ADMINISTRATIVE PROCEEDING
FILE NO. 3-6085

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
ADVANCED CHEMICAL CORPORATION	:
	:

INITIAL DECISION

Washington, D.C.
September 10, 1982

Jerome K. Soffer
Administrative Law Judge

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APPEARANCES: Delano S. Findlay, of the Salt Lake City Branch Office and Martha S. Fulford, of the Denver Regional Office, for the Division of Enforcement.

Frank J. Allen, for the respondent.

BEFORE: Jerome K. Soffer, Administrative Law Judge

On December 23, 1981, the Commission issued an Order Fixing Time and Place of Public Hearing ("Order") pursuant to Section 8(d) of the Securities Act of 1933, as amended ("Securities Act"), naming Advanced Chemical Corporation ("Advanced") as respondent.

The Order is based upon allegations of the Division of Enforcement ("Division") with respect to the filing by Advanced on June 18, 1981 of a registration statement (Form S-18) under the Securities Act, and respective amended filings thereafter on September 4, October 19, and November 9, 1981, covering an offering of its common stock. The offering became effective on November 16, 1981. The Order alleges that the registration statement includes untrue statements of material facts and omits to state material facts required to be stated therein, or necessary to make the statements therein not misleading, as specified in the Division's "Statement of Matters" made part of the Order.

The Order directed that a public hearing be held to determine whether the allegations in the Statement of Matters are true, to afford respondent an opportunity to establish any defenses to said allegations, and whether a "stop order" suspending the effectiveness of the registration statement should issue.

Hearings were held pursuant to said Order before me on March 30, 31, and April 5, 1982, in Salt Lake City, Utah. After the close of the hearings, Proposed Findings of Fact and Conclusions of Law and supporting Briefs were filed, respectively, by the

Division and by respondent. The Division served a reply to respondent's brief.

The findings and conclusions herein are based upon the evidence as determined from the record and from observation of the demeanor of the witnesses. The preponderance of evidence standard of proof has been applied. See Steadman v. S.E.C., 450 U.S. 91 (1981).

Advanced is a self-described "development stage company" with no significant operating history. It was organized under the laws of the State of Utah on September 17, 1980 and is in the process of developing the business of manufacturing and marketing epoxy-based industrial coating or paint. It has a small plant and warehouse (1700 sq. ft.) in Salt Lake City. During the relevant period herein, Ronald E. Eames was its president and Board Chairman, M. Edward Eames its vice-president, and Barton T. Eames its secretary and treasurer. All three were and are its only directors. Although Ronald E. Eames stepped down as president about a month prior to the hearings, he is still Chairman of the Board.

Some 36% of the outstanding capital stock of Advanced is owned by Anafuel Unlimited ("Anafuel"), a corporation of which Ronald E. Eames is president and owner of 44% of its capital stock. His brother, Barton Eames, is secretary-treasurer. Byron Nagata, who was its vice-president, owns 3 million shares of Anafuel stock. All three comprise its board of directors. Additionally, Nagata

owns more than 15% of the capital stock of Advanced. Anafuel, a Utah corporation, has as its principal business the proposed manufacture and marketing of a synthetic fuel under a licensed process. It shares the same business offices with Advanced. The commonality of interest and control of both corporations, particularly by Ronald E. Eames, is undisputed.

A third corporation involved in the matters relating to this proceeding is Metro International, Inc. ("Metro"), a corporation located in Grand Junction, Colorado, and under the control of Glenn Paden, Jr. Metro supposedly maintains a mill in Colorado for smelting gold and silver ore and also owns two mines in that state. During the relevant period, Mr. Paden had a relationship with Ronald E. Eames including claimed attempts on his part to obtain financing for the construction of a methanol plant for Anafuel, to obtain environmental waivers, and to sell rights to manufacture or market the synthetic fuel.

The underwriter of the offering, Olsen and Co., of Salt Lake City, appeared with counsel at the outset of the hearing to enter into a stipulation with counsel for the parties that the underwriter would testify, if called, that no stock subject of the registration was ever sold nor any solicitations for sales were made by him. The Division stipulated that it did not intend to offer evidence to the contrary.

THE STATEMENT OF MATTERS

The specifications in the Division's Statement of Matters

in support of its contention that a stop order should issue, constituting five in number, are based upon the provisions of Section 8(d) of the Securities Act relating to the taking effect of registration statements and amendments thereto. The provision reads as follows:

> (d) If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may *** after opportunity for hearing*** issue a stop order suspending the effectiveness of the registration statement.***

I. The $125,000 Certificate of Deposit

The Statement of Matters alleges the failure of the registration statement to disclose that a time certificate of deposit totalling $125,000, purportedly assigned by Anafuel to the respondent as payment for 12,500,000 shares of its stock had, in fact, been encumbered to secure a bank loan in that amount to Metro, and that Metro had subsequently defaulted on its loan resulting in the certificates being foreclosed by the bank to satisfy the loan.

a. The Metro Loan

On October 1, 1980 Metro through its owner, Paden, borrowed from the First National Bank-North, in Grand Junction, Colorado, the sum of $125,000 for a period of 90 days. The loan was personally guaranteed in writing by Ronald E. Eames.

Simultaneously, Anafuel purchased out of the proceeds of an intrastate stock offering two 90-day certificates of deposit totalling $125,000, which it pledged as security for the loan to Metro, and the certificates remained in the bank's custody. Eames, as Anafuel's president, signed the pledge agreement. Anafuel contends it entered into this transaction to assist Metro which allegedly had spent "a considerable amount of money" (unspecified) on Anafuel's behalf. 1/ Its corporate resolutions authorizing its participation were dated as early as September 5, 1980.

At maturity, on December 31, 1980, Metro was unable to pay the loan and obtained a 15-day extension on the note. At that time the two certificates were replaced by a single certificate of deposit in the sum $125,000. When the loan came due on January 15, 1981, it was renewed for another 30 days by Metro. On February 16, 1981, the loan was again extended until April 1, 1981.

In each instance, renewal applications were signed by Paden on behalf of Metro and the loans personally guaranteed by Ronald E. Eames. In each instance, the bank was represented by a vice-president, Edward Cisney. In each instance, a replacement

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1/ In a letter dated September 29, 1980 Metro and Anafuel wrote the bank to "confirm" that there was "good consideration" for Anafuel pledging its certificates of deposit. No such consideration is spelled out in the letters or anywhere in this record.

certificate of deposit was issued to Anafuel, although never released by the bank because they were being held as security for the loan, with the term of the certificates co-extensive with the term of the loan. In each instance, Eames signed a pledge agreement, as well as the note evidencing the loan.

As part of each loan agreement and each renewal thereof, whatever interest was to be earned by the certificates of deposit were applied against the loan interest owing by Metro to the bank. Usually, there was a net deficit due the bank for interest, which Metro paid by check.

Eventually, Metro defaulted on the last payment of net interest due the bank (its check was dishonored) and on March 18, 1981, the bank executed its lien against the certificate of deposit (which by then had an April 1 termination date) using the proceeds as an offset against the Metro loan.

b. The Confirmation of a Transfer to Advanced

On January 6, 1981, in a letter to Cisney, Anafuel advised the bank that as of December 30, 1980, it was purchasing 12,500,000 shares of respondent Advanced stock to be paid for by a transfer of ownership of the certificates of deposit from Anafuel to the respondent. This letter was accompanied by appropriate corporate resolutions and a confirmation letter by Advanced. On the same date, Cisney was given a form, "Standard Bank Confirmation Inquiry" customarily used by accountants in

preparing audits, to be filled out by him. Two days later on January 8, Cisney completed this form, confirming to respondent's accountants that as of December 31, 1980, the Anafuel certificates of deposit were owned by Advanced Chemical Corp. and that they were unencumbered.

Cisney, called as a witness herein, admitted that the certificates of deposit were never issued to respondent and were always pledged for the Metro loan. Hence, the confirmation was false. He offered no explanation as to how he could have certified otherwise. Had the "Confirmation Inquiry" been filled out in the normal course of the bank's business, there was no way that the bank records would have shown (1) ownership by Advanced, and (2) that the certificates were unencumbered.

Ronald E. Eames, who signed for each renewal and therefore had to know the true facts, offered no explanation as to how he permitted the "Confirmation Inquiry" to be used and relied upon by respondent's accountants as proof of unencumbered ownership of the certificates by Advanced in preparing the subject registration.

c. The Balance Sheet Treatment

The registration statement filed June 19, 1981 and each of the three amendments filed, respectively, on September 4, October 19 and November 9, 1981, contain an audited balance sheet for respondent as of December 31, 1980, and revised unaudited

balance sheets for succeeding later dates.[2/] In the original statement and each of the amendments, the audited December 31, 1980 balance sheet treats the certificate of deposit as a cash asset belonging to respondent. In the unaudited balance sheet as of April 30, 1981, appearing in the original filing and the first amendment, the certificate is also treated as a cash asset of $125,000. However, in the second amendment, this amount is dropped as a cash asset as of July 31, 1981, and there is added an explanatory note, under the heading of "related parties", that

> "During the seven-month period ended July 31, 1981, a time certificate of deposit of $125,000 was transferred to Anafuel Unlimited in partial payment of moneys owed."

As of the last amended filing, the balance sheet reads:

	December 31, 1980 (note 9)	August 31, 1981 (Unaudited)
Current assets:		
Cash (including $125,000 in time certificate December 1980)	$ 130,573	$ 2,351

This is followed by an explanatory note, as follows:

(2) Related Parties

> "During the eight month period ended August 31, 1981, a time certificate of deposit of $125,000 was transferred to Anafuel Unlimited in partial payment of moneys owed."

2/ Item 15(a)(2) of Form S-18 requires that there be filed an audited balance sheet as of a date within a year when there is also filed an unaudited one.

Respondent's auditor states that in listing the certificate as an unencumbered cash asset, he was relying upon the confirmation to that effect received from the bank official, Mr. Cisney. He did not think it unusual that the certificate had remained in possession of the bank, nor did he think it necessary or in accord with generally accepted accounting principles actually to see it for himself even though he might have learned thereby that the certificate was not in the name of Advanced and that in fact it was pledged for the Metro loan.

The auditor did not learn of the fact that the certificate had been foreclosed by the bank in satisfaction of the Metro loan until September 24, 1981, some six months thereafter. He contends that by reducing the cash amount by $125,000 in the July and August 1981 unaudited balance sheets, together with the explanatory note concerning the re-transfer of the certificate against moneys allegedly advanced by Anafuel on respondent's behalf, the transaction was adequately explained in accordance with generally accepted accounting principles. 3/

Nevertheless, the auditor clearly did not think it necessary to mention the circumstances surrounding the encumbering and foreclosure of the certificate, nor to correct the audited balance sheet erroneous treatment showing that the respondent had owned

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3/ There is nothing in any of the filed financial statements to show when, how and for what purposes Anafuel advanced such substantial sums on respondent's behalf. Moreover, the date when the certificate was transferred back to respondent is not given in the registration.

the certificate free and clear on December 31, 1980.

In his brief, counsel for respondent argues that, in view of the Cisney confirmation to the auditor, there is some question as to whether the certificate was in fact encumbered on December 31, 1980; that whether it was so encumbered does not matter so long as the last balance sheet no longer shows the certificate as a cash asset of respondent; and that in any event, it does not matter since respondent's officers relied upon the professional advice of the accountant and hence were not guilty of "incorrigible malignity".

In the first place, there is no question that on this record the certificate was continually encumbered from October 1, 1980. There is no question that respondent's principal officer, Ronald E. Eames, was aware of this fact from the very inception. There is no question that Cisney knew of the encumbrance from the very inception, and was so aware when he prepared the false confirmation. His inability to explain how such a confirmation could have possibly been issued, the fact that it was part of a package embracing the purported transfer of the certificate to respondent from Anafuel, and the further fact that it was to be presented to the accountant for his reliance in preparing the subject registration, all point in the direction of an intent on somebody's part to distort respondent's financial picture as portrayed in the registration.

There is no merit to the argument by respondent and his

accountant that it does not matter what the December 31 audited balance sheet shows so long as in the last unaudited one the certificate no longer appears as a cash asset. As seen, setting forth the prior audited balance sheet is a requirement of Form S-18 (footnote 2, ante). These requirements are designed for the protection of the investing public. That being so, it is also required that the balance sheet drawn in conformity with this requirement be true and accurate, cf. Lowell Neibhur & Co., Inc., 18 SEC 471, 475 (1945). Once it became known to the auditor (as it was well known to respondent) the true status of the certificate on December 31, 1980, there continued no justification to show in the audited balance sheet of that date that respondent owned a cash-equivalent asset of $125,000 when in fact this was not so.

Finally, respondent can find no haven in the claim that it relied upon the expertise of its accountant. The accountant was not told all the relevant facts, only that the certificate was foreclosed. He was never told, for example, that the Cisney "confirmation" was false at the time it was issued, a fact which Eames (and, of course, Cisney) well knew. The accountant was told only that at some unspecified time prior to August 31, the certificate of deposit was transferred to Anafuel as an offset against some unsubstantiated and unaudited debt owed. However, no such transfer could have occurred since the certificate no longer existed. Consequently, the explanatory note to this effect was untrue and failed to describe what actually happened.

Whether this misstatement of fact and the failure to set forth the actual facts are material will be discussed hereinafter.

II. Interest Income

The Statement of Matters charges that respondent improperly claimed as income the interest earned from the Anafuel certificates of deposit.[4/]

In the third and last amended registration, respondent's audited balance sheet as of December 31, 1980 shows under "current assets" an item designated "Accrued interest receivable" in the amount of $3,318. In the same registration, the latest unaudited balance sheet, as of August 31, 1981, shows this item as $16,925, or the claimed accruing of interest receivable of $13,607 during the intervening eight months.

According to the respondent's bookkeeper, the greater part of the interest income was purportedly earned from the Anafuel Certificates of Deposit.[5/] The auditor who prepared the financial statements confirmed this as the source of the balance sheet entries. However, even after he had learned that the certificate had been fully encumbered and had been eventually foreclosed as

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4/ This specification was added to the Statement by the Division's amendment thereof at the hearing. This amendment was allowed as being within the scope of the original charges attached to the Order.

5/ The only other source of earned interest income, as seen from the balance sheets, would be "notes receivable" which ranged in amounts from $7,000 to no more than $10,500. Any interest earned therefrom would have had to be a minor part of the total interest earned.

early as March 11, the auditor nevertheless continued to show the earning of interest therefrom on a regular basis and apparently would continue to do so indefinitely into the future.

As seen, the certificate (and the various renewals thereof) was never issued in the name of respondent, was foreclosed by the lending institution on March 11, 1981, was to expire by its term in any event on April 1, 1981, and was allegedly reassigned from respondent to Anafuel to offset preexisting debts during the interviewing period. Hence, under any of these circumstances the certificate was no longer (if it ever was) an interest-earning asset of respondent. In fact, by the very terms of the lending agreement between the bank and Metro, the interest accruing from the Anafuel certificate was to be applied against the interest due the bank under the Metro loan, and not paid to the certificate owner.

The auditor justifies this treatment of interest income because he was told that Anafuel had guaranteed respondent it would continue to receive the equivalent of interest on the principal sum indefinitely. However, if there were any such obligation on the part of Anafuel, there is no proof thereof in this record. 6/ If we accept respondent's unproven version

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6/ The only reference to disposition of the certificate interest is in a letter dated December 30, 1980, from respondent addressed to Anafuel acknowledging that any profits involved in utilizing the certificates up to January 1, 1981, was to be the property of Anafuel, and, that after January 1, "any interest or profits obtained from the monies shall become the property of Advanced Chemical." There is nothing to show acceptance by Anafuel of this understanding.

that Anafuel had, in effect, guaranteed the interest payments to respondent, then it was not interest income but some form of contractual relation creating a debt obligation. To call this event "interest income" is pure fiction.

III. The Metro Paint Sale

The Statement of Matters further alleges that the registration materially misrepresents the amount of respondent's sales. In a Statement of Loss attached to the last amended registration, respondent's gross sales for the 8-month period ending August 31, 1981 are stated at $120,891. Included in this sum is a purported sale of 1,000 gallons of paint to Mr. Paden's Metro International, at a price of $59.95 per gallon, or a total of $59,950.

a. The Paint Sale

With respect to this sale, respondent's records show a purchase order dated June 22, 1981 from Metro for 1,000 gallons of respondent's "M-25" paint and primer at the price stated, for delivery by July 24, "via truck", to the office address of Metro in Grand Junction, Colorado. This was followed by a Metro sales order dated June 26 for truck delivery to the home of Glenn Paden in Grand Junction. Finally, there was respondent's invoice to Metro dated June 30, 1981 stating that the order had been shipped via truck.

In accordance with the order, the employees of respondent at its Sale Lake City warehouse prepared the paint which they placed in twenty 55-gallon drums. Handwritten paper labels showing Metro's name and address were affixed with tape to each of the drums. The cost of the materials used to make up the order was about $4,820.

The paint was never shipped to Metro at either address in Grand Junction shown on the purchase order. At some point, a small portion of the order was trucked to another warehouse of respondent in Salt Lake City. However, the bulk of the paint remained in the respondent's original facility in that city. A few weeks after the order was prepared, the warehouse employees were instructed to remove and destroy the paper labels and to so place the paint in the warehouse as not to be seen or distinguishable from the other materials stored there.

Thereafter, whatever paint had been made to fill the Metro order was used by respondent as inventory to fill orders from other customers during the ensuing months. Receipts from these sales were retained by respondent. By the end of 1981, only 288 gallons of the original order remained on hand. Although Paden testified that he had asked Eames to move the paint to respondent's second Salt Lake City warehouse for the account of Metro, no warehouse receipt was ever issued to it, Metro was never charged for storage, and at no subsequent time did Metro exercise dominion over the goods.

b. The Factoring Transaction

Almost simultaneously with the execution of the documents relating to the paint sale amounting to $59,950, respondent applied to a commercial factoring company, Wasatch Factoring, to factor the account represented by the sales invoice to Metro. Wasatch checked with Metro and was advised that the sale had taken place and that the paint had been delivered pursuant thereto. Relying on these representations, Wasatch advanced the sum of $50,950 (after deducting its fees) on July 6, 1981, taking back an assignment of the Metro account together with respondent's guarantee of payment. Shortly thereafter, an official of Wasatch visited respondent's Salt Lake City warehouse and was surprised to see that the order bearing the Metro paper labels was still there. However, he was assured by Bruce Anderson, respondent's then sales manager (and now its president) that Metro was going to send its own truck to pick up the paint, which, of course, never happened. Wasatch never learned that the paint was not shipped to Metro until after the Commission's investigation into the matter had commenced.

When the account became due on September 6, 1981, Wasatch made demands upon Metro for payment, and, when not made, upon respondent under its guarantee. In return for an extension of time until November 6, respondents paid Wasatch $6,000. Respondent assured the factor that it eventually would be able to pay the amounts due out of the proceeds of the sale of the

securities which were to be issued under the registration involved herein. 7/ Wasatch received no further payments.

c. Conclusions as to a "Sale"

It is clear from the circumstances that no sale of paint from respondent to Metro had taken place. Section 2-106 of the Uniform Commercial Code defines a "sale" as "the passing of title from the seller to the buyer for a price." Section 2-401 of the Code describing when title passes, says, in paragraph (2) thereof:

> "Unless otherwise directly explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods***."

And, with respect to delivery, subparagraph (a) to the above states:

> "If the contract requires the seller to send the goods to the buyer, but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment, but if the contract requires delivery at destination, title passes on tender there***."

Applying these principles to the facts herein, it is concluded that title to the paint never passed to Metro, since there was no delivery as called for in the sales invoices, nor

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7/ In a letter from Wasatch to Advanced at the time the extension was granted, the factor said it was granting the extension "so that your accountant could submit recent financials without your obligation to us showing up as overdue."

any bona fide attempt at delivery.[8] No price was paid. Hence, there never was a sale of the goods to Metro, and title always remained in respondent, as demonstrated by the removal of the paper labels and the subsequent use respondent made of the paint.

All of the maneuvering of the principals purporting to show a sale of paint makes sense only when considered in connection with the virtual simultaneous factoring of the account. In order to obtain the factoring, the parties had to show some semblance of a sale.[9] As a result, more than $50,000 of working capital was obtained at an investment in paint materials of less than one-tenth that amount. Thereafter, most of the paint was later sold to others.

In apparent recognition that the transaction needed some bolstering, and apparently intending to justify what otherwise was not a normal business transaction between the parties,[10] respondent offered the testimony of Glenn Paden to the effect that he had placed the order for the paint following a meeting with one Arthur Andrews, who was in control of American Exchange

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8/ As stated above, the movement of a small portion of the paint order from one respondent warehouse to another, supposedly at Paden's request, was in no sense a bona fide delivery.

9/ Once the factor had purchased the account, there appears to have been no further interest in going through with the sale to Metro.

10/ This was the only paint transaction from respondent to Metro.

Corporation.[11/] Ostensibly, Andrews (or his Company) was to purchase the paint to be used in connection with some unnamed individuals who were somehow involved with negotiating a contract to paint an unnamed hotel in Las Vegas, Nevada, with an unnamed contractor to do the job. Metro was to receive $59.95 per gallon for the first 1,000 gallons of paint, the same price it was supposed to pay respondent. As justification for engaging in the alleged protracted negotiations over a no-profit deal, Paden asserted the hope of eventually receiving from respondent exclusive distribution rights for the paint in Nevada plus the right to purchase 3,000 additional gallons at $12 per gallon.

Paden claims he distrusted the financial ability of those with whom he was dealing and asserts that they did not seem ready to make a commitment. Nevertheless, he alleges that he ordered the paint from respondent, even though he had no other outlet for the paint.[12/]

d. The Attempt at Payment

On March 29, 1982, the day before this hearing began, a writing was executed between Paden and Bruce Anderson, now the respondent's president, in which Paden caused two of his business

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11/ Mr. Andrews is likewise no stranger to the parties involved herein. American Exchange Company owns 1 million shares of Anafuel stock for which it gave its promissory note for $50,000.

12/ The testimony relating to the negotiations over a Las Vegas paint deal is patently incredible.

associates to assign to respondent a deed of trust note on some California land and to convey by deed other California lots, all in payment for the paint sold. The assigned note and the deed are annexed to the writing, together with an appraisal by a related person to Paden that the land was worth more than the indebtedness plus interest. The trust note is executed by two individuals who apparently do not own it, and the deed is not recorded, has no transfer stamp affixed and recites no specific consideration. Respondent offers these documents to show an intent had always existed by Metro to pay for the paint. Why payment, if that were intended, was not made to Wasatch, who owned the account by virtue of the factoring, and made demand of Metro for payment on November 19, 1981 is not explained.

It is concluded that this attempt to show a prior intent by Metro to pay for the paint is patently frivolous.

e. The Accounting Treatment

The operating statement submitted with the third amended registration statement shows no sales for the audited period ending December 13, 1980, and sales totalling $120,891 for the unaudited 8-month period ending August 31, 1981. This latter total includes the $59,950 amount of the purported sale of paint to Metro, or almost half of the total. Further, the last statement shows an offset to gross sales designated "Provision for doubtful accounts (note 11)" in the sum of $59,950. The Note

11 to which it refers is designated "Subsequent Event", and states that subsequent to the balance sheet date a factored account receivable of $53,355 became doubtful because payment was not received during the normal time expected, and that respondent would pursue collection of the account including the promise to commence collection procedures after November 15, 1981.

The matter of the paint sale is also treated in respondent's unaudited balance sheet as of August 31, 1981. There, under the account item "Accounts receivable" there is an offset designated "net of allowance for doubtful accounts of $59,950 (Note 11)". Then on the liabilities side, there appears the item "Notes payable (Note 3)". Note 3 recites that a demand note amounting to $56,453 was payable for a factored account receivable, and referred the reader to the same Note 11.

It is the Division's contention that the amount of respondent's sales are grossly and materially misrepresented by including the Metro deal as a sale. Respondent, on the other hand, argues that there was a bona fide sale, that respondent expected to be paid by Metro, that payment was in fact made, and that the treatment of the transaction as a "doubtful account" as of August 31, together with the descriptive notes adequately describes what had occurred.

If the Metro/Wasatch arrangements actually involved a true sale, then there is room for the argument that the recitals

in the financial statements complied with accounting practices adequate to inform investors of the state of the account. However, the underlying fault is the fact that, as clearly indicated above, a sale of paint from respondent to Metro never occurred nor intended to occur. The entire purport of the arrangements was to obtain some working capital from the factor to be repaid if and when the sale of respondent's stock under the issue contemplated herein would have taken place. Thus, the true state of affairs does not appear in the registration statement, and the total sales amount is grossly inflated.

To this extent it contains both affirmative misrepresentations and factual omissions.

IV. The Anafuel Intrastate Offering

The Statement of Matters also charges that the registration statement does not disclose that the management of registrant had misapplied funds from a Utah intrastate offering by Anafuel, its commonly owned and managed affiliate.

On August 7, 1980, Anafuel (by Ronald Eames) filed a registration with the Utah Securities Commission for the sale within that state of 16 million shares of its common stock at $.05 per share, totalling a maximum of $800,000 with a minimum sale of $300,000.[13/] By September 5, 1980, sales passed the $335,000

13/ After allowing for underwriting commissions, the net proceeds would have amounted to between $680,000 and $255,000.

mark. By October, sales exceeded $665,000.

According to the Utah registration, the net proceeds of the sale were to be used primarily to acquire property for and to construct a plant to manufacture its synthetic fuel. 14/

By October 1, 1980, as hereinbefore shown, the Anafuel management used (and ultimately lost) the sum of $125,000 in order to guarantee a loan to Metro. Subsequently, it advanced as much as $151,570 to pay unspecified "expenses" on behalf of respondent, its commonly-controlled affiliate. It would appear that these substantial expenditures were never authorized in the Utah registration, nor disclosed to the Anafuel stock purchasers, nor did its principals file any amendment to the Utah registration or offering statement with respect thereto.

It is the contention of the Division that the failure by Advanced to disclose in the registration that its management had diverted the Anafuel moneys constitutes a material omission in violation of Section 8(d) of the Securities Act. It argues that disclosure of the misapplication of Anafuel funds would have allowed prospective investors in Advanced to evaluate the integrity of management and the way it resolved conflict of interest situations.

14/ The Anafuel registration also provided for the payment out of the proceeds the sum of $130,000 to Intermountain Energy Corp. for the license to manufacture and sell synthetic fuel. Ronald E. Eames was the principal stockholder of Intermountain.

On the other hand, respondent contends that authority to make these expenditures was a decision approved by the Board of Directors and confirmed by Anafuel stockholders at a regularly scheduled stockholders meeting, [15/] and that, in any event, respondent is not required by Form 18 to disclose every impropriety in its management's past conduct.

While there is evidence indicating that the moneys expended by the Anafuel management on behalf of Metro and of respondent were improperly diverted from moneys raised by the intrastate offering, and very little evidence to the contrary on the part of respondent's officers, the proof is far from conclusive.

There exists a more basic question as to how far beyond what is specifically requested in Form S-18 a registrant must go in searching the past conduct of its officials in order to make its own determination that they had engaged in illegal, questionable or improper conduct that might, if known to prospective investors, influence a decision to invest in the registrant's

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15/ In a letter to stockholders sent November 24, 1980 announcing a meeting for December 16, 1980, the Anafuel management announced "the acquisition of a position in Advanced Chemical, a private company to be underwritten during February or March of 1981."

The minutes of a stockholders meeting on December 16 show that Ronald Eames (President) made up the quorum as owner and/or controller of 51% of the capital stock, that on motion of the Secretary (Barton T. Eames) seconded by the President, and by the voting of shares controlled by management, general approval was given to all management actions. These minutes do not show that whatever stockholders were present were advised of the commonality in the Advanced/Anafuel mangements, nor of the decision to pledge $125,000 to support a loan by a bank to Metro. Hence, it is not at all clear that the stockholders were also approving the latter deal.

endeavors. Conceivably, even conduct not directly related to business activities might be material.

In the last analysis, it is concluded that, absent other factors not apparent herein, only past conduct which resulted in some kind of proceedings based thereon, whether governmental or private, whether before a federal or state court or agency, should be disclosed in the current registration. This conclusion is made not because past misconduct of the type described in this record is not worthy of consideration by a prospective investor, but because it places an unseemly burden on registrants and establishes an uncertain and ill-defined ground for rejecting a registration or seeking a stop order. If such is to be required, it should be set out in the regulations and instructions pertaining to registration statements. The Division points to no specific requirement of this type.

Moreover, to agree with the proposition advanced by the Division would require a full-blown collateral hearing in order to determine how and to what extent there had been a misapplication of funds from a completely different stock issue of another company. Such a hearing was not had here, and the ultimate conclusion must be that a finding of material omission cannot be fairly made on this record.

V. Undisclosed Shareholders

The fifth and final charge in the Statement of Matters is that the registration statement does not disclose all of respondent's principal shareholders and their interests in certain transactions.

Specifically, the Division contends that Glenn Paden, Jr., who controls Metro International, was the holder of more than 5 percent of respondent's outstanding capital stock, and his interest should have been disclosed in the registration statement as required by Item 12(a) of Form S-18. It is further urged that if Paden had such a stock interest, the registration statement should have described it in connection with the reporting of the Metro paint sale and of the transactions surrounding the $125,000 Anafuel certificates of deposit, as required by Item 13 in Form S-18, entitled "Interest of Management and Others in Certain Transactions."

The sole basis for the claim by the Division that Paden was an unreported stockholder is found in a letter dated August 18, 1981 (Exhibit 21), written by Ronald E. Eames on Anafuel stationery to Barton Eames and Byron Negata. The letter was written in response to a request by Negata, who is a stockholder in both Anafuel and respondent, and who was during the relevant periods herein an officer and director of Anafuel to find out what would happen to Anafuel and Advanced if Eames should ever terminate his position with the companies.

The letter purports to outline "the situation concerning any agreements made outside of the standard knowledge of the Board of Directors, as contained in the resolutions". It first describes that in the event of the death of Eames, the distribution of his 12,000,000 shares of Anafuel stock would include 180,000 shares going to Paden, unless Paden had failed to repay "all of his and Metro's loans to the company and to my estate".

With respect to respondent Advanced, the letter states that "Mr. Paden owns 50%"of the inside stock which Eames had received "for services performed". Despite this unequivocal statement of Mr. Paden's stock ownership, the letter goes on to state: "If Glen (sic) has not paid his debts, he shall own no stock."

Mr. Paden denies having any knowledge of the existence of the Eames letter, and denies the existence of any understanding that he has any stock interest in respondent. Mr. Negata, who had requested the letter, understands therefrom (and from prior conversations) that only if Paden paid all of the debts to either Anafuel or Advanced, and liquidated his debt to Eames, would he then own the described stock of Advanced.

There is no other affirmative proof concerning Paden's alleged ownership of Advanced stock. If he in fact owned 50% of all of Eames's shares then he would have owned more than 5

percent of respondent's outstanding and issued shares. 16/ Consequently, had he owned the stock, he should then have been listed as a shareholder and a related party in connection with the paint and certificate transactions.

The Division contends that the bald statement that Paden owned 50% of Eames's stock plus an adverse inference that may be drawn from the failure of Eames to testify concerning the meaning of this letter is sufficient to establish that Paden actually owned the stock.

However, the apparently unequivocal statement by Eames that Paden owns 50% of his shares is surrounded by statements of contingencies and prior conditions with respect to Paden's holding of stock in both respondent and Anafuel as to leave doubts and ambiguities concerning Paden's stock ownership. Although Eames never undertook to explain the contents of his letter, the burden of proof is ultimately upon the Division to establish Paden's stock ownership. Given the present state of the record and the lack of any corroboration of the Division's contentions, it must be concluded that the Division has failed to sustain its burden and that undisclosed stock ownership by Paden has not been proven.

16/ The registration statement shows that Ronald Eames was given 7,506,200 shares for services rendered the company out of a total of 35,000,000 issued and outstanding shares, or more than 21 percent thereof.

DISCUSSION AND CONCLUSIONS

The record herein has established that the involved registration statement (1) incorrectly stated that respondent owned a time certificate of deposit of $125,000 on December 31, 1980, and further misstated the circumstances concerning the ownership and subsequent disposition of the certificate; (2) improperly claimed interest income; and (3) misrepresented the amount of sales made and omitted to state the actual circumstances embracing the claimed sale of almost half of them.

Section 8(d) of the Securities Act requires that in order for misstatements or omissions to result in the issuance of a stop order, they must be of "material" facts. The Commission's Rule 405 to Regulation C (17 CFR 230.405) defines "material" with respect to a requirement for the furnishing of information in registration forms, as "those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."

In the landmark case of TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, the Supreme Court stated with respect to materiality of an omitted fact (at p. 449):

> What the standard (i.e., materiality) does contemplate is a showing of substantial likelihood that, under all the circumstances, the omitted fact would assume actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

The definition of a materiality is the same whether misrepresentation or omission is involved. Kramas v. Security Gas & Oil, Inc., (current) Fed. Sec. L. Rep. (CCH) ¶98,634, (C.A. 9, 1982) at p. 93,141.

Finally, each case must proceed on its own facts in the light of all the information conveyed or available to investors. See S.E.C. v. Shapiro, 494 F.2d 1301, 1306 (C.A. 2, 1974) and S.E.C. v. Geon Industries, Inc., 531 F.2d 39, 47 (C.A. 2, 1976).

Not only must account be taken of how a reasonable investor would evaluate a single piece of information in isolation, but also how one fact relates to all the others available to investors. It is simply a case of the greater including the lesser. Dirks v. S.E.C., (current) Fed. Sec. L. Rep. (CCH) ¶98,669 (C.A.D.C., 1982), at p. 93,345).

In the world of "penny stock" issues where the proposed sale of Advanced stock was consigned, investors are invited to venture in the realm of the highly speculative. Those who choose to seek out this type of investment should and do expect a high degree of risk with the further expectation of a large reward should the speculative enterprise prove successful.

A reading of the prospectus accompanying the involved registration clearly shows that those who would have been called upon to invest in Advanced Chemical were being asked to bet on a "long shot". Thus, they are informed at the very outset in

upper case type that investment in the securities offered involves a high degree of risk and immediate and substantial dilution. This is followed by the advisories that Advanced Chemical is a developmental stage company with no significant operating history, and that those who purchase its securities should be able to sustain a loss. Prospective investors are warned that the manufacture and sale of industrial coatings involves a product which has been tested only on a limited basis, and that the Company's management has had very limited experience in this industry. They are further admonished that the offering price bears no relationship to the actual value of the assets.

The registration and prospectus are replete with similar advisories. With specific reference to the financial statements, respondent's last balance sheet shows a highly unfavorable ratio of current assets to current liabilities at $70,591 for the former and $248,919 for the latter; and that total liabilities of $248,919 far exceed the tangible assets of $81,631. Its operating statement shows a net loss for the 8-month period ending August 31, 1981 of $160,390 on claimed sales of $120,891 (with a claimed non-itemized expenditure for "selling, general and administrative expenses" of $198,113). Accumulated net loss for the entire period of respondent's operations commencing September 17, 1980 amount to an astounding $228,259.

It is within the framework of the gloomy and pessimistic

picture painted by the amended registration (and the prospectus based thereon) that the materiality of the misrepresentations and omissions becomes apparent. In effect, they tend to ameliorate the pessimism otherwise found in the registration. As part of the "total mix," they say to a prospective "penny-stock" investor that, although the stock issue represents a decided risk, here is a company which while still in the development stage, already has had a cash asset in the form of a time certificate of deposit worth $125,000, has investments generating better than $1,700 in interest monthly, and during the 8-month period following the last audited financials has already generated more than $120,000 in sales of an untested product. Even the explanations offered in the amended registrations are distortions, i.e., implying that the certificate was a clear asset, that it was used to reduce debt, that significant interest income was still being earned, and that what was actually a non-existent paint sale was merely a "doubtful account."

Taking into consideration the particular facts in this case, the total of all the information made available and the speculative climate in which the registration statement is laid, it is concluded that a reasonable investor in such issues would attach importance to all of the misrepresentations and omissions found to have occurred herein in determining whether to purchase the security registered. This makes them "material."

Under the circumstances, it necessarily follows that the

public interest as embodied in the provisions of Section 8(d) require that a stop order should issue.

Respondent urges the Administrative Law Judge to direct that the stop order in this case be rescinded and that respondent be permitted to withdraw the registration. It argues that the stock issue involved was never offered for sale, that no solicitations have been made and that the issue has been abandoned. It cites in support the decisions of the Supreme Court in Jones v. S.E.C., 298 U.S. 1, holding that under such circumstances there is virtually an absolute right to withdraw. However, subsequent cases have held that in view of statutory changes, this ruling is no longer persuasive, at least after the effective date of the registration. See Peoples Securities Co. v. S.E.C., 289 F.2d 268 (C.A. 5, 1961). 17/

Respondent further asserts that a stop order is not called for because its principals have not engaged in any wilful disregard of statutory obligations, nor exhibited indifference to truth, nor demonstrated a persistent disposition to defraud. It further advances its "good faith" contention by claiming that reliance was made on professionals, such as its certified public accountants and attorneys in the preparation of the registration

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17/ Official note is taken of the records of this proceeding showing that subsequent to the close of the hearing, respondent had petitioned the Commission for permission to withdraw the registration and that by Order dated July 7, 1982, the request was denied in view of the pendency of these proceedings which preclude a finding before a determination herein that the public interest and the protection of investors permit such withdrawal. See Rule 477 to Regulation C (17 CFR 230.477).

and in the accounting treatment of the challenged items. However, not only does the record show that respondent's principals withheld information or furnished inaccurate information to their advisers, but this defense is irrelevant. As stated by the Commission in Clinton Engines Corporation, 42 SEC 353, 358 (1964):

> Our concern in these stop order proceedings is with the adequacy and the accuracy of the registration statement and not with the guilt or the innocence of those who control the registrant.

Again, the Commission stated in Franchard Corporation, 42 SEC 163, 174 (1964):

> Since public investors are primarily concerned with the accuracy of the registration statement and only secondarily with the question of who might have been at fault in preparing it, our responsibility, at least initially, is directed to the adequacy of the document rather than to the good faith or diligence of those who prepared it. If the registration statement is in fact deficient, we must so find.

Even if the accountant had been following "generally accepted accounting principles", it does not excuse a registration containing material misstatements or omissions. See, S.E.C. v. Seaboard Corp., (current) Fed. Sec. L. Rep. (CCH) ¶98,722 (1982).

Finally, respondent alludes to the "punitive" impact the stop order might have upon respondent's principals and its underwriter, none of whom is a party to this proceeding. 18/

18/ Although, as stated, the underwriter appeared at the outset of the hearing with counsel to enter a stipulation concerning lack of sales, neither it nor the respondent's principals sought to intervene in the proceedings at any time.

Such "severe" punishment is said to consist of the requirement that the principals would have to make self-denigrating confessions in future registration statements, and that the underwriter may be foreclosed from participation in Regulation A underwritings for 5 years pursuant to Rule 252(e)(1) [17 CFR 230.252(e)(1)].

In administrative proceedings, any sanction which might result therefrom is not intended as punishment but only to protect the public interest. Leo Glassman, 46 SEC 206, 211 (1975). It was stated, in Clinton Engines Corporation, supra, at page 360:

> However, the fact that such an order (i.e., a stop order) may have adverse effects upon the registrant is not in itself sufficient to overcome the interest of investors which under the regulatory pattern of the act is served by the entry of the stop order.

In the last analysis, whether or not a stop order should issue does not depend upon such moral questions as guilt or innocence, fraud or scienter, good or bad faith. Section 8(d) is not couched in such terms. The Securities Act relies on public disclosure, and the stop order is the most effective means of warning the investing public that unreliable statements have been filed. See Wolf Corporation v. S.E.C., 317 F.2d 139, 142 (C.A.D.C. 1963); and Clinton Engines Corporation, supra, at p. 361.

The Fifth Circuit has said concerning a stop order, in Columbia General Investment Corp. v. S.E.C., 265 F.2d 559, 564 (1959):

> On the larger scene, the public interest is served because it stands as a deterrent to the filing of registrations by an issuer indifferent to the accuracy or honesty of the statement because he knows that if caught, or nearly caught, or threatened with being caught, or even investigated, he can withdraw the offensive statement at will. As a stop order prevents this, it will indeed promote truth in securities, and that is what Congress intended.

Accordingly, IT IS ORDERED that the effectiveness of the registration statement filed by Advanced Chemical Corporation be, and it hereby is, suspended. 19/

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission pursuant to Rule 17(c), determines on its own initiative to

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19/ In their briefs and arguments, the parties have requested the Administrative Law Judge to make findings of fact and have advanced arguments in support of their respective positions other than those heretofore set forth. All such arguments and expressions of position not specifically discussed herein have been fully considered and the Judge concludes they are without merit, or that further discussion is unnecessary in view of the findings herein.

review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.

Jerome K. Soffer
Administrative Law Judge

Washington, D.C.
September 10, 1982