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ADMINISTRATIVE PROCEEDING  
FILE NO. 3-6193

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

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In the Matter of :

AMERICAN WESTERN SECURITIES, INC. :

JACK DAROLD KELLEY :

DEE MARIE KNOBLAUCH :

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INITIAL DECISION

WASHINGTON, D.C.  
JULY 17, 1984

IRVING SCHILLER  
ADMINISTRATIVE LAW JUDGE

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APPEARANCES:

John J. Kelly, Jr., Thomas J.  
Amy and Patricia H. Ferree for  
the Division of Enforcement.

David A. Zisser of Fishman,  
Gersh & Bursien for respondent  
Jack Darold Kelley.

Raul N. Rodrigues, for respondent  
Dee Marie Knoblauch.

BEFORE:

Irving Schiller  
Administrative Law Judge

This public proceeding was initiated by an order of the Securities and Exchange Commission (Commission) dated November 26, 1982 (Order) pursuant to Sections 15(b) and 19(h) of the Securities Exchange Act of 1934, as amended (Exchange Act)<sup>1/</sup> to determine whether American Western Securities, Inc. (AmWest) and seven named respondents willfully violated and willfully aided and abetted violations of the antifraud provisions of Section 17(a) of the Securities Act of 1933 (Securities Act)<sup>2/</sup> and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;<sup>3/</sup> whether respondents willfully violated or willfully aided and abetted violations of Section 15(b) and (c) and 17(a) of the Exchange Act and specified Rules thereunder, and whether any remedial action is appropriate in the public interest.

The Order,<sup>4/</sup> in essence, charges that respondent Jack Darold Kelley (Kelley), during periods of time specified therein, willfully violated and willfully aided and abetted violations of the antifraud provisions of the securities acts in connection

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1/ 15 U.S.C. § 78o (b), 15 U.S.C. § 78 s(h).

2/ 15 U.S.C. § 77q(w).

3/ 15 U.S.C. § 78j(b); 17 CFR 240.10b-5.

4/ The Order alleges violations against the following persons whose cases have been determined by the Commission on the basis of Findings and Orders Imposing Remedial Sanctions as reflected in the Commission's Releases as noted: Harold Junior Morris, Craig Stanton Norton, Loyd John Harty, Richard Bruce Graibus, and Gordon Kerr, Release No. 19805, dated May 23, 1983, 27 SEC Docket 1740; American Western Securities, Inc., Release No. 20316, dated October 21, 1983, 29 SEC Docket 4.

with the offer and sale of the common stock of Solar Development, Inc. (SD), Greenwood Resources, Ltd. (GR), Marine Nutritional Systems, Inc. (MNS) and Rogue Oil & Gas, Inc. (Rogue). In connection with the alleged violation relating to SD and GR, Kelley is charged with failing reasonably to supervise persons subject to his supervision with a view to preventing violations by such persons of the aforesaid antifraud provisions of the securities acts. Kelley is also charged with willfully violating Section 15(b)(6) of the Exchange Act in that he became associated with AmWest in a supervisory capacity, without the consent of the Commission at a time he was suspended by a Commission order, from being so associated in such capacity. Kelley is further charged with willfully aiding and abetting violations of Section 15(c)(2) and (c)(3) of the Exchange Act and specified Rules thereunder and Section 17(a) of the Exchange Act and specified Rules thereunder.

Additionally, the Order charges that Dee Marie Knoblauch (Knoblauch) willfully aided and abetted violations of an order of the Commission issued on November 8, 1979 In the Matter of American Western Securities, Inc. (File No. 3-5662) and Section 15(b)(6) of the Exchange Act. In connection with the aforesaid alleged violations Knoblauch is charged with failing reasonably to supervise persons subject to her supervision with a view to preventing the violations by such persons. Knoblauch is further charged with willfully aiding and abetting violations of the antifraud provisions of Section 17(a) of the Securities Act in connection with the offer and sale of the common stock of Rogue. Knoblauch is also charged with aiding and abetting violations of Section 15(b) and (c) and 17 (a) of the Exchange Act and specified Rules thereunder.

After appropriate notice a hearing was held on June 7,  
1983 in Denver, Colorado<sup>5/</sup>. Proposed Findings of fact , conclusions

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5/ At the opening of the hearing counsel for Kelley and Knoblauch stated that they had submitted documents one of which is entitled "Appearance of Respondent Jack D. Kelley" and the other entitled "Appearances of Respondent Dee Marie Knoblauch". Both documents are similar and state, in substance, that because of the unreasonable delay in bringing this proceeding (Kelley does not complain of the delay which occurred since the filing of the Order) and the pendency of another investigation relating to Kelley and Knoblauch totally unrelated to the issues in this proceeding, there is no real incentive for the respondents to expend the enormous amounts involved in an attempt to litigate this action and that neither of them would appear at the hearing or attempt to rebut the case put on by the staff of the Commission. They also claim they have been prejudiced because witnesses (not identified) who could provide information necessary to their defense have either left the area, or if they could be found, "the passage of time has resulted in fading memories". When asked at the hearing whether they intended to be present while the Division presented its case, both counsel for the respondents responded in the negative. Both counsel stated they had no intention of cross examining any witnesses nor did they intend to present any rebuttal evidence in their own behalf. Counsel for the Division thereupon offered in evidence 50 transcripts containing statements under oath taken during an investigation preceding the instant hearing, (an additional transcript was received in evidence after the record was closed) together with about 10 affidavits. Counsel for the respondents objected to the receipt in evidence of these transcripts and affidavits on the grounds of hearsay. Such objections were overruled by reason of the statements previously made by counsel that they had no intent to cross examine any such witnesses if they were called to testify. Kelley's counsel stated "if those people were here personally, I would not have cross examined them as I stated before".

In addition to the forgoing documents, the staff presented the testimony of an official of the National Association of Securities Dealers (NASD) relating to the liquidation of Am West, a staff member of the Denver Regional Office of the Commission with respect to the public interest factor relating to Knoblauch's alleged violation and another staff witness regarding certain schedules she prepared. At the request of Kelley's counsel, the Division made her available for voire dire. All of this live testimony took approximately 60 minutes. At the conclusion of the Division's presentation, counsel for respondents moved to dismiss the allegations of violations, as stated in the Order, on grounds that they were prejudiced because of the delay in bringing this proceeding and that the passage of time had greatly "burdened any efforts in mounting a defense. Memories fade, people move, evidence gets disipated"(sec). The motions were determined to lack merit and denied. Counsel were then advised of their opportunity to present a defense. They stated " For reasons . . . stated orally before and in . . . written submission "they were" not going to put on any rebuttal witnesses". Counsel for the parties were then permitted to make statements with regard to sanctions and the record was closed.

of law and brief in support thereof was filed by the Division. Respondents Kelley and Knoblauch did not submit any proposed findings or brief. By order dated September 29, 1983 the failure of respondents to file post-hearing documents, within the time specified, was noted. As indicated in note 4 supra, the cases against several respondents charged in the Order with a variety of violations have been concluded. Accordingly, any findings that may be made herein relating to those respondents in light of their involvement in the conduct and activities which are the subject of charges against the remaining respondents Kelley and Knoblauch, will have no application to the respondents whose cases have been determined.

The findings and conclusions herein are based upon the record.<sup>6/</sup> Preponderance of the evidence is the standard of proof applied.

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6/ The record in this case consists solely of 51 transcripts of testimony taken from 36 witnesses during the investigation by the Division prior to this proceeding and about 10 affidavits, all of which were received in evidence, together with exhibits relating to the testimony of certain witnesses, under the circumstances detailed above in footnote 5. In addition three witnesses testified briefly at the hearing. No evidence was adduced by Kelley or Knoblauch. References hereinafter to the testimony of certain witnesses refers to the statements they made under oath as reflected in the aforesaid transcripts which are not disputed and accepted. References to documentary evidence relates to exhibits obtained in the course of the investigation and received in evidence along with the transcripts. They too are not disputed and are accepted.

The Respondents

The Order alleges and Kelley admits that he is the beneficial owner of more than 50% of AmWest from on or about June 1973 to on or about November 19, 1979 and from on or about April 19, 1981 to the present. The Order alleges and the record supports the finding that on February 23, 1979 the Commission instituted an administrative proceeding in the Matter of American Western Securities, Inc., Jack Darold Kelley and others.<sup>7/</sup> AmWest and Kelley, among others, submitted offers of settlement in which they consented to findings of violations and the imposition of certain sanctions without admitting or denying the allegations in the order for proceedings. Accordingly, on November 8, 1979, the Commission issued an order in which it found that AmWest and Kelley, among others, willfully violated specified provisions of the federal securities laws and imposed certain remedial sanctions (the November 8, 1979 order<sup>8/</sup>). The sanctions, inter alia, censured AmWest and ordered it to comply with the undertaking in its settlement offer to employ an independent chief executive officer for a period of one year; and among other things, restricted it for two years from: (1) engaging in any market or trading activity in any security in which it participated in the underwriting, except on an unsolicited agency basis, for the

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7/ Administrative Proceeding File No. 3-5662.

8/ Exchange Act Release No 16238; 18 SEC Docket 879 (November 8, 1979).

initial ten trading days beginning on the day that the security initially appeared in the "pink sheets" or the NASDAQ; and (2) participating in any underwriting as a principal underwriter wherein AmWest purchases for distribution, or sells as agent on a best efforts basis, or otherwise, more than 40% of the aggregate amount of the offering; provided however, that to the extent any other broker-dealer participates in the offering in excess of 10% of the aggregate amount of the offering, AmWest's 40% participation was to be correspondingly reduced by the aggregate amount that each broker-dealer's participation exceeded 10%. The November 8, 1979 order also suspended Kelley from being associated with any broker or dealer, investment company, investment advisor or transfer agent for a period of twelve months, from November 19, 1979 to on or about November 19, 1980, provided that after the initial six months of said suspension he was permitted to engage in normal and regularly accepted duties of a registered representative with a broker or dealer under proper supervision.

The Order alleges and the record supports the findings that Knoblauch is and has been a vice-president of AmWest since June 1978 and a director since on or about September 1979. From at least November 1979 to the present, Knoblauch has been vice-president in charge of operations and syndications at AmWest.

Violations of the antifraud provisions of the Securities Act and the Exchange Act regarding the common stock of GR

As noted earlier Kelley is charged with willfully violating and willfully aiding and abetting violations of the antifraud provisions of the securities acts in connection with the offer and



sale of the common stock of GR. The charges, in essence, relate to the activities and conduct of Kelley and others from the period about June 26 to about July 21, 1978 and from about August 8, 1978 to on or about August 18, 1978 during which times they allegedly employed devices and schemes to manipulate the aftermarket price of GR common stock by utilizing various techniques that substantially raised the price of the said stock and operated as a fraud and deceit upon purchasers. In addition, unfounded price predictions concerning GR securities were made and material information was not disclosed to customers. The manner in which Kelley employed various techniques to accomplish his fraudulent activities and conduct will be detailed below.

GR, a Colorado corporation engaged in the organization, sale and management of oil and gas investment programs and in the acquisition, exploration and development of oil and gas properties for GR's own account, filed an S-1 registration statement with the Commission which became effective on May 25, 1978. On that date GR commenced a public offering of 1,500,000 shares of its common stock at an offering price of \$1.00 per share on a "Best efforts 1,125,000 shares or None" basis. AmWest was the underwriter of the public offering. The prospectus utilized in connection with the public offering discloses that the securities being offered involve a high degree of risk, that at the time of the offering the company was in a development stage, that although it owned a few oil and gas properties, none of them

were providing a net profit; that the company had no revenues; that though additional financing may be required to carry out its exploration activities there was no assurance such funds can be acquired; and that there can be no assurance that the company will ever have revenues or profits. From its inception on November 14, 1977 through March 31, 1978 GR incurred a net loss of \$35,102<sup>9/</sup>.

Although, as noted above, the Order charges that the manipulative conduct began during the period commencing June 26, 1978, the record discloses that Kelley began to prime the market even prior to the filing of the GR registration statement and continued such activities during the offering. As early as November 1977 Kelley interviewed a prospective salesman he wanted to hire for AmWest telling him that GR stock would be issued in the next three to six months and that it would be a "hot issue". The salesman, who joined AmWest in February 1978, testified that in several talks he had with Kelley, from January through May, Kelley (and other management personnel) told the salesman that there were many brokerage houses around Denver and outside the area that wanted the stock. The president of GR testified he had many conversations with Kelley during the negotiations for the underwriting by AmWest and was told that

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9/ It appears reasonable to assume that AmWest and Kelley used GR as a vehicle to capitalize on investors interest in new oil and gas issues and the then current fervor of the hot issue market in Denver.

the firm had professionals who could sell the offering. At Kelley's request GR's president attended two due diligence meetings in New York prior to the effectiveness of the registration statement where Kelley introduced him to many brokers whom Kelley had invited in an effort to interest them in the offering. At these meetings Kelley created the impression that the GR offering was oversubscribed. A former secretary and director of GR testified that at one of the negotiating meetings for the underwriting, Kelley obtained an agreement that the officers and directors of GR, who owned about 2,250,000 shares of GR restricted stock, would not sell any of such stock for two years after the public offering, for the purpose of maintaining an orderly market. Kelley was told, at the meeting, that there were a number of insiders and persons in a private investors group who wished to purchase GR stock in the public offering. Kelley promised to satisfy the request of the insiders. The documentary evidence shows that Kelley sold approximately 149,500 shares to officers and directors of GR, family members and others on an issuer-directed basis.

Activities Related to Establishment and Support of Market Price of GR-First Period

The alleged after-market manipulation occurred in two separate four week periods (June 26-July 21, 1978; August 8 to about August 18, 1978). The after-market trading began on June 26, 1978. On

that date GR stock reached a high of 2-3/4 bid - 3-1/4 asked. The inside quotes during the four week period ending July 21, 1978 reached a high of 2-7/8 bid - 3-3/8 asked on the last two days in June 1978 but dropped off by July 19, 1978 to 2-1/4 bid = 2-3/4 asked. The documentary evidence discloses that during this same period AmWest's customers engaged in substantially more than 50% of the total trades in GR. Of the 19 trading sessions in this period AmWest's share of the total media volume in GR ranged between 50%-90% on 15 days and between 60%-90% on 11 days.<sup>10/</sup> During these same trading sessions, of the 454 shares of GR sold by AmWest to its customers all but 8 shares were solicited by registered representatives of AmWest and of 462 shares of GR purchased from customers all but 50 shares were solicited by registered representatives of AmWest. During the same period AmWest bought 22,850 shares of GR from other broker-dealers but sold only about 2,000 shares to dealers.

The price increases and sales volume of GR stock were generated as a result of a major sales effort directed by AmWest management. AmWest's compliance officer during this period described such effort in his testimony, stating that Kelley directed the sales efforts carried on by the salesmen, that in the first several months of the aftermarket trading Kelley conducted several informal sales meetings in his office regarding

GR stock, that such meetings by salesmen were usually called by loudspeaker announcements and attendance was regarded as mandatory. Kelley told the sales force of AmWest's excellent reputation as an underwriter, that it brought only quality deals public and that they always performed well in the market place. He also testified that if any of Kelley's underwritings, like GR stock, were to falter in the market place, Kelley attempted to promote it inside and bolster the price of the security.

Re-Establishment and Support of Market Price of GR-Second Period

In late July and early August 1978 the market price of GR stock began to decline. The documentary evidence shows that on Friday, July 14, 1978 the inside quote on GR stock was 2-5/8 bid - 3-1/8<sup>11/</sup> asked. On Monday, July 17, 1978 the inside quotes on GR started to decline (2-3/8 bid - 2-7/8 asked) and by August 7, 1978 the inside quotes on GR stock hit a new low of 1-7/8 bid 2-3/8 asked. On the evening of August 7, 1978 Kelley held a pre-arranged dinner meeting with key sales personnel and the management of AmWest at the London House Restaurant that one of the participants attending the meeting testified that he had no doubt the meeting

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11/ The record discloses that on the same date the registration statement of MNS became effective and AmWest, the underwriter of the offering began its public offering. See infra p 21 et seq. It is reasonable to assume that the sales force at AmWest concentrated its selling efforts on the new issue of MNS securities.

was for the purpose of hatching "a conspiracy to get the stock (GR) up in price". Kelley told the group that the name AmWest was at stake because a hot issue stock like GR was going down the drain, that AmWest needed to show its power in the street by getting GR stock "moving up". Kelley also told them that at the end of the quiet period (90 days from the offering date) GR would be giving them information about a new development in the company, regarding oil drilling operations that "was going to shatter the world" and that certain large brokerage houses on the east coast would start buying GR and help support it. Kelley then added that AmWest had to get GR's price over \$3 per share to attract other broker-dealers and predicted that the price of GR stock would rise to \$5 a share. They all agreed before the meeting was concluded to get on the phone the next morning in a concerted effort to raise the price of the GR stock.

The following morning August 8, 1978, Kelley was at the elevator greeting his salespersons telling them that if they wanted their clients to make money to start buying GR stock. The documentary evidence shows that AmWest had an inventory long position of about 9,700 shares of GR stock at the opening of trading that day and that between 8:00 a.m. and 10:34 a.m. AmWest purchased 23,600 shares of GR in six transactions with four other market makers at prices ranging from 2-5/16 to 2-13/16.

On August 8, 1978 Kelley was the most active salesman in GR stock; the record discloses that of the total of 73,155 GR shares purchased by AmWest customers on that date Kelley's customers purchased 14,400 shares or 19.7% at prices ranging from \$2.06 to \$2.88. Kelley's trades exceeded those of any other salesman. On the same date AmWest purchased 23,050 shares from its customers of which about 13,500 shares or 58.6% were purchased by Kelley at prices ranging from \$2.38 to \$2.63. Of the 9 trading sessions during the period August 8 to August 18, 1978 AmWest's share of the total media volume in GR shares ranged between 50%-90% on eight days and between 60%-90% on six days.

AmWest went into a short trading position in GR stock in the afternoon of August 8, 1978 and remained in such position until the morning of August 22, 1978. On August 10, 1978 AmWest had a short position in its inventory account at one point of approximately 49,000 GR shares. The inside quotes of GR moved from a low of 1-7/8 bid - 2-3/8 asked to 2-1/2 bid - 3-1/2 asked on August 18, 1978, remaining at those quotes until August 22, 1978. The following day the GR quotes began to decline and by October 31, 1978 reached a new low of 1-1/2 bid - 2 asked. The documentary evidence further shows that between August 8 and August 18, 1978 AmWest sold about 214,200 shares of GR to its customers and purchased from them about 131,700 shares. Due to the intensive effort by AmWest to sell

GR stock and by reason of the firm's short inventory position, it was essential to buy GR stock to cover the short positions. Kelley would post \$100 bills on the trading window as an incentive to new brokers at the firm to buy GR stock. The broker with the largest amount of purchases for the day would be awarded the \$100 bills.

For the entire trading period between June 26, 1978, when Kelley and AmWest mounted their first aftermarket campaign, until August 31, 1978, AmWest sold a total 651,941 shares of GR stock of which 642,441 shares were sold to its customers; and of a total of 601,215 GR shares AmWest purchased during this same period, it purchased 479,575 such shares from its own customers. Most of the retail transactions were solicited by AmWest salespersons. During this same period AmWest purchased 121,640 shares of GR from other broker-dealers and in turn sold most of these shares to its own customers in small lots.

The record discloses that in the June-July 1978 and again in the August 1978 period no information was released by GR relating to its activities which would have made an impact upon the price of the firm's stock. The rise in the price of GR stock during this period could only have been the result of the concentrated sales effort which the evidence shows was orchestrated by Kelley, who not only personally participated in the selling effort, but predicted that the price of the GR stock would go



to \$5 per share.

Kelley is found to have violated and willfully aided and abetted the willfull violation of the aforesaid provisions of the securities acts by engaging in a scheme and fraudulent course of business to support and manipulate the price of GR stock upward during the period June 26 through August 18, 1978. As noted earlier, it was Kelley who instigated and conducted sales meetings with AmWest's registered representatives in the immediate aftermarket trading of GR stock. At such meetings Kelley told the sales force that GR would soon be coming out with very favorable information about its operations, that other brokers and dealers would be brought in to promote the said stock all of which would result in raising the price of GR. The offering price of GR was \$1 per share. On June 26, 1978 the first day of aftermarket trading the quotes for GR stock reached a high of 2-3/4 bid - 3-1/4 asked. When GR's price declined to under \$2 per share for the first time in August 1978, Kelley held a dinner meeting of AmWest sales managers and urged them to intensify their inhouse retail sales campaign to move the price of GR stockup to at least \$3. Kelley told the group that GR would rise to \$5 per share.

It is evident that Kelley intended that his prediction of a price rise would be transmitted to customers to entice them into buying the stock. Evidence of such intent is found in the testimony of several AmWest customers who bought the stock in the August 1978

period. Customers were told by AmWest sales persons that GR stock would "jump", that it would rise in price, or that a major price move was expected, or used similar expressions conveying the predictions of a GR price increase, which, in essence, paraphrased Kelley's predictions. The record demonstrates that there was no reasonable basis for such predictions. The Commission has held that such predictions concerning the future price rise of a speculative security of an unseasoned company cannot be justified and constituted a fraud within the meaning of the antifraud provisions of the securities acts. John R. Brick, 46 SEC 43, 52 (1975); Alexander Reid & Co., Inc. , 40 SEC 986, 991 (1962). It is concluded that Kelley thus willfully violated and willfully aided and abetted violations of the anti-fraud provisions of the securities acts.

Moreover, in light of Kelley's activities relating to his participation in the sales activities of GR at AmWest, as detailed above, Kelley is also found to have engaged in a course of business and a scheme to manipulate the price of GR stock upward. Such conduct was fraudulent and violative of the aforesaid provisions of the antifraud provisions of the securities acts. It is well settled that a scheme calculated to manipulate the market price of a stock is within the ambit of Section 10 of the Exchange Act and Rule 10b-5 thereunder. The evidence is overwhelming that Kelley, particularly in August 1978, exhorted the AmWest sales force of the necessity to

preserve AmWest's reputation as an underwriter, told them that GR stock was a hot issue which should not be permitted to decline as it had been doing in the latter part of July and early August 1978<sup>12/</sup> and that it was essential to "run up" the price of the stock to show the power and strength of AmWest on the street.

The record further establishes that, as a part of the fraudulent scheme Kelley engaged in, he urged the AmWest sales force not only to concentrate its efforts to sell GR stock but also to purchase the stock. To carry out the plan envisaged by Kelly the individual salespersons recommended to customers to purchase GR stock while at the same time they were recommending to other customers to sell the same stock. There was no basis for making such inconsistent recommendations to AmWest customers.

The foregoing evidence, which is not controverted, manifests a deliberate and conscious effort to manipulate the market price of GR stock by unlawful and fraudulent means.

Kelley's conduct as detailed above, warrants the finding that he acted with the requisite scienter to establish the

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12/ The documentary evidence discloses that between July 31, 1978 and August 3 the high quotes for GR stock were 2 bid - 2-1/2 asked and between August 4 and August 7 the quotes declined to high bid 1-7/8 - 2-3/8 asked. By August 9, 1978 when Kelley mounted the sales campaign the quotes rose to high bid 2-3/4 = high asked 3-1/4. The quotes then continued to rise and by August 18, 1978 reached a high of 3 bid = 3-1/2 asked.

willfull violation of Section 17(a)(1) of the Securities <sup>13/</sup> Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Aaron v • Securities and Exchange Commission, 446 U. S. 680 (1980).

Unreasonable Markups and Markdowns in GR Stock

The Order charges that Kelley and AmWest violated the antifraud provisions of the securities acts in that in connection with purchases and sales of GR stock the retail customers of AmWest were charged unreasonable markups and markdowns. The documentary evidence discloses that during the period August 8 to August 18, 1978 AmWest charged their retail customers markups and markdowns ranging between 16% and 21% in 165 (43%) of the total of 388 retail transactions of purchase and sale of the GR stock and that in 254 (66%) of the firm's total of 388 retail transactions AmWest charged retail customers between 11% and 21%. The foregoing percentages were based on contemporaneous inside bid prices. The evidence further establishes that in 147 (approximately 50%) of its total of 303 transactions of sale of GR stock during the same period, AmWest charged its retail customers markups ranging between 8% and 14%. The aforesaid percentages were based on contemporaneous ask prices. The documentary evidence shows that both

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<sup>13/</sup> It is noted however, that scienter is not necessary to establish violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

contemporaneous bid and ask quotes utilized for computing the markups and markdowns were taken from the NASDAQ Market Maker Price Movement Report.

The question to be determined is whether Kelley and AmWest charged prices to its retail customers that were not reasonably related to the prevailing market price of GR stock at the time the customers purchased their securities. The Commission has consistently held that when a dealer is not simultaneously making a market in a security, a dealers contemporaneous cost is the best evidence of the current market, in the absence of countervailing evidence. DMR Securities, Inc., 20 SEC Docket 762, 763 (1980). However, in the instant case the record establishes that AmWest was the dominant market maker in GR stock. As noted earlier herein AmWest's share of the total media volume during the period August 8 through August 18, 1978 ranged between 50%-90%, on eight of the nine trading sessions and between 60%-90% on six days. The Commission has recently held that where a market maker is involved, markups may be computed on the basis of contemporaneous price charged by the firm or other market makers in actual sales to other dealers, or if no such prices are available on the basis of representative asked quotations. The Commission has pointed out that there are situations involving a market maker, where the use of representative asked quotations, in the absence of inter-dealer sales, is appropriate

in determining prevailing market price. Alstead, Dempsey & Company Incorporated, Securities Exchange Act Release No. 20825 (April 15, 1984).

The instant case presents one such situation. The evidence reflects that during the period in question, while other broker-dealers who were making a market in GR stock, engaged in purchases and sales of the said stock they were insignificant as compared to AmWest's transactions and the evidence does not reflect whether their sales of GR stock were actual inter-dealer transactions. Hence, there is no evidence of actual inter-dealer sales which may be used to compute the markups. Consideration is also given to other factors in determining to use contemporaneous inside bid and ask quotations. As noted earlier herein, AmWest was in continuous short position in GR stock from about noon on August 8, 1978 through August 18, 1978. Throughout this period AmWest consistently sold short at increasingly higher prices despite a small floating supply and consistently maintained a large spread (\$.50 per share) between bid and ask prices. Since the evidence shows that AmWest sold about 5,000 shares on only two days to other professionals no computation can be made of markups

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14/ For example, the documentary evidence reveals that during the said period one market maker sold 1,000 shares on two days and made no purchases, another sold 5,200 shares on two days and bought 1,300 shares on two days and a third sold 3,700 shares on three days and bought 500 shares on one day. AmWest on the other hand, sold about 204,629 shares to its retail customers and bought a total of about 194,235 shares in the same period.

based on contemporaneous sales to other broker dealers. Accordingly, it is concluded that the markups noted above based on the use of representative ask quotations is appropriate in determining prevailing market price.

In addition to the foregoing, the evidence further reveals that a number of AmWest registered representatives matched or crossed several retail buy and sell orders of GR stock during this period. Even in these few transactions the overall markups charged ranged from 9.5% to 17.5% based on cost. In such riskless transactions the markups were unjustifiable and excessive.

Kelley is found to have willfully violated and willfully aided and abetted violations of the antifraud provisions of the securities acts, during the period August 8 through August 18, 1978 by charging prices to AmWest retail customers of GR stock which were not reasonably related to the prevailing market price and such markups and markdowns were unreasonable and excessive.

Violations of the Antifraud Provisions of the Securities Acts in Connection With the Public Offering and Aftermarket Sales of MNS Common Stock.

MNS was organized under the laws of the State of Colorado on April 15, 1975 for the purpose of developing closed recirculating systems for the commercial production of finfish, and algae (aquaculture). MNS filed a registration statement with the Commission for a public offering of 1,700,000 shares of its common stock at a price of \$.75 per share. AmWest was the underwriter of the offering

which became effective July 14, 1978. At the time of the public offering MNS had been engaged for about two years in the limited production of algae. It intended to direct its future business efforts to the commercial culture of clams, oysters, and shrimp in an artificial aquatic production facility or "closed system" to be located adjacent to a power plant in Lamar, Colorado. As of July 14, 1978 (the date of the public offering) MNS had grown 50 shrimp to adult size and approximately 25 pounds of clams and oysters.

The offering by MNS was highly speculative involving a high degree of risk including, among other things, the fact that the closed system commercial production of shell fish had never been profitable, they had sustained losses since its inception, none of the companies executive officers, including its president James E. Kitchel, (Kitchel), had any prior experience operating or managing an enterprise engaged in the type of business activities conducted by MNS and there was no assurance that the company's operations would prove profitable nor was there any assurance that if the company's production and marketing of shellfish were unsuccessful it would remain in business. MNS received approximately \$1,052,259 from the public offering prior to September 4, 1978.

Some time in the latter part of 1976 Kitchel began discussing with Kelley the possibility of having AmWest act as underwriter for



the MNS public offering. Negotiations were carried on for several months and culminated with the signing of a letter of intent in May 1977 for AmWest to act as underwriter notwithstanding that Kitchel, at that time, had no specific business plan or financial projection. In August 1977 Kelley contacted Nicholas Kondur to evaluate MNS with respect to the feasibility of MNS to conduct its shellfish operation. Kondur visited the MNS facilities on three occasions, talked to various persons at MNS concerning its proposed operations and obtained a pro-forma balance sheet and income statement. As part of his investigation Kondur discussed with the MNS personnel such matters as expected income, costs, profitability, capital expenditures and the probability of success of achieving their technical objectives. Whatever information Kondur obtained he passed on to Kelley. He orally reported to Kelley that he did not feel that Kitchel or his staff had the ability to conduct a business, that he had serious questions with respect to the successful outcome of utilization of technology about which Kitchel spoke, that he did not feel the company was worthy of public financing and that if he were Kelley he would not underwrite it. Kelley responded by telling Kondur he fully intended to underwrite MNS because he believed in the concept of the aquaculture facility. Kelley requested Kondur to do whatever he could to rearrange the corporate structure and the balance sheet in such a way as to make the deal "minimally acceptable".

Notwithstanding his advice to Kelley not to underwrite MNS because he believed that the enterprise would not be successful. Kondur complied with Kelley's request and told Kitchel to make two changes in the balance sheet, Kondur was concerned with the fact that a large portion of the proceeds of the public offering was to be used to repay a substantial debt owed to Kitchel, his family and friends and that there were a huge number of options that Kitchel and his family owned from which they could reap a profit. Kondur testified that he was trying, from a cosmetic point of view, to make the balance sheet of MNS look minimally acceptable and in that manner comply with Kelley's request.

In October 1977 MNS entered into an agreement with an engineering firm to design the aquaculture facility and to establish basic design criteria for the facility together with cost estimates. The engineering firm CH2M Hill prepared and submitted to MNS a report dated December 23, 1977. The report estimated a cost to MNS of about \$1,104,000 to build an aquaculture system with an annual production of 1,700,000 shellfish. MNS did not agree with the report and came up with its own design criteria in lieu of the CH2M Hill criteria and estimated a cost of about \$780,184. Early in 1978 Kelley obtained a copy of the aforesaid report <sup>15/</sup> and due diligence information furnished him by

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15/ Harold A. Roberts (Roberts), who was counsel for AmWest in connection with the MNS underwriting testified that in early January 1978, he was present in Kelley's office and Kelley handed him a copy of the CH2M Hill report. After looking at it in Kelley's office he returned it to Kelley.

Gary Agrow, counsel for MNS, which set forth the following:

(1) that CH2M Hill estimated that an aquaculture facility, less than 20% of the size of MNS' proposed aquaculture, would cost approximately \$323,816 more than the \$780,184 cost estimated by MNS; (2) that MNS had no design specifications and merely partial bids which failed to include bids for certain major items essential to construct the proposed facility, to support its estimated cost of \$780,184.

Roberts testified he visited MNS on two occasions during March and August 1977, accompanied by Kelley on one such trip. He told Kelley that he questioned Kitchel's projection of the cost of the facility and his belief that Kitchel had no experience in building or operating a facility of that size. Between March and June 1978 Roberts talked with Kelley about the MNS offering and told Kelley he was concerned with the information in the prospectus relating to the cost of the aquaculture facility and asked Kelley if the time projected for building was "realistic". Kelley's response was "it probably was".

It is determined from all of the foregoing that Kelley had received substantive material information from his own expert Kondur, his counsel Roberts, the CH2M Hill report and the due diligence information from the MNS counsel that should have alerted him that the information in the prospectus was far from accurate, that, in fact, MNS had no plans, blueprints or design specifications for building the aquaculture facility, had no formal blueprints or

design for the heat transfer system, had no bids for such construction, no bids for the concrete tanks which were to be used to raise oysters and that the projected cost for the facility was unrealistically understated. Kelley nevertheless determined to go forward with the underwriting without making any effort to make further investigation to ascertain whether the informatin in the registration statement accurately presented the manner in which the proposed aquaculture facility would be constructed, the cost of construction and the competency of the MNS personnel to operate the facility.

It is well settled by the Commission and the Courts that an underwriter of securities to be offered to the public, particularly of a new, high risk and speculative issue such as MNS, has a duty to verify the information appearing in the registration statement and to conduct a due diligence investigation to assure full and fair disclosure of the accuracy of the representations made in such statement. Securities Act Release No. 5275 dated July 26, 1972. The Commission explained that the underwriters' duties in connection with the distribution of securities include (a) making a reasonable investigation of the "non-expertised" statements in the registration statement; (b) calling upon business or technical experts during the course of the investigation; (c) acting as intermediary between the issuer and the investing public and providing protection the public has a right to expect; and (d) assume an adverse posture to the issuer

and demand access to information which verifies the statements in the registration statement. (SA Release 5275 supra at 7-8). The Commission and the Courts have held that an underwriter, by associating himself with a proposed offering, impliedly represents that he has made a due diligence investigation into the issuer's business and the adequacy and accuracy of the information in the registration statement. The Richmond Corporation, 41 SEC 398, 406 (1963). The underwriter who does not make a reasonable investigation is derelict in his responsibilities to deal fairly with the investing public. Charles Hughes & Company, Inc. v. SEC, 139 F2d 434 (C.A. 2, 1943) cert. denied , 321 U.S.C. 786.

The record amply supports the finding that Kelley failed to discharge his duties and responsibilities as underwriter for the public offering of MNS. The evidence detailed above establishes that in January 1978, prior to the effective date of the registration statement Kelley knew from his copy of the CH2M Hill Report that the engineering firm estimated the cost of the proposed aquaculture facility to be in excess of \$1,100,000, a figure which was more than \$323,000 greater than the \$780,000 cost estimate made by MNS personnel, none of them engineers. Kelley also knew from the report he received from Kondur, the expert he retained to evaluate MNS, that MNS had no detailed design plans or specifications for constructing the aquaculture facility and that Kondur opined that MNS did not have the know how or personnel to operate the complex aquaculture facility. Kelley was told by his own attorney, Roberts, that he had questions concerning the cost and time estimates

reflected in the prospectus and questioned Kelley as to whether the estimates were realistic. Kelley's response was "it probably was".

Such a response by an underwriter is indicative of a lack of understanding of the responsibility and duty to investigate. Kelley had the obligation to independently satisfy himself that there was an adequate basis for stating in the prospectus that the aquaculture facility could be built and operational within 90 days of completion of the offering. The record shows that inquiry by Kelley would have revealed that, absent blue prints, complete or final bids, and a skilled labor force, the proposed facility could not be completed within the time specified in the prospectus. Moreover, an engineer hired by MNS in December 1978 (5 months after the effective date of the MNS registration statement) to oversee construction of the proposed aquaculture facility testified that when he arrived at MNS in December 1978 no buildings had been erected, that there were still no designs or bids for the facility. He further testified that, in his opinion, for the aquaculture facility to be built within the time frame described in the prospectus MNS would have had to employ an engineering firm with ten to twenty engineers working around the clock 7 days a week and spend several million dollars.<sup>16/</sup>

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16/ His testimony is not refuted and is credited.

A reasonable investigation by Kelley would have revealed the aforesaid information and demonstrated the impossibility of commencing operations in the proposed facility within 90 days of completion of the offering as represented in the prospectus.

It is concluded that Kelley, who the record establishes, was primarily and indeed solely involved in negotiating for and determining that AmWest act as underwriter for the MNS public offering, failed to exercise due diligence by not making a reasonable investigation of the adequacy and accuracy of the statements made in the prospectus for the MNS public offering, and was derelict in his responsibilities to deal fairly with the investing public and otherwise engaged in a course of conduct which operated as a fraud and deceit on investors in willfull violation of the anti-fraud provisions of the securities acts. The Richmond Corporation, supra; Charles E. Bailey & Company, 35 SEC 33,41 (1953); Brown Barton & Engell, 41 SEC 59,62-64 (1962). It is also concluded that Kelley's conduct, as detailed above, warrants the finding that Kelley acted with the requisite scienter to establish the willfull violation of Section 17(a)(1) of the Securities Act and Section 10b of the Exchange Act and Rule 10b-5 thereunder. Aaron v. Securities and Exchange Commission, supra. In addition, the

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<sup>17/</sup> As noted earlier herein, scienter is not necessary to establish willfull violations of Sections 17(a)(2) and 17 (a)(3) of the Securities Act.

the record establishes, and Kelley does not dispute, that he continued to use the false and misleading prospectus in connection with transactions in MNS during the aftermarket trading in MNS from about August 21, 1978 through at least July 1979.

It is evident from the record that Kelley knew in the summer of 1979 that the aquaculture facility had not been built but he made no effort to correct or amend the misleading and false representations in the prospectus. Such conduct manifests that Kelley engaged in a course of conduct which operated as a fraud and deceit on investors in willfull violation of the antifraud provisions of the securities act.

Willfull Violation of Section 17(a) of the Securities Act in connection with the offer and sale of the Common Stock of Rogue

The Order charges that Kelley, and Knoblauch willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act in connection with the offer and sale of the common stock of Rogue and engaged in a course of business which operated as a fraud upon purchasers and prospective purchasers.

The record establishes that AmWest was the underwriter of a public offering of 30,000,000 shares of common stock of Rogue at \$.10 per share. The offering commenced about November 9, 1981. The prospectus states, in essence, as pertinent here, that AmWest agreed to sell 30,000,000 shares of stock on a "best efforts 10,000,000 shares or none" basis to obtain a total sum of \$3,000,000 and that pending the sale of 10,000,000 shares



all proceeds from the securities sold "will be deposited in escrow in a non-interest bearing account at the Aurora Mountain Bank, Aurora, Colorado ('Escrow Agent')". The Agreement also provides that unless the said shares are sold within 90 days (unless extended for an additional 30 days) from November 9, 1981, the offering would terminate, and all funds would be promptly returned to the subscribers by the Escrow Agent without deduction or interest.

An investigator of the Commission staff stated under oath that as of December 31, 1981, AmWest had collected at least \$234,112 from its customers for purchases of Rogue common stock and that such funds had been deposited in AmWest's operating account and not, as represented in the prospectus, in the escrow account. As of that date AmWest's records reflected it had only \$100,153 in its operating account to pay the \$234,112. Another Commission investigator stated under oath that he was told by the Senior Vice-President of the Escrow Agent that the Aurora Bank had been provided with a copy of the proposed escrow account agreement but neither the bank, the issuer (Rogue) nor AmWest had ever executed the agreement and that the bank had not opened an escrow account relating to the Rogue offering. The Senior Vice-President also stated that no proceeds from the sale of Rogue shares were ever received from AmWest. It appears evident from the record

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18/ The records of the bank reflect that on December 12, 1981 it received \$15,000 from a broker-dealer in New York in connection with the Rogue offering which the bank returned to the said broker-dealer on January 12, 1982.

that Kelley and Knoblauch were the officers of AmWest who arranged with the Escrow Agent regarding the establishment of the escrow account. Neither of them offered any evidence contradicting the foregoing facts.

It is concluded that the prospectus used by AmWest in connection with the offer and sale of the Rogue common stock was false and misleading in stating that AmWest, the underwriter would deposit the proceeds of the offering in an escrow account at the Escrow Agent in Colorado and if 10,000,000 shares were not sold, in a specified time, the funds would be returned by the bank. The record reveals that, in fact, no escrow agreement was ever signed by either AmWest, Rogue or the bank and no escrow account was established by the Bank for the Rogue offering. The record also shows that AmWest never deposited the funds it received in the public offering in any escrow account but did deposit such funds in its own operating bank account. Kelley and Knoblauch are found to have willfully aided and abetted AmWest's violation of Section 17(a) of the Securities Act. <sup>19/</sup> SEC v. Blazon (CCH Fed Sec Law Repr., ¶ 97,212 (1979))

In connection with the foregoing AmWest is also found to have willfully violated Section 15(c)(2) of the Exchange Act and Rule 15C2-4 thereunder. As noted above, AmWest failed promptly to

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<sup>19/</sup> The findings herein are made under Section 17(a)(2) and (3) which do not require a finding of scienter. SEC v. Blazon, supra

transmit the money it received from the sale of the common stock of Rogue to a bank escrow account while it was participating, as an underwriter, in a distribution of the common stock of Rogue on a "best efforts" basis. Such failure violated the aforementioned Rule. Kelley, AmWest's president and Knoblauch, who was vice-president and officer at AmWest in charge of operations and syndications are found to have willfully aided and abetted the violation by AmWest of Section 15(c)(2) of the Exchange Act and Rule 15C2-4 thereunder.

#### Net Capital Violations

The Order charges that Kelley and Knoblauch willfully aided and abetted AmWest's violation of Section 15c(3) of the Exchange Act and Rule 15c3-1 thereunder. The record shows, and respondents do not controvert, that, as of December 31, 1981, AmWest had a net capital of \$44,384 which was \$13,519 below that required by Rule 15c3-1 under the Exchange Act. As of February 26, 1982, AmWest had a net capital deficit of \$73,657.52 and a capital deficiency of \$173,657.12. Part of the net capital deficiency on both occasions was due to AmWest's failure to record on its books a \$50,000 liability for a loan to AmWest from the Aurora Mountain Bank. The Commission and the Courts have held that under the federal securities laws brokers and dealers are charged with the responsibility of insuring that the firm's books and records are

kept in compliance with the requirements of the Exchange Act. SEC v. Reich-Cassin & Co., 362 F Supp 946,949 (S.D.N.Y. 1973); Jerome H. Shapiro, 46 SEC 472,475 (1976). The Commission has also held that principals of a brokerage firm are under a duty to keep informed of the firm's financial condition. Herman M. Solomon et al., 44 SEC 910,912 (1972). In Merritt, Vickers, Inc., 42 SEC 274,280 (1964) the Commission held that to acquit [a chief executive] of responsibility. . . .

"would encourage ethical irresponsibility by those who hold themselves out as active operating heads and who in the very nature of the corporate setup should be primarily responsible".

Kelley as president and Knoblauch as vice-president in charge of operations were operating principals of AmWest and, by virtue of their conduct, considered as active heads of the firm. Kelley and Knoblauch were under a duty to keep informed of the firm's financial condition and are found to have aided and abetted AmWest's violation of Section 15(c)3 of the Exchange Act and Rule 15c-3 thereunder.

Aiding and Abetting Violations Relating to Filing of False FOCUS Report

Kelley and Knoblauch are charged with willfully aiding and abetting AmWest's violation of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder. An accountant employed by the Commission stated under oath that he participated in the investigation of AmWest to determine whether violations of the federal securities laws may have occurred. In that connection he obtained from the National Association of Securities Dealers (NASD) a copy of AmWest's FOCUS

Report Part II, dated December 31, 1981. That Report was filed by AmWest with the NASD pursuant to Rule 17a-5(a). The evidence discloses that AmWest failed to record a liability on the FOCUS Report Part II with respect to a loan made to AmWest by the Aurora Mountain Bank on October 30, 1981. (See preceding section - "Net Capital Violations"). The above mentioned Rule requires the filing of various financial reports with the NASD and the Commission. The evidence also shows that Knoblauch signed a FOCUS Report for the period June 26, 1981 to December 31, 1981. Kelley and Knoblauch signed the note for the loan of \$50,000 by AmWest and were cognizant of the existence of the liability. They were also aware of the necessity of recording the loan on AmWest's books and records and as president and vice-president of the firm respectively they are chargeable with knowledge of the requirement to report such liability on AmWest's FOCUS Report. Kelley and Knoblauch are thus found to have aided and abetted AmWest's violation of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder.

Failure to Make and Keep current Books and Records

The Order further charges that from about November 1981 through at least March 16, 1982, AmWest failed to make and keep current its books and records in willfull violation of Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder and that Kelley and Knoblauch willfully aided and abetted such violation.

The record shows that on October 30, 1981 Kelley and Knoblauch negotiated with the Aurora Bank and obtained a loan for AmWest in the amount of \$50,000. Kelley signed the note as vice-president. The purpose of the loan was to purchase an Aurora Bank certificate of deposit to use for reserve requirements and the loan was to be repaid from income from AmWest by cashing in the certificate of deposit. The loan was not recorded as a liability on the books of AmWest. Such failure resulted in a net capital deficiency in January and February 1982. The unrecorded liability was not discovered until March 1, 1982 when staff members of the Commission learned of the existence of the loan from an official of the Aurora bank in connection with their confirmation of the \$50,000 certificate of deposit.

The evidence also shows that from October 1, 1981 through February 1982 AmWest followed the practice of writing checks at the end of the month for bills recorded during the month but failed to accrue the expense until the following month. In January and February 1982 AmWest engaged in the practice of recording deposits to bank accounts in one month rather than the later month when the deposits actually occurred. Both practices avoided the required recording of bank overdrafts.

One of the staff investigators stated under oath that he made an examination of AmWest's book and records and reviewed cash items, bank reconciliations, bank accounts and other supporting

documents. His examination included a review of AmWest's bank reconciliation for seven bank accounts as of January 29, 1982 and the supporting documents. The investigator noted inconsistencies and unexplained items in the various bank accounts and supporting documents and concluded that the firm's January 29, 1982 bank reconciliations were inaccurate. His statements are not refuted and are credited. During the periods described above Kelley, the president and Knoblauch, vice-president in charge of operations of AmWest bore responsibility for the maintenance and accuracy of AmWest's books and records. It is well settled that the requirement that books and records be kept embodies the requirement that such records be true and correct. Richard D. Bertoli, 18 SEC Docket 486,488 fn.11 (1979). The record amply supports finding that Kelley and Knoblauch willfully aided and abetted AmWest's willfull violation of Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder. SEC v. Reich-Cassin & Co., supra; Merrit, Vickers, Inc., supra.

Failure to Give Notice of Net Capital Deficiencies and Inaccurate Books and Records

The Order charges that Kelley and Knoblauch willfully aided and abetted AmWest's willfull violation in failing to give the public notice and report to the Commission and the NASD of its insufficient capital and its incomplete and inaccurate books and records as required by Section 17(a) of the Exchange Act and Rule 17a-11 thereunder. As noted earlier AmWest experienced

net capital deficiencies as of December 1981 and February 1982. No telegraphic notice of such events was given by AmWest to the Commission or the NASD as required by the aforesaid Rule. Similarly no telegraphic notice was given by AmWest as required by the above mentioned Rule of its failure to make and keep current its books and records in accordance with Rule 17a-3. Kelley, AmWest's president and Knoblauch its vice-president in charge of operations are held to be responsible for making certain not only that AmWest complied with the net capital requirements and the maintenance of accurate books and records but to insure that AmWest complied with the notice requirements of the above-mentioned section of the Exchange Act and Rule thereunder.

Aiding and Abetting the Customer Reserve Rule Violations

Kelley and Knoblauch are charged with aiding and abetting AmWest's violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder. As noted earlier herein, AmWest, in January and February 1982, failed properly to record deposits when they were actually made to avoid disclosing overdrafts and failed to record expenses as they accrued. These bank overdrafts, particularly the evidence showing that AmWest, in January 1982, wrote at least 92 checks, totalling \$317,435.10 to pay its customers, should have been included in the computation to determine the required reserve deposits, pursuant to Rule 15c3-3(e); Exhibit A thereto; Item 1 and Note A. AmWest's failure to record



overdrafts resulted in an understatement of the calculations appearing in Item 1. Again Kelley and Knoblauch were the principals in the firm primarily responsible for insuring compliance with the requirements of the Commission's Rules. Kelley and Knoblauch are found to have aided and abetted AmWest's violation of Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder.

Willfull Violations by Kelley and AmWest of a Commission Order of November 8, 1979 Suspending Kelley for Twelve Months and Willfull Aiding and Abetting by Knoblauch of Such Violations.

The Order charges that Kelley willfully violated an order of the Commission, dated November 8, 1979, which, on the basis of an Order for Proceedings and the Offer of Settlement submitted by Kelley, found that he willfully violated the antifraud provisions of the securities acts and aided and abetted violations of other specified provisions of the securities acts and that Knoblauch aided and abetted such violations. The Commission ordered that Kelley be suspended from association with any broker, dealer, investment company, investment adviser or transfer agent for a period of twelve months, with the proviso that after the initial six months of said suspension he may engage in the normal and regularly accepted duties of a registered representative with a registered broker-dealer under proper supervision. The order became effective as of November 19, 1979. The order further provided that Kelley not vote, directly or indirectly, any securities of AmWest, during his twelve month suspension period, for the election

or removal of any director and if a shareholder vote is anticipated or any other matter, he would provide notice to the Denver Regional Office at least three days in advance that he intends to vote on such matter. The order also directed that AmWest comply with its undertaking to employ an independent chief executive officer and at least two compliance officers to supervise sales and securities trading activities.

The record discloses that Robert Montgomery, an attorney from Albuquerque, New Mexico was retained as chief executive officer, and that Edward Larkin (Larkin), a former NASD staff member, and Harold Morris, (Morris) a retired U.S. Air Force officer, were hired as the two compliance officers. Montgomery actively functioned as chief executive officer only until about March 1980. Kelley returned to AmWest on May 18, 1980 and under the suspension order was permitted to engage in the normal and regularly accepted duties of a registered representative under proper supervision. Upon his return Kelley was given a memorandum, dated June 5, 1980 signed by Knoblauch and Morris, as Directors of AmWest, which informed him, among other things, that the "penalties" in the Commission proceeding and those of an NASD decision prohibited him from "performance in a principal capacity for an 18 month period"<sup>19/</sup> and explained that the effect

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<sup>19/</sup> Although the Commission order suspending Kelley for a twelve month period terminated November 18, 1980, the sanctions imposed by the NASD decision ran until May 18, 1981.

of the prohibition is to limit Kelley "from actively engaging in the management of American Western Securities business". The memorandum advised Kelley that "No special consideration will be afforded to you"; that "Any recommendations by you to the company, to investigate any opportunity, or change any policy will be made to the department of compliance" and that "You will not take part in any negotiation, where it might be conceived, by another party that you are acting as an officer, to ensure the integrity of the settlement".

The record demonstrates that Kelley failed to comply with the Commission's suspension order and paid little or no attention to the memorandum noted above. The evidence reveals that in July 1980 Montgomery arranged for Kelley to meet Manuel P. Sanchez for the purpose of having Kelley discuss a proposed underwriting of a public issue of a mining venture relating to a group of claims Sanchez owned near Hillsboro, New Mexico. Kelley met with Sanchez about July 12, 1982 and they discussed "funding requirements", the application and use of funds ranging between \$700,000 and "even one million (dollar)" and in general the manner in which the funds would be used for exploration purposes and for the development of the properties. Kelley did not disclose that he was then subject to sanctions imposed by the Commission.

Another instance of Kelley's involvement in an AmWest underwriting occurred during the period September-October 1980. AmWest

was the underwriter for a public issue of American Medical Devices, Inc. (AMDI). In September 1980 Kelley conducted a meeting in offices he maintained to rehearse the principals of AMDI on the best presentation to be made at a due diligence meeting which was to be held in New York. The meeting was attended primarily by AmWest brokers. Kelley told the brokers he was going to New York with the AMDI officials to present the company to New York Stock brokers and wanted "to bounce this off you guys". He then proceeded with a repetition of a dry run he held earlier in his office with AMDI personnel regarding the presentation to be made to brokers. The due diligence meeting was held in October in New York at which about 120 persons were present. Kelley introduced himself as president of AmWest and following the presentation by himself and AMDI executives, responded to questions concerning the stock and the timing of the offering.

On May 28, 1980 and September 9, 1980 Kelley and Knoblauch executed a Certification of Corporate Resolution Granting Authority to Transfer Securities on behalf of AmWest. In each certification Kelley was named as one of the officers authorized to sell, assign transfer or deliver securities in the name of or belonging to AmWest. On May 28, 1980 Kelley and Knoblauch executed an Authority to Maintain Deposit Accounts at the First National Bank of Denver. Kelley was one of the persons named as having authority to withdraw funds from the bank account by checks, drafts and orders for payment

of money when signed in the name of AmWest.

By memorandum dated May 27, 1980, Morris, one of the compliance officers, informed Knoblauch that Kelley would be one of the persons authorized to sign checks on the three AmWest bank accounts. When Larkin, the other AmWest compliance officer, saw some checks signed by Kelley he told Morris "we got to get him off". Morris agreed but according to Larkin nothing was done. In the fall of 1980 Kelley signed notes with banks on behalf of AmWest. Larkin testified that in the summer and fall of 1980 Kelley, unlike any other AmWest registered representative, went into the trading room daily with position sheets on security holdings of the firm and gave Patrick L. Moore (Moore) the head trader, who was an officer of the firm, instructions to reduce the firm's long position or to buy in to cover its short positions.<sup>20/</sup> When Moore on occasion disagreed with Kelley's instructions Kelley told him to do what Kelley wanted done or leave. Early in January while Kelley was under restrictions, imposed by the NASD, from acting as a principal, Kelley again told Moore to follow instructions or leave. Moore thereupon resigned.

It is concluded that during the period from about May 19 to about November 19, 1980 Kelley willfully violated the provisions of the Commission's November 8, 1979 suspension order. In essence,

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<sup>20/</sup> Moore testified that Kelley told him he had worked out an agreement with the Commission whereby he could see the daily runs of the company, "because he was protecting his interest in the company". There is no evidence in the record of any such agreement with the Commission.

Kelley by signing checks and securities and executing certifications to transfer securities and by executing authority to maintain bank accounts all on behalf of AmWest; by conducting due diligence meetings on behalf of AmWest which was acting as an underwriter; by making underwriting decisions for the firm; and by causing the resignation of Moore as head trader, engaged in activities proscribed by the Commission's suspension order. No consent was obtained from the Commission by Kelley to become associated with AmWest in a supervisory capacity or to engage in the above mentioned activities, as required by Section 15(b)(6) of the Exchange Act. Kelley is thus found to have willfully violated Section 15(b)(6) of the Exchange Act.

Knoblauch who, the record amply reveals, knew of Kelley's disability, nevertheless authorized Kelley to sign checks and securities and, as the record also shows, was aware of Kelley's involvement in AmWest's underwriting activities, is found to have willfully aided and abetted Kelley's violation of the aforesaid suspension order. Knoblauch is thus found to have aided and abetted Kelley's violation of Section 15(b)(6) of the Exchange Act during the period from about May 19, 1980 to about November 19, 1980.

It is further concluded that AmWest knew or, in the exercise of reasonable care should have known, of the provisions of the November 8, 1979 suspension order and willfully violated Section 15(b)(6) of the Exchange Act by permitting Kelley to become and

remain associated with it in a supervisory capacity, without the consent of the Commission, while the aforesaid suspension order was still in effect. Knoblauch is found to have willfully aided and abetted AmWest's aforesaid violation of Section 15(b)(6) of the Exchange Act.

The record reflects that while AmWest hired Montgomery as chief executive officer, in accordance with the November 8, 1979 suspension order, he served only until approximately March 1980 and AmWest never hired a replacement for him. AmWest is thus found to have willfully violated the aforesaid suspension order during the period about April 1, 1980 to about November 19, 1980. Knoblauch, in her capacity of vice-president, a director, and principal of operations was aware of such facts and the requirements of the suspension order but made no effort to seek or replace the chief executive officer and is found to have willfully aided and abetted AmWest's violation.

Failure to Amend Form BD

Knoblauch is charged with willfully aiding and abetting AmWest's violation of the broker-dealer reporting requirements of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder. The record shows that during the period from about November 19, 1979 to on or about May 7, 1981 AmWest failed to amend its Form BD on file with the Commission to reflect the following information necessary to make the said form accurate: (1) that Kelley was no longer associated with AmWest as its president and chief executive officer; and (2) that AmWest employed

a new, independent chief executive officer and his identity. For the reason stated earlier herein relating to Knoblauch's relationship with AmWest and her functions, it is found that Knoblauch aided and abetted AmWest's violation of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

The record also shows that from about April 1, 1980 to the present, AmWest failed to reflect the following information necessary to make the BD Form accurate: (1) that the chief executive officer discontinued his association with AmWest after approximately five months of his employment; and (2) Kelley's reassociation with AmWest in a supervisory capacity. For the reason stated in the prior paragraph Knoblauch is found to have aided and abetted AmWest's violation of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

#### Failure to Supervise

Kelley is charged with failing reasonably to supervise persons subject to his supervision with a view to preventing the violations by such persons in connection with the offer and sale of GR stock.

Under the heading "Violations of the antifraud provisions of the Securities Act and the Exchange Act regarding the common stock of GR". Kelley was found to have willfully violated the antifraud provisions of the securities acts and to have engaged in a scheme to defraud investors and manipulate the price of GR stock. His



conduct and activities in connection with the sales of GR stock were previously detailed and need not be repeated hereunder. Suffice it to say that as AmWest's chief executive officer during the periods the stock was being sold, Kelley bore the responsibility for supervising the AmWest salesmen and, in fact, conducted meetings with salesmen at which he encouraged them to make false representations concerning GR stock, including unwarranted price predictions. It is concluded that Kelley reasonably failed to supervise salesmen subject to his supervision with a view to preventing the violations by such persons of the antifraud provisions of the securities Acts.

Willfull Violations of the Antifraud Provisions of the securities acts in connection with the Offer and Sale of SD stock

The Order charges that Kelley willfully violated and aided and abetted violations of the antifraud provisions of the securities acts in connection with the offer and sale of the common stock of SD. The Division in its proposed findings and brief does not address itself to the above mentioned allegations relating to SD.

Pursuant to Rule 16(d) of the Commission's Rule of Practice the violations as alleged in paragraphs "O" and "P" in the Order are regarded as waived and are hereby dismissed.

Public Interest

The remaining question is whether it is in the public interest to impose a sanction upon Kelley and Knoblauch. The findings that the respondents willfully violated and/or willfully aided and abetted violations of specified provisions of the securities acts and the provisions of the November 8, 1979 order of the Commission have been detailed above and need no repetition here. An appraisal of the record suggests scrutiny of several aspects of the manner in which the said respondents comported themselves, in connection with the operations of AmWest, to determine whether sanctions are appropriate.

Kelley was found to have been directly involved and the primary architect of the scheme to defraud investors in the offer and sale of the securities of GR and MNS. The manner in which the fraud was perpetrated upon investors in each of the issues manifests a deliberate attempt by Kelley to encourage the AmWest sales force to engage in high pressure sales efforts and to make misleading statements regarding the issuers. Kelley was also the architect of the manner in which the price of the GR stock was manipulated in the market place. Sales of GR stock by Kelley and the AmWest sales force, under Kelley's directions, carried with it the clear -though implied- representation that the prices were related to that prevailing in an open market. Charles Hughes & Co. Inc., 13 SEC 676 (1943), aff'd Charles Hughes & Co. Inc. v. SEC, 139 F 2d 434, cert den., 321 U.S. 786 (1944). Without disclosure revealing

that the market was created and dominated by Kelley's conduct, that representation was materially false and misleading. Norris & Hirshberg, Inc., 21 SEC 865,882 (1946), aff'd, Norris & Hirshberg, Inc. v. SEC, 177 F2d 228 (D.C. Cir. 1949).

Another instance of Kelley's manifestation of conduct inimical to the interests of investors is demonstrated by his failure to revise the prospectus of the MNS public offering when he knew, or certainly should have known, that the information contained therein was inadequate, false, and misleading. Kelley, though furnished with due diligence information by counsel for the issuer, failed to conduct a proper due diligence inquiry and continued to use, and permitted AmWest to use, a false and misleading prospectus in connection with the aftermarket sale of MNS stock.

Consideration is also given to the fact that Kelley bore prime responsibility for AmWest's failure, as underwriter of the Rogue offering, to establish an escrow account at the Aurora Bank as represented in the prospectus used in connection with the public offering of Rogue. The record reflects not only that the escrow account was never established but that AmWest collected in excess of \$200,000 from its customers which it deposited in its operating bank account, notwithstanding its underwriting agreement and the representations in the prospectus. What such conduct demonstrates is that Kelley should not be permitted to deal unfairly

with customers or jeopardize their funds. In this latter connection Kelley was found to have aided and abetted a number of violations as detailed earlier herein including AmWest's net capital violation; the firm's failure to give telegraph notice of its net capital violation and of the inaccurate books and records maintained by the firm and the filing of a false FOCUS Report.

In determining the appropriateness of a sanction as to Kelley, consideration is further given to significance of his failure to abide by the restrictions placed upon him by the Commission's November 8, 1979 suspension order, as detailed earlier herein. Prior to the closing of the record counsel for Kelley requested that, upon the assumption that Kelley is found to have violated the securities laws, consideration be given to the sanctions imposed by the Commission in other cases where fraud and manipulation were found and less than a bar was deemed to be appropriate. Most of such cases, noted by counsel, were those where the Commission accepted an offer of settlement and respondents consented to a finding of violation. Consideration has been given to such cases but none of them are factually similar to the facts in the instant case nor to Kelley's pervasive violative conduct as found here. The picture which emerges with respect to Kelley's egregious conduct is one of callous disregard of his obligations as a broker-dealer toward investors, and a course of business which Kelley operated as a fraud and deceit upon such investors.

In light of all of the foregoing findings of violations and aiding and abetting violations of the Securities Acts by Kelley it is concluded that a severe sanction is mandated and that anything less would not serve to protect investors nor would it be in the public interest. Steadman v. SEC, 603 F.2d 1126,1137,1139 (5th Cir. 1974), aff'd 450 U.S. 91 (1981).

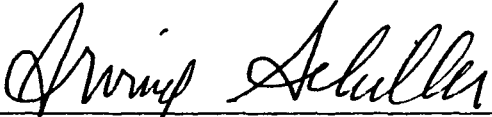
The findings made with respect to Knoblauch relate primarily to aiding and abetting violations by AmWest and Kelley of the anti-fraud provisions of the securities acts with respect to the Rogue offering and the failure to transmit funds received from the sale of the stock of Rogue in accordance with the escrow agreement and the representation in the Rogue prospectus. She was also found to have aided and abetted various violations by AmWest in connection with the failure of AmWest to maintain in books and records as required by the Exchange Act and Rules thereunder. The record also substantiated the findings that Knoblauch knew of the Commission's November 8, 1979 order suspending Kelley and, notwithstanding, permitted Kelley to sign checks and securities for AmWest. In addition, as a director of AmWest and principal operations officer, Knoblauch attended "Executive Meetings" of AmWest and knew of Kelley's involvement in underwritings by AmWest or underwritings being considered by Kelley on behalf of AmWest while Kelley's suspension order was in effect. Accordingly, it is found to be in the public interest to impose a sanction upon Knoblauch.

IT IS ORDERED that Jack Darold Kelley is hereby barred from association with any broker or dealer.

IT IS FURTHER ORDERED that Dee Marie Knoblauch is hereby barred from association with any broker or dealer, with the proviso that, after fifteen months she may apply to the Commission to become so associated in a non-proprietary, non-supervisory capacity upon an adequate showing she will be properly supervised.

THE ORDER shall become effective in accordance with and subject to Rule 17(f), of the Commission's Rules of Practice, 17 CFR 201.17(f).

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party that has not within fifteen days after service of this initial decision upon him or her, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him or her. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.<sup>22/</sup>

  
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Irving Schiller  
Administrative Law Judge

Washington, D.C.

July 17, 1984

27/ All proposed findings, conclusions and supporting arguments of the parties have been considered. To the extent that the proposed findings, conclusions are in accordance with the findings, conclusions and views stated herein, they have been accepted and to the extent they are inconsistent therewith, they have been rejected. Certain proposed findings and conclusions have been omitted as not relevant or as not necessary to a proper determination of the material issues presented. To the extent that the testimony of various witnesses is not in accord with the findings herein, it is not credited.