburn Hills, Michigan has won the manufacturing contract and formed a strategic alliance with OnLine, enhancing viability in the eyes of customers. . . . PFC orders will be taken in the next 60 days and the first product should be shipped around the end of the first quarter of next year.

> I recently had the opportunity to spend several hours with the OnLine staff during an orientation for potential new board members and came away with even more (if that's possible!) enthusiasm than ever. While it is not reflected very strongly in the price of the stock, the company continues to move forward. The power factor correction (AC-DC conversion) module (PFC) has been fully completed and is being actively marketed. The 48 volt integrated power supply is 3 to 5 weeks from completion and should be ready to bring to market during that time frame. . . . Our OnLine staff is a [sic] actively marketing all of this technology. . . .
>
> We know many of you feel somewhat frustrated by what seems a lack of progress as reflected in the stock price. Along with the pains of development and production, add increased testing requirements laid on by potential customers to slow our progress. . . . Once we progress beyond these final stages of preparation over the next few weeks, we should be able to nail down purchase orders and actually generate net ***REVENUE!*** That profit would, of course, eventually be recognized in the stock price. . . .
>
> A few weeks ago the staff totaled up the probable orders, as specified by the customers, for only the top 25 companies. That total exceeded $140 million. We think a more probable total approaches $200 million and we've barely scratched the surface. Clearly our optimism is not misplaced. (Div. Ex. 10 at 19113-19114.)

Glaza told investors Jim Doukas and James O'Rourke, in late 1999, that an annual contract between Qualcomm Ericsson and OnLine for over $10 million was imminent. (Div. Ex. 13 at 137; Div. Ex. 14 at 33-34.) He said that Qualcomm Ericsson chose OnLine as the sole source provider for all its power supplies and ordered 20 evaluating units. (Div. Ex. 13 at 137; Div. Ex. 14 at 33.) According to Thomas Glaza, Qualcomm Ericsson would not allow OnLine to announce that it would be the sole source provider. (Tr. at 616.)

Glaza admitted that he erroneously used the word "orders" interchangeably with "indications of interest," when talking to clients. (Tr. at 205, 371, 377.) Glaza believed there was "never any misunderstanding on the client's part" about his erroneous use of the term "orders." (Tr. at 205.)

Glaza had the following conversation with Dr. Haughey about the PFCFE product: (Div. Ex. 13 at 67-68.)

> Glaza: Yeah. . . . Oh, we have 320 million in orders and another 400 under negotiation.
> Haughey: 320 million orders?
> Glaza: Yeah. By orders, I mean we have exact specifications, numbers desired and the price they are willing to pay.
> Haughey: I see.
> Glaza: That is not the same thing as a purchase order.
> Haughey: Okay.
> Glaza: Which says give me a delivery?
> Haughey: Sure, sure.
> Glaza: But that's obviously so close, it's -- it remains to be finally negotiated.

In October 1999, Glaza told Madison that the company had $320 million in "pending orders," which he described as "companies who have come to us and said, 'These are my specifications. These are the numbers I want and this is what we are willing to pay.'" Glaza added that "there's another $400 million under negotiation" in addition to the $320 million. (Tr. at 46-48; Div. Ex. 14 at 39-40.) Glaza told Maas, in late 1999, that "we have $320 million in orders. We're negotiating another 400 million, but we haven't started to manufacture. That should happen in the next eight to 10 weeks." (Tr. at 374-376; Div. Ex. 14 at 59.)

Budinger testified that he did not tell Glaza the company had orders in 1999. (Tr. at 257.) Further, OnLine only had approximately $8 million dollars in total orders from the sale of the PFCFE module when Budinger left in 2002. (Tr. at 271, 288.)

3. Production Problems

Timely delivery of the products was an essential factor in the success of the company. Budinger testified that some of OnLine's potential customers wanted the new technology to be customized for the buyer's own products. (Tr. at 284.) According to Thomas Glaza, buyers needed to redesign their product to incorporate the OnLine technology. (Tr. at 610-611.) He

believed the company was not able to sell its products because it was unable to meet delivery dates. (Tr. at 610-611.)

Maxwell realized in the summer or fall of 2000 that OnLine would be unable to meet the deadlines to roll out the new technology. (Tr. at 559, 564-565.) Maxwell testified that the PFCFE was still in the early stages of production in May 2000. (Tr. at 549.) She explained that by summer/fall of 2000 OnLine "had potential customers on the hook for a two-year period at that point" and were not able to give them any products. The "salespeople and the customers both started asking difficult questions as to what stage we were at and how much further it was going to be; how much longer it was going to be until this product was completed enough for the customer to evaluate." (Tr. at 559-560.) She added that no evaluation units were available to give to customers to show them what progress was being made and there was no "hardware for them to test to verify our technology." (Tr. at 560.) Maxwell stated that "many conversations had been had [with management] about the fact that opportunities were being lost." (Tr. at 561.) However, Glaza continued to tell investors that OnLine's prospects were very encouraging even though there were indications that the company's business plans would not materialize.[17]

The spring 2000 newsletter stated the following: (Div. Ex. 10 at 19099.)

> OnLine Entertainment, Inc. (NASDAQ Electronic Bulletin Board symbol: OPWR) is quietly going about its business of producing and distributing the world's smallest, coolest and most efficient power supplies. Some of you have indicated that you are anxious to sell some or all of your OPWR shares to recover your investment or to realize the significant appreciation to date. Before you do this, we suggest that you consider an alternative that may allow you to gain even more on a stock that continues to look as though it may enjoy significant long-term appreciation.
>
> The Falcon Financial team remains very optimistic about OnLine's future prospects. . . . All indications are that the company continues to work toward realization of its business plan. Marketing continues. Refinement of its first new technology product, the Power Factor Corrected Front End Module, is coming to an end. Manufacturing of the production modules is closer.

[17] The last newsletter was published in spring 2001. The OnLine section is titled: "OnLine Reveals Revenue." The letter stated, "While the company still lost $1,200,700 or $.06 per share, revenue increased 16-fold over the prior quarter. . . . PFCFEM units shipped went from 400 test units in last year's fourth quarter, to 1000 evaluation and production units in the first quarter with expectations of sales of 7000 units this current quarter. This acceleration of units sold and gross revenues is a positive indicator. . . . OnLine's proprietary 48 volt-500 watt power supply is being developed for release to the marketplace later this year. . . . OnLine reports that a number of potential customers are actively evaluating their technology for use in their design systems. . . . Anticipating increases in sales order volumes in the second through fourth quarters of this year and the first quarter of next year, OnLine is working with its manufacturer, Saturn Electronics, to move production to Saturn's larger facility in Mexico. . . . This growing value of OnLine Power Supply as a company, while not yet reflected in its stock price, is why we invested. (Div. Ex. 10 at 19110.)

Further, Budinger explained that the sale of the 48-volt product, which had the greatest marketing potential of the OnLine products, would have enabled the company to achieve the projected revenue. (Tr. at 281-282.) However, by the time Budinger left the company in 2002, OnLine had not begun to manufacture that product. (Tr. at 281.)

4. Listing on the NASDAQ

Glaza testified that Budinger told him in the fall of 1999 that the company applied for a listing on the NASDAQ. (Tr. at 501.) The Falcon fall 1999 newsletter stated that "OnLine *has filed* with NASDAQ to move to the 'small cap board.'" (emphasis added.) (Div. 10 at 19095.) Budinger could not confirm whether he believed the application was filed in 1999. (Tr. at 252-256, 298-300.) The November 1999 PPM stated, "the company intends to apply for a listing on the NASDAQ Small Cap market in early 2000." (Div. Ex. 24 at 25864.) In fact, OnLine did not actually file a NASDAQ National Market Application and Listing Agreement until May 30, 2000. (Div. Ex. 40.)

B. Conclusions of Law

The OIP alleges that Glaza willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder by making misstatements and omissions of material facts to numerous Falcon clients in the offer, purchase, and sale of OnLine stock. Proof of willful conduct requires a showing of intent to commit the act that constitutes the violation, not intent to violate. Wonsover v. SEC, 205 F.3d 408, 413-15 (D.C. Cir. 2000); Arthur Lipper Corp. v. SEC, 547 F.2d 171, 180 (2d Cir. 1976).

Section 17(a) of the Securities Act proscribes fraudulent conduct in the offer and sale of securities, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder proscribe fraudulent conduct in connection with the purchase and sale of securities. These provisions prohibit essentially the same type of conduct. See United States v. Naftalin, 441 U.S. 768, 773 n.4 (1979). To establish violations of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, the Division must establish: (1) misrepresentations or omissions of material facts or other fraudulent devices; (2) made in connection with the offer, sale, or purchase of securities; and (3) that the respondent acted with scienter. Scienter is not required for violations of Sections 17(a)(2) or 17(a)(3) of the Securities Act; rather, negligence is sufficient to establish liability. Aaron v. SEC, 446 U.S. 680, 697 (1980); SEC v. Solucorp Indus., 274 F. Supp. 2d 379, 419 (S.D.N.Y. 2003); SEC v. Scott, 565 F. Supp. 1513, 1525-26 (S.D.N.Y. 1983).

Scienter is defined as "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). The scienter requirement may be satisfied by a showing of recklessness. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-1569 (9th Cir. 1990); David Disner, 52 S.E.C. 1217, 1222 & n.20 (1997). Recklessness is defined as "an extreme departure from the standards of ordinary care . . . present[ing] a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it." Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1044-1045 (7th Cir.

1977), cert. denied, 434 U.S. 875 (1977). Proof of scienter can be demonstrated by circumstantial evidence. Herman & MacLean v. Huddleston, 459 U.S. 375, 390 n.30 (1983).

A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision and would view disclosure of the omitted fact as having significantly altered the total mix of information made available. Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). Materiality is a mixed question of law and fact. TSC Indus., 426 U.S. at 450.

Courts have interpreted broadly the requirement of Exchange Act Section 10(b) and Rule 10b-5 that violations must occur "in connection with" the purchase or sale of a security. See SEC v. Zandford, 535 U.S. 813, 819-825 (2002); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971); In re Ames Dep't Stores, Inc., Stock Litig., 991 F.2d 953, 964-965 (2d Cir. 1993). "Any statement that is reasonably calculated to influence the average investor satisfies the 'in connection with' requirement of Rule 10b-5." SEC v. Hasho, 784 F.Supp. 1059,1106 (S.D.N.Y. 1992); see also SEC v. Zandford, 535 U.S. 813, 821 (2002).

The jurisdictional clauses under the antifraud provisions are given broad interpretation and are satisfied by intrastate telephone calls and by incidental use of the mails. See McDaniel v. United States, 343 F.2d 785, 787-88 (5th Cir. 1965); see also Reube v. Pharmacodynamics, Inc., 348 F. Supp. 900, 912 (ED. Pa. 1972); Ingraffia v. Belle Meade Hosp., Inc., 319 F.Supp. 537, 538 (ED. La. 1970).

1. Fiduciary Duty

Liability for failing to disclose material information is "premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." Chiarella v. United States, 445 U.S. 222, 230 (1980). Securities dealers owe a special duty of fair dealing to their clients. SEC v. Hasho, 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992) (citing Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943)); see also Timoleon Nicholaou, 51 S.E.C. 1215, 1223 (1994), aff'd, 81 F.3d 161 (6th Cir. 1996) (finding respondent "exhibited a disturbing lack of understanding of a registered representative's fiduciary duty to his customers"). By his recommendation, a registered representative implies a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Hasho, 784 F. Supp. at 1107. A registered representative who makes representations lacking an adequate basis will incur liability even if he believed the representations he was making were true. Id. Moreover, registered representatives dealing in over-the-counter stocks are under a special duty not to take advantage of their customer's trust and confidence. Id. at 1107-1108 (citing Hughes, 139 F.2d at 436-437).

As a registered representative, Glaza offered and sold the common stock of OnLine. By virtue of his position, Glaza was a fiduciary to his clients. Glaza's clients, in effect, placed their trust and confidence in him and followed his recommendations to buy, sell, or hold OnLine's over-the-counter stock.

2. Glaza Acted Recklessly in Making Stock Price Projections

Predictions of specific and substantial increases in the stock price of any security violates the antifraud provisions of the securities laws, if made without a reasonable basis.[18] See Joseph A. Barbato, 53 S.E.C. 1259, 1273 (1999); Donald A. Roche, 53 S.E.C. 16, 18-19 (1997); Lester Kuznetz, 48 S.E.C. 551, 553 (1986). An honest belief in an issuer's prospects does not in itself give one a reasonable basis for recommending the stock to others. Gilbert F. Tuffli, 46 S.E.C. 401, 405 (1976).

OnLine had a history of financial losses and staked its future on the development and manufacturing of new technology. Nevertheless, Glaza predicted specific and substantial increases in the price of OnLine stock. Specifically, Glaza told clients that the stock price would reach $70 by the end of 2000 and $120 by the end of 2001. However, the highest stock price was $6.25 for 1999 and $32.37 for 2000.

Glaza placed great weight on the EPS projections in the July 1999 PPM and based his stock price predictions on this information. However, Glaza knew very little about the pro forma projections and therefore, he did not have a reasonable basis for his predictions. Glaza believed that Lintz, a professional business consultant, conducted an independent analysis of OnLine revenue for his report. He further believed that OnLine then reduced those independently verified revenue projections by 60 percent and included those numbers in the July 1999 PPM. Lintz testified that he was not acting in his professional capacity and did not conduct an independent investigation of the sales information he obtained from OnLine management. Lintz also did not prepare his revenue projection with the expectation that it would be used in a private placement memorandum. Glaza's close relationship with company insiders would have enabled him to obtain and disclose these important details to his clients. Glaza also failed to question why the company only used 40 percent of the potential orders for its pro forma projection and to disclose this information to his clients.

Glaza's reckless reliance on the July 1999 projections is further established by the testimony of his brother, Thomas, who was a member of the OnLine board of directors. Thomas Glaza testified that the pro forma income projection he received after he came to the board in July 1999 was unreliable and did not have a logical basis. He believed that the projection was overstated and should have been based on more concrete information such as the volume requested by each buyer, the expected price, and the expected closing dates.

Glaza had been unreasonably projecting the OnLine stock price since 1997. During the relevant period, he continued to make price projections without a reasonable basis. OnLine had significant losses and development problems and was traded on the Bulletin Board system. Yet in predicting the OnLine stock price, Glaza recklessly used a P/E ratio for companies listed on national stock exchanges and even increased the ratio he used from 20 to 30 and failed to disclose all of this information to investors.

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[18] See also Richard J. Buck, 43 S.E.C. 998, 1006 (1968) (explaining that the Commission has "repeatedly held that predictions of specific and substantial increases in the price of a speculative and unseasoned security are inherently fraudulent and cannot be justified.")

3. Glaza Was Reckless in Making Misleading Statements, Revenue Projections, and in Failing to Disclose Product Development Issues

Falcon's fall 1999 newsletter stated that "OnLine has filed with NASDAQ to move to the 'small cap' board." (Div. Ex. 10 at 19095.) Statements regarding future listings on NASDAQ are material. See SEC v. Wellshire Securities, Inc., 737 F. Supp. 251 (S.D.N.Y. 1990). Glaza testified that Budinger told him in the fall of 1999 that OnLine had filed an application for the NASDAQ Small Cap list. However, Budinger could not recall telling this to Glaza. In fact, the application was not filed until May 2000. The November 1999 PPM stated that the company intended to file an application for listing in early 2000. Glaza had no reasonable basis to represent in his investor newsletter that the NASDAQ application had been filed in the fall of 1999. He acted recklessly when he made this misstatement to investors.

Predictions of a sharp increase in earnings for a speculative and unseasoned security are also inherently misleading, without full disclosure of the facts on which the projected earnings are based and the associated uncertainties. Richard J. Buck, 43 S.E.C. 998, 1006 (1968).

Glaza had a close relationship with company insiders. He spoke with management on a regular basis. He also visited the company on occasion and spoke with the staff. However, a registered representative is not entitled to rely on statements from management of an unseasoned company without doing his or her own due diligence. Id. at 1004. When a company has a history of losses, the registered representative's burden is increased. Id. Glaza's claim that he was only passing on information provided by the company is not sufficient to avoid liability.

Budinger testified that he did not tell Glaza the company had any orders in 1999, because there were none. Budinger believed that OnLine did not earn net income during the years he was associated with the company, which was approximately 1994 through 2002. In fact, the net losses sustained by the company increased from $1,449,530 in 1998 to $3,786,372 in 2000. As a result, the company needed the proceeds of the offerings to operate and to bring the new technology to market.

In late 1999, Glaza made predictions that the company would earn significant revenue from the sale of the PFCFE product in the near future. Glaza told investors, Doukas and O'Rourke, that an annual contract between OnLine and Qualcomm Ericsson for over $10 million was imminent. He also told them that Qualcomm Ericsson chose OnLine as the sole source provider for all its power supplies. However, Thomas Glaza testified that OnLine did not announce that to investors. Glaza also told investors Haughey, Madison, and Maas that OnLine had orders of $320 million and another $400 million under negotiation for the PFCFE module. Glaza essentially told these investors that it was likely that OnLine would generate potentially $720 million from sales of the PFCFE module in the next two years.

The testimony of OnLine's management indicates they believed the potential sales were contingent on meeting significant conditions. Maxwell was the director of sales and marketing during the relevant period and was responsible for marketing the new technology for design into the buyer's products. She and a partner compiled a list of potential buyers based on verbal

expressions of interest. She testified that $225,580,000 was a reasonable estimate of the total expressions of interest as of mid-1999, provided that the product met the buyer's requirements. Maxwell testified that this information was disseminated to broker-dealers. Nevertheless, there is no evidence that Glaza told his investors that his revenue projections came from a list prepared by Maxwell based on verbal expressions of interest from potential buyers and were conditioned on the company's ability to meet certain specifications and requirements of the potential buyers. Glaza was reckless in failing to disclose this information to his clients.

Glaza failed to inform his investors how important timely delivery of the products was for the financial success of the company. Glaza told investors in late 1999 that OnLine could assure delivery of the OnLine products, but he failed to explain the uncertainties associated with providing the new technology to the customer. Maxwell testified that the PFCFE was still in the early stages of production in May 2000. By the summer or fall of 2000, she realized that OnLine would be unable to meet the deadlines to roll out the new technology. She testified that no evaluation units were available to give to customers to show them what progress was being made and there was no "hardware for them to test to verify our technology." (Tr. at 560.) She stated that "many conversations had been had [with management] about the fact that opportunities were being lost" and that by mid-2000 the company had been telling customers for two years that the product was almost ready and it was still unable to deliver. (Tr. at 560-561.) Thomas Glaza and Budinger testified that timely delivery of the products was important because buyers needed to redesign their products to incorporate the OnLine technology.

In the spring of 2000, Glaza told clients via a newsletter, that "The Falcon Financial team remains very optimistic about OnLine's future prospects. . . . All indications are that the company continues to work toward realization of its business plan. . . . Refinement of its first new technology product, the Power Factor Corrected Front End Module, is coming to an end. Manufacturing of production modules is closer." (Div. Ex. 10 at 19099.)

Further, OnLine needed to sell the 48-volt power supply to achieve the company's revenue projections. Falcon's summer 1999 newsletter states: "The 48 volt power supply is projected to go to UL on the first of September, with manufacturing anticipated around mid-September. . . . 45 potential customer companies who have provided specifications, numbers of units wanted and pricing, totalling [sic] over $230 million in gross revenue." (Div. Ex. 10 at 19091.) However, the 48-volt power supply was still in development in 2000 and still had not reached the production stage when Budinger left OnLine in 2002.

Based on the foregoing, I find that Glaza recklessly made misstatements and omissions of material facts in the offer, purchase, and sale of OnLine stock. Therefore, I conclude that Glaza willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

SANCTIONS

A. Cease-and-Desist Order and Associational Bar

Section 8A(a) of the Securities Act and Section 21C(a) of the Exchange Act authorize the Commission to impose a cease-and-desist order on any person who "is violating, has violated, or is about to violate" any provision of the Securities Act, the Exchange Act, or the rules and regulations thereunder.

In pertinent part, Section 15(b)(6) of the Exchange Act permits the Commission to sanction persons associated with a broker or dealer or who have participated in a penny stock offering, if it finds that the sanction is in the public interest and such persons have willfully violated the Securities Act, the Exchange Act, or the rules and regulations thereunder. Specifically, the Commission may censure a broker or associated person, place limitations on the activities or functions of such person, suspend such person for a period not exceeding twelve months, or bar such person from being associated with a broker or dealer, or from participating in any offering of penny stock.[19]

I have already concluded that Glaza willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Therefore, I must now determine whether a cease-and-desist order and sanctions under Section 15(b)(6) of the Exchange Act are appropriate.

In determining whether a cease-and-desist order and sanctions under Section 15(b)(6) are appropriate, the Commission considers the following factors:

> [T]he egregiousness of the respondent's actions; the isolated or recurrent nature of the infraction; the degree of scienter involved; the sincerity of the respondent's assurances against future violations; the respondent's recognition of the wrongful nature of his conduct; and the likelihood that the respondent's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981). No one factor controls. See SEC v. Fehn, 97 F.3d 1276, 1295-96 (9th Cir. 1996).

In addition to the Steadman factors discussed above, in determining whether to impose a cease-and-desist order, the Commission considers whether there is a risk of future violations, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings. KPMG Peat Marwick LLP, 54 S.E.C. 1135 (2001). The Commission explained that the Division must show some risk of future violations. However, it also ruled that such a showing should be "significantly less than that required for an injunction, and that, "absent evidence to the contrary," a single past violation ordinarily suffices to raise a significant risk of future violations. Id. at 1185, 1191.

[19] See Rule 3a51-1 of the Exchange Act, which defines the term "penny stock."

Glaza's actions were egregious and recurrent. He continued to offer stock price projections in 1999 after two years of unsuccessfully projecting the stock price of OnLine. He gave clients overstated revenue projections and indicated to clients that expressions of interest were essentially orders. Glaza also failed to caution clients that the potential orders from these buyers depended on OnLine's ability to deliver a timely product and that the company might not complete development in time. Further, he projected stock prices from questionable earnings per share estimates and a P/E ratio for more seasoned companies. He made OnLine stock projections to his clients throughout the time he sold the stock. He frequently predicted the orders OnLine would receive to many of his clients during this period.

Glaza does not provide assurances against future violations, nor does he recognize the wrongfulness of his actions. He continues to believe that projections are essential despite the fact that his projections were made without a reasonable basis. He also fails to understand why his close relationship with the company compromised his ability to objectively evaluate the company's information on behalf of his clients.

Glaza no longer owns Falcon and he has not participated in the securities industry since the Commission instituted this action in 2001. However, he has not participated in the industry because the State of Colorado refused to license Glaza due to this pending matter. (Tr. at 458; Resp. Post-Hearing Br. at 5-6.) Even if an associational bar is ordered, a cease-and-desist order is also necessary to help ensure that Glaza is more conscious of potential violations if he becomes active in the financial markets in the future.

Viewing the Steadman and KPMG factors in their entirety, I conclude that a cease-and-desist order, and a bar from association with any broker or dealer and from participating in any offering of penny stock are appropriate in the public interest. There are no mitigating circumstances in this case to warrant lesser sanctions.

B. Disgorgement and Civil Penalties

Section 8A(e) of the Securities Act and Section 21C(e) of the Exchange Act provide that the Commission may enter an order requiring disgorgement, including reasonable interest, in any cease-and-desist proceeding. Disgorgement is designed to deprive a wrongdoer of his ill-gotten gains and deter others from violating the securities laws. SEC v. First City Financial Corp., 890 F.2d 1215, 1230-1232 (D.C. Cir. 1989.) It returns the violator to where he would have been absent the misconduct. An order to disgorge a certain amount need only be a reasonable approximation of the profits causally connected to the violation. Id. at 1231-1232.

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

The Division called Anne Romero, a certified public accountant with the Division, to testify as to the amount of disgorgement that should be imposed. (Tr. at 32-39.) She testified that Glaza earned $778,787 in commissions from the sale of OnLine stock during the relevant period.[20] (Tr. at 35.) The Division's posthearing brief states that Glaza earned $709,561 in commissions. (Div. Post-Hearing Br. at 15 and n.8.) Glaza maintains that Falcon received one check from Northstar for the OnLine stock sales made by all Falcon representatives. (Resp. Post-Hearing Br. at 24.) Glaza testified that his wife gave the other Falcon representatives their portion of that check and divided the remaining amount between her and Glaza. (Tr. at 441-444; Resp. Post-Hearing Br. at 24.) Glaza maintains that his portion of the commission from OnLine stock sales during the relevant period was $318,192.66. (Resp. Post-Hearing Br. at 24.) Glaza will be ordered to disgorge $318,192.66, plus prejudgment interest.

Under Section 21B(a) of the Exchange Act, the Commission may impose a civil monetary penalty if a respondent has willfully violated any provision of the Securities Act, the Exchange Act, or the rules and regulations thereunder. It must also find that such a penalty is in the public interest. In considering whether a penalty is in the public interest, the Commission may consider the following six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) prior violations; (5) need for deterrence; and (6) such other matters as justice may require. See Section 21B(c) of the Exchange Act.

Section 21B(b) of the Exchange Act specifies a three-tier system for determining the maximum amount of a penalty. For each "act or omission" by a natural person, the maximum amount of a penalty is $5,000 in the first tier; $50,000 in the second tier; and $100,000 in the third tier.[21] A second-tier penalty is permissible if the act or omission involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

A third-tier penalty is permissible for an act or omission that not only must have involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, but also must have "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission."

Glaza's actions took place between August 1999 and May 2000 and involved serious allegations of fraud and substantial gains to himself. There was no mitigating evidence presented.

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[20] The Division requests that I hold Glaza and Falcon jointly liable for the disgorgement amount. (Div. Post-Hearing Br. at 15.) However, at the January 26, 2005, prehearing conference, the Division represented that it would only seek disgorgement from Glaza. (Prehearing Conference Transcript at 5-6.)

[21] As required by the Debt Collection Improvement Act of 1996, the Commission increased the maximum penalty amounts for violations occurring after December 9, 1996, and, again for violations occurring after February 2, 2001. 17 C.F.R. §§ 201.1001, .1002. For a natural person, the adjusted maximum penalty amounts for each violation occurring after December 9, 1996, and on or before February 2, 2001, were $5,500 (tier one), $55,000 (tier two), and $110,000 (tier three), respectively.

In order to deter Glaza and others from committing future violations, a third-tier penalty is warranted in the public interest. On this record, I will order Glaza to pay a civil penalty in the amount of $110,000.

CERTIFICATION OF THE RECORD

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I hereby certify that the record includes the items set forth in the record index issued by the Secretary of the Commission on March 22, 2005.

ORDER

Based on the findings and conclusions set forth above:

IT IS ORDERED THAT, the Initial Decision issued on September 8, 2003, is hereby VACATED;

IT IS FURTHER ORDERED THAT, the charge that James F. Glaza violated Section 5 of the Securities Act of 1933, is hereby DISMISSED;

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, James F. Glaza shall hereby cease and desist from committing or causing any violations or future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder;

IT IS FURTHER ORDERED THAT, pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, James F. Glaza shall hereby disgorge the sum of $318,192.66, plus prejudgment interest at the rate established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), compounded quarterly, pursuant to 17 C.F.R. § 201.600. Prejudgment interest is due from June 1, 2000, through the last day of the month preceding the month which payment is made;

IT IS FURTHER ORDERED THAT, pursuant to Section 21B of the Securities Exchange Act of 1934, James F. Glaza shall hereby pay a civil penalty in the amount of $110,000;

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, James F. Glaza is hereby barred from association with any broker or dealer; and

IT IS FURTHER ORDERED THAT, pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, James F. Glaza is hereby barred from participating in any penny stock offering.

Payment of the disgorgement, prejudgment interest, and civil penalty shall be made on the first day following the day this initial decision becomes final. Payment shall be made by

certified check, United States Postal money order, bank cashier's check, or bank money order, payable to the U.S. Securities and Exchange Commission. The payment, and a cover letter identifying the Respondent and the proceeding designation, shall be delivered to the Comptroller, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, Virginia 22312. A copy of the cover letter and the instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of counsel of record.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 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.

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Robert G. Mahony
Administrative Law Judge