ADMINISTRATIVE PROCEEDING
FILE NO. 3-4669

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

U. S. SECURITIES & EXCHANGE COMMISSION
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In the Matter of	:
INVESTORS RESEARCH CORPORATION	:
MULLANEY, WELLS AND COMPANY	:
JAMES E. STOWERS	:
RICHARD H. DRIEHAUS	:
	:

JUL 22 1976
U.S. SECURITIES AND EXCHANGE COMMISSION

Initial Decision

July 19, 1976
Washington, D.C.

Ralph Hunter Tracy
Administrative Law Judge

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MULLANEY, WELLS & COMPANY (8-1967)	:	INITIAL DECISION
JAMES E. STOWERS	:	
RICHARD H. DRIEHAUS	:	
	:	

APPEARANCES: Paul B. O'Kelly and Max M. Luck, Attorneys of the Chicago Office of the Commission for the Division of Enforcement.

Irving Kuraner for Investors Research Corporation and James E. Stowers.

Philip N. Smith, Jr., for Richard H. Driehaus.

Pope, Ballard & Fowle for Mullaney, Wells & Company.

BEFORE: Ralph Hunter Tracy, Administrative Law Judge

This is a public proceeding instituted by Commission Order (Order) dated April 22, 1975, pursuant to Sections 15(b), 15A, and 19(a) of the Securities Exchange Act of 1934 (Exchange Act), Section 9(b) of the Investment Company Act of 1940 (Investment Company Act), and Sections 203(e) and (f) of the Investment Advisers Act of 1940 (Advisers Act), to determine whether the above-named respondents,[1/] committed various charged violations of the Securities Act of 1933 (Securities Act), the Exchange Act, the Investment Company Act and the Advisers Act and regulations thereunder, as alleged by the Division of Enforcement (Division), and the remedial action, if any, that might be appropriate in the public interest.

The remaining respondents in this proceeding, Investors Research Corporation (Research), James E. Stowers (Stowers), Richard Driehaus (Driehaus) and Mullaney, Wells & Company (Mullaney, Wells) were represented by counsel throughout the proceeding. Proposed findings of fact and conclusions of law and supporting brief were filed on behalf of all of the parties except Mullaney, Wells.[2/]

The findings and conclusions herein are based upon the preponderance of the evidence as determined from the record and upon observation of the witnesses.

1/ The Commission has accepted an offer of settlement from Olde and Company, Inc., and imposed remedial sanctions, Exchange Act Release No. 11952/December 24, 1975.

2/ Mullaney, Wells' counsel during the course of the hearing withdrew at its conclusion and was replaced by other counsel who subsequently withdrew, also. No findings of fact, conclusions of law or supporting brief have been filed by or on behalf of Mullaney, Wells.

The Order alleges, in substance, that the remaining respondents in this proceeding, Investors Research Corporation (Research), Mullaney, Wells & Company, (Mullaney, Wells), James E. Stowers (Stowers) and Richard H. Driehaus, (Driehaus), wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; that Research wilfully violated and Mullaney, Wells, Stowers and Driehaus wilfully aided and abetted violations of Section 206 of the Advisers Act; that Mullaney, Wells and Olde wilfully violated and Driehaus wilfully aided and abetted violations of Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder; and that Research and Stowers wilfully violated and Mullaney, Wells, Driehaus and Stowers wilfully aided and abetted violations of Section 17(e) of the Investment Company Act.

FINDINGS OF FACT AND LAW

Respondents

Investors Research Corporation (Research), a Delaware corporation with its principal place of business at 605 West 47th Street, Kansas City, Missouri, has been registered with this Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act since December 14, 1971. Research is and has been the investment adviser of Twentieth Century Investors, Inc., (Fund), a fully managed open end diversified investment company which has been registered with this Commission as an investment company pursuant to Section 8 of the Investment Company Act since May 28, 1958. Fund issues two classes of shares,Income and Growth.

James E. Stowers (Stowers) has AB and BS degrees from the University of Missouri, and attended the University of Iowa Medical School for 2 years until 1951. In 1952 he became a sales representative for Waddell and Reed, principal underwriter for the United Funds Group of mutual funds, continuing in that capacity until 1956. In 1956 Stowers formed J. E. Stowers & Company, a registered broker-dealer limited to the sale of mutual funds. In the same year he formed Survivors Benefit Insurance Company. Since 1957 he has been president, a director and owner of 66% of the common stock of Research. He is president of Fund and makes all of its investment decisions.

Richard H. Driehaus has B.S. and M.B.A. degrees from DePaul University and has been in the securities business since 1965. He was with Rothschild from June 1965 until the spring of 1968, when he went to A. G. Becker where he was a stock broker and engaged in research and money management. He was assistant vice president when he left in July 1973 to join Mullaney, Wells, where, in August 1973 he became Director of Research and shortly thereafter a director of the firm. By the spring of 1974 he had acquired a 12-15% equity interest in Mullaney, Wells. On August 12, 1974, Olde took over Mullaney, Wells' accounts and, at the same time, Driehaus joined Olde as Director of Research and a director of Olde.

Mullaney, Wells, located in Chicago, Illinois, has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since June 8, 1938. Mullaney, Wells filed a notice of withdrawal of its registration on Form BDW on January 20, 1975, but this was

withdrawn on March 4, 1975, and its registration remains in effect. On or about August 12, 1974, Olde acquired the customer accounts and certain of the assets and liabilities of Mullaney, Wells which ceased doing business at that time. Olde, whose principal place of business is in Detroit, Michigan, has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since October 28, 1971.

Background

James E. Stowers (Stowers) organized James E. Stowers & Co., (JESCO) in 1956; Survivors Benefit Insurance Co. in 1957; Twentieth Century Investors, Inc., (Fund) in 1957; and Investors Research Corp. (Research) in 1958. He is the president, principal stockholder and a director of JESCO and Research. Fund began offering shares to the public in 1958, and JESCO and its wholly owned subsidiary, Plaza Securities Corp. (Plaza) are the distributors of the Fund shares. As agents, JESCO offers the shares to the public through its own sales organization and Plaza offers the shares through securities dealers. All of the companies occupy a common office at 605 West 47th Street, Kansas City, Missouri.

Stowers, as president of Research, has been portfolio manager of Fund since late 1970. When Stowers took over the portfolio the Fund's business was being placed with numerous brokerage firms. However, Stowers gradually came to rely almost entirely on investment suggestions from Driehaus and, as a result, began placing more and more of the Fund's business with him and the firms he was with, A. G. Becker, Mullaney, Wells, and Olde, as shown in the following schedule:

Year	Total Commission Dollars	Broker	% Total Commission Dollars	Principal Transactions	% Principal Transactions
1971	$310,934	A.G. Becker	47.9%	$3,616,734	75.3%
1972	256,702	A.G. Becker	93.1	13,456,259	76.7
1973 (Prior to 1 August 1973)	146,872	A.G. Becker	95.0	3,276,625	86.5
(Subsequent to 1 August 1973)	170,057	Mullaney, Wells	97.6	1,558,450	100.0
1974	252,407	Mullaney, Wells and Olde	100.0	2,156,801	99.1

Over a period of time Stowers, in consultation with Driehaus, worked out certain criteria for determining the selection of securities for Fund's portfolio. However, the identification of candidates for acquisition (or disposition) by the Fund required a great deal of work which, when done manually, proved to be monumental. It was impossible to examine many securities because of the time involved and although by 1972 Stowers believed that his method of analysis worked he felt that he was missing many stocks because of the cumbersome method of reviewing them. He felt that in order to secure and analyze the information faster a computer would be helpful. Accordingly, in the spring of 1972 he ordered an IBM system for delivery in 1973.

Stowers undertook the job of programming the computer and this was completed in June or July 1973. The first data that went into the computer covered about 2600 stocks. The data bank in the computer is now up to about

6500 stocks. The hardware for the computer included a display station at Stowers' desk in Kansas City and one at Driehaus' desk in Chicago. When the information is fed into the computer the computer immediately updates the data base, and analyzes the information and displays it on a display station. Thus Stowers and Driehaus could examine the same companies simultaneously on their respective display stations and discuss the advisability of investment on the telephone at the same time. This was a tremendous improvement over having to do all the work manually.

Once the computer was ready for operation in the spring of 1973 Stowers told Driehaus that while he was willing to provide his time, energy and expertise to the computer, he felt that someone else who believed that the information was useful would have to pick up the cost of the computer. By July 1973 Stowers had paid $15,000 to IBM in development costs and he wished to recoup this plus $6,000 a month for operating costs. Although Driehaus had initially not been enthusiastic about the computer he assisted Stowers in his efforts to sell it to A. G. Becker (Becker) his employer. Becker chose not to purchase the service as did Chicago Corporation. Driehaus then sought employment with Mullaney, Wells and Stowers asked him to help sell the computer to Mullaney, Wells. Stowers told prospective purchasers that he would do business with Driehaus regardless of who purchased the computer because of his experience and the quality of his ideas and suggestions.

In July 1973 John A. Kieft (Kieft), Executive Vice President and a

director of Mullaney, Wells visited Stowers in Kansas City for a demonstration of the system and on August 1, 1973 Research and Mullaney, Wells signed an agreement whereby Mullaney, Wells would pay $15,000 to Research and $6,000 per month beginning August 1, 1973 for the use of the computer system. The agreement provided that Research would furnish to Mullaney, Wells one display station and supporting equipment installed and ready to utilize the program developed by Research and operated from its premises in Kansas City, Missouri.

In early August 1973, Driehaus became Director of Research at Mullaney, Wells, having joined Mullaney, Wells upon its decision to purchase the computer sevice. Shortly after August 1, 1973 Stowers began directing virtually all fund portfolio business to Mullaney, Wells and Fund became its largest account. From then until October 1975 Mullaney, Wells and its successor, Olde, received almost 100% of Fund business.

In late 1973 Mullaney, Wells' financial condition became precarious, its net capital position declined to a 15 to 1 ratio and it was forced to institute a number of cost-cutting prodecures. However, it continued to use the computer system and to pay the $6,000 a month.

On or about August 12, 1974, Olde took over Mullaney, Wells' accounts and assumed certain of its assets and liabilities, including the computer service purchasing agreement.

The computer hardware used in this system is leased from Maryland National Leasing Corporation, an unaffiliated company, and IBM. The lessees are JESCO, and an unaffiliated garment company, Stearns, Slegman, Prinz.

A company called Softwear System and Management Company Inc. runs the system for the garment company and Research. Research also agreed Mullaney, Wells could sell the display station service to other brokers and institutions for $7500 in commission business and Mullaney, Wells would then pay Research $2,000 a month for each such installation. Mullaney, Wells apparently made no serious effort to sell the system but did propose to hire some one for that purpose. However, Stowers dissuaded them saying he could demonstrate it better himself. Accordingly, he purchased a GMC motor home in March 1974 and equipped it with a display station. He made several trips with the motor home in an attempt to sell the system to institutions but was not successful.

VIOLATIONS

Section 17(e) of the Investment Company Act

The Order charges that during the period from about August 1, 1973, to April 22, 1975 (the date of the Order) Research and Stowers wilfully violated and Mullaney, Wells, Olde, Driehaus and Stowers wilfully aided and abetted violations of Section 17(e) of the Investment Company Act [3/] in that Research and Stowers, acting as agents, accepted compensation (other than regular salaries or wages from Fund) for the purchase and sale of property to and from Fund, not in the course of their business as underwriters or brokers.

Research is contractually obligated to provide Fund with investment management for which it receives a fee based on Fund's assets. For Income Fund the fee is .5 of 1%. However, in the case of Growth Fund there is a sliding scale premium, depending on success, ranging from a minimum of .3 of 1% to a maximum of .7 of 1%. In this connection, Stowers believes that the computer service is needed to provide Fund with proper management; Stowers and Research, therefore, personally benefit to the extent they are able to pay expenses incurred in managing Fund (i.e. computer costs) with fees received from subleasing the computer to other brokers rather than paying such computer costs out of the management fee. To

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3/ Section 17(e)(1) of the Investment Company Act makes it unlawful for, among others, any affiliated person of a registered investment company "... acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker..."

the extent that computer leasing fees represent a return of commissions and profits generated by Fund, Stowers and Research are benefiting from the purchase and sale of property to and from Fund.

Once the agreement to purchase the computer had been executed and Driehaus had entered its employ, Mullaney, Wells began receiving practically all of Fund's portfolio business as shown in the chart on page 5, supra. In return Mullaney, Wells paid Research $6,000 a month for the computer service. Driehaus became Director of Research at Mullaney, Wells, was allowed to purchase an equity interest of up to 12-15 percent, and became a director of the firm. On August 12, 1974, when Olde acquired Mullaney, Wells' customer accounts Stowers then directed all of the Fund's portfolio business to Olde and Driehaus became an Olde employee, continuing to service Fund's account and to share in the commissions and profits generated by it.

Reciprocity, or "doing business with people who do business with you" is an accepted custom of the business world in general, and the securities industry is no exception. In the mutual fund industry, however, it takes on a unique characteristic. While it is the mutual funds themselves whose portfolio transactions generate the brokerage which provides the currency of reciprocity, the principal beneficiaries are not the funds but their investment advisers and principal underwriters.[4/]

4/ Report of Special Study of Securities Markets, (1963), Part IV, p. 233. Hereinafter referred to as Special Study.

Respondents strongly deny that the instant case is one of reciprocity. Stowers testified that he never promised Fund brokerage business to anybody for buying the computer, or threatened to take it away because the computer was not purchased. Stowers testified that Mullaney, Wells was interested in the computer because they wanted to develop their own research organization and the computer would be a fantastic tool for increasing its staff; it would help Mullaney, Wells to be known as the company with investment ideas and that would bring in business from other funds and institutions.

During the period from August 1, 1973 to September 31, 1975, Research received directly and Stowers received indirectly, by reason of his 66% ownership of Research, $171,000 in computer service payments from Mullaney, Wells and Olde. Respondents claim that the entire amount of these payments was for value received from the computer service and were in no part compensation for directing Fund portfolio business to Mullaney, Wells and Olde. The fact is, however, that every dollar received by Research as a result of subleasing to Mullaney, Wells was reimbursement for leasing fees it admitted, that in its opinion, it had to incur in order to properly manage the Fund. Further, the record establishes that in order to reduce expenses by this method Research and Stowers directed all of Fund's business to Mullaney, Wells without concern for the interest of Fund in obtaining best execution. These conclusions are supported by the fact that Mullaney, Wells, which had the right to sell a portion of the service to other broker-dealers,

was unable to interest anyone in purchasing the service. Stowers, who equipped a GMC motor home with the computer system and made a concerted sales effort travelling many thousands of miles, was unable to find a single firm or institution willing to purchase the service. In addition, despite the expectations expressed by Mullaney, Wells as to what the service would do for its business, the fact is that it suffered such severe financial losses that it was forced to cease doing business and to have its customer's accounts taken over by Olde.

Olde, in turn, was undoubtedly influenced to take over the computer agreement because of the hundreds of thousands of dollars in brokerage commissions and the millions of dollars in principal transactions which Stowers could direct to it.

Respondents contend that the sole beneficiaries of the computer are the Fund and its shareholders, and Driehaus. There is no doubt that Driehaus benefited as will be discussed later herein. With respect to Fund they rely on evidence introduced through an expert witness which shows that for the period from December, 1967 through June, 1972 Fund's performance was quite poor, ranking among the bottom 5% of mutual funds, and that from June 1971 to July 1975 its performance showed marked improvement. They point out that between January 1, 1975 and May 31, 1975, Fund was the subject of favorable comment in the mutual fund industry. A mutual fund publication, Agressive Growth Funds listed Fund's Growth in its Report for February 1975 as a "Fund Under Observation" and described it as outstanding. It was also listed as the best performer among similar mutual

funds for February and April 1975. On May 5, 1975, after the Commission's Order became public, Fund attached a sticker to its prospectus describing the proceeding. In its June, 1975, Report, Agressive Growth Funds deleted Growth from a "Fund Under Observation" because of "the cloud produced by this investigation."

In addition, respondents point out that during the first part of the period described above, from January through March, sales were minimal, hovering around $20,000 a month; that in April they improved to almost $89,000 and in May and June skyrocketed to $698,000 and $591,000 respectively. In July, August and September, following notice of the Commission's action, Fund sales dropped off to $192,000, $156,000 and $42,000 respectively.

The improvement of Fund's position in relation to similar funds and the increase in the sale of its shares to the public did not justify additional payment to Research by Mullaney, Wells and Olde in return for Fund's business. The former could be due to fortuitous circumstances and the latter to the favorable Reports. In any event, Research was being compensated by fees which could only increase when Fund's asset value accelerated.

The Commission has recently commented on the very practice at issue here. In Exchange Act Release No. 12251/March 24, 1976, it said:

> The Securities and Exchange Commission today called attention to practices that appear to be developing in the payment of brokerage commissions by fiduciary money managers. Those practices generally involve the payment to brokers of commissions, which are charged to the beneficiaries' accounts, to acquire brokerage services and, in addition, to pay fiduciaries' bills for, or

> otherwise provide fiduciaries with, products and services which are readily and customarily available and offered to the general public on a commercial basis. Specifically, in recent months, there appear to have been an increasing number of arrangements under which fiduciaries have been procuring, among other things newspapers, magazines and periodicals, directories, computer facilities and software, government publications, electronic calculators, quotation equipment, office equipment, airline tickets, office furniture and business supplies and causing brokers to pay the bills for such products.
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> * * * *
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> Since some of the practices and arrangements which have been brought to the Commission's attention may constitute fraudulent acts and practices by fiduciaries, brokers should recognize that their compliance with any direction or suggestion by a fiduciary which would appear to involve a violation of the fiduciary's duty to its beneficiaries could implicate them in a course of conduct violating the anti-fraud provisions of the federal securities laws. (Emphasis added)

Research, as adviser to Fund and Stowers as an officer and director of Fund, were both affiliates of Fund 5/ and were acting as agents for Fund in the purchase and sale of Fund property when placing Fund orders with Mullaney, Wells and Olde. 6/ Research directly and Stowers indirectly, accepted compensation from Mullaney, Wells and Olde, in the form of payment for a research service which was all or in part payment for directing Fund portfolio business to those broker-dealers. This was an impermissable form of compensation and a violation of Section 17(e)(1) of the Investment

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5/ Section 2(a)(3)(E) of the Investment Company Act states, " 'Affiliated person' of another person means...if such other person is an investment company, any investment adviser thereof...." Section 2(a)(3)(D) of the Investment Company Act states, " 'Affiliated person' of another person means....any officer, director...or employee of such other person...."

6/ U.S. v. Deutsch, 541 F. 2d 98, 109 (C.A.2, 1971), cert. den. 404 U.S. 1019; Winfield & Co., Inc., et al, 44 S.E.C. 810, 815 (1972); Consumer-Investment Planning Corp. et al, 43 S.E.C. 1096, 1100 (1969); Provident Management Corporation et al, 44 S.E.C. 442, 448 (1970).

Company Act by Research and Stowers.[7/] The fact that the payments were ostensibly for "computer service" makes no difference. In other cases the Commission has found a violation of Section 17(e)(1) when it determined that, despite the purported reason for the payment it was, in actuality, for the placement of fund portfolio business.[8/]

It is found that Research and Stowers wilfully violated Section 17(e)(1) of the Investment Company Act and that Mullaney, Wells, and Driehaus wilfully aided and abetted such violations.[9/]

7/ Winfield & Co., Inc.; Provident Management Corporation; Consumer Investor Planning Corp., et al.,note 6 above; Financial Programs, Inc., Exchange Act Release No. 9030/November 30, 1970.

8/ Winfield & Co., Inc., note 6 above.

9/ Winfield & Co., Inc., note 6 above; Dishy, Easton & Co., et al., Exchange Act Release No. 8702/September 23, 1969.

Anti-Fraud Provisions

The Order charges that during the period from August 1, 1973 to April 22, 1975 (the date of the Order), Research, Mullaney, Wells, Stowers and Driehaus wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act[10/] and Rule 10b-5 thereunder and Section 206 of the Advisers Act by effecting transactions in certain over-the-counter stocks purchased and sold from and to Fund, directly and indirectly, and in connection therewith obtained money and property by means of untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and, engaged in transactions, acts, practices and a course of business which operated as a fraud and deceit upon Fund and its shareholders. As part of this conduct and activity respondents, among other things, charged prices not reasonably related to the prevailing market price or to their contemporaneous cost; and made false and misleading statements of material facts and omitted to state material facts concerning the securing of favorable prices and executions on Fund portfolio transactions.[11/]

10/ Section 10(b) as here pertinent makes it unlawful for any person to use or employ in connection with the purchase or sale of a security any manipulative device or contrivance in contravention of rules and regulations of the Commission prescribed thereunder. Rule 10b-5 defines manipulative or deceptive devices by making it unlawful for any persons in such connection: "(1) to employ any device, scheme, or artifice to defraud, (2) to make any untrue statement of a material fact or to omit 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 act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . ." Sections 17(a) and 206 contain analogous antifraud provisions.

11/ Some of the charges listed under the anti-fraud section of the Order duplicate conduct charged under other sections and, therefore,have been considered under those sections.

Stowers testified that when he became portfolio manager in late 1970 he placed most of his orders on an agency basis. He preferred to give the broker-dealer the order and let him fight it out with the market-makers and get the best price for the Fund. However, he stated that in 1971 and 1972 the Commission's staff in both Washington and Chicago put pressure on him to do the OTC business with principal market-makers. Accordingly, he testified, he instructed A. G. Becker to do enough business as a principal market-maker to satisfy the SEC. In 1973 when Driehaus went to Mullaney, Wells and the Fund business was directed there, Stowers gave Kieft of that firm the same instructions. Stowers told Kieft to get the best price and execution and informed him of his controversy with the Commission staff over agency versus market-maker transactions. Because of this he was sure that the SEC would check the Fund's transactions and he wanted Mullaney, Wells to be able to substantiate everything that was done.

There appears to be, at best, a misunderstanding on the part of respondents concerning market-maker transactions. In Report on Public Policy [12/] it is stated, at page 179:

> If great care must be taken to obtain the best possible prices when commissions are not subject to negotiation, vigilance should be doubled when executing orders on which commissions are not fixed by an exchange and profits and prices are not fixed by an agreement or by a prospectus. Prices, profits, and commissions, if any, are all subject to negotiations in the over-the-counter markets. Certain brokers maintain a market in a limited number of stocks. They are considered to be the 'primary market' and ordinarily the best prices can be obtained from them. Therefore, if an investment company should ask a dealer who does not maintain a primary market to execute an order for an over-the-counter security, a second profit or commission would be added to the price that could have been secured in the primary market itself.

12/ Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth. (1966)

In other words, the Commission's position is that quite often in OTC situations the best price can be obtained by going to competing brokers who are making a market in a security and taking advantage of the competition to get the best price. It does not mean a broker should go into the market as a so-called market-maker for the express purpose of either buying or selling a particular security as was done here. In that case the broker enters a higher bid than the market-makers in order to attract sellers and a lower offer to attract buyers which results in the customer paying more or getting less.

The Special Study says, Part 2, p. 611:

> It is important to recognize the difference between a broker-dealer executing as principal in a riskless transaction and the market-maker who also acts as a principal. While both may execute on a principal basis, the function of the former is limited to execution of the order, and in essence performing the function of a broker from which his undisclosed markup is a service charge. The market-maker, on the other hand, in addition to executing the transaction, provides marketability by assuming the risk of taking positions.

Following consultation with Driehaus, Stowers, as president of Research, made all of the decisions to purchase or sell securities for Fund's account and telephoned his orders to Driehaus who had discretion to execute them as he saw fit, either on an agency or principal basis. The record shows that during the period from August 1, 1973 to November 1974, Driehaus executed 38 Fund orders involving 18 over-the-counter (OTC) stocks on a principal basis involving no risk. In these instances after receiving specific orders to purchase or sell securities he bought or sold at the market but did not resell or bill out to the Fund until, in

some cases, 14 days after such purchase or sale and at the market price then prevailing.

In the meantime the stock had risen (or fallen) in price and it was then billed to Fund at the "market price" for the day of billing. For example, in one instance Fund placed an order for 3,000 shares on September 25, 1973, the shares were accumulated at prices ranging from 43 1/4 to 44 1/4, and then billed to Fund on October 2, 1973, at 47 1/4. This practice resulted in the Fund paying excessive markups or markdowns, and, accordingly, not getting best execution.

Driehaus testified that he delayed execution of offsetting trades with Fund in order to give Fund an "average price". Normally, a dealer, who after receiving a customer's order for a security, accumulates a corresponding inventory position in that security and then executes an offsetting trade with its customer engages in a "riskless" transaction. It assumes none of the risks of ownership normally attendant to maintaining such an inventory position.

Driehaus, after receiving Fund orders, was able to accumulate and maintain inventory positions in anticipation of favorable price movements with little or no risk. Such favorable price movements could be reasonably anticipated in most cases because of a thin market in the stock and the activity generated by the volume of purchases or sales made by Driehaus for Fund. When favorable price movements occurred, as in the majority of cases they did, they were reflected in the price Fund was charged.

Evidence in the record shows that, based on the method of execution and pricing used by Driehaus while at Mullaney, Wells and Olde, as described above, Fund was overcharged $93,634.60 in transactions involving the 18 OTC stocks examined for the pertinent period.

Respondents claim that the transaction executed in the 18 securities referred to above, on a principal market-maker basis resulted in an overall average markup of 4.1%, which, they argue, is not excessive under NASD regulations and prior Commission decisions. The Division, while not claiming that every markup or markdown may have been excessive, points out that they should be examined on an individual basis and the reasonableness of the execution of each Fund order must be considered on its own merits. At least one of the markups here ran as high as 24% and 9 of the 18 exceeded 5%.

In <u>Trost & Company, Inc.</u>, 12 S.E.C. 531, 535 (1942), the Commission stated that a violation of the anti-fraud provisions exists "when unreasonable prices are charged in individual transactions... (and) a dealer may (not) avoid the onus which attaches to the practice of gouging customers in individual transactions by pointing to the over-all percentage of profits he has extracted." See, also: <u>Wm. Harrison Keller, Jr.</u>, 38 S.E.C. 900, 906 (1959).

That Driehaus was aware that he was improperly executing Fund orders is illustrated by a transaction involving 1,700 shares of Valmont stock. On November 22, 1974, Driehaus called Stowers and told him that he had 1,700

shares of Valmont which he had purchased sometime previously at $13 or $13.50 per share to fill a Fund order. Somehow, according to Driehaus, those shares had been overlooked and the price had risen to $20-3/8 while they were held in inventory. Driehaus offered the 1,700 shares to Stowers at $13.50 per share and he accepted. This transaction in which Driehaus allowed Fund to profit is in sharp contrast to his other transactions to which he testified that, "It was my understanding that you always bill out at the prevailing market. I believe to do anything else is in violation of the NASD rule." It appears more than coincidental that Driehaus in this instance did not bill out at the prevailing market but allowed Fund to acquire the profit. The record indicates that Driehaus' action was motivated by the appearance of a Commission inspection team at Fund's offices on November 22, 1974, questioning the manner in which certain Fund orders executed on a principal basis were being handled. Therefore, Driehaus sold the shares to Fund at his cost rather than at the current market. This exception in the manner of executing Fund orders at a time when such executions were being examined indicates an awareness by Driehaus that his previously described method of handling principal transactions for Fund were violative of his duty to secure best price and execution.

Stowers contends, also, that Mullaney, Wells charged Fund $57,701.52 less than it was justified in charging. This conclusion is reached by comparing the prices Fund actually was charged to the average prices Mullaney, Wells actually paid or received plus or minus the spreads quoted by market-makers. However, this conclusion does not take into account that Mullaney,

Wells was not acting as a true market-maker.

A true market-maker intends to "deal" in securities, to make offers to buy and sell even when it does not have offsetting buy and sell orders in hand. Because its intention is to "deal" in, rather than "hold" securities, it attempts to balance its purchases and sales. Whenever it is unable to balance purchases and sales it risks capital. The true market-maker becomes a market-maker for its own account and deals with all others on an arms-length basis. The spread is its compensation for "dealing" in a security and risking its capital. Mullaney, Wells' so-called "market-making" activity was nothing more than a device to facilitate the execution of large Fund Orders; it did not function as a true market-maker. That Driehaus knew that Mullaney, Wells was not a true market-maker is evident from his testimony that he "...was worried about interpositioning." */

Beginning in 1971 when Stowers and Research began placing most of Fund's business with Driehaus the portfolio turnover increased markedly as shown in the following schedule introduced by respondents:

Portfolio Turnover

Year	Income Fund	Growth Fund
1970	31 %	75 %
1971	169 %	218 %
1972	180 %	183 %
1973	185 %	141 %
1974	142 %	100 %
1975	192 %	125 %

*/ Public Policy, page 178, states:
Improper executions in over-the-counter transactions also result whenever an investment company "interpositions" a superflous broker-dealer into a transaction between the company and the brokerage firm from which it is buying, or to which it is selling, an over-the-counter security.

Research, by virtue of its agreement with Mullaney, Wells, put itself in a position where it could not object to unreasonable markups without jeopardizing its arrangement to receive $6,000 a month from the broker-dealer. Also, the increased portfolio turnover could, in effect be dictated by the need to generate sufficient commissions to, at least, cover the payments of $6,000 a month to compensate Research for the purported computer expense.

There is no doubt, as respondents concede, that Driehaus was one of the principal beneficiaries of Fund's portfolio business. Although Stowers denied promising Fund's business to any brokerage firm he made it clear that it would be given to Driehaus. This put Driehaus in an enviable bargaining position so that when Mullaney, Wells signed the agreement with Research it, also, employed Driehaus thus being assured of getting all of Fund's business. Because of his equity interest he could share in any profits generated by the Fund's business. In addition, he received 40-45% of the commissions from Fund's business. This arrangement encouraged the excessive markups and portfolio turnovers which have been found to have occurred.

Fund's prospectus of May 1, 1974 and its proxy statement of April 29, 1974, used in the offer and sale of Fund shares did not accurately and adequately disclose the fact that the computer service payments received by Research were all or in part a rebate of commissions and profits generated in the execution of Fund portfolio transactions. The practice of directing Fund portfolio business to Driehaus in return for the purchase

of the computer service made false and misleading the statement in Fund's prospectus and proxy statement that Research and Stowers were observing Fund's policy of securing the most favorable prices and best execution of its orders. Also, it was not disclosed that Fund orders were being executed in a fraudulent manner resulting in Fund being charged prices not reasonably related to the prevailing market prices.

The effect of failure to disclose under the Advisers Act has been considered by the Supreme Court in S.E.C. v. Capital Gains Bureau, 375 U.S. 180 (1963) where, at 200 it said:

> The Investment Advisers Act of 1940 was 'directed not only at dishonor, but also at conduct that tempts dishonor.' United States v. Mississippi Valley Co., 364 U.S. 520, 549. Failure to disclose material facts must be deemed fraud or deceit within its intended meaning, for, as the experience of the 1920's and 1930's amply reveals, the darkness and ignorance of commercial secrecy are the conditions upon which predatory practices best thrive.

It is found that Research, Mullaney, Wells, Stowers and Driehaus wilfully violated and wilfully aided and abetted violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206 of the Advisers Act.

Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder.

The Order charges that during the pertinent periods herein Mullaney, Wells and Olde, wilfully aided and abetted by Driehaus, wilfully violated Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder by failing to accurately make, keep current, and preserve certain books and records including memoranda of each purchase and sale of securities for their own accounts.[13/]

It is not disputed that during the period from August 1, 1973 to January 1975, neither Driehaus nor anyone at Mullaney, Wells (and later Olde) prepared memoranda of Fund orders as required by the Commission's rules. Driehaus testified that when he received an order from Stowers he would make a note of the name of the stock, the account and the number of shares for his own personal use but that he did not prepare an order ticket or an order memorandum. No one else prepared any firm records either. After a while he would throw away the personal notes which were cluttering up his desk.

Driehaus testified that he never knew and that no one ever told him that it was necessary to prepare and maintain memoranda on the transactions he was executing for Fund. He contends that the preparation of such order memoranda was the responsibility of the broker-dealer and not his. However, as an officer, director and owner of an equity interest in Mullaney,

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13/ Section 17(a), as here pertinent, requires broker-dealers to make, keep and preserve such books and records as the Commission may prescribe by its rules and regulations. Rules 17a-3 and 17a-4 require, generally, that registered broker-dealers prepare and maintain order tickets which show, among other things, the date and time of receipt and the size of each order, and the name of the customer.

Wells he cannot escape responsibility by claiming ignorance of the rules or reliance on others. It should be noted, also, that while the NASD by-laws required his registration as a principal he was never registered as such.

The Commission has repeatedly stressed the importance in the regulatory scheme for strict compliance with the requirement that books and records be kept current and in proper form.14/ The requirement that records be kept embodies the requirement that such records be true and correct.15/ Compliance with the rule relating to maintenance of books and records is regarded as a "unqualified statutory mandate" dictated by a broker-dealer's obligation to investors to conduct its securities business on a sound basis.16/

It is found that Mullaney, Wells wilfully violated Section 17(a) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder and that Driehaus wilfully aided and abetted such violation.

Wilfullness

All of the violations and the aiding and abetting of violations found herein have found to have been wilfull. It is well established that a finding of wilfullness does not require an intent to violate the law; it

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14/ "It is obvious that full compliance with those requirements must be enforced and registrants cannot be permitted to decide for themselves that in their own particular circumstances compliance with some or all is not necessary": Olds & Company, 37 S.E.C. 23, 26 (1956); Pennaluna & Company, Inc., 43 S.E.C. 298, 312 (1967).

15/ Lowell Neibhur & Co., Inc., 18 S.E.C. 471, 475 (1945).

16/ Billings Associates, Inc., 43 S.E.C. 641, 649 (1967).

is sufficient that the person charged with the duty knows what he is doing.[17/] Respondents argue that under the recent Supreme Court decision in Ernst & Ernst v. Hochfelder, No. 74-1042, 44 U.S.L.W. 4451 (March 30, 1976) a finding of wilfullness will not lie in the absence of "scienter" - intent to deceive, manipulate or defraud. However, that decision is inapplicable to the present proceeding.[18/]

17/ Billings Associates, Inc., 43 S.E.C. 641, 649; Biesel, Way & Company, 40 S.E.C. 532 (1967); Hughes v. S.E.C., 174 F 2d 969, 977 (C.A.D.C. 1949); Tager v. S.E.C., 344 F 2d 5 (C.A. 2, 1965); Churchill Securities Corp., 38 S.E.C. 856 (1965).

18/ The Court did not consider the question of scienter with respect to an administrative proceeding. Cf. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest with respect to the respondents who have been found to have committed certain violations as alleged in the Order.

The appropriate remedial action as to a particular respondent depends on the facts and circumstances applicable to him and cannot be measured precisely on the basis of action taken against other respondents,[19/] particularly where, as here, the action respecting others is based on offers of settlement which the Commission deemed appropriate to accept.[20/]

The violations found herein were serious and cannot be excused by a claim of a lack of knowledge of pertinent requirements. Investment advisers are fiduciaries and the Commission has clearly enunciated the duties and responsibilities of fiduciaries in Kidder, Peabody & Co., et al, 43 S.E.C. 911 at 915 (1968):

> One of the basic duties of a fiduciary is the duty to execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances, cf., Thompson and McKinnon, 43 S.E.C. 785 (1968); Arlene W. Hughes, 174 F. 2d 1969 (DC 1949). This duty encompasses not only obtaining 'best execution' in the marketplace, cf., Delaware Management Co., Inc., 43 S.E.C. 392, (1967); but encompasses the obligation of an investment adviser, who is a fiduciary, to execute transactions for advisory clients on an agency rather than a principal basis in instances where similar transactions for non-advisory clients normally would be executed on an agency basis at a commission less than the markup imposed when executing the transaction on a principal basis.

The Commission's admonition was not followed here and all of the respondents must share the blame. When Stowers required the broker-dealer

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19/ Dlugash v. S.E.C., 373 F. 2d 107, 110 (C.A. 2, 1967).

20/ Benjamin Werner, 44 S.E.C. 952, 958 (1964).

to pay for the computer service in return for the Fund's portfolio business and gave Driehaus complete discretion in the execution of Fund transactions he opened the door for the abuses found herein. Driehaus, in turn, took advantage of the situation to benefit himself and Mullaney, Wells. Any benefit which inured to Fund was incidental. At the time the agreement between Research and Mullaney, Wells was entered into there was no assurance that Fund would receive any benefit, but it was a foregone conclusion that Stowers, Research, Driehaus and Mullaney, Wells would.

A review of the record discloses no genuinely mitigating circumstances. On March 31, 1967, Mullaney, Wells was fined and censured by the NASD for a violation of its "free riding" rule and on September 15, 1970, the U. S. District Court for the Northern District of Illinois issued a consent decree permanently enjoining Mullaney, Wells from violating Section 17(a) of the Investment Company Act. Commission Litigation Releases 4699 and 4777, dated July 27, 1970 and October 9, 1970, respectively.

ORDER

Upon careful consideration of the record and the arguments and contentions of the parties, it is concluded that the public interest requires that the registration of Research as an investment adviser and the registration of Mullaney, Wells as a broker-dealer be revoked and that Stowers and Driehaus be barred from association with a broker-dealer, investment advisers or mutual fund.[21/]

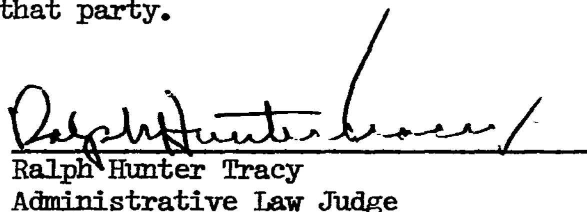
21/ It should be noted that a bar order does not preclude the person barred from making such application to the Commission in the future as may be warranted by the then-existing facts. Fink v. SEC, (C.A. 2, 1969), 417 F. 2d 1058, 1060; Vanasco v. SEC, (C.A. 2d 1968), 395 F. 2d 349, 353.

Accordingly, IT IS ORDERED that the registration of Investors Research Corporation as an investment adviser is revoked; and that the registration of Mullaney, Wells and Company as a broker-dealer is revoked; and

IT IS FURTHER ORDERED that James E. Stowers and Richard H. Driehaus, and each of them, is barred from association with any broker, dealer, or investment adviser, and each is prohibited from serving or acting in the capacities enumerated in Section 9(b) of the Investment Company Act.

This order shall become effective in accordance with and subject to 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 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.



Ralph Hunter Tracy
Administrative Law Judge

July 19, 1976
Washington, D.C.

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