ADMINISTRATIVE PROCEEDING
FILE NO. 3-640

Orig R/A

FILED

MAR 31 1967

SECURITIES & EXCHANGE COMM

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

STANFORD INVESTMENT MANAGEMENT, INC., a California corporation (801-2854)

and LAWRENCE RONALD ROSS (801-3404)

INITIAL DECISION

Washington, D.C.
March 31, 1967

Samuel Binder
Hearing Examiner

ADMINISTRATIVE PROCEEDING
FILE NO. 3-640

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of STANFORD INVESTMENT MANAGEMENT, INC. a California corporation (801-2854) and LAWRENCE RONALD ROSS (801-3404)	INITIAL DECISION

APPEARANCES: William H. Joseph, and W. Stevens Tucker, appearing on behalf of the Division of Trading & Markets, Securities and Exchange Commission, San Francisco, California.

Dorothy Von Beroldingen, 683 McAllister Street, San Francisco, California, appearing on behalf of Stanford Investment Management, Inc. and Lawrence Ronald Ross.

BEFORE: Samuel Binder, Hearing Examiner.

These are private proceedings instituted by an order of the Securities and Exchange Commission ("Commission") issued on May 19, 1966 pursuant to Section 203(d) of the Investment Advisers Act of 1940 ("Act") to determine whether the respondents engaged in violations of the anti-fraud, bookkeeping, and other provisions of the Act as charged by the Division of Trading and Markets ("Division") and to determine what remedial action, if any, is appropriate in the public interest. Both Stanford Investment Management, Inc. ("Stanford"),[1/] a California corporation, and Lawrence Ronald Ross ("Ross") are registered with the Commission as investment advisers and Ross is the president, a director and the controlling stockholder of Stanford.

In substance, the Division charged (1) that during the period from on or about May 28, 1962 to the date of the Commission's order Stanford violated and Ross aided and abetted violations of Section 204 of the Act and Rules 204-2(a)(1) through 204-2(a)(6) inclusive and Rule 204-2(e)(1) thereunder in that Stanford and Ross failed to make, keep, and maintain Stanford's books and records on a true, accurate, and current basis; (2) that within the same period in which respondents were violating Section 204 of the Act and the rules thereunder, i.e., between July 12, 1965 and August 26, 1965 and while Ross was the president and in control of another registered

---

1/ In May 1962 an amendment to the registration of Insider Management, Inc. (not to be confused with The Insider Report, Inc. referred to hereinafter in the text) was filed to change its name to Stanford Investment Management, Inc.

investment adviser, viz., The Insider Report, Inc. ("Insider")[2/] Stanford and Ross violated Sections 206(1) and (2) of the Act by engaging in solicitations of consents to the assignment by Insider clients of investment advisory contracts to Stanford by means of false and misleading literature mailed to them. Specifically, the Division contended that Insider clients were not informed in such literature, that they had the right to pro rata refunds upon cancellation of their subscriptions but that Insider was not financially able to make substantial refunds and that Stanford would not give pro rata refunds on Insider subscription fees upon cancellation by the subscriber. In addition, the soliciting material did not disclose what arrangement would be made with Insider subscribers who did not consent to the assignment and also failed to disclose that consent to such assignment would be deemed to have been given after approximately three and one-half weeks if the subscriber remained silent during such period. In addition, the Division charged that the soliciting material failed to disclose to subscribers of Insider that no assignment to Stanford of their Insider contracts could be made without their consent; (3) that during the period from on or about July 24, 1964 through August 1965, Stanford wilfully violated Sections

---

2/ As of December 11, 1964 Ross became president and sole stockholder of The Insider Report, Inc., publisher of The Insider Report. The registration of The Insider Report, Inc. as an investment adviser was withdrawn effective December 1, 1965. (File No. 801-3386).

206(2) and 206(4) of the Act and Rules 206-4(1)(a)(2) and 206-4(1)(a)(5) thereunder[3/] and Ross aided and abetted such violations in that Stanford and Ross circulated and distributed advertisements[4/] which referred directly and indirectly to past specific recommendations without setting forth all such past recommendations within the preceding twelve months,[5/] and that such advertisements also contained

---

3/ Section 206(2) forbids an investment adviser from engaging in "any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Section 206(4) prohibits investment advisers from engaging "in any act, practice or course of business which is fraudulent, deceptive or manipulative." Rule 206(4)-1 deals with advertisements, and subdivision (a)(5) thereof provides that any advertisement "which contains any untrue statement of a material fact, or which is otherwise false or misleading" is fraudulent under that Section.

4/ Rule 206(4)-1 provides that

> "(b) For the purposes of this rule the term 'advertisement' shall include any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."

5/ Rule 206(4)-1(a)(2) provides that it is fraudulent within the meaning of Section 206(4) for any investment adviser to distribute any advertisement "which refers, directly or indirectly, to past specific recommendations of such investment adviser which were or would have been profitable to any person," but permits advertisements that set out (or offer to furnish a list of) all of the adviser's recommendations within the immediately preceding period of not less than one year if such advertisements (or such list, if it is furnished separately) "(A) state the name of each such security recommended, the date and nature of each such recommendation (e.g., whether to buy, sell or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the market price of each such security as of the most recent practicable date, and (B) contain the following cautionary legend on the first page thereof in print or type as large as the largest print or type used in the body or text thereof: 'it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list.'"

hypothetical examples of option writing which, when taken as a whole, were materially deceptive in that, while containing some unobtrusively placed caveats, misleadingly emphasized the possibilities of very high profits and obscured and minimized the possibilities of loss and; (4) that during the period from about May 28, 1962 through January 25, 1955 Stanford aided and abetted by Ross wilfully violated Section 204 of the Act in that they failed to file or cause to be filed required amendments on Form ADV to correct information in amendments previously filed relating to (a) the beneficial ownership of 10% of more of the outstanding common stock of Stanford by Lafayette C. Weeks and the total number of shares outstanding, (b) the list of officers and directors of Stanford and, (c) the periodical publications or special reports issued by Ross and Stanford.

A private hearing was held in San Francisco, California and the respondents appeared and contested the charges made against them by the Division. Thereafter, proposed findings of fact, conclusions of law and supporting briefs were filed by counsel for respondents and by counsel for the Division.

The Division urged the revocation of the registration of Ross and Stanford as investment advisers, and the respondents contended that the Division had failed to sustain any of the charges made against them.

The following findings and conclusions are based upon the record, upon observation of the witnesses and upon consideration of the proposed findings and conclusions filed by the parties and their supporting briefs.

I. Respondents' Failure to Make and Keep True, Accurate and Current Books and Records as Required by the Act and the Rules

Section 204 of the Act requires registered investment advisers to "make, keep and preserve for such periods, such accounts, correspondence, memoranda, papers, books and other records and make such reports as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Pursuant to its statutory authority under the Act, the Commission adopted Rule 204-2 containing various subsections which are applicable to the respondents and require Stanford to keep true, accurate and current books and records relating to its advisory business.5/

5/ Rule 204-2(a)(1) through 204-2(a)(6) required Stanford to make and keep true, accurate and current the following books and records:

"(1) A journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger.

(2) General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital income and expense accounts.

(3) A memorandum of each order given by the investment adviser for the purchase or sale of any security, of any instruction received by the investment adviser from the client concerning the purchase, sale, receipt or delivery of a particular security and of any modification or cancellation of any such order or instruction. Such memoranda shall show the terms and conditions of the order, instruction, modification or cancellation; shall identify the person connected with the investment adviser who recommended the transaction to the client and the person who placed such order; and shall show the account for which entered, the date of entry, and the bank, broker or dealer by or through whom executed where appropriate. Orders entered pursuant to the exercise of discretionary power shall be so designated.

(4) All check books, bank statements, cancelled checks and cash reconcilations of the investment adviser.

(5) All bills or statements (or copies thereof) paid or unpaid, relating to the business of the investment adviser as such.

(6) All trial balances, financial statements, and internal audit working papers relating to the business of such investment adviser."

In addition, Rule 204-2(e)(1) provided that

"(e)(1) All books and records required to be made under the provisions of paragraphs (a) to (c)(1), inclusive, of this rule shall be maintained and preserved in an easily accessible place for a period of not less than 5 years from the end of the fiscal year during which the last entry was made on such record, the first 2 years in an appropriate office of the investment adviser."

The facts in this case were developed following an initial routine inspection of Stanford made by the San Francisco Regional Office. Shortly after this inspection, the Commission's San Francisco Regional Administrator wrote a letter on March 5, 1963 [6/] to Ross, the president of Stanford, stating, among other things, that an inspection of Stanford's books and records and other business operations covering the period from February 1, 1962 through December 31, 1962 had disclosed numerous and serious violations of the Act and the Rules thereunder. This letter pointed out, in pertinent part, that Stanford's "books and records kept by you have been inadequate. I call your attention to Rules and Regulations under the Investment Advisers Act of 1940 (as in effect May 1, 1961), which rules have been furnished to you. Rule 204-2(a) and (c) prescribes the books and records which must be kept by your firm and in that particular you are required to keep a journal, including cash receipts and disbursements records, and other general ledgers reflecting asset, liability, reserve, capital, income and expense accounts. It is important for you to realize your records must be kept current." [7/]

6/ The correspondence between the Regional Administrator and the respondents also dealt with the fraudulent character of respondents' literature and the unlawful solicitation of consents to assign investment advisors contracts from The Insider Report to Stanford. These aspects of the proceedings will be dealt with hereinafter.

7/ Division's Exhibit No. 11.

On March 8, 1963 Ross wrote to the Regional Administrator in response to the latter's letter of March 5, 1963[8/] stating, among other things, that he had a journal, disbursement records, general ledger, etc." but that "The difficulty comes over what is meant by being 'kept current'". Ross stated that he had a small business, that his monthly receipts seldom exceeded two thousand dollars and that he rarely wrote more than a dozen checks in a month. He added that he felt that bringing the books and records up to date, and preparing a trial balance sheet once a quarter was sufficient, and the idea of a San Francisco employee of the Commission that he "should have a balance sheet, profit and loss statement, etc. at least once a month" was "nonsense".[9/]

Ross went on to say that he had tried to comply with the request of personnel of the San Francisco Regional Office but that they were being unreasonable. In this connection he stated that an employee of the San Francisco office had called him in November [1962] and said "that he would like to inspect my books and would I put them in order. So I had a balance sheet and the whole bit prepared as of October 31, then I hadn't heard from him for <u>six weeks</u>. When he finally came around, I gave him the books along with the October 31, statements he had asked for and he criticized me because the records were almost two months old!. . ."

8/ Division's Exhibit No. 13.

9/ Division's Exhibit No. 10.

Ross sought the Regional Administrator's opinion "as to whether or not keeping his books on a quarterly basis was unreasonable or not."

"On March 22, 1963 the San Francisco Regional Administrator advised Ross, among other things, that

> "In reference to your bookkeeping records, we have furnished you with copies of the Investment Advisers Act and the Rules. The responsibility for keeping the financial records of your firm rests upon you. You will note that Rule 204-2(a) requires that you 'shall make true,accurate and current' the records therein specified. You state that your business is small. If this is true, it certainly does not constitute any burden on your part to keep the necessary books required by the Acts or the Rules. There should be no necessity for an inspector to make two visits in order to inspect these records. You are required to keep a journal or journals, including cash receipts and disbursement records. The inspection report indicates that you do not keep such journals, your principal method of bookkeeping being entries in your check stub book. Your failure to maintain such books cannot be tolerated.
>
> "This office has no choice but to administer the Acts and the Rules and Regulations in an impartial manner. It is not authorized to make exceptions, especially in the case of bookkeeping rules. Accordingly, as long as you are registered you will be expected to conduct your business as required by the Act and the Rules and Regulations thereunder." 10/

Thereafter, further inquiry into Stanford's books and records was made by the San Francisco Regional Office. This resulted in the discovery of certain facts relating to violations of the Commission's rules relating to the maintenance of books of account by the respondents of a more far-reaching character than had been

---

10/ Division's Exhibit 12.

discovered prior to the exchange of letters between the Regional Administrator and the respondents. The facts as they unfolded in this proceeding reflected that subsequent to the serious admonitions contained in the Regional Administrator's letters and after the respondents had been made fully aware of the gravity of violations of the Commission's accounting regulations, Stanford's books and records were not only maintained at all for many months at a time but such financial statements as were prepared for it were so inaccurate that they could not be relied upon to reflect the company's condition.

During the course of the hearing, Mrs. Ross, the respondent's wife, who was secretary-treasurer of Stanford testified she began working for Stanford on February 15, 1965; that since March 1965 she had been working on the books of account of Stanford[11]; that prior to March 1965 the journals, ledgers, and other books of accounts of Stanford were kept by a firm of certified public accountants at the latter's offices; and that the books maintained at Stanford's office were a check book, duplicate deposit slips, invoices, bills and statements, and these were turned over to the accountants when the monthly bank statement came in. Mrs. Ross went on to testify that there were irregularities in the manner in which Stanford's accountants

---

11/ Mrs. Ross had very little experience or training as a bookkeeper but undertook to determine the manner in which Stanford's books were to be maintained and how the financial position of the company should be represented in financial statements. Van Tassel, a bookkeeper employed from time to time by Stanford testified that he taught Mrs. Ross how to prepare trial balances, but not to prepare balance sheets.

maintained its books; that in April 1965, Stanford had requested their accountants "for a profit and loss statement and trial balance as of the end of March . . ." but that the company's accountants told her that they would not be able to comply with her request because it was the "income tax season", that she advised them that Stanford would pick up the books and prepare "it" themselves, but that the accountants "stalled" Stanford for a short time and that when Stanford finally picked up the books, "the checkbook didn't balance with the books for the end of March, and some of the entries were just completely out in left field."

"I mean you could tell it had been done very hurriedly by someone who didn't even know what they were supposed to be doing. . . . So that, anyway, in allocating expenses it [Stanford's books] couldn't begin to give a picture of what was actually going on."

Mrs. Ross conceded that she had informed a member of the Commission's staff that in March 1965, Stanford's "check book was out of balance", and "could not be relied upon as being 100 percent accurate" and that Stanford's March 31, 1965 financial statement "could not be relied on as being 100 percent accurate." 12/

In April 1965 the former controlling person of The Insider filed a complaint against the latter company seeking to obtain a

---

12/ In this connection, it should be noted that Stanford's then accountants were making entries relying upon the correctness of the check books which were maintained and kept in Stanford's office.

judgment against the company for $25,000 and to seize all its assets. Mrs. Ross explained the respondent's position with regard to its books of account at the time of the institution of this lawsuit in the following language:

> "So here we were with two corporations, two sets of books which had absolutely no value for practical purposes. . . ." (underscoring supplied)

She also pointed out at this time,

> "we were in the process of trying to find out what was going on with The Insider, because we realized that if they weren't keeping Stanford's books, what were they doing with the Insider's books, which had been even more confused."

While this lawsuit was still pending and about six months later, Stanford in October 1965, hired a bookkeeper by the name of Van Tassel.

Van Tassel testified that he was retained by Stanford in October 1965 but was not employed to act as a bookkeeper on a regular basis. He performed only such bookkeeping assignments as were specifically requested by the client.

In November 1965, Van Tassel prepared for Stanford a profit and loss statement for the first 10 months of 1965 and a balance sheet as of October 31, 1965.[13/] The facing page of this document

---

13/ Van Tassel testified that he was not a certified public accountant or a public accountant.

states that it was "prepared from the books and papers without audit" and it carried the following note:

> "NOTE: During this report period the corporation adopted and first used a new and expanded system of accounts. Also during this period the corporation departed substantially from its previous accounting policy of recording all revenues and expenses on the cash basis. The purpose of this departure was to provide a more accurate definition of the corporation's transactions with certain outside interests than would have been possible on a strict cash basis."

Van Tassel explained that the financial statements he prepared were not prepared "on what is generally known to the accounting profession as the cash receipts and disbursement basis," but on a material modification of that basis. The material "modification was that certain payables and receivables were given in the statement and were listed on the balance sheet that would not have been present under the cash receipts and disbursement basis."

Van Tassel stated that he modified the cash receipts and disbursement approach because Stanford "wished to display the relationship clearly between Stanford Investment Management and another firm -- more than one other firm -- and Insider Report, Inc. was one of them, and Lists of California was another, but the amount is not really material, $20.00." However, at a later point the witness pointed out that an amount of $3,082.32 which appeared in the balance sheet as prepared by him as of October 31, 1965 "would not appear under the

cash receipts and disbursements basis." Further the October 31, 1965 balance sheet also failed to reflect a liability to Lafayette C. Weeks in connection with the termination of his employment and the re-purchase from him of 882 shares of Stanford common stock for $3,800 payable at the rate of $200 a month.

Van Tassel conceded that he had exercised no independent judgment as to which receivables and payables would be shown and which would not be shown in the financial statements of October 31, 1965. These were dictated to him by Mrs. Ross on behalf of Stanford, and the financial statements did not reflect certain of Stanford's obligations.[14/] Mrs. Ross informed the accountant that Stanford's purpose was to produce a balance sheet "for internal purposes and use only" with one exception. The exception was that "the statement could be used or might be used in what [his] clients informed [him] could have been a prospective court battle with stockholders of Insider Report, and [he] was aware of that at the time [he] made these statements up."

Van Tassel also testified that while he was given ledgers and journals to assist him to prepare his October 1965 financial statements he was given no check books, although Stanford's primary books of

---

14/ The balance sheet carries a footnote reading "There are other receivables and payables besides those listed; those not listed are still being handled on a cash basis.

original entry were actually the check books. He explained that when he examined the journal and ledgers which were furnished to him, he found that the month of April 1965 was not completely posted and that the months of May, June, July, August, September and October of 1965 had not been posted at all. He also testified that there were erroneous postings in January, 1965 and he reposted back to the first of the year.

Although he had no check books, Van Tassel "coded" a schedule of expenses based on information furnished him by Mrs. Ross.[15/] Mrs. Ross explained to Van Tassel that "it was a schedule of Stanford's expenses that had been paid by Insider Report and a schedule of Insider Report expenses that had been paid by Stanford Investment Management."

Van Tassel testified that "the net effect of these two situations was that The Insider Report had paid $10,596.39 of Stanford Investment Management expenses" after "taking into account both types of situations". However, the final result reflected in the October 31, 1965 financial statements was a receivable due Stanford from Insider Report, Inc. in the amount of $3,082.13. Van Tassel testified that he was unfamiliar with Insider's books and, in fact, had never seen them.

15/ See Division's Exhibit No. 15.

Having in mind that Insider was insolvent during most of the time Ross was in control of it and that Stanford's monthly receipts seldom exceeded $2,000, the use of Insider Report to pay such a large percentage of Stanford's obligations was a highly questionable practice, particularly in view of the fact that Ross had fiduciary obligations to Insider clients which he could not meet and also because he and Insider were defendants in a lawsuit where a money judgment was being sought in excess of Insider's assets. 16/

Stanford's balance sheet as of October 31, 1965 did not reflect a liability to Lafayette C. Weeks, formerly associated with Stanford. This liability was incurred in connection with the termination of Weeks' employment contract and the repurchase from him of 882 shares of common stock of Stanford in the amount of $3,800 payable at the rate of $200 per month. The obligation to Weeks was not reflected even for the dates when the obligation to Weeks had accrued.

Stanford was engaged in part in giving investment advice in connection with put and call transactions and with regard to the writing of options. In this connection there were occasions when respondents placed stop-buy and stop-sell orders. 17/ The placing of these orders formed a very small percentage of respondents' business. The Commission's

---

16/ See footnote 2 *supra*.

17/ See Shultz, "The Securities Market; and How it Works (1948) pp. 124 *et seq*.

rules,[18] however, require investment advisers to make, keep and preserve memoranda of open orders as well as executed orders. This the respondents did not do. Instead they contended in regard to open orders that respondents were "using the broker as an agent to hold open orders accessible to registrant."[19] Respondent's interpretation, if accepted, would emasculate Rule 204-2(a)(3) insofar as open orders are concerned. Ross was under a duty to maintain books and records which would reflect all his transactions on behalf of clients,[20] and such records included orders and copies of such orders to brokers with which Stanford was doing business. The fact that Stanford could obtain information by requesting it from the brokers does not serve to excuse its own failure to comply with the Act and the Rules and in fact, the brokers' records were not his records. The purpose of the requirement that the investment adviser keep his own memoranda of orders is the same for executed and unexecuted orders, namely, that the investment adviser have an independent record against which to check the broker's performance of the order placed on behalf of the investment adviser's clients.

18/ See particularly Rules 204-2(a)(3) and 204-2(e)(1) under the Investment Advisers Act of 1940.

19/ See Respondent's brief p. 40.

20/ Where there was no trade Ross had no confirmation and he testified that he had no record of any open order; and that while the brokers sent Stanford "notice of the open orders" he didn't keep them.

When Van Tassel was asked whether he considered that the October 31, 1965 financial statements represented a correct showing of the financial condition of the company, he conceded that they did not.[21/]

It may be observed that Van Tassel prepared two subsequent financial statements for Stanford. These were both prepared "on the cash receipts and disbursement basis," and were distinguishable from the October 31, 1965 financial statements in that they were "general purpose" statements whereas the October 31, 1965 statement was a special purpose statement and no "general purpose" statement appears to have been prepared for the period ending October 31, 1965.

Stanford had solicited subscriptions to its advisory service and was required to render investment advisory service thereafter to clients who had paid for such services. The preparation of financial statements on a cash basis or modified cash basis of accounting was inappropriate for Stanford and inconsistent with applicable generally accepted principles of accounting for a company which had subscription income received at the beginning of a period during which it was obligated to render services therefor.[22/]

In addition to the extremely serious violations of the bookkeeping rules discussed hereinabove, it appears material to pass upon

---

21/ The respondents produced an accountant who testified on September 30, 1966 that he met the respondent Ross for the first time on September 25, 1966 and the books at that time appeared "current". However, this testimony will not serve to cure the patent violations of the accounting rules outlined above, nor should it be considered of any value in relation to the sanctions which should be imposed by reason of such violations.

22/ Montgomery's Auditing (8th ed., 1957) pp. 89, 90.

the respondents' contention that the requirement in Rule 204-2(a) that books be maintained on a "current" basis was satisfied by Stanford although such records were "almost two months old" when a Commission inspector visited the company towards the end of 1962 or the beginning of 1963.[23/]

Where accounting records subject to Commission inspection are concerned a lapse of almost two months without recording transactions by a registered investment adviser cannot be considered as being in compliance with the requirements of Rule 204-2(a).

In Benjamin and Company, et al., 38 S.E.C. 614 at pages 619 and 620, the Commission, in connection with a broker-dealer's failure to comply with Rule 17a-3 adopted under Section 17(a) the Securities Exchange Act of 1934, stated that

> "In our opinion, it is clear that a cash book that is not posted to reflect receipts and disbursements occuring during the preceding 22 days, and a general ledger and general journal that do not reflect securities transactions which were effected over 1 month before cannot be considered current."

The legislative history of Section 204 of the Act reflects the fact that the Commission's power of inspection granted thereunder was patterned after the similar power accorded to the Commission under the Securities Exchange Act of 1934.

The Senate Committee on Banking and Currency (86th Cong., 2d Sess.) in Calendar No. 1832, Report No. 1760, to accompany S. 3773 (June 28, 1960) stated, in pertinent part, that

---

23/ Division's Exhibit No. 10.

> "In the opinion of the committee, the power of inspection under the Securities Exchange Act of 1934 has been indispensable in enforcing the requirements of the statute with regard to broker-dealers who are similar to advisers. The prospect of an unannounced visit of a Government inspector is an effective stimulus for honesty and bookkeeping veracity.
>
> * * * *
>
> . . . [T]he bill would authorize the Commission to require registered investment advisers to keep such books and records as the Commission may prescribe by rule and would provide that these books and records are subject to reasonable inspection by the SEC. This power is modeled after that presently found in the Securities Exchange Act treating brokers and dealers."

Ross' unwitting concession in his letter of March 8, 1963 that Stanford's records had not been kept current for approximately two months subsequent to October 31, 1962 and his comment that the Commission inspectors' insistence that the books be kept current was "nonsense" leads fairly to the inference that Stanford had no intention of complying with the bookkeeping requirements insofar as the maintenance of Stanford's books on a current basis was concerned. This inference is buttressed by the respondents' subsequent and even more serious violations of the Commission's rules.

The evidence in this case shows that during the period from on or about November, 1963 to May 19, 1966, the date of the Commission's order, Stanford violated and Ross aided and abetted violations of Section 204 of the Act and Rules 204-2(a)(1) through 204-2(a)(6) inclusive and Rule 204-2(e)(1) thereunder in that Stanford and Ross failed to make, keep, and maintain Stanford's books and records on a true, accurate and current basis.

II. Respondents' Violation of Sections 206(1) and (2) of the Act in Soliciting Consents to Assignment of Advisory Contracts

The historical background[24/] from which the respondents' unlawful solicitation of consents stemmed and the material facts pertaining to the violations of Sections 206(1)[25/] and (2) of the Act may be summarized as follows:

On October 25, 1961, Bridwell & Co., Inc., a company controlled by Rodger W. Bridwell became registered as an investment adviser.[26/] On December 18, 1964, the investment adviser registration of Bridwell & Co., Inc. was revoked by the Commission because, among other things, the company between September and October 1963,"aided and abetted by Bridwell and Whalen, wilfully violated Section 206 of the Advisers Act in that, in soliciting assignments of registrant's investment advisory contracts with its clients, respondents sent to them a notice of assignment which failed to disclose that no assignment could be made without the consent of the client, and what arrangements would be made with regard to the advisory contract if the client did not consent to the assignment,

---

24/ A summary of the background facts against which respondents' misconduct occurred would appear to be helpful in understanding and evaluating the evidence adduced during the proceeding.

25/ Section 206(1) provides in pertinent part that it shall be unlawful for any investment adviser to employ any device, scheme or artifice to defraud any client or prospective client.

26/ Bridwell & Co., Inc., subsequently changed its name to Lyon Financial Publications, Inc. and thereafter to The Insider Report, Inc. This corporation under each one of its various names and through a succession of managements distributed to its clients through the mails a publication known as "The Insider Report" at all times pertinent to this proceeding.

and which misled the clients into believing that the mere failure to object to such assignment within a short prescribed period would constitute a consent." 27/

According to Ross his connection with The Insider Report, Inc. came about substantially as follows:

In November 1963, approximately a month before the issuance of Investment Advisers Act Release No. 180, Rodger W. Bridwell entered into a contract whereby he sold all of his company's outstanding stock to Raymond R. Lyon who merged the company into another company called Lyon Financial Publications, Inc. ("Lyon"), which was separately registered with the Commission in February 1964 as an investment adviser but continued to publish and distribute The Insider Report, a market letter,originally put out by Bridwell & Co., Inc. In October, 1964, an amendment on Commission Form ADV was filed by Lyon to reflect the change in the registrant's name from Lyon Financial Publications, Inc. to The Insider Report, Inc.

According to Ross, Lyon "never even finished paying for the purchase contract", which he had entered into with Bridwell. Bridwell then "repossessed" the company. Ross (who had been an employee of Bridwell & Co. from June 1961 to May 1962) testified that on

---

27/ Investment Advisers Act Release No. 180 (December 18, 1964). The respondents in the instant proceeding are charged, among other things, with violations of Section 206 which were substantially similar to those which occurred in the Bridwell case.

December 11, 1964 he entered into a contract with Bridwell by which he acquired all the stock of the company which had been repossessed from Lyon by Bridwell and became the president of The Insider Report, Inc.[28/] In this connection, he testified that "as a former employee [of the Insider] he was aware that a great deal of money had been made in this company. I don't know exactly but I would guess that anywhere from $25,000 to $75,000 a year profit", and that he was "willing to take a certain amount of risk" in taking over the company. Ross, however, invested no money in acquiring control of The Insider Report. The purchase agreement between Bridwell and Ross provided that Ross' total obligation for all the stock of The Insider Report would be to pay Bridwell 10% of the gross revenues received by The Insider Report up to a maximum of $25,000.

Ross did not get immediate delivery of The Insider stock. Bridwell had delivered the stock in escrow to an attorney in San Francisco. Bridwell notified Lyon by telegram that he was repossessing the stock for nonpayment and shortly thereafter Ross received the stock from the attorney who had been holding The Insider stock in escrow.

Ross claimed that at the time of his acquisition of the stock of The Insider he received no books and records because they were in Lyon's possession and that when he acquired the company's stock

---

28/ Ross made it clear that he also got possession of Insider's place of business, and all its physical assets. Although Ross claimed to be a financial analyst capable of giving investment advice of a highly technical and complex character to others, he claimed that he did not know the financial condition of Insider when he acquired control of it, nor did he ever bother to obtain accurate knowledge of its financial condition during the entire period in which he operated the company.

he knew nothing about Insider's financial condition. In addition, Ross testified that "strange as it may seem" he did not receive any financial statements from Bridwell at the time the latter assigned the stock to him because he knew the company "was in trouble." At another point, Ross testified, however, that "The reason I didn't examine the books and records of The Insider was that because Mr. Lyon was a deceitful man and nobody had access to the books until he was let out." Later in his testimony, Ross said "We had the books of the former owner who had made falsified entries in them, and I wouldn't accept the information in them."

Ross also testified that while he was operating The Insider he was getting financial statements from his accountant "to some extent" but that "We had a great deal of difficulty with the financial statements because the books had been rigged for Mr. Lyon." He added that ". . . the books were in such a mess I was advised by my attorney we would have to pay several thousand dollars for a complete audit." No complete audit was ever made.

An additional problem which Ross testified he had with The Insider Report was that Lyon "had collected a number of advance subscription revenues in the amount of $35,000, I think, which he took off with" (sic). Ross went on to testify "the subscribers [to the Insider] were there which we had to service and fulfill, but he left with the money and at the same time he tried a cute switch from a cash accounting basis to an accrual accounting basis, and he filed a tax return laying the liability on to us in the coming year."

Ross also said that for the seven or eight months that he operated The Insider, the company had "no credit at the bank," it had no profits, its income was solely the product of its advertising and the company was "on a month-to-month basis."

Ross also ascertained shortly after he obtained control of Insider that "The Lyons . . . had left the company and claimed that the equipment was theirs because they very neatly signed it over to themselves before they left." Ross went on to say that "We had arguments and discussions about this for several months, and I was uncertain whether we owned the equipment or not."

When Ross was asked when he had become aware of the fact that The Insider Report had more liabilities than it had assets, he replied, "I would say that this was a condition that prevailed most of the time, that I operated it because when I -- it was a kind of midnight raid when I took over the company.

They changed the locks on the door and I had to get in and publish an issue to meet the next deadline because it comes up every two weeks."

After obtaining control of The Insider Report, Ross found that its bank account, as it was when it got to [him] had been overdrawn and 'through some trick that [he didn't] fully understand yet, Mr. Lyon made a further withdrawal in January after we were supposedly in charge."

As Ross saw it, "The problem was we had a considerable amount of equipment, mailing machines, typewriters, furniture and so on which if I could have established title to that would have given us borrowing power at the bank and the means to sell some of it maybe to keep the business operating."

Ross testified that the major asset of The Insider was its subscription list which together with its lists of " prospects" amounted to perhaps 75,000 names. During Ross' operation of The Insider he sold addressograph plates involving between 10,000 and 15,000 names for "several thousand dollars." When Ross was asked to be more specific as to the amount of money he got for the names which he had sold, he professed not to be able to recall.

In addition to income received from the sale of names held by The Insider, Ross pointed out that there "was continuing revenue because there were subscriptions in the mail and there were regularly renewals each month, but some of the bills and the lawsuit did not catch up with us for several months thereafter."

The respondents' books and records did not disclose the amount of revenues received from the subscribers. However, it appeared that The Insider paid $6,000 to Bridwell between November 1964 when Ross acquired the stock of The Insider from Bridwell and July 1965. The Division reasonably infers from this fact that Insider received approximately $60,000 in gross receipts for this period since The Insider had undertaken to pay Bridwell 10% of all of its gross receipts. Thus, it appears that The Insider had substantial receipts for the seven-month period and in addition had received several thousand dollars from the sale of the names on its subscription list.[29/]

29/ In this connection it will be recalled that Ross had testified that Stanford's receipts were only in the order of $2,000 per month.

According to Ross, he had been having discussions with Lyon concerning the latter's claim against the company almost from the time that Ross had acquired the stock of The Insider from Bridwell in the latter part of 1964. However, in April 1965, Lyon and his brother instituted a lawsuit against The Insider seeking a money judgment of approximately $25,000. According to Ross, the respondents "were in such poor financial shape on The Insider Report that we were unable to defend it." According to Ross, Insider was in a severely straitened financial condition from the time he obtained control of it to the time of its demise, principally because its assets had been looted by Lyon, his predecessor in control of the company. Further, Ross claimed that he was ignorant of the company's financial condition; that its books were in such bad shape that it would have cost in the order of $2,000 to obtain an audit of the company; and that respondents did not have the means to have such an audit made. In any event, as has been pointed out hereinabove, Ross claimed that The Insider had more liabilities than it had assets. While the company was in this extremely bad financial condition, and during a period when it knew that it would inevitably be put out of business as a result of the lawsuit instituted by the Lyons, Ross was continuously employing Insider funds in advertising to persuade people to enter into investment advisory contracts with The Insider.

Furthermore as Ross testified, Insider's income was solely the product of its advertising. His conduct in advertising and accepting new subscribers for Insider Report in the light of the financial condition pictured by Ross, himself, and the inevitable and disastrous impact of the Lyons' lawsuit upon Insider was of course, reprehensible.30/ Finally, as the Lyons' lawsuit was reaching toward its inevitable end, Stanford and Ross entered upon a campaign to persuade clients of Insider, an unknown number of whom had been persuaded to enter into contracts with that company when it was on the verge of bankruptcy, to assign their investment contracts to Stanford, a company which itself had been consistently in violation of Section 204 of the Act in that it did not keep or maintain its books and records on an accurate and current basis.

On or about July 12, 1965, a letter on the stationery of Insider was executed by Ross and mailed to clients of Insider soliciting assignments of their investment advisory contracts to Stanford, a company controlled by Ross.31/ The consideration offered the clients of Insider was a subscription to "Investing For Tomorrow's Profits" ("IFPT"), a publication put out by Stanford. With the letter

---

30/ Cambridge Research and Investment Corp., 40 S.E.C. 252 (1960).

31/ The respondents argued in their brief that the letters mailed by them to clients of The Insider did not solicit any assignments but were only an "offer of a novation of the parties". Section 202(a) defines the term "assignment" as employed in the Act in very broad terms to include "any direct or indirect transfer. . . of an investment advisory contract by the assignor." A solicitation of such an assignment was made by the respondents in this case.

The Insider Report enclosed a reply card containing a form to be executed by the subscriber of Insider consenting to an assignment of his contract to Stanford. The soliciting letter advised the recipients that it was to their advantage to execute the consents since IFTP would combine the best features of The Insider Report with those of IFTP, permit more in depth research and eliminate a lot of duplication. Nothing whatever was said in this letter about the lawsuit, nor the financial condition of either one of the companies. A second letter was sent on or about July 26, 1965 to those subscribers who had not replied to the July 12, 1965 letter in which the respondents indicated that publication of The Insider Report had been suspended, that in its place subscribers would receive IFTP, and that other than offering this exchange, "The Insider Report" would not be in a position to offer cash refunds at this time and that the suspension and substitution was necessitated by pending litigation and organization problems. The respondents mailed out two other letters relating to the substitution of IFTP for The Insider Report, one was a catchall letter used after substitution and consolidation had been completed in reply to many inquiries and a second letter was sent to those subscribers whose Insider Report subscription were about to expire, inviting them to subscribe to IFTP since The Insider Report was being combined with IFTP and was no longer being published. No other general communication relating to the consolidation and substitution of services were sent to subscribers.

Approximately 1,000 Insider Report subscribers received only the letter of July 12, 1965. About 400 subscribers who executed consents received Insider's letter advising them of the suspension of publication of The Insider Report. The letters sent out by the respondents did not state what arrangements would be made with regard to Insider's Report subscription contracts if the subscriber did not consent to the assignment. None of the literature sent out by the respondents indicated that Insider Report subscribers had a right to pro rata refunds or that The Insider Report, Inc. was not in a position to meet more than a few requests for refunds. Furthermore, the literature sent out by respondents did not indicate that consent to the assignment of Insider Report contracts would be deemed to have been given if no answers were received from subscribers within any particular period of time. Nevertheless, within about two weeks those who had not agreed to the assignment were made subscribers to IFTP. Furthermore, the respondents did not inform subscribers of The Insider that their contracts could not be assigned without their consent.

The only advice given to The Insider Report subscribers to the effect that their subscriptions could not be assigned without their consent was in a legend printed on the initial subscription and renewal card forms which the subscribers signed and returned to initiate or renew their subscriptions. These forms were retained by The Insider Report and copies were not furnished to subscribers.

Although a considerable period of time estimated in some cases to be as much as a year had elapsed from the time of the original execution of the subscription card by subscribers, the facts regarding their rights concerning cancellation of the investment advisory contracts were not called to the attention of the subscribers to The Insider by respondents in letters mailed out by them.32/

When considering the provisions of Section 206, it should be borne in mind that investment advisers are professionals and should adhere to a stricter standard of conduct than that applicable to merchants. In this connection it should be kept in mind that securities are "intricate merchandise" and clients or prospective clients of investment advisers are frequently unskilled or unsophisticated in investment matters.33/

The major influence which motivated the respondents' determination to solicit consents from subscribers of The Insider Report to assign their investment advisory contracts to Stanford was the filing of the lawsuit by Lyon against them. As Ross put it, "In my opinion" Lyon had "milked the company. He had taken subscription revenues in advance and left the company without the funds which correspond to the subscriptions we had to service.

32/ Section 205 of the Act requires in substance that investment advisory contracts contain a provision "that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract."

33/ *Cf*. Investment Advisers Act Release No. 121.

Now, by what means I am not sure yet, but he had written himself a note to his brother for $25,000 as debt of The Insider Report which was the basis of the subsequent law suits, and we were in such poor financial shape on The Insider Report that we were unable to defend it."

Ross went on to explain that his "only reason" to solicit the consents was that it was his "only recourse and one which, perhaps I wish now I had taken would have been to put The Insider into bankruptcy because the claims of the Lyons would have the effect of The Insider Report at which time The Insider subscribers would have gotten zero for their subscriptions." (sic).

The addition of subscribers of Insider to those who were already subscribing to Stanford would be a distinct financial benefit to the latter. The respondent's failure to advise the subscribers of Insider concerning Insider's financial condition and regarding the existence of the lawsuit and Insider's inability to defend against the lawsuit, as the facts which triggered the solicitation of consents was a breach of respondents' fiduciary obligation to the subscribers of Insider to tell them the truth. Moreover, respondents should have furnished Insider clients with pertinent information concerning the fact that Stanford was a very small company having monthly receipts seldom exceeding $2,000., and did not maintain books on a current and accurate basis. When these facts are coupled with the further fact that the

respondents immediately prior to the solicitation of consents and when Insider was in extremely bad financial shape, had solicited persons to become subscribers to the Insider, the respondents' gross breach of their fiduciary duties to Insider subscribers becomes crystal clear.

Ross' protestations that his solicitation of clients of Insider was motivated solely by a desire to help them are not supported by the evidence in this case.

The evidence in this case shows that between July 12, 1965 and August 6, 1965, the respondents Ross and Stanford wilfully violated Section 206(1) and (2) of the Act by, directly employing a device and artifice to defraud clients and prospective clients and by engaging in transactions, practices and a course of business which operated as a fraud and deceit upon clients and prospective clients. In these connections, Stanford and Ross engaged in the solicitations of consents to the assignment by Insider clients of investment advisory contracts to Stanford by means of false and misleading literature mailed to them. The literature employed by respondents was false and misleading in that respondents did not inform Insider clients that they had a right to pro rata refunds upon cancellation of their subscriptions but that Insider was not financially able to make substantial refunds and that Stanford would not give pro rata refunds on Insider subscription fees upon cancellation by the subscriber. The soliciting material was also

false and material in that it did not disclose what arrangements would be made with Insider subscribers who did not consent to the assignment and also failed to disclose that consent to such assignment would be deemed to have been given after approximately two weeks if the subscriber remained silent for such period. In addition the soliciting material was false and misleading because it failed to disclose to subscribers of Insider that no assignment to Stanford of their Insider contracts could be made without their consent.

Violations of Section 206(2) and Section 206(4) of the Act and Rules 206(4)-1(a)(2) and 206(4)-1(a)(5).

In 1962 while Ross was an employee of Bridwell & Co.[34/] a certain number of management accounts were "attracted to that firm". Ross left Bridwell about May 1962 and "took the management accounts" with him. Stanford had been incorporated as a separate organization in January 1962 but Ross did not leave Bridwell until May of that year. When Stanford first began to do business the company managed accounts dealing with options and general accounts as well, but Ross' policy was to place no emphasis on the general accounts and to develop the option management accounts. Stanford's business of managing option writing accounts continued from mid-1962 through the spring of 1965. In this connection, the company engaged in the

---

34/ Ross was an employee of Bridwell & Co. from approximately June, 1961 to approximately May, 1962.

management of between 75 and 90 accounts and Ross exercised a limited power of attorney to order the execution of transactions on behalf of each advisory client. Ross testified that Stanford at first was a management concern with no subscription reports until June, 1964. It appeared, however, that Stanford began publishing a periodical newsletter on a subscription basis in approximately June or July of 1964. This newsletter was initially entitled "INVESTING FOR TOMORROW". Beginning with the issue date February 15, 1965, the name of the newsletter was changed to "INVESTING FOR TOMORROW'S PROFITS". All clients with accounts managed by Stanford, if they were not already subscribers, were added to the list of prospects for subscriptions to the newsletter. Accordingly, Stanford mailed its newsletter to persons who were both management account clients and persons who were not. In addition, Stanford published a brochure entitled "A NEW APPROACH TO STOCK MARKET PROFITS". This brochure was offered initially to "INVESTING FOR TOMORROW" subscribers at $1.00 per copy. Thereafter, it was furnished free to all new subscribers to Stanford's bi-weekly newsletter.

This brochure is the focal point towards which the Division has directed its claim that the respondents violated Section 206(2) and Section 206(4) of the Act and Rules 206(4)-1(a)(2) and 206(4)-1(a)(5).

The respondents contend that "A NEW APPROACH TO STOCK MARKET PROFITS" was not a document subject to the provisions of Section 206(4) of the Act and Rule 206(4)-1 thereunder because it was a financial publication of general and regular circulation

issued for educational purposes entitled to the benefits of the exclusionary provisions of Section 202(a)(11)(D) of the Act relating to "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." Thus it becomes necessary to consider the brochure to determine whether or not respondents' reliance on the section was justified.

The brochure in question consists of 8 pages. At the bottom of each page in large printed words is the caption, Stanford Investment Management, Inc." and the address of Stanford. A box appears on the facing page of the document in which in large print appears the following question "What is the Best Way to Invest My Money?" The answer to this question also appears within this box and is framed in part in the following language. "This is the one question that members of our staff hear time and time again. This is because there are so many different methods of investing." Then four different illustrations of methods of investing are presented and the following statements, among others, are made:

> "Unless you know in advance how you are going to handle the situation, it becomes very difficult to succeed in the stock market.
>
> "We believe that we have found one method of investing which goes a long way in overcoming the problems outlined above."

The document itself, among other things, sets forth various examples of option writing, some purporting to be hypothetical and others purporting to be actual. In these examples the option writers for the most part make enormous profits but never suffer losses.

At page 7 of the brochure there appears a caption reading as follows:

"PUT & CALL OPTION WRITING -- QUESTIONS AND ANSWERS"

The first question is "Who decides what option I will sell?" The answer is "We do, this is a part of our management service. First we determine if the premium offered is a fair one and if it is based upon a stock which we consider desirable. Then we check to see if it 'fits' with your portfolio."

A few of the other questions and answers read as follows:

> "Should I start writing options with cash or with a portfolio of securities?
>
> Either way is possible. We prefer cash, of course, because it is simpler. But some clients have started by transferring a list of stocks into an option writing account, with equal success.
>
> "How much cash do I need to start an option writing account?
>
> $50,000 or more gives us complete freedom to accept any type of attractive option for your account. Obviously, options on IBM, Polaroid, Xerox and other high priced stocks cannot be placed in a smaller account simply for a lack of funds. And many of these 'high flyers' produce very attractive option premiums, indeed. However, ample options exist on more moderately priced stocks to handle smaller management accounts with equal success. Our minimum account, however is $25,000.
>
> "Does anyone else manage option writers -- as Stanford Investment Management, Inc. does?
>
> To the best of our knowledge, our firm is the largest investment advisory organization offering aid to individual option writers. Several of the put and call dealers offer 'management' assistance to writers who place all of their business through that firm. However, since they are buying options for their own account from the clients they manage, we feel that a possible conflict of interest could arise in such a situation. Stanford Investment Mgmt. is not affiliated with or controlled by any put and call firm or broker.

"Does Stanford Investment Management manage funds other than for option writers?

Yes. We also manage regular portfolio investments for individuals and institutions. For different personal and business reasons, some individuals prefer not to undertake option writing but still desire help with their investments. For more information on this phase of our service, write for specific details.

"Where can I find information concerning income taxes on puts and calls?

Stanford Investment Management does not provide an accounting service although periodic summaries are sent to all clients. Each new client will receive a booklet containing detailed information concerning options and taxes.

"Can I write options for myself? Why do I need your management service?

Unless you live in New York, Los Angeles, or San Francisco, you may not even be able to find an option dealer or broker who will be willing to help you. Many firms will not accept option writing accounts for individuals with less than $100,000.

The total of the accounts we manage exceeds this amount many times). Certain stocks which we select for you are 'repeaters'. This is, options can be written on them time after time. Other options which are offered to us are sucker plays and which we know how to avoid. As a beginner, working on your own, you could get trapped in some undesirable situations. Our experience works for your benefit. Because we write hundreds of options, we are in a good bargaining position with the put and call dealers. A small, individual option writer often does not get a chance to do the most attractive options. These are usually offered to us first.

"How do you manage my funds? Do I send a check to you?

No. We are merely advisers. We do not assume custody of your assets. You will deposit your funds with the NYSE broker we recommend. We then place orders for you by means of a limited power-of-attorney which is deposited with the broker.

"Am I informed as each trade takes place?

> The broker sends you the usual buy and sell confirmation of each trade as it is made. Then, periodically, we submit a summary of all transactions which shows your current position. Of course, you are free to check with us whenever you wish. However, speed is essential in handling option orders and we do not have time to check with you prior to completing each trade."

Since one of the major purposes of this document was to attract clients to Stanford and to earn fees for specific investment services to be performed by Stanford, this brochure is an advertisement within the meaning of Rule 206(4)-1(b). Respondents' argument that this and other brochures employed by Stanford are not subject to the provisions of the Act and the Rules adopted thereunder by reason of the provisions of Section 202(a)(11)(D) of the Act are without merit.

"A NEW APPROACH TO STOCK MARKET PROFITS" was first used by Stanford and Ross in mid-1964. According to Ross 10,000 copies of this brochure were printed and about 2,000 were distributed. In addition to "A NEW APPROACH TO STOCK MARKET PROFITS" Stanford issued various newsletters to its subscribers of which five were received in evidence.

In "A NEW APPROACH TO STOCK MARKET PROFITS" the respondents under the heading "EXAMPLES" set forth six hypothetical examples illustrative of various types of option transactions.

For each hypothetical example, the brochure sets forth the results based on each of three alternative possiblities, the underlying stock goes up in price, goes down, or stays about the same.

The brochure then states the worst possible result on an annual basis and the average yield over a period of years. The latter figure is derived by taking a mathematical average of the worst and best possible results achievable based on the given hypothetical assumptions.

For the first two hypothetical examples the worst possible result is shown as a 13% return on investment on an annual basis and the average yield over a period of years is shown as 23%.

For the next two hypothetical examples the worst result shown is breaking even on an annual basis and the average yield over a period of years is shown as "57-1/2%!"

For the fifth hypothetical example the worst possible result is shown as a 200% yield on an annual basis and the average yield over a period of years is shown as "300%".

For the sixth hypothetical example the worst possible result is shown as breaking even on an annual basis and it is stated that "We are more likely to receive $3,000 in an average year — 80% on an annual basis."

In addition to the hypothetical examples, four additional examples are presented under the heading "ACTUAL EXPERIENCE WITH OPTIONS". The respondents refer to "a few options <u>which we know were recently written by local option writers</u>". [Italicized in original]. In this connection the respondents described options said to have been actually written on the stocks of Westates Petroleum,

United Fruit, Control Data, and Chrysler.

In the first actual example, if the stock underlying the option stays at the same price or rises, the "writer will receive 91% gain on an annualized basis!" [Language in quotations italicized in original]. It is further pointed out that the underlying stock would have to drop from $5 per share to $3-7/8 per share "before the option writer could suffer any possible loss." [Language in quotations italicized in original].

In the second actual example the transactions on behalf of the option writer placed him in a position whereby he "could not suffer a loss" if the underlying stock stayed within a 9-1/4 point range in which it had traded for the last 8 months." [Language in quotations italicized in original].

In the third actual transaction given as an example, as long as the underlying stock stays between $75 and $123-1/4 per share "the writer could not suffer a loss!" [Language in quotations italicized in original].

In the fourth actual transaction given as an example, the writer received a gain of 33% on his investment on an annual basis.

The document also contains 10 footnotes following the hypothetical examples one of which reads as follows:

> "While these examples closely parallel the normal maneuvers of successful option writers, actual results may vary in degree from the examples shown. Obviously, no representation is made that these gains will always be obtained in actual practice."

In addition the brochure contains a caption headed "SOME RISKS INVOLVED" pointing out some ways in which an option writer could suffer losses. Immediately under this heading is a heading labeled "MINIMIZING LOSS" under which examples are given purporting to show how an option writer's risks can be made less than those taken by an ordinary buyer of stock.

The glittering examples of enormous return on investment to be made by using the respondents' expert services in writing options lose little luster by the unobtrusively placed caveats contained within "A NEW APPROACH TO STOCK MARKET PROFITS". The dominant and overriding appeal is for the prospective client to employ Stanford in order to make huge profits quickly.

For example the hypothetical illustrations show average yields over a period of years of 23%, 57-1/2%, 300% and 80% with the worst possible results in any of the hypothetical examples as breaking even. One of the principal features under the actual examples pictured in "A NEW APPROACH TO STOCK MARKET PROFITS" was the minimal risk involved in writing options as recommended by respondents. The one actual example which was followed through to completion with no unexpired options shows a return on investment on an annualized basis of approximately 33%. The allegedly easily attainable high returns on investments in "option writing", providing the reader subscribes to Stanford's investment advisory services, contrasts unfavorably with the results reached by the

respondents in the actual management of Stanford's investment advisory accounts.

When Ross was asked what his actual experience was in dealing with Stanford's clients, he either would not or could not give a direct answer to the question. After an effort to obtain a direct answer from Ross as to Stanford's actual results on behalf of the clients was made he finally replied that "Some of those [customers] who didn't last that long who chose to leave early had various losses. Some of them had minor gains. Some of the larger accounts and more active accounts have gains of 20% or more."

Ross pointed out that in his material soliciting clients he had stated that options were normally written for periods of 35, 65, 95 days and 6 months and 10 days. He went on to explain that in order for an investor to earn substantial profits it was necessary that such person be engaged in the business of option writing for a long period of time but that investments of this character offered no assurance of profits particularly when the person is investing over a short period of time.

The witness' answers as to the actual return received on investment by Stanford's clients were hesitant, frequently evasive, and of doubtful credibility.

The technique employed by respondents in "A NEW APPROACH TO STOCK MARKET PROFITS" had a substantial similarity to the advertising approach described in Spear & Staff, Incorporated, 35/ namely, to picture

35/ Investment Advisers Act Release No. 188 (March 25, 1965).

examples or purported examples of outstanding success in making investments on either a hypothetical or actual basis and then to attribute the success achieved by the investors to the virtues of making investments based on the highly specialized knowledge of the market and of option writing which the respondents attributed to themselves and their organizational facilities. For example in "A NEW APPROACH TO STOCK MARKET PROFITS" under the hearing "INVESTMENT MANAGEMENT ESSENTIAL FOR OPTION WRITING SUCCESS" Stanford referred to most dealers having "direct phone lines or teletype wires installed to their bigger writers. Stanford Investment Management, for instance, maintains a private wire for the exclusive use of option dealers across the country. When the dealer queries a writer, the buyer may be waiting on another phone. In an active market, a potential buyer who is interested in a call on a $25 stock may not be interested at $25 1/4. Therefore, he must have an answer <u>right away</u>." [Underscored words italicized in original]. Further, "At Stanford Investment Management, the option dealers and brokers call us at least five to ten times <u>each hour</u>. [Underscored words italicized in original]. This is why we feel you can profit by using us as your agent and eliminating any bothersome deals."

The reference to the high profits contained in the illustrations set forth in " <u>A NEW APPROACH-TO STOCK MARKET PROFITS"</u> together with the picture presented of an extremely high powered organization which Stanford is depicted as being imply that utilization of registrant's

investment advisory services would bring similarly high profits to persons who subscribed to its services.[36/] The registrant's advertisements were aimed at arousing false hopes of quick and substantial profits to those who would subscribe to Stanford's services.

The Division charges that not only did Stanford and Ross violate Section 206(2) and 206(4) of the Act but that they also violated Rules 206(4)-1(a)(2) and (5) adopted thereunder.[37/] The latter two rules relate to advertising.

Section 206(4) makes it unlawful to use the mails to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative, and authorizes the Commission to adopt rules designed to prevent such practices. Pursuant to this authority the Commission adopted Rule 206(4)-1 which is directed in specified respects towards the character of advertising which may be published, circulated or distributed by a registered investment adviser. In this connection Rule 206(4)-1(b) defines the term "advertisement" to include a written communication which "offers (1) any analysis, report, or publication concerning securities, any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula or other

---

36/ This picture of Stanford in this brochure as a highly successful and busy organization contrasts sharply with respondents' contention that it was not obligated to maintain its books on a current basis because its business was so small that it rarely wrote more than a dozen checks a month and its receipts seldom exceeded $2,000 a month.

37/ See footnote 3 *supra*.

device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities." (Underscoring supplied.)

"A NEW APPROACH TO STOCK MARKET PROFITS" offers Stanford's advisory services and is clearly an advertisement within the meaning of the rule.

The respondents, among other things, challenge the Division's contention that "A NEW APPROACH TO STOCK MARKET PROFITS" "refers, directly or indirectly to past specific recommendations of <u>such investment adviser</u> which were or could have been profitable to any person". (Underscoring supplied.)

The language "such investment adviser" in Rule 206(4)-1(a)(2) refers specifically to the investment adviser charged with a violation of the rule.

The first ten examples referred to in "A NEW APPROACH TO STOCK MARKET PROFITS" are stated to be hypothetical. Accordingly, they cannot be considered to be "past specific recommendations" of Stanford or Ross.

The four actual examples referred to in the document are stated to be "options <u>which we know were recently written by local option writers</u>". [Language underscored are italicized in original].

The respondents contend that "A NEW APPROACH TO STOCK MARKET PROFITS" contains no past specific recommendation of Stanford or Ross coming within the ambit of the rule.

Stanford's language in "A NEW APPROACH TO STOCK MARKET PROFITS" under the heading "ACTUAL EXPERIENCE WITH OPTIONS" does not at any point directly refer to a past specific recommendation made by Stanford or Ross. However, the Division contends that the language employed by Stanford and Ross in this document refers to past specific recommendations indirectly and thus comes within Rule 206(4)-1(a)(2). In this connection the Division points out in its reply brief that in the document under the heading "ACTUAL EXPERIENCE WITH OPTIONS" the text reads "'Having worked through the above examples,you may wonder how close they come to reality. Here are a few options which we know were recently written by local option writers' (Emphasis in original.). This introduction in the context of the whole pamphlet, strongly implies that the local option writers referred to are customers of the respondents and were following respondents advice."

The respondents deny that such an implication was intended or could fairly be implied.

The implication that the "local option writers referred to are customers of the respondents and were following respondents' advice" does not necessarily follow from the text of the brochure.

Neither the document itself nor the testimony in the record impels the conclusion drawn by the Division. The correctness of the Division's implication is, in the Hearing Examiner's opinion open to reasonable doubt. Accordingly, the Division has not established by a preponderance of the evidence the conclusion which it urged upon the Hearing Examiner that the respondents in "A NEW APPROACH TO STOCK MARKET PROFITS" either directly or indirectly made a specific recommendation falling within the ambit of Rule 206(4)-1(a)(2).

The Division also points to several specific recommendations contained in the various letters mailed by Stanford to its subscribers pursuant to its agreement to render advisory services.

It is quite true that Stanford in such letters made various recommendations without referring to any of its past recommendations made during a previous 12-month period. However, the provisions of Rule 206(4)-1 deal with advertisements by investment advisers soliciting the public to buy their services and not with statements relating to recommendations made in investment advisory letters to subscribers. Rule 206(4)-1 relating to advertisements does not apply to such letters except in a case where the letters themselves are employed as and come within the definition of an "advertisement" contained in subsection (b) of the rule. A showing that letters to the subscribers were so employed has not been made here.

Accordingly, the Hearing Examiner finds and concludes that Stanford and Ross violated Sections 206(2) and 206(4) of the Act and Rule 206(4)-1(a)(5) thereunder, but did not violate Rule 206(4)-1(a)(2).

Violations of Section 204 of the Act and Rule 204-1(b) Adopted Thereunder

Section 204 of the Act requires every investment adviser who makes use of the mails to "make such reports as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest for the protection of investors." If the information contained in the application, or in any supplement or amendment thereto, filed by a registered investment adviser is or becomes inaccurate for any reason, Rule 204-1(b) adopted under Section 204 requires an amendment be filed promptly on Form ADV correcting such information.

The Division charged that during the period from on or about May 28, 1962 through January 25, 1966 Stanford aided and abetted by Ross wilfully violated Section 204 of the Act in failing to make timely filings of information which were required because the information on file was inaccurate. The Division charged that respondents failed to make prompt filings as required by the Rule in connection with the outstanding stock of Stanford and in regard to the stock holdings of Lafayette C. Weeks; in regard to changes in the list of officers and directors of Stanford, and concerning changes in the periodic publications or special reports published by Ross and Stanford.

Form ADV, among other things, requires registered investment advisers to furnish information concerning the full name, class

of security, number of shares owned, and the total number of shares outstanding, in the case of any person, directly or indirectly the beneficial owner of ten percent or more of the outstanding stock of any class of any equity security of applicant or registrant; requires a complete list of officers and directors, and persons holding similar status or functions; and requires registered investment advisers to state whether they issue periodic publications relating to securities on a subscription basis and if so to furnish the name of each publication, the period covered and the subscription price. The filing of information of this character is material and necessary to the functions of the Commission in its regulatory activities under the Act.

The facts in connection with the respondents' failures to file promptly as required under Section 204 and Rule 204-1(b) thereunder may be summarized as follows:

The respondents made a filing on Form ADV on December 9, 1963 showing that the total number of shares of Stanford's common stock outstanding was 5,555, of which 555 were held by Lafayette C. Weeks.

On May 14, 1964, 327 additional shares of stock were issued to Weeks. The Division charged that this change had never been reported by the respondents on Form ADV.

In March 1966 Stanford and Ross furnished to the Commission a copy of a May 1965 agreement referring to the fact that Weeks

owned 882 shares. Copies of this contract which had been provided to the Division in response to an inquiry made by it were forwarded to the San Francisco Regional Office and were erroneously placed in Stanford's duplicate registration file. The May 1965 agreement had not been filed as an amendment to Stanford's ADV filing. In fact no filing on Form ADV had ever been filed reflecting this change by Stanford. However, no matter what view may be taken of this particular occurence, i.e., whether the furnishing of a copy of the agreement to the Division be considered a filing on Form ADV or not, the fact of the matter is that the information relating to the change in stock ownership and the issuance of additional shares to Weeks were received in March 1966 — almost two years after the event. Accordingly, the filing relating to Weeks could not be considered as meeting the requirements of Rule 204-1(b) requiring that such filings be "promptly" made.

Mrs. Ross, the respondent Ross' wife, became secretary-treasurer of Stanford in June 1965 and Weeks ceased to be a director and officer at that time. On January 26, 1966 the respondents filed an amendment on Form ADV reflecting the resignation of Weeks and the ascension of Mrs. Ross to the post of officer and director of Stanford. An amendment on Form ADV filed seven months after the event reported does not constitute compliance with the "promptness" provision of Rule 204-1(b).

Stanford published a newsletter called "INVESTING FOR TOMORROW" at a subscription price of $30.00 per annum. On February 22, 1965 Stanford began publishing a newsletter under the name "INVESTING FOR TOMMORROW'S PROFITS" and this newsletter was offered at $48.00 per annum. As charged in the May 19, 1966 order instituting this proceeding, no amendment reflecting this change in the name of the publication and in the price was filed until January 25, 1966. An amendment filed some 11 months after the change in the name and price of a newsletter cannot be considered as having been made promptly as required by the Rule.

In mid-August, 1965 the respondents began publishing a monthly entitled Ross Research Report. This was a document offered to IFTP subscribers on a two-year subscription basis at $125.00. In addition to this report the subscriber was entitled to receive a one-year extension of his current IFTP subscription. The first issue of Ross Research Report was mailed to approximately 300 subscribers. Although the Ross Research Report began publication in mid-August 1965, no amendment on Form ADV was filed by Stanford and Ross prior to February 28, 1966. The respondents argue that the failure to disclose the existence and distribution of the Ross Research Report monthly service by Stanford was unnecessary because the latter was merely an extension of IFTP.

Contrary to this contention, the Ross Research Report was not merely an extension of IFTP but was a different research report

costing subscribers substantially more money than the IFTP service and was in addition to IFTP which they continued to print and distribute to their clients.

Stanford and Ross had been advised in a letter dated March 5, 1963 by the San Francisco Regional Administrator of the importance of filing amendments whenever any information contained in the application for registration or any amendment thereto became inaccurate for any reason. While such amendments were filed in most instances by the respondents such filings as were made, were not filed promptly as required by the Rule.

The respondents contend that the information which the Division contends should have been filed promptly on Form ADV was not material and that in any event their failure to file should be excused because they had left such filings to Stanford's corporate counsel who, for reasons apparently best known to himself, had not made the filings. The Commission's Form ADV calls specifically for filing amendments in each of the cases where respondents either did not file at all or failed to file promptly as required by the statute and the rule. In substance the respondents are contending that the information which the Commission requires registered investment advisers to file is not really material and therefore they do not have to comply with the rule or supply the information demanded by the Form. The argument is not persuasive and is rejected.[38/]

38/ Cf. Filosa Securities Company, 39 S.E.C. 896, 899.

Ross had been made aware of the importance of filing amendments by reason of the San Francisco Regional Administrator's letter to him of March 5, 1963. In addition, Ross was well aware that every amendment required his signature and he made no claim that his signature had ever been affixed promptly to any Form ADV as required by the Rule. Accordingly he was personally aware that the filings had not been made promptly.

The failure of the respondents to file corrective amendments as charged by the Division were so persistent and so numerous that they must be regarded as wilful.[39]

Due Process of Law

The respondents contend that they have not been accorded due process of law, among other reasons, because the rules promulgated by the Commission under the Investment Advisers Act and the amendments thereto are not, in their view, reasonably specific. The principal focus of this contention appears to relate to the Division's charges of fraud made against the respondents.

It is quite correct to say that the Act does not define fraud. The courts have traditionally refused, whether at common law deceit or under the securities laws, to define fraud with specificity.

39/ Cambridge Research and Investment Corp., 40 S.E.C. 252 (1960); Security Forecaster Co., Inc. 39 S.E.C. 188 (1959); Edwin Hawley, 32 S.E.C. 375 (1951).

Were any hard and fast rule to be laid down as to what constitutes fraud under the securities acts "a certain class of gentlemen of the 'J. Rufus Wallingford' type — 'they toil not neither do they spin' — would lie awake nights endeavoring to conceive some devious and shadowy way of evading the law. It is more advisable to deal with each case as it arises." 40/

In S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963), the Supreme Court made it clear that the anti-fraud provisions of all the federal securities laws, including those contained in the Investment Advisers Act, have as their fundamental purpose the substitution of a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a higher standard of business ethics in the securities industry by eliminating all manner of fraud and deceit. 41/ Both the Investment Advisers Act and the Rules adopted thereunder are phrased in material respects similarly to other federal securities statutes and rules administered by the Commission. The argument that the Investment Advisers Act and the Rules adopted thereunder are not sufficiently specific is rejected as unfounded.

40/ State v. Whiteaker, 118 Ore. 656, 661, 247 Pac. 1077, 1079 (1926).

41/ As the Court pointed out in a footnote at p. 193 of its opinion in quoting a letter of Lord Hardwick to Lord Kames dated June 30, 1759

> "Fraud is infinite, and were a Court of Equity once to lay down rules, how far they would go, and no further, in extending their relief against it, or to define strictly the species or evidence of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's invention would contrive."

The same comment is equally applicable to an administrative agency.

The respondents claim that the instant proceeding is akin to a "criminal proceeding for wilfully violating the Act (in which). . . other considerations may be relevant", and is a "quasi-penal proceeding." Contrary to respondents' contentions the sanctions sought by the Division in this case are not penal or quasi-penal in character but remedial. They are designed principally to protect the public from the continuance of conduct which has been found to be in violation of the Act. The Commission's power to suspend or revoke the registration of an investment adviser is dependent upon the making of a finding that such suspension or revocation is in the public interest, and that such investment adviser has wilfully violated the Act. It is plain from the provisions of the Act as well as from the form of remedy sought that the imposition of sanctions under the Act is not a penal measure but a remedial step to be taken by the Commission in an appropriate case to protect the public against future dangers of exposure to the type of conduct which impelled the Commission to order the sanction. Blaise D'Antoni & Associates v. S.E.C., 289 F.2d 276, 277 (5th Cir. 1961); Pierce v. S.E.C., 239 F.2d 160, 163 (9th Cir. 1956). See Wright v. S.E.C., 112 F.2d 89, 94 (2d Cir. 1940). See also Mutual Fund Distributors, Inc., S.E.C. Securities Exchange Act Release No. 6862, p. 7, Kimball Securities, Inc., 39 S.E.C. 921, 924-5 (1960).

In addition, the respondents object to the exclusion of evidence during the hearing "particularly that of the opinions of qualified experts concerning trade practices in the area of Put and Call trading." In the opinion of respondents ". . . absent specific and definite guidelines promulgated by the Commission, the custom of the trade becomes the only standard to which registrant may look and is, therefore, highly relevant to the issue of the violations herein alleged."

The evidence which was offered by respondents and excluded by the Hearing Examiner related to the presentation of opinions by expert witnesses who were registered representatives in brokerage firms dealing in puts and calls as to whether "A NEW APPROACH TO STOCK MARKET PROFITS" contained false and misleading statements and whether the statements contained in such document were in accordance with "the custom of the trade".

The determination whether the document was false and misleading is an issue solely for the determination of the Hearing Examiner and the Commission and the appropriate test whether the document was false or misleading is not "the custom of the trade." but the standards established under the Act. 42/

The respondents also point to the testimony of a registered representative for a stock exchange firm to the fact that some

---

42/ See footnotes 3, 4, 5 and 25 *supra*.

person not employed by the Commission had informed him at some point prior to the hearing at which he testified that the respondent Ross was under investigation by the Commission. Based upon this testimony the respondents claim that the fact of this investigation had become public knowledge and that, therefore, the requirements of due process and the Commission's own Rules of Practice relating to investigations require the dismissal of this proceeding. The fact that a witness received information concerning the existence of an investigation is not a valid basis on which to dismiss the proceeding for lack of due process or under the Commission's rules.

The respondents' claims concerning failure to comply with the requirements of due process are without merit and are rejected.

Public Interest

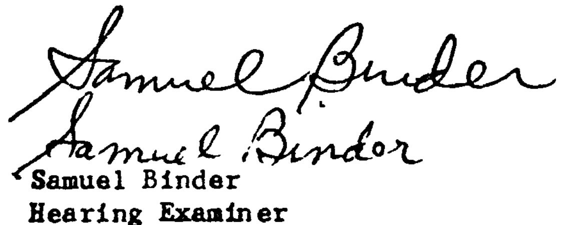
In view of the numerous and serious violations of the Investment Advisers Act including the respondents' gross violation of their fiduciary duties to subscribers of Insider and Stanford, in view of the false and misleading character of the solicitation of consents and because of the false and misleading advertisements employed by the respondents, and in view of their persistent and wilful violation of the Commission's bookkeeping rules and their wilful neglect and refusal to file amendments promptly to Stanford's investment adviser registration, it is in the public interest to revoke the registration of Stanford Investment Management, Inc. and Lawrence Ronald Ross as investment advisers.

The violations of the Act which were established in the proceeding were not merely technical in character, but were wilful, grave and numerous and involved gross fraud and serious breaches of respondents' fiduciary duties to their clients.

Accordingly, IT IS ORDERED that the registrations of Stanford Investment Management, Inc. and Lawrence Ronald Ross as investment advisers be and they are hereby revoked.

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(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within fifteen days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 14(b) or 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 to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.



Samuel Binder
Hearing Examiner

Washington, D.C.
March 31, 1967