UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
GEORGE HARMON COMPANY, INC. 18141 Napa Street Northridge, California File No. 24SF-2922	
Securities Act of 1933 Section 3(b) and Regulation A	

RECOMMENDED DECISION

SIDNEY L. FEILER
Hearing Examiner

Washington, D. C.
November 6, 1963.

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APPEARANCES:

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BEFORE: SIDNEY L. FEILER, HEARING EXAMINER

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I. THE PROCEEDINGS

On January 16, 1962, the Commission issued an order pursuant to Rule 261 of the General Rules and Regulations issued by it under the Securities Act of 1933, as amended ("Securities Act"), temporarily suspending the exemption under Regulation A of a public offering of securities of George Harmon Company, Inc. ("the Issuer") and affording any person having an interest therein an opportunity to request a hearing. 1/ The Issuer having made a written request for a hearing, and the Commission deeming it necessary and appropriate to determine whether to vacate the temporary suspension order or to enter an order

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1/ Regulation A adopted under Section 3(b) of the Securities Act provides for an exemption from registration for securities offered by an issuer if the aggregate public offering price does not exceed $300,000 provided, among other things, that the issuer files with the Commission a Notification and Offering Circular satisfactorily setting forth certain specified information.

Rule 261 provides in pertinent part for the issuance of an order temporarily suspending an exemption if the Commission has reason to believe that (1) any of the terms or conditions of Regulation A have not been complied with; (2) the notification or offering circular contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (3) the offering is being made or would be made in violation of Section 17 of the Securities Act. Rule 261 further provides that where a hearing is duly requested, the Commission will, after appropriate notice of and opportunity for such hearing, either vacate the order or enter an order permanently suspending the exemption.

Section 17 of the Act makes it unlawful in the offer or sale of securities by the use of the mails or interstate facilities to employ any device to defraud, to obtain money by means of untrue or misleading statements of material facts, or to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

permanently suspending the exemption, ordered that a hearing be held to determine issues set forth in an amending order dated February 8, 1962. As further amended at the hearing, these issues are:

Whether the Issuer had complied with the terms of and conditions of Regulation A in that:

A. The offering circular contained untrue statements of material facts and omitted to state material facts necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading, particularly with respect to:

1. The representation in the offering circular that the Issuer had a backlog of orders totalling $4,314,349;

2. The representation in the offering circular that the Issuer had an order totalling $4,130,000 for telephone answering devices.

3. The representation in the offering circular that the Issuer had an order totalling $59,415 for Talk-A-Way Transceivers.

4. The representation in the offering circular that there was a further order aggregating approximately $1,540,000 for inertia switches which the company had been assured would be placed with it by a prime West Coast missile contractor upon a showing of adequate working capital, which in the opinion of management would be available upon completion of the offering.

B. The terms and conditions of the Regulation had not been complied with in that the offering circular actually used and distributed did not conform to the offering circular filed in the Regional Office.

A rider amendment to be affixed to page 7, dated December 20, 1961, as filed, was in fact affixed to the facing page.

C. Untrue statements of material facts and omissions to state material facts necessary in order to make the statements made, not misleading, were made with respect to the backlogs of orders to George Harmon Company, Inc., in the offer and sale of the common capital stock, 10¢ par value, of George Harmon Company, Inc., made pursuant to its offering circular, in violation of Section 17 of the Securities Act of 1933, as amended.

D. The offering has been and would be made in violation of Section 17 of the Securities Act of 1933, as amended.

Pursuant to notice, a hearing was held in Los Angeles, California and New York, N. Y. before the undersigned Hearing Examiner.

The Division of Corporation Finance and the Issuer were represented by counsel. All parties were afforded full opportunity to be heard and to examine and cross-examine witnesses.

At the conclusion of the presentation of evidence, opportunity was afforded the parties to state their positions orally on the record. Oral argument was waived. Opportunity was then afforded the parties for the filing of proposed findings of fact and conclusions of law, or both, together with briefs in support thereof. Proposed findings of fact and conclusions of law, together with supporting briefs, were received from the parties as well as reply briefs.

On the entire record, and from his observation of the witnesses, the undersigned makes the following:

II. FINDINGS OF FACT AND LAW

A. The Issuer

1. The Issuer is a non-operating holding company, incorporated in Nevada in 1961, and owns all the shares of common stock of a corporation of the same name incorporated in California in 1958,[2/] and known as the operating company.[3/] At the times here relevant, it was a manufacturer in the field of electronics and electro-mechanical devices. It traced its beginnings to a solely-owned proprietorship begun by George Harmon Cooke in the field of electronics instrument manufacturing. Cooke was president and a director of the Issuer until his resignation as president on or about March 19, 1962 when he became Chairman of the Board of Directors.

2. The Issuer maintained its electronics manufacturing plant at Northridge, California.

B. The Regulation A Filing

3. The Issuer filed with the Commission on July 21, 1961 at its San Francisco Regional Office a notification and offering circular relating to a proposed public offering of 62,500 shares of its 10¢ par value common stock to be offered on its behalf at $4 per share and 10,000 stock purchase warrants at 10¢ a share and 10,000 shares of common stock underlying such warrants, for the benefit of Hamilton Waters & Co., Inc., Hempstead, N. Y., the underwriter, and certain finders, all for an aggregate offering price of not to exceed $300,000. The filing was made

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2/ The Issuer is now in bankruptcy. The current state of the Issuer's affairs is not a part of this record. This decision deals solely with the condition of the Issuer as of the time of the hearing.

3/ The term "Issuer", as used herein, applies to both companies.

pursuant to Regulation A and under a claimed exemption from the registrant requirements in the Securities Act, pursuant to Section 3(b) thereof. The 62,500 shares would be offered on behalf of the Issuer by the underwriter on a best-efforts basis for ninety days from the effective date of the offering circular, at the end of which time or when all 62,500 shares were sold, the warrants and underwriting shares could be offered on behalf of the underwriter and finders.

4. Details of the Issuer's business and financial condition were provided in the offering circular. It was noted that since the inception of the business in 1958, the total aggregate sales of the company had been $436,751.71. The issuer was described as a diversified manufacturer in the field of solid-state electronics and electro-mechanical devices. Its capitalization is listed as 1,000,000 shares of common stock of 10¢ par value of which 107,500 shares were outstanding at the time of the offering. The Issuer also had an agreement that the issuance of 10,000 warrants to the underwriter was contingent on the latter's selling the entire issue or else receiving a pro-rata share of the warrants. The Issuer filed certain amendments to its offering circular and began its public offering of stock on September 8, 1961, employing a definitive offering circular bearing that same date.

5. The offering circular stated that the backlog of the Issuer, as of July 10, 1961 was approximately $130,000.

6. On December 15, 1961, the Issuer filed the following two amendments to its offering circular:

(1) An amendment in the form of a rider to be affixed to page 7 of the offering circular as follows (known herein as the "backlog amendment"):

> "As of the date of this rider the Company's backlog of orders for its products amounts to approximately $4,314,349.00, consisting of the following orders: telephone answering devices, $4,130,000; acceleration testing equipment, $28,454; converter power supplies, $4,480; Talk-A-Way Transceivers, $59,415; Walk-A-Phone Transceivers, $92,000.
>
> "There is a further order aggregating approximately $1,540,000 for inertia switches which the Company has been assured will be placed with it by a prime west coast missile contractor upon a showing of adequate working capital, which in the opinion of management will be available upon completion of this offering. The Company, however, cannot give any positive assurance that such order will in fact be made firm. The Company's facilities are adequate to handle present and contemplated orders. It may be necessary to secure bank financing to handle such business if delivery schedules so require."

(2) An amendment in the form of a rider to be affixed to the covering page of the offering circular as follows (known herein as the "warrants amendment");

> "The sale of 62,500 shares of Common Stock on behalf of the Company has been completed. The offering is now being continued on behalf of the Underwriter and Finders as to 10,000 shares of Common Stock underlying the Warrants referred to above."

7. The definitive revised offering circular containing the above rider amendments, dated December 20, 1961, was filed with the Commission on December 22, 1961.

8. On January 16, 1962, the Commission issued its order of temporary suspension. The Issuer, on February 7, 1962, sought to file a Third Amendment to the offering circular. By letter dated February 9, 1962 the Issuer was advised bytthe San Francisco Regional Office that it was "unable to accept this material for formal filing".

9. On February 8, 1962, the Commission issued its order scheduling a hearing on March 5, 1962.

10. On February 28, 1962, the respondent filed its "Motions to Terminate or Expedite Proceeding," with supporting brief. These motions sought, in summary, to expedite or terminate the proceeding, in the alternative and in their order of priority, (1) by the acceptance for filing of a proposed Fourth Amendment to the Offering Circular, as amended, and by the entry of a Commission order vacating the temporary suspension order; (2) by requiring the Commission's Staff to disclose the deficiencies or inaccuracies, if any, in the proposed Fourth Amendment and to permit respondent to file a further amendment or to enter into a stipulation with respect thereto, and by the entry of a Commission order thereupon vacating the temporary suspension order; or (3) by requiring the Commission's Staff to disclose the deficiencies or inaccuracies, if any, in the proposed Fourth Amendment and to permit respondent to file a further amendment or enter into a stipulation with respect thereto and by the entry of a permanent Commission order suspending the Regulation A exemption, upon respondent's agreement thereto, provided the Commission immediately thereafter entered an order vacating

such suspension order. Under any of the above circumstances, provided the offer was accepted, respondent agreed to offer to rescind, at the cost paid therefor, the sale of any of its shares of stock made by the underwriter on behalf of respondent on or after November 1, 1961, where such purchase was made in reliance upon the information contained, or similar to that contained, in the amendment dated December 20, 1961.

11. Issuer's proposed Fourth Amendment represented a revision of its proposed Third Amendment sought to be filed on February 7, 1962. The Fourth Amendment purported to cancel the rider amendments to the offering circular, dated December 20, 1961 and to furnish full disclosure of material facts as then known to the Issuer.

12. After considering briefs filed by the parties in support of their respective positions, the Commission, on March 2, 1962, denied the motions. The Memorandum ruling concluded with the following language:

> The Commission duly considered the motions, which it viewed as in the nature of an offer of settlement of the proceedings which it could accept or reject in its sound discretion. It was of the opinion that in the light of the serious nature of the issues raised in the proceedings it was appropriate that the motions be denied and the hearings proceed as scheduled. At the hearings all pertinent facts relating to the alleged grounds for suspension and the question of whether it should be vacated or made permanent, including any facts bearing on the asserted good faith of the issuer and underwriter, could be developed.

13. The hearing in this proceeding convened on March 5, 1962. On March 9, the Issuer filed Motions to Terminate or Expedite Proceeding. Filed at the same time was a proposed Fifth Amendment to the

offering circular. Counsel stated that the Motion to Expedite was in effect the same motion filed on February 28 and that the Fifth Amendment was a revision of the proposed Fourth Amendment. In connection with the Motion, an offering of rescission of all sales of stock dating back to September 8, 1961, the date of the offering circular, was made. The factual statements contained in the proposed Fifth Amendment were also offered unconditionally by the Issuer as stipulations of fact in the proceedings (Tr. p. 736). Subsequently, the facts stated in the proposed Fifth Amendment were not agreed to by the Division as a full stipulation of facts and issues but a stipulation as to testimony to be given by certain witnesses to be called by the Division was arrived at and the proposed Fifth Amendment was then revised by the Issuer to conform to this stipulation (Tr. pp. 818-819).

C. Issues for Determination

14. The issues raised by the Division are the items set forth in the temporary order of suspension, as amended. The Division contends that the offering circular, as amended, contained false and misleading statements in citing the backlog of business of the Issuer, that untrue statements of material facts and omissions to state material facts necessary in order to make the statements made not misleading were made with respect to the backlog in the offer and sale of the common stock of the Issuer in violation of Section 17 of the Securities Act, and that the offering circular used did not conform to the offering circular filed in the Regional Office in that an amendment to be affixed

to page 7 was in effect affixed to the facing page in violation of Regulation A.

15. The Issuer conceded at the outset of its brief that certain statements made in its Amendment dated December 20, 1961 were inaccurate or deficient and therefore may have been misleading. It maintained that it filed three separate amendments thereafter in an attempt to make full and true disclosure of all material facts and to terminate the proceedings in the public interest. It raises additional issues in the following statement:

16. "The record in this proceeding clearly presents for adjudication the additional issue of whether or not, without regard to a favorable or unfavorable decision by the Hearing Examinerr, the issuance of the SEC Order temporarily suspending exemption under Regulation A and the resulting hearings were such as to effectively deny Respondent due process of law and the right to a full and fair hearing under the Constitution and within the meaning of the Administrative procedure Act of 1946, by virtue of (1) the Commission's failure to issue a letter of deficiency, thus discriminating against Regulation A issuers as compared with the issuer who uses a full registration, (2) the staff and the Commission's refusal to observe both the letter and the spirit of Section 5(b) of the Administrative Procedure Act with respect to settlement, (3) the staff's treatment of this proceeding as essentially punitive, and (4) the staff and Commission's use of two proceedings, one against the Issuer and the other against the underwriter, as complementary to each other. (Issuer Br., pp. 13-14)"

D. Background of the Backlog Amendment

17. Beginning in May, 1961, Cooke was searching for working capital for his business operations. He met, and discussed his business problems with J. Homer Overholser and Bernard Klavir, who are partners in business as financial consultants and finders in Los Angeles, California. Klavir suggested a public offering of stock and Cooke accepted the suggestion. Shortly thereafter, through Klavir, Cooke met with Harry Wasser, president of the brokerage firm of Hamilton, Waters & Co., Inc. Wasser offered to underwrite the public offering and his firm was selected as the underwriter. On June 30, 1961, the Issuer was organized, and on July 21, 1961, a notification was filed with the Commission under the Regulation A. The public offering was commenced on September 8, 1961.

18. From the beginning, the underwriter and other brokers attempting to sell the issue encountered difficulties, sales were made but cancellations were heavy. 4/

4/ A recapitulation of the underwriter's sales and cancellations through the month of November 1961 shows (Resp. Ex. 25A)

	September	October	November
Sales (Shares)	31,920	29,313	34,112
Cancellations	14,750	5,955	11,395

19. Actual cash turned over to the Issuer was relatively small. 5/

20. Manuel Posey, a New York broker, whose firm was engaged in the offer and sale of the issue as part of the selling group was one of those whose firm had suffered substantial cancellations. On or about November 14, 1961, he had a conference with Wasser, an associate of Wasser's, and Klavir, in which the difficulty in selling the Issuer's stock was discussed. Posey undertook to arrange a meeting at which the possibility of private interim financing for the Issuer could be discussed.

21. On November 15, 1961, a meeting was held at which Posey, Klavir, John D. Glynn, Esq., of the law firm representing the Issuer in the Regulation A filing, Wasser, Nelson Finkelman, manager of the underwriting firm, a person whose last name was Alkow, and an attorney, Krevor, were present. The entire meeting was devoted to the affairs of the Issuer. A discussion was had concerning the difficulty of selling the stock of the Issuer. At that time only approximately one-half of the

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5/ The amounts paid by the underwriter to the issuer from the beginning of the offering through the month of November are the following (Resp. Ex. 25A, 25B)

September 25, 1961	$10,200
October 18, 1961	20,400
November 13, 1961	40,800
November 30, 1961	18,717
Total	$90,117

Regulation A offering had been sold. The underwriter wished to terminate the offering but was advised by Glynn, as counsel for the company, that this could not be done before the expiration of the initial offering period set forth in the offering circular which Glynn calculated would end about the 8th or 9th of December.

22. The discussion then turned to its interim financing. At this conference, and at a further conference the next day, copies of the Issuer's orders were in the possession of Wasser and Klavir showing very substantial orders on hand. On November 15, a Los Angeles attorney was requested by Posey and Alkow to verify with Cooke the existence of certain specific orders and to submit his analysis and opinion to Alkow (Div. Ex. 35). The attorney verified the existence of substantial orders on the books of the Issuer. Cooke came to New York and met with Alkow and Klavir on November 17, 1961 for further discussions but the negotiations did not result in any concrete arrangements among the parties.

23. According to Glynn, at either the meeting on November 15 or 16, he mentioned the possibility of amending the offering circular to set forth pertinent backlog information. On November 17, he discussed such an amendment by telephone from New York with a Commission staff member at its San Francisco office, W. S. Tucker. Both Tucker and Glynn, in their testimony, agreed that Glynn stated that the backlog of the Issuer had increased substantially since the date of the offering circular. Glynn told Tucker that the issue was about half sold and wanted to know whether the increase in the backlog of the Issuer should not be

shown by an appropriate amendment. Glynn said he had photostats of the orders in his hand and gave Tucker some details about them. Tucker told Glynn that if the information were true and correct, it ought to be disclosed, but warned Glynn to be sure of his facts and told Glynn that the sharp increase in the backlog of $130,000 to an estimated $5,000,000 to $8,000,000 " . . . looked like a shot in the arm coming in the middle of a stock offering . . ." (Tr. p. 1064). Glynn assured Tucker that he had copies of the orders in his hand. In the course of their discussions, Glynn and Tucker agreed on the general language in which a proposed amendment by the Issuer could be phrased to cover the backlog changes.

24. Glynn testified that he called Tucker to make sure whether it would be possible to amend the offering circular by rider so that he could convey that information to the underwriter and Cooke and that he felt that the disclosure of favorable developments in the Issuer's business would aid the underwriter in selling the stock (Tr. pp. 1251-1252).

25. After negotiations for financing had fallen through, Glynn did not proceed with the preparation of the proposed amendment. On or about December 14, 1961, Air Space Devices, Inc., a corporation in which Glynn, and a partner in his law firm, Ronald H. Freemond, owned substantial interests, purchased the unsold 28,000 shares of the Issuer.

26. On December 13, 1961, Glynn wrote Tucker at the San Francisco Regional Office of the Commission setting forth language of a proposed

amendment to the offering circular with reference to the backlog of the Issuer. He also stated that he had been informed that the initial offering had been completed and set forth language of a proposed amendment setting forth that fact and other information relating to the sale of stock underlying warrants. A supply of the printed rider amendments was sent from California to the underwriter in New York where they were affixed to the offering circular.

E. The Backlog Amendments

27. As previously noted, it was stated in the original offering circular that the Issuer's backlog as of July 10, 1961 was approximately $130,000. It was stated in the December 20, 1961 backlog rider that as of that date the Issuer's backlog of orders was $4,314,349. Five specific orders were mentioned as making up the total. In addition, there was mention of another order aggregating approximately $1,540,000. The statements in this amendment have been attacked by the Division as incomplete, false and misleading.

1. The Telephone Answering Devices Order

28. Of the asserted backlog of $4,314,349, the largest item was listed as "Telephone Answering Devices, $4,130,000;" The background of this order is as follows:

29. The files of the Issuer contain a purchase order from Phonomatic, Inc., dated October 26, 1961 for 50,000 telephone answering machines at a unit price of $82.60. Delivery was to start in January, 1962 (Div. Ex. 4).

30. Phonomatic was organized as a corporation in September, 1961 for the purpose of marketing a telephone answering machine. It was started on an original investment of $3,000 of which approximately $600 remained at the time of the hearing. The corporation had no office or employees. Marvin Rudin, its president, owned an insurance agency and was actively engaged in that business until November, 1961. Rudin considered himself a salesman for any items which he felt he could sell. He became interested in marketing telephone answering machines to be manufactured by the Issuer and marketed by Phonomatic to dealerships established nationwide on a franchise basis. Rudin had discussions with George Harmon Cooke, president of the Issuer, prior to the placing of the aforementioned order with reference to the development of the answering machines. When Cooke asked for a firm order to justify spending additional money in the development of the machine, according to Rudin, although they had been talking in terms of 10,000 units, Rudin said, "George, will 100,000 make you feel any better?" (Tr. p. 824). Cooke replied that it did not have to be that much and Rudin thereupon placed the order for 50,000 units.

31. Rudin further testified that no franchise fees had been received by Phonomatic at the time of the hearing.

32. Rudin testified that he had personally talked with six or more potential dealers for the machine before he placed the order with Cooke on October 26, 1961 and that they, added to persons who had been personally contacted by his associates, amounted to a total of 15 or 20. He further testified that he had oral commitments for initial orders

of 1,000 machines, that these were "handshake" commitments. He had not received any money from anyone and actually ceased attempting to obtain dealers approximately two and a half months prior to the hearing and had never made any attempts to establish dealerships on a nation-wide basis.

33. On the date of the backlog amendment, there was doubt that the Issuer could perform its part of the agreement. According to Cooke, engineering work on the machines was begun in August, 1961. As of December 20, according to Cooke, the third prototype of the proposed machine was completed and its functional engineering feasibility had been established. However, certain difficulties remained to be cleared up. Others appeared later on. Rudin testified that the only devices delivered to Phonomatic by the Issuer were two breadboards.[6/] A breadboard is different from a prototype, which is a device technically complete and able to perform specified services. A prototype in turn is substantially different from a commercial model ready for mass production with all engineering completed. Rudin testified that he received a second breadboard right after the first of the year. Cooke testified that he delivered a third prototype to Rudin some time in December, 1961. In any event, it is very apparent that the feasibility for commercial production of the telephone answering machine by the Issuer had not been established at the time the backlog amendment was filed.

6/ The term "breadboard" was defined by one of the witnesses as one of the first steps in the development of the devices - an assembly to test components (Tr. p. 490).

34. In its brief, the Issuer concedes that the statement in the offering circular with respect to this order was inadequate or deficient in that no such backlog of $4,130,000 for firm business in such amount did, in fact, exist.

35. The Fifth Amendment to the offering circular repeating information in the Fourth Amendment contains the following information with reference to Phomatic:

> (1) On October 26, 1961, Harmon Company received a request from Phonomatic, Inc., of Los Angeles, California, to manufacture 50,000 telephone answering machines at a unit price of $82.60 each. Delivery of these machines was to start the first week of January, 1962, to be running at 50 units per day by February 1, 1962, and to reach 200 units per day by April 1, 1962.
>
> (2) As of December 20, 1961, and as of the date of this Fourth Amendment, no machines had, or have, been delivered to such purchaser for sale thereby because of technical difficulties which were encountered in the machine. Harmon Company believes that it has received from the purchaser an extension of time to commence deliveries until March 15, 1962. Harmon Company has hired the president of the purchaser, as a consultant at $125. per week to help in the production of the machine, Harmon Company presently intending such consultantship to last for several weeks.
>
> (3) In the opinion of Harmon Company, this machine represents a combination of devices and services which individually are offered by one or more competing companies with established markets and greater financial resources than Harmon Company. In the opinion of management, the device does not appear to be patentable.
>
> (4) Harmon Company understands that Phonomatic, Inc., intends to establish dealerships nation-wide to directly sell the telephone answering machines on a franchise basis and that, under such proposed method of operation, the franchised dealer would pay Phonomatic, Inc., in cash when an order was placed. Harmon Company further understands that Phonomatic, Inc. is newly incorporated

> and has a nominal capitalization. Therefore, Harmon Company cannot make any representation as to the number of units which ultimately will be sold to Phonomatic, Inc., or as to the dollar value of business to Harmon Company which eventually will result from such sales.

36. It is argued that as of the date of the issuance of the original backlog rider, the Issuer believed it had a firm order and that it acted in good faith. It is asserted that while a technical problem arose after December 20, 1961, management did believe from working models it delivered that all technical problems in the machine had been solved. It is pointed out that while Phonomatic did not have much assets, its plan of operation under a franchise system by which orders would be paid for in advance would make it unnecessary for it to have a substantial amount of capital.

37. These contentions ignore the fact that as of the date of the backlog amendment, December 20, 1961, the company which had placed an order for over $4,000,000 with the Issuer was little more than a paper organization with limited assets and no experience in the marketing of these devices or any equipment on a nation-wide basis. The Issuer had done some work on the machines, but had not succeeded in getting much beyond the experimental basis and had not yet come to grips with the problems involved in mass production of the telephone answering device on a commercial basis. All of these facts were known on December 20 or could easily have been ascertained by careful checking. The evidence indicates that no such effort was made, but that Cooke was anxious to obtain a volume order from Phonomatic and to have that information given wide publicity without pointing out factors which mitigated

against the successful completion of the order.

38. The Fifth Amendment points up some of the problems involved in the successful completion of the order. It still does not deal with all the problems which limit the successful completion of the order and which should have been mentioned in order to make the statement complete and not misleading. The price set for the machines in the order, according to Rudin, was an "outside ball park figure" based on what was felt the machines could be manufactured for and what price was necessary to meet competition (Tr. pp. 832-833). Once, and if, mass production had started, the price estimates might be subject to modification (Tr. p. 491). Accoring to Rudin, substantial modifications had taken place in arrangements for delivery, the period of the agreement, and the right of Phonomatic to terminate the agreement (Tr. pp. 850-852, 856, 868). No amendment was filed indicating these new arrangements. While the amendment does mention that the company had not made any deliveries of the machines because of technical difficulties, readers are not informed that the Issuer was still working on developing such prototypes and had not yet begun to deal with the difficulties involved in mass production. While the amendment does mention some of the speculative marketing aspects of its arrangement with Phonomatic, no mention is made of the fact that at the time of the amendment Phonomatic did not have any nation-wide organization or franchising arrangements suitable for the marketing of these devices in the numbers contemplated in the order.

2. The Talk-A-Way Transceivers Orders

39. The backlog amendment lists orders for Talk-A-Way transceivers in the sum of $59,415. This amount consists of two purported orders from the AVTA Corporation, Los Angeles, California, one in the amount of $1,165 and the other for $58,250. There is a serious conflict in the evidence as to whether the second order was ever given by AVTA in the amount claimed by the Issuer. The Division contends that a second order was placed, but for only one-tenth of the sum or $5,825. It has also been argued that it was improper to claim the orders as part of the backlog since the first order was for items which had already been delivered to AVTA and the Issuer was having such difficulties in the manufacture of said transceiver that it was improper to claim the second order as part of the backlog for which it could make delivery.

40. In September, 1961, AVTA became interested in the purchasing and marketing of transceiver devices.[7/] During that month, and in October, 1961, about 100 such units were delivered by the Issuer to AVTA as salesmen's samples. Because of technical difficulties in the machine, approximately half of the units were returned to the Issuer to be reworked and redelivered when in working order.

40. A meeting was held between representatives of the parties on either October 31st or November 3rd. The weight of the credible

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7/ The transceiver is a two-way radio set and is sold and used in sets of two. It was originally developed by the Issuer under the name of Walk-A-Phone for the Asiatic Import Co., another purchaser from the Issuer. The Talk-A-Way is essentially the same device as the Walk-A-Phone with a few outward modifications (Tr. pp. 243-247, 691-7, 1011).

evidence would indicate that the former date was the one on which the meeting was held. There were several purposes for the meeting. Representatives of AVTA who were present, Clyde W. Lindsey, vice-president, and James Jones, its president, were interested in discussing a redesign of the case of the Talk-A-Way transceivers and the institution of quality control to obviate difficulties that were being encountered with transceivers already delivered. Representatives of the Issuer who were present, Cooke, its head, Paul Rutschman, general manager, and two engineering employees were also interested in these problems and further wished to obtain a written order for the 100 transceivers already delivered and an order for a new shipment which could be undertaken on a commercial or mass basis.

41. Lindsey, Jones, Rutschman, and Cooke all gave detailed testimony about occurrences at the meeting. All were in agreement that there was extensive discussion of engineering and designing problems in connection with the manufacture of transceivers. All were in agreement that at the meeting two orders were placed by AVTA for transceivers; the first to cover the 100 transceivers already delivered and the second to cover new units. At that point there is sharp divergence in the testimony as to the circumstances under which the second order was placed and the total amount of the units involved.

42. Lindsey wrote out both orders. On his first order, he noted that he was ordering 100 Talk-A-Way salesmen samples at a unit price of $11.65, for a total cost of $1,165. On the second order he listed 500 as the quantity desired at a price of $11.65. He showed both order blanks

to Jones who silently approved them. He then handed them to Rutschman. Some time thereafter, the order blank was altered to show the quantity as 5,000. The total price figure of $58,250 was added (Div. Ex. 5). The principal question is - who made the alteration. Rutschman left the room for a short period, taking the order blanks with him. When he returned he placed the order blank for the second order, which still had the quantity figure of 500 on it, before Cooke. He also gave Cooke the first order. There is sharp disagreement as to what happened thereafter. Cooke testified that when he saw the quantity figure of 500, he stated to Rutschman that that was not right and that it should be for 5,000. He stated that thereafter the order blank was altered by the AVTA representative but that there was no further discussion after he made his statement. Jones maintained that during the meeting he proposed that 250 units be made with one type of case and 250 units with another and Cooke agreed with this proposal and thereafter Lindsey wrote up the order for 500 units (Tr. pp. 714, 715).

43. The versions of Lindsey and Rutschman differed from those of Jones and Cooke.

44. Lindsey supported the testimony of Jones that at the time there was a discussion and agreement for the production of 250 devices of one type and 250 of another(Tr. pp. 535, 536). He denied that a figure for 5,000 Talk-A-Ways was mentioned. He was vague as to what discussion took place about the number of units (Tr. pp. 611-613). He further stated that the unit price of $11.65 was the price quoted him on a thousand unit basis and he used this in filling out the order for

the smaller amount. He recalled giving the orders to Rutschman but could not recall what Rutschman did with them when he returned to the room. He was certain that neither he nor Jones changed the unit quantity on the second order. He also stated that an order for 500 units was given instead of a larger one because of the inferior quality of the instruments that had been received up to that date.

45. There is evidence that the Issuer was expecting a sizable order from AVTA. Rutschman testified that Cooke authorized the price of $11.65 per unit based on an expected order for 10,000 units and that Rutschman expected an order for that number of units from Lindsey. Rutschman saw Lindsey write the order for 500 units, give it and the first order for 100 units to Jones, saw the latter glance at them and pass them back, and then Lindsey passed them to Rutschman. There was no conversation at that point about the order, according to Rutschman. Rutschman then left the room with the orders and returned about ten or fifteen minutes later. He passed the two purchase orders to Cooke because, as he put it, he wanted Cooke to see what type of order the Issuer had received (Tr. p. 1021).

46. Continuing his testimony, Rutschman stated that Cooke glanced at the purchase orders, shook his head at the 500 unit order, and nodded at the 100 unit order. There was general discussion after that with no mention of the number of units other than reiteration of the $11.65 unit price. Rutschman did not see anyone else at the meeting write on the order form other than Lindsey who, late in the meeting, wrote additional information at the place of his signature. The order

forms remained on Cooke's desk at the meeting and when Rutschman saw them the next day the number of units had been increased on Lindsey's second order from 500 to 5,000. Rutschman also stated that outside of Cooke shaking his head when he noticed the 500 unit order, he did not say that he would not accept the order or discuss it (Tr. p. 1032).

47. Rutschman impressed the undersigned as having a clearer recollection of exactly what had taken place at the meeting than the other witnesses, all of whom were hazy on some of the details. His version of what took place is credited. It is clear that regardless of the expectations of the Issuer's representatives that a sizable order would be given at the meeting, in fact a much smaller order was given. There was no open discussion regarding the size of the order and it does not appear that either Jones or Lindsey revised the second order.[8/] There is no evidence that there was any further negotiation between the parties about the size of the order. Under these circumstances, the undersigned concludes that it was erroneous for the Issuer to claim in the backlog amendment that it had an order from AVTA of the size indicated. In fact, it had a much smaller order.

48. It also has been established that at the time the two orders were given to the Issuer, on October 31, 1961, the Issuer was experiencing difficulty with the units it was furnishing both AVTA and Asiatic Import Company. Units were being returned for adjustment and AVTA was

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8/ Rutschman did not support Cooke's assertion that Rutschman told Cooke that Lindsey had changed the size of the order (Div. Ex. 8, p. 49).

concerned about the installation of quality controls. These problems continued right up to the time of the backlog amendment filed in December, 1961 (Tr. p. 240, Div. Ex. 8, pp. 46-47). Regardless of the number of units actually involved in the second AVTA order, the assertion of the existence of that order without qualifying information indicating the production difficulties which the Issuer had been encountering over a period of months and which materially affected its ability to perform its obligations under the contract, rendered the information contained in the backlog amendment incomplete, false and misleading. For reasons not material to the issues herein, Cooke cancelled the marketing arrangement between the parties on December 22, 1961.

49. While the first order for 100 units is a relatively small one, it should not have been listed as part of the backlog since deliveries had already been completed of these units prior to the filing of the backlog amendment.

3. The Walk-A-Phone Transceivers Order

50. Of the backlog of $130,000 mentioned in the original offering circular, most of it, $111,500, consisted of an order for 10,000 Walk-A-Phone transceivers ordered by Asiatic Import Co., Inc. on July 6, 1961 (Div. Ex. 3). In the backlog amendment of December 20, 1961, this item was listed at $92,000 without any limitation or further explanation.

51. The proposed Fourth Amendment submitted on behalf of the Issuer after the commencement of the instant proceeding, the language of which was repeated in the proposed Fifth Amendment, has much more clarifying detail as to the state of that order and the Issuer's lack of success in fulfilling it.

> "11. As of July 10, 1961, the Company had order forms on hand amounting to $130,000, consisting principally of an order form, dependent upon the successful development and testing of the device involved, for $110,000 worth of Walk-A-Phone Transceivers. (P. 6)
>
> (1) Following receipt of an order form dated July 6, 1961, from the Asiatic Import Co., Inc. for $111,500 for Walk-A-Phone Transceivers, Harmon Co. commenced work on the device. The Walk-A-Phone Transceiver is substantially similar to the Talk-A-Way Transceiver except with respect to appearance.
>
> (2) As of December 20, 1961, approximately $19,500 in Walk-A-Phone devices had been shipped to Asiatic Import, but many of these devices had been returned both before and after such date because of technical difficulties in the operation thereof. No further shipments are to be made by Harmon Company, and no further sales made by Asiatic Import, until these difficulties are overcome. Harmon Co. has submitted the device to a products laboratory of a nationally known manufacturer of transistors, for advice as to the correction of such difficulties." (Pp. 9-10).

It was also noted in the amendment that because of the return of the devices, Asiatic had refused to make payment on accounts receivable assigned by the Issuer to a finance company.

52. The evidence establishes, and it has been admitted by the Issuer, that it had a great deal of difficulty in the manufacture of Walk-A-Phone transceivers. It had similar trouble with the AVTA transceivers, essentially the same units internally as the Walk-A-Phone transceivers. The Issuer, of course, knew all of these difficulties all during the period since it was trying to overcome them (Tr. p. 356). Employees of the Issuer also knew that the transceivers were not commercially marketable. By December 20, 1961, the Issuer had had a conspicuous lack of success in filling the order obtained from Asiatic months before. Yet this order was listed in the December 20 amendment without any language of limitation indicating the difficulties it was having. In fact, it could be deduced from the figures supplied that the Issuer was successfully filling that order and reducing the backlog. It is concluded that the backlog amendment was incomplete, false and misleading in its representations of the Walk-A-Phone order and in the failure to furnish information on the difficulties it was having in filling the order.

53. While the Fourth Amendment gave a more honest representation of the actual situation, it did not give a full representation of the state of the Asiatic order. This order provided that 1,000 units were to be delivered in good workable condition during August, 1961 and the order would be subject to final confirmation after receipt of the first 1,000 pieces. The evidence does not establish that as of August 1, or even the date of the hearing, 1,000 units in good workable condition had been delivered. There was, therefore, not a firm order as of the

time of the hearing for the remaining 9,000 units. This was not set forth in the proposed amendment.

4. The Inertia Switches Order

54. The backlog amendment of December 20, 1961, after listing specific orders, some of which have been dealt with herein, continued with the following paragraph:

> There is a further order aggregating approximately $1,540,000 for inertia switches which the Company has been assured will be placed with it by a prime west coast missile contractor upon a showing of adequate working capital, which in the opinion of management will be available upon completion of this offering. The Company, however, cannot give any positive assurance that such order will in fact be made firm. The Company's facilities are adequate to handle present and contemplated orders. It may be necessary to secure bank financing to handle such business if delivery schedules so require.

55. Even though there was a statement that no positive assurance could be given that the order would in fact be made firm, the obvious meaning of the paragraph is that the only obstacle in the path of the Issuer's obtaining a very substantial order was its showing that it had adequate working capital. Investors, in substance, were assured that if the stock issue covered by the offering circular was fully sold, the Issuer would obtain the contract. The actual facts were much different.

56. During the hearing, the parties entered into the following stipulation with regard to this order:

> The George Harmon Company began in June, 1961 negotiations with a prime West Coast missile contractor for the purchase of inertia or acceleration switches by such company under a prime contract which that company might obtain with the United States Government

with the supply of air-to-air nuclear ballistic missiles. The amounts of such prime contracts and any subcontract thereunder for such switches are not now definitely known or established.

On February 1, 1962 Harmon Company received a request for quotation from such company for the purchase of 122 acceleration switches for future use on a rocket fusing system to be produced by such contractor. The latter also requested a quotation for six additional units to be tested by the contractor for qualification purposes. Harmon Company is one of a member companies to which requests for quotation were made, some of which companies have greater financial resources than does Harmon Company. Quotations were due on or before February 15, 1962, and Harmon Company submitted such a quotation as follows:

A. $110 per unit for the 122 acceleration switches; and

B. The aggregate price of $5,500 for the six qualification units, which figure includes cost of the qualification.

2. (sic) Harmon Company cannot give any assurance that submission of said quotation will, in fact, result in an order. In the event such order is actually received, it is not anticipated that additional working capital will be required. If additional working capital is required, the company cannot represent or give any assurance that such financing will in fact be available.
(Tr. pp. 818-819)

57. According to Cooke, the company learned in June or July, 1961 that Douglas Aircraft Co. needed inertia switches. Several visits were made to Douglas and a sample switch was furnished it. The Issuer was informed that Douglas might need as many as 14,000 switches. The Issuer made some modification in the sample which it furnished Douglas at the request of the latter. Then the Issuer was informed that the program for which the switch was intended had run out of funds. Weeks

later, Cooke, according to his own testimony, learned from an engineer employed by Douglas on the project that the program was now funded, "that we were on the drawing, it would go to Purchasing, and not to worry about it, that we'd have - - we'd get the business." (Tr. pp. 291, 292).

58. On the basis of this assurance Cooke, in a letter to the underwriter on November 14, 1961 enclosing copies of orders on hand, stated: "we have telephone confirmation of 14,000 Inertia Switches at $110 each, which amounts to $1,540,000.00, with delivery scheduled over 26 months, starting January 1962." (Div. Ex. 7). Actually, neither at that time nor at the time of the hearing did the Issuer have any firm contract for the supplying of any specified number of inertia switches. Giving full credence to Cooke's version of what took place, it is clear that he had merely had a conversation with an engineer working on the project who had no control over the actual issuance of purchase contracts. Cooke knew that bidding procedure would have required that his company would have had to submit bids in competition with other bidders. It is apparent that the statement in the backlog amendment concerning the status of the inertia switches order was incomplete, false and misleading in that it did not accurately describe what obstacles had to be surmounted in order to obtain the inertia switches contract if and when the missile contractor was able and willing to award such a contract.

F. The Affixing of the Backlog Amendment to the Offering Circular

59. It is alleged in the amended order, which is the basis for this proceeding, that the terms and conditions of Regulation A have not been complied with in that the offering circular, as actually used and distributed, did not conform to the offering circular filed in the Regional Office in that the backlog amendment which, as filed with the Commission, was affixed to page 7 of the offering circular, in fact was affixed to the facing page of the offering circular as distributed by the underwriter.

60. After the filing with the Commission of the two December 20 amendments to the offering circular[9/] counsel for the Issuer caused a supply of these amendments to be sent to the underwriter in New York. Under separate cover, counsel sent the underwriter a letter stating "the enclosed Riders should be attached to page 7 of the offering circular" (Resp. Ex. 18). The president of the underwriter testified that he never received these instructions. In October, 1961, he received a communication from counsel for the Issuer in which reference was made to the fact that warrant amendments would be shipped and that these should be pasted on the front of the offering circular (Div. Ex. 39, Ex. 3 attached).

9/ The first amendment which was affixed to the facing page noted that the offering is now being continued on behalf of the Underwriter and finders; the second amendment which was affixed to page 7 was the so-called "backlog amendment".

61. The president of the underwriter testified that relying on the October instructions, he directed his secretary to affix the 300 copies of the December 20 amendments to the covering page of the offering circular. He then had copies of the amended offering circular mailed to purchasers of the Issuer's stock, those who had expressed an interest in it, and to persons having accounts with the underwriter. Copies of the amendments were also furnished other brokers. Most of the supply of 300 amendments was used up between December 21, 1961 and about January 3, 1962 when further distribution was ended.

62. It is urged on behalf of the Issuer that a mistake occurred in the affixing of the amendments to the offering circular but that such action was not done at the behest or instructions of the Issuer or its California counsel in order to induce sales of stock in the market. The Division contends that there was negligence in the failure to see to it that the underwriter had definite instructions on behalf of the Issuer as to what place on the offering circular the amendments should be affixed and that the effect of the placement of the backlog amendment on the cover page serves to give it undue emphasis in the offering circular.

63. The undersigned agrees with the contention of the Division that the terms and conditions of Regulation A were not strictly complied with in that the amended offering circular used by the underwriter did not conform to the one filed with the Commission. The backlog amendment was placed on the front page of the offering circular where it had a position of greater prominence than if it had been affixed to an

inner page. It has not been established that this was due to any deliberate intent to mislead the Commission or readers of the offering circular.

G. Violations of the anti-fraud provisions of the Securities Act

64. It is alleged that violations of the anti-fraud provisions of the Securities Act took place in the offer and sale of the stock made pursuant to the offering circular involved in this proceeding.[10/]

65. It has already been found that the amended offering circular was violative of Section 17 in that the information contained in the backlog amendment was incomplete, false and misleading. The distribution to the public by the underwriter of the amended offering circular with misinformation as to the Issuer's backlog was violative of Section 17 of the Securities Act.[11/] The proposed amendments offered by the Issuer later in connection with motions made to the Commission and to the undersigned did not fully remedy the defects found.

10/ Section 17 of the Securities Act, the so-called anti-fraud section, provides that it shall be unlawful for any person in the offer or sale of any securities by the use of any means of transportation through interstate commerce or by use of the mails to employ any device, scheme or artifice to defraud, to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon purchasers.

11/ Cemex of Arizona, Inc., 40 S.E.C. 919, 925, footnote 7.

66. It is also alleged that in addition to the above violations, further violations occurred in that the underwriter, prior to the backlog amendment, passed along to customers incomplete and misleading information as to the state of the backlog of the Issuer, which information had been furnished by the Issuer itself.

67. The record indicates that substantially before the filing of the actual backlog amendment, Cooke, on behalf of the Issuer, was passing on to the underwriter incorrect information as to the state of the Issuer's backlog. On September 28, 1961, Cooke gave a letter to Bernard Klavir, one of the financial consultants used by the Issuer in connection with the Regulation A offering, who was then acting as consultant to the Issuer, listing the alleged backlog of the company for the next twelve months. The items totalled $5,848,400. The letter included some of the orders which have already been commented upon in prior sections of this decision. The letter was headed: "FOR USE OF BROKERS AND UNDERWRITERS ONLY." This letter was given by Cooke to Klavir in California on September 28 for delivery to Wasser, president of the underwriter. Klavir gave the letter to Wasser in New York a few days later.

68. Additional optimistic information was sent by Cooke to Wasser on November 14, 1961 when he mailed photostats of orders and also stated that the Issuer had a $1,540,000 order for inertia switches. The orders and the information were used in conferences on interim financing which took place on November 15 and 16 and which were attended by Wasser.

69. The Division introduced evidence to establish that some or all of the above information was relayed to customers of the Issuer.

B.B.B. bought 200 shares of the Issuer's stock from the underwriter on October 19, 1961. He testified that prior to his purchase he had received an offering circular from the underwriter and had had two telephone conversations with one of the salesmen. He further testified that the salesman, Stanley Miller, told him that the Issuer had a backlog of either $4 or $5 million dollars. B. could not recall exactly which figure was used. Two weeks later, according to B., he was urged by the same salesman to make an additional purchase of the Issuer's stock and in that conversation mention was made that the Issuer had a backlog of orders of $4 or $5 million. B.'s recollection was that the figure of $4 million was used in one conversation and $5 million in the other (Tr. p. 1309). In December, 1961, B. wrote to the treasurer of the Issuer asking for the approximate value of the company's backlog of orders. He stated in his letter that a salesman of the underwriter twice urged him to buy some stock "saying the backlog is $4 million - - which sounds like a gross exaggeration in light of the value of $130,000 as of July." (Div. Ex. 41). B. did not wait for a reply but sold 100 shares at the urging of the salesman in order to buy another stock and then decided of his own volition to sell his remaining 100 shares.

70. It was pointed out by the Issuer that B. was a customer of the underwriter who had purchased speculative stock before and in his dealings in the stock of the Issuer achieved a short-term capital gain.

71. Mrs. A. F. received a phone call in September, 1961 from Miller. She purchased 100 shares of the Issuer's stock on September 14, 1961, 200 shares on December 15 and 400 shares on December 28. She

testified that in connection with her first purchase the salesman, Miller, recommended the Issuer as a good company and that the stock would do well. She further testified that subsequent to her purchase, Miller told her that the stock had gone up and that the company had received or was going to receive a $4 million contract from the Government. She then purchased an additional 200 shares at the price of $4-3/4. She placed this conversation shortly before her purchase on December 15th. About a week after her second purchase, according to A. F., Miller urged her to buy more stock, telling her that it had risen in price. She agreed to, and did, buy more stock on December 28th. She testified she received the original offering circular but not the amended circular revised as of December 20.

72. On cross-examination, she testified that she had had experience in buying stocks traded over-the-counter and was purchasing the Issuer's stock for short-term capital gain and as a speculation.

73. L. M. F., son of Mrs. A. F., purchased 400 shares of the Issuer's stock on September 14, 1961 after he also had spoken with Mr. Miller and examined a copy of the original offering circular used in the sale of the Issuer's stock. He testified that he had many telephone conversations with Miller after his purchase with regard to the condition of the Issuer and the prospects for its stock. He stated that in the latter part of December, Miller told him that soon after the first of the year, newspapers would carry the stories of contracts of the Issuer totalling more than $4 million. He never received an amended offering circular (Tr. pp. 1438-39).

74. On cross-examination, he testified that he had had other dealings in stocks and bought the Harmon Company stock as a speculation hoping for a short-term gain.

75. Wasser, president of the underwriter, denied that he gave any information to his salesmen of the alleged improvement in the backlog position of the Issuer. However, he did see the letter written by Cooke on September 28, 1961 addressed to Klavir, which Klavir brought to New York with him on a trip immediately after the date on the letter.

76. Stanley Miller testified that he did not have any information about the Issuer other than what was contained in the offering circular and first learned of the alleged extent of the increase in the Issuer's backlog of orders after the December 20th amendment was filed. He denied telling Mr. B., prior to December 20, that the Issuer had a backlog of $4 to $5 million dollars. He also denied giving similar information about a Government contract.

77. The evidence establishes that the distribution of the Issuer's stock was not going as well as the underwriter and the Issuer had hoped. It has also been established that Cooke gave Klavir a letter shortly before the end of September, 1961 claiming a very heavy increase in the backlog of the Issuer. The letter, from its heading, was intended for the use of brokers and underwriters. Further specific information was transmitted to Wasser and through him to others on the state of the Harmon orders in mid-November. Under these circumstances and from the evaluation of the testimony of the witnesses, the undersigned credits the testimony that a substantial backlog of $4 or $5 million of the Issuer's orders

was mentioned to B. shortly before and after his stock purchase on October 19, 1961 in his conversations with Miller acting on behalf of the underwriter. These representations, without the qualifications which have been discussed in other sections of this decision, were violative of the anti-fraud provisions of the Securities Act. Similar figures were used by Miller in a conversation with Mrs. A. F. prior to December 20, although her recollection was that the figure was mentioned in connection with Government contracts.

78. It has been urged that only three purchasers of the Issuer's stock, out of a substantial group of investors, were called to testify and that these three were speculators who were trying to make short-term gains. These circumstances do not affect the findings herein since all investors are entitled to protection against misrepresentations and omissions of material facts in the course of their dealings with brokers. A customer must be dealt with fairly and in accordance with high standards.[12/]

12/ Duker & Duker, 6 S.E.C. 386, 388, (1939).

H. Due Process

79. It is contended that the Issuer was not afforded due process. It is pointed out that no letter of comment or deficiency was ever furnished it by the Staff of the Commission and that thereby there was a failure to comply with Section 9(b) of the Administrative Procedure Act which provides, in pertinent part, that:

> [e]xcept in cases of willfulness or those in which public . . . interest . . . requires otherwise, no . . . suspension . . . of any license shall be lawful unless, prior to the institution of agency proceedings therefor, facts or conduct which may warrant such action shall have been called to the attention of the licensee by the agency in writing, and the licensee shall have been accorded opportunity to demonstrate or achieve compliance with all lawful requirements.

80. The Commission has ruled that a letter of comment need not be furnished all registrants. In the case of Doman Helicopters, Inc., it stated:

> The letter of comment is an informal administrative aid developed by us for the purpose of assisting those registrants who have conscientiously attempted to comply with the Act. 20/ The burden of seeing to

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20/ Our policy with respect to letters of comment is one of long standing and has been publicly announced. The Code of Federal Regulations contains the following description of our deficiency letter procedure:

> "The usual practice is to bring the deficiency to the attention of the person who filed the document by a letter from the Assistant Director assigned supervision over the particular filing, and to afford a reasonable opportunity to discuss the matter and make the necessary corrections. This informal procedure is not generally employed where the

(footnote continued on next page)

> it that a registration statement filed with us neither includes any untrue statement of a material fact nor omits to state any material fact required to be stated therein or necessary to make the facts therein not misleading always rests on the registrant itself, and it never shifts to our staff. When the Division has reason to believe that a registrant has failed to make a proper effort to shoulder this burden, it is its duty to bring such information to our attention and to recommend that we proceed in accordance with Section 8(d) of the Act.
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> 20/ (continued from preceding page) deficiencies appear to stem from careless disregard of the statutes and rules or a deliberate attempt to conceal or mislead or where the Commission deems formal proceedings necessary in the public interest." 17 CFR § 202.3.
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> See also Orrick, Organization, Procedures and Practices of the Securities and Exchange Commission, 28 Geo. Wash. L. Rev. 50, 63 (1959).

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While the Doman case involved a full registration statement, the same approach has been followed by the Commission in Regulation A filings.

81. In the case of Mutual Employees Trademart, Inc., the Commission reaffirmed prior holdings that Issuer is not entitled to a deficiency letter as a matter of right. It stated that where there are serious questions as to the adequacy of disclosure in the notification and offering circular, the public interest requires the issuance of a temporary suspension order without previously sending a letter of deficiency.[14/]

13/ Sec. Act Rel. No. 4594 (March 27, 1962), p. 10.

14/ Sec. Act Rel. No. 4478 (April 17, 1962). See also Cemex of Arizona, Inc., 40 S.E.C. 919, 924 (1961); See also The Wolf Corporation v. S.E.C., 317 F. 2d 139 (C.A.D.C. 1963).

82. The Commission, in effect, has already passed on this contention. In its Motions to Terminate or Expedite Proceedings filed by the Issuer with its proposed Fourth Amendment on February 28, 1962, the Issuer requested that the Commission direct the Staff to disclose any deficiencies or inaccuracies contained in the proposed Fourth Amendment. The Commission ruled that in the light of the serious nature of the issues raised in the proceedings, it was appropriate that the motions be denied and the hearing proceed as scheduled.

83. The Issuer also urges that the Staff failed to comply with both the spirit and letter of Section 5(b) of the Administrative Procedure Act and thus is responsible for a prolonged and unnecessary proceeding.

84. Section 5(b) of the Administrative Procedure Act of 1946 provides, with respect to proceedings involving a hearing on the record, that:

> "The agency shall afford all interested parties opportunity for (1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment where time, the nature of the proceeding, and the public interest permit . . ."

Special procedures have been adopted by the Commission to implement this provision of the Administrative Procedure Act.

85. It is true that the Issuer has made efforts to settle and dispose of the proceeding by filing written motions which included amendments seeking to cure the alleged defects in the offering circular and which also included offers of rescission to stockholders. The undersigned also afforded time to the parties to confer informally off the

record to discuss various proposals advanced on behalf of the Issuer. Outside of some minor stipulations which were arrived at, the negotiations were not successful. It is urged that the Staff had an adamant attitude which prevented any agreement.

86. The Administrative Procedure Act does not require any more than the affording of an opportunity for the submission of offers of settlement. It does not require that an interested party recede from a position which it feels is well taken. The fact that the Division took a position which the Issuer considered harsh under the circumstances does not establish that there has been a violation of the section of the Administrative Procedure Act cited above.[15/]

III. RECOMMENDATIONS

The Commission may enter an order permanently suspending an exemption from registration for an issuance of securities where it finds that any of the terms or conditions of Regulation A have not been complied with or that the notification or offering circular contain false and misleading statements or material omissions or that the offering is being made or would be made in violation of the anti-fraud provisions of the Securities Act. It has been found that violations of these provisions which are set forth in Rule 261 of the General Rules and Regulations issued

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15/ Gimbel Bros., Inc., 100 N.L.R.B. 870-871

by the Commission under the Securities Act, were willfully committed by the Issuer and that the offering of common stock being made by the Issuer, which offering is the subject of this proceeding, was made and would be made in violation of Section 17 of the Securities Act.

The Issuer concedes that certain statements in its amendments dated December 20, 1961 were inaccurate or deficient and therefore may have been misleading. However, it contends that it successively filed amendments in an attempt to make a full and true disclosure of all material facts and to terminate the proceedings in the public interest but that it was thwarted by the attitude of the Staff in refusing to dispose of the proceedings without formal hearings and treating this proceeding, it is alleged, as essentially punitive in nature. It is urged that any deficiencies or inaccuracies in the statements made in the backlog rider stem from a misunderstanding by Cooke as to the meaning of the word "orders", "purchase orders" and "backlog" as used by businessmen generally and the more precise meaning and information which would be required to be disclosed to the investing public in an offering circular.

It is further argued that when defects have been found to exist in a full registration statement and the Commission has issued a stop order, the order is terminated when the Commission finds that amendments have been filed remedying the deficiencies and, that practice should be followed here.[16/]

Finally, it is contended that the evidence establishes that the Issuer has made a clear showing of good faith and of other mitigating

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16/ Hazel Bishop, Inc., 40 S.E.C. 718, 737 (1961).

circumstances in connection with the deficiencies and thus no permanent order of suspension should be issued. The Issuer relies on the Illowata Oil Company case.[12/]

In the Illowata case, the Division agreed to consider amendments filed after the issuance of a temporary suspension order in an effort to cure deficiencies alleged in the order where the Commission found that there was a clear showing of good faith and other mitigating circumstances in connection with the deficiencies. However, it used this cautionary language:

> "We are of the opinion that in an appropriate case we may consider amendments filed after the issuance of a temporary suspension order. We have exercised our discretion to consider amendments filed to registration statements after the institution of stop order proceedings under Section 8(d) of the Act, although the Act does not specifically provide for amendments at that time. 4/[footnote omitted]. However, in the case of a Regulation A offering, where suspension of the conditional exemption obtained under the Regulation does not bar the issuer from effecting a public offering if it complies with the registration requirements, we consider the opportunity to amend which should be accorded an issuer which has not properly met the simplified requirements provided by Regulation A to be more limited than the opportunity to amend in the case of a registration statement. The opportunity to amend cannot in any event be permitted to impair the required standards of careful and honest filings under the Regulation and encourage a practice of irresponsible or deliberate submission of inadequate or false material followed by correction by amendment of the deficiencies found by the staff in its examination. Not only would a free amendment procedure tend to result in less than full and accurate disclosure, but it would impose unwarranted administrative burdens that would tend to impair our investor-protection functions generally. Therefore, before we will consider such

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12/ 38 S.E.C. 720 (1958).

> amendments in any case, there must be a clear showing of a good faith and of other mitigating circumstances in connection with the deficiencies." (pp. 723-724). 18/

Enthusiasm for a product and its market does not obviate the necessity of a full, careful and objective disclosure of problems as well as potentialities. 19/

The record discloses that serious misstatements and omissions were made in the offering circular as to the extent of the backlog orders of the Issuer. The Issuer's officials were fully familiar with all the factors affecting the ability of Phonomatic tomake delivery and sell the 50,000 telephone answering machines contained in its order or could easily have ascertained those factors with a very limited inquiry. The Issuer also was fully aware of the problems it faced in getting a large order for inertia switches. These problems were not mentioned in the amended offering circular. The Issuer had had months of difficulty in trying to manufacture suitable machines to satisfy the AVTA and Asiatic orders. It was not in a position to undertake commercial production on a mass production basis of those machines as of the date of the amended offering circular. As the Commission has said

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18/ See to the same effect Inspiration Lead Company, Inc., 39 S.E.C. 108, 114 (1959); Hart Oil Corporation, 39 S.E.C. 127,431 (1959).

19/ American Television & Radio Co., 40 S.E.C. 641 (1961).

of similar misstatements in another case: "These were basic matters with which the issuer was most familiar and which it was its duty to present most carefully and fairly so as to inform potential investors of the hazards as well as the disadvantages of an investment in the securities."[20/] It has been found that the above and other violations which have been previously noted were willfully violative of the anti-fraud provisions of the Securities Act. The Issuer did not demonstrate good faith, care and attention, all of which have been insisted upon by the Commission in its decisions as a pre-requisite to withholding a permanent order of suspension and permitting an issuer to cure deficiencies by suitable amendment or withdrawal. The Issuer here demonstrated a gross disregard of the care which must be exercised not to over-state orders or to disregard problems which have arisen time and again and which cast doubt on the ability of the Issuer to perform its commitments.

Under these circumstances, the undersigned recommends that the Commission issue an order permanently suspending the Regulation A exemption under which the common stock of the Issuer was offered to the public. This is not recommended as a punitive measure but as one necessary in the public interest and for the information and protection of investors and potential investors.[21/] The Issuer is free to offer its securities after a suspension order is entered if it files a full registration statement, from which a public investor may make an informed

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20/ General Aeromation, Inc., Sec. Act Rel. No. 4536 (Sept. 19, 1962, p. 9).

21/ As previously noted, the proposed amendments did give a more accurate picture of the Issuer's situation, but still did not cure all the deficiencies found.

judgment with respect to these securities.[22] The conduct of the Issuer and the violations found evidence that investors are entitled to that protection.[23]

Respectfully submitted,

Sidney L. Feiler

Sidney L. Feiler
Hearing Examiner

Washington, D. C.

November 6, 1963.

22/ Aluminum Top Shingle Corporation, 40 S.E.C. 941, 946-7 (1961).

23/ Detailed proposed findings of fact and conclusions of law have been submitted by the parties. All have been carefully considered. To the extent they are in accord with the findings and conclusions, they have been accepted. Otherwise, they have been rejected.