

ADMINISTRATIVE PROCEEDING
FILE NO. 3-5273

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
EMER-GO CORPORATION :
(24D-3462) :
:

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INITIAL DECISION

Washington, D.C.
MAY 25 1978

Irving Sommer
Administrative Law Judge

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In the Matter of :
EMER-GO CORPORATION : INITIAL DECISION
(24D-3462) :

APPEARANCES: Robert H. Davenport, John E. Jones and
William J. Klein of the Denver Regional
Office of the Commission for the Division
of Corporation Finance.

William V. Stowell, President of Emer-Go
Corporation, for the Issuer.

BEFORE: Irving Sommer, Administrative Law Judge

By order of the Commission dated November 8, 1977 ("Order"), the exemption of Emer-Go Corporation ("Emer-Go" or "Issuer") from the registration requirements of the Securities Act of 1933 ("Securities Act") provided under Regulation A of that Act was temporarily suspended.

The Order charged that Emer-Go's notification, offering circular and sales literature filed under Regulation A^{1/} contained untrue statements of material facts and omitted to state material facts necessary in order to make the statements made in light of the circumstances under which they were made not misleading. In substance, the Order alleged that the offering circular was false and misleading in, among other things, failing to adequately disclose material facts concerning management's limited managerial and technical abilities; the failure to disclose the possible adverse impact on an analysis of potential markets of management's limited experience in marketing; the failure to disclose the possible adverse impact on future profits of royalty payments required to be made and that Emer-Go has not employed an accountant to prepare and maintain its books and records. Allegations were also made that Emer-Go failed to comply with generally accepted accounting principles and practices in preparing its financial reports, and that they failed to set forth what provisions, if any, have been made for the return

of funds to subscribers in the event of an unsuccessful offering, as required by item 6(b) of Schedule I of Form 1-A. It is further alleged that Emer-Go failed to cooperate with the Commission in connection with the processing of the filing in question under which Emer-Go proposed to offer 100,000 shares of its 1¢ par value Class B common stock at \$3 per share, and that the offering, if made, would operate as a fraud upon purchasers in violation of Section 17(a) ^{2/} of the Securities Act.

Emer-Go filed an answer denying the allegations, and a hearing was held pursuant to its request to determine whether to vacate the Order, or to enter an Order permanently suspending the Regulation A exemption. Emer-Go was represented at the hearing by its president, William V. Stowell. Proposed findings of fact and conclusions of law and briefs in support were filed by the parties. The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record.

Securities Act of 1933 and General Rules and Regulations thereunder Section 17(a), as amended, provides:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly -

(1) to employ any device, scheme, or artifice to defraud, or

^{2/} 15 U.S.C. Sec 77 Q(a)

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operated or would operate as a fraud or deceit upon the purchaser.

Rule 261, insofar as here pertinent, provides as follows:

Rule 261 ^{3/} Suspension of Exemption

(a) The Commission may, at any time after the filing of a notification, enter an order temporarily suspending the exemption, if it has reason to believe that -

(1) no exemption is available under this regulation for the securities purported to be offered hereunder or any of the terms or conditions of this regulation have not been complied with, including failure to file any report as required by Rule 260;

(2) the notification, the offering circular or any other sales literature contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;

(3) the offering is being made or would be made in violation of Section 17 of the Act,

* * *

(7) the issuer or any promoter, officer, director or underwriter has failed to cooperate, or has obstructed or refused to permit the making of an investigation by the Commission in connection with any offering made or proposed to be made hereunder.

* * *

ISSUER

Emer-Go Corporation was incorporated on May 3, 1976 under the laws of New Mexico through consolidation for the purpose of manufacturing, designing, buying and selling luggage, and manufacturing of "dual purpose carrying cases" under a license granted by the William Victor Stowell Trust, owner of the patent thereon. The corporation's principal office is located in Huntington Station, New York.

The corporate officers and directors are all members of the Stowell family. William Victor Stowell ("Stowell") is the president, general manager, and chairman of the board. His wife Valerie Constance Stowell is vice-president, treasurer and secretary. Their two sons Craig William Stowell and Brad Victor Stowell are officers and directors.

On July 1, 1976 Emer-Go filed a notification and offering

circular pursuant to Regulation A under the Securities Act for the purpose of obtaining an exemption from the registration requirements of that Act for a proposed offering of 100,000 shares of its 1¢ par value Class B common stock at \$3 per share. Emer-Go was to act as its own underwriter, agreeing to use its best efforts on a "40% or none" basis to find purchasers for that stock.

Misleading Statements in Regulation A Filing

1. Misleading Statements in Risk Factor Section of Offering Circular.

The record clearly demonstrates that Stowell, the president, board chairman and main driving force behind Emer-Go has de minimus experience in the marketing, manufacturing and sales fields. He described himself as "self trained". He has no degrees and attended the "Arts Center College in Los Angeles". His major prior work activity was as a "scientific and technical illustrator". The remaining members of the management group at Emer-Go are Mrs. Valerie Constance Stowell, wife of the president, and their two sons. Mrs. Stowell is a high school graduate, and her prior work experience was in real estate sales and management of a real estate office. Stowell testified she did the typing for Emer-Go.

One of the sons is "trained in heavy equipment" and according to Stowell "extremely adaptable to being trained in the injection molding and vacuum forming", while the other son is a salesman of chemical products.

In short, the entire management team at Emer-Go woefully lacks any modicum of experience in sales, marketing or manufacturing of luggage or any other type of carrying case. Their severe lack of marketing depth is illustrated by the elementary self serving questionnaire distributed at random which allegedly demonstrates the great potential for their product and signals to them its future success. The survey was not conducted by an independent marketing organization and the alleged responses are meaningless considering the shallow research carried out. The elementary caliber of the self serving questions, the groups contacted both orally (among others, a class of grammar school children), and by random mailings, strikingly portrays a survey totally inadequate to demonstrate a need for Emer-Go's products or their acceptability in the world of business. No comprehensive documentary evidence was produced of this survey which potential investors could scrutinize. No potential investor could rely on this cursory unprofessional survey as demonstrative of the need for and sale potential of the products that Emer-Go was to manufacture, and potential investors should have been apprised of the severe shortcomings of the survey. The record shows that Emer-Go is seeking to engage in a speculative venture in which it has no prior experience, a business it has never been engaged in, and has no sales force, manufacturing facilities, and no real market prospects.

It is concluded that Emer-Go's offering circular is materially false and misleading in failing to disclose 1) the extremely limited managerial and technical experience and abilities of the entire management team, (2) the almost total lack of education and training in marketing and marketing research of the entire management team, (3) and that the market survey submitted was not conducted or supervised by an independent marketing organization.

Emer-Go has a license from the William V. Stowell Trust, owner of the patent to produce the carrying cases, and is required to make a \$1 royalty payment to the trust for each item sold. The offering circular is materially misleading in failing to disclose the possible adverse affects on profits by reason of these royalty payments. It is obvious that the extra \$1 - royalty charge on each item sold will lower the profit therein. Emer-Go's contention that this payment is not a "risk to profits" is untenable and demonstrates a fallacious knowledge of accounting principles.

The Division contends that the financial statements filed by the Issuer are inadequate and misleading and "the fact that Emer-Go has not employed an accountant to prepare and keep its books and records" should be shown in the risk section. Stowell's response to this allegation is that there is no requirement that the company do so, and they will provide "audited statements after the public offering is successful".

The record shows that Stowell has no accounting training, no accounting experience and has never made any registration filings similar to this one. The by-laws of Emer-Go dated March 27, 1970 provide for this problem by stating at paragraph eleven that :

"The Vice President and Treasurer shall be the corporate controller and as such will establish good accounting practices initially through the hiring of a public accounting firm to establish, maintain and set up corporate books - - -." However, this by-law was not followed. Instead, Stowell, totally bereft of any accounting training, education or experience kept the books and drafted the financial statements for use by the investing public perusing the offering circular.

Investors reading the offering circular and the by-laws of the corporation would assume that an accounting firm has been engaged to maintain the books and records from which the financial statements flow. One important purpose of the Securities Act of 1933 is to provide an investor proper information prior to his making any investment. Investors are interested in financial statements which adequately disclose the corporate business and financial affairs. The failure of Emer-Go to disclose that it had not employed an accountant either to maintain and keep its books and records, or to prepare the financial statements which are part of the offering circular renders the offering circular misleading.

Item 6(b) of Schedule I

Item 6(b) calls for a statement describing the arrangement, if any, for the return of funds to subscribers if all of the securities are not sold. In answer to this item Emer-Go set forth on the cover page of its proposed offering circular in tabular form minimum-maximum data (total minimum -\$120,000, total maximum - \$300,000). On page two of the offering circular is the following statement: "- - A potential investor should realize the Company has full intention of continuing the offering until its successful conclusion and all proceeds will be used by the Company for the purposes and on the priorities as shown in Use of Proceeds, however, there is no provision for the return of proceeds, unless the company were to file for liquidation which is a legal procedure". These statements are inconsistent and materially misleading, in that an investor could reasonably be lulled into thinking that a minimum amount of sales was necessary to make the offering effective when in fact any amount of money received by Emer-Go was to be retained, with no return of proceeds. In my opinion, regard for the interests of investors required full and clear disclosure of the specific amount of stock required to be sold, and of arrangements for return of funds under those circumstances.

Financial Statements

The financial information provided in the offering circular was materially misleading due to the improper classification of corporate assets. The Issuer's balance sheet submitted with the May 1977, June 1977, and August 1977 amendments reported over \$100,000 as inventory under the current asset classification, when in fact these sums represented a composite of research and development costs, organization expenses, jigs and tooling costs etc, which under generally accepted accounting principles belonged in various categories such as fixed assets, other assets or in an expense account entirely.

"The failure to break down this item on the balance sheet into its component parts results in concealing from the view of investors matters of relevancy to the worth and nature of the underlying assets." ^{4/}

Similarly deficient is the information set forth in a footnote to the balance sheet as of June 30, 1977 under the heading "Non Cash Considerations" totalling \$107,633. This item is not reconciled to any items listed in the action of the balance sheet.

The failure of the Issuer to comply with generally accepted accounting principles resulted in misleading financial statements which did not adequately and fully disclose the nature of corporate assets.

^{4/} Yumuri Jute Mills Company, 2 S.E.C. 81, 87 (1937)

The Order also charged that patent amortization costs (research and development etc.) were improperly classified as assets instead of expenses resulting in an overstatement of assets in the balance sheet by \$600,000.(Paragraph II A2(c)) However, the Division's reply brief urges a completely opposite opinion regarding this item, stating that since Emer-Go possesses only a license to produce the articles on payment of royalties, it has no intangible assets. I agree with this interpretation.

The agreement between William Victor Stowell and Emer-Go dated January 26, 1971 states, "I, William Victor Stowell, sole investor of United States Patent 3,557,916, hereby assigns sole licensing rights of manufacture and distribution, of any product manufactured from said patent to the Emer-Go Corporation - - -", in exchange for royalty payment on each article manufactured and sold. The Corporation is a mere licensee with authority to produce the patented article based on payment of royalties for each item manufactured and sold.

"Royalty and license contracts granted under patents and copyrights are not usually recognized formally in the accounts of the persons to whom the rights are granted. Fees of attorneys for drafting the contracts may be capitalized, but in practice minor amounts are charged to expense. If an assignment of royalty and license agreements is obtained for a consideration, the cost of obtaining the assignment may be capitalized." 5/

There is no evidence of record that Emer-Go paid any sum of money for the license agreement, but rather royalty payments would be made based on future sales. Under generally accepted accounting principles Emer-Go has no intangible assets or expenses relating to the patent research and development stage. Had this been charged in the Order, it would have warranted findings adverse to the Issue. However, the Division did not do so, and the Issuer has not had adequate notice that it would have to meet this contention. Hence, as to the financial irregularity charged in paragraph II A2(c) of the Order, I make no findings.

Events Since Notice of Order Temporarily Suspending Exemption

The respondent's answer dated December 7, 1977 to the Commission's Order of Temporary Suspension contains financial statements dated November 30, 1977. While not formally requesting that such statements be accepted in lieu of the previous filings, it is apparent that by submitting them the Issuer impliedly requests their acceptance. The Division opposes any such consideration in view of the apparent deficiencies therein. Although the financial statements show some changes have been made, many material deficiencies remain. Specifically, there are two balance sheets with different valuations, statements of change in financial position is incomplete and inaccurate, and Emer-Go fails to comply with generally accepted accounting principles in preparation of its financial statements. An examination of these statements shows serious deficiencies, and as such it would not be in the best interests of investors and the public to consider the financial statements submitted with the answer filed by Emer-Go.

Omission of Required Financial Statements

Although the response to item 2(a) of the notification as amended names William Victor Stowell as predecessor of Emer-Go, a financial statement of Stowell as a predecessor was not submitted with the filing as required by item 11 of Schedule I under Regulation A. In view of the requirements under Regulation A that financial statements of predecessors be included in the offering circular, it follows that the omission of such a statement that the offering circular does not meet the terms and conditions of Regulation A.

Failure to Cooperate

The record establishes that the Denver Regional office of the Commission sent eleven comment letters to the Issuer between July 16, 1976 and August 3, 1977 seeking additional information and clarification of statements set forth in Emer-Go's filings. Moreover, because of the absolute ignorance of Stowell as to accounting principles, basic knowledge of legal principles, and the forms required to adequately compile a notification and offering circular in connection with a Regulation A offering, the Denver office via personal calls and extensive comment letters attempted to guide the Issuer, all to no avail. Stowell made changes grudgingly, filing seven amendments based on Regional office suggestions. However, his filings continued to be materially deficient. In order to further assist Stowell a personal meeting was arranged between Commission personnel and Mr. and Mrs. Stowell

at the New York Regional office on July 19, 1977. Mr. Cappellini, a staff accountant who represented the Commission at the conference, testified that an attempt to discuss improper classification of Inventories on the Emer-Go balance sheet ended in failure with Mr. Stowell stating, "if we required him to change this item from the current assets section, that he would take us to court, that he would not do it --." Mr. Cappellini stated that Stowell thereupon abruptly terminated the conference and left. Mr. Stowell testified that when he left he asked for written specifications of errors in his financial statements. However, the personal contact was arranged because despite numerous comment letters and suggestions the Issuer continued to issue financial statements utterly lacking in fundamental accounting principles and obviously incomplete. The failure of the Issuer to appropriately respond to the repeated and proper requests of the Denver Regional office must be viewed as an obdurate refusal to comply with those requests and a failure to cooperate.

Section 17(a) of the Securities Act

As found above the offering circular is materially misleading, includes untrue statements of material facts and omits required material information. Additionally the financial statements filed are materially misleading, and have not been prepared in accordance with generally accepted accounting principles. The use of the offering circular in connection with the offer or sale of Emer-Go's

Common Stock therefore would operate as a fraud and deceit upon purchasers in violation of Section 17(a) of the Securities Act.

Suspension of the Regulation A Exemption

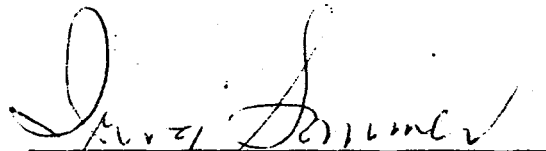
The exemption under Regulation A is conditional and its availability dependent upon compliance with the specific provisions and standards laid down by the provisions of that regulation. In view of the findings that the Emer-Go offering circular was false and misleading, that the terms and conditions of Regulation A were not complied with, and that the offering was made in violation of Section 17(a) of the Securities Act, it is concluded that the exemption of Regulation A should be permanently suspended. ^{6/}

Accordingly, IT IS ORDERED, pursuant to Rule 261 of Regulation A under the Securities Act of 1933, that the exemption of Emer-Go Corporation, under Regulation A be, and it hereby is, permanently suspended.

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

^{6/} All proposed findings and conclusions submitted by the parties have been considered, as have their conclusions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

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


Irving Sommer
Administrative Law Judge

Washington, D.C.
May 25, 1978