ADMINISTRATIVE PROCEEDING
FILE NO. 3-5104

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
INSTITUTIONAL SECURITIES OF COLORADO, INC., et al.	:
File No. 8-16443	:

INITIAL DECISION

Washington, D.C.
August 14, 1978

Edward B. Wagner
Administrative Law Judge

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APPEARANCES:

John Kelly, Gregory Guilford and Gregory Tevis, Securities and Exchange Commission, Denver, Colorado, appearing on behalf of the Securities and Exchange Commission.

Harold S. Bloomenthal, Roath & Brega, P.C., 1100 Writers Center IV, 1720 South Bellaire, Denver, Colorado, appearing on behalf of the Respondent, Lloyd H. Harty, Jr.

Paul H. Metzinger, Nelson, Harding, Marchetti Leonard & Tate, 2310 Colorado State Bank Building, 1600 Broadway, Denver, Colorado, appearing on behalf of the Respondent, Stanley Richards.

Before: Edward B. Wagner, Administrative Law Judge

The Proceeding

This public proceeding was instituted by the Commission on October 14, 1976 against seven respondents. Five of these respondents have either defaulted or settled. [1/]

The two remaining respondents who are the subjects of this Initial Decision are Stanley Richards and Lloyd J. Harty, Jr.

In the Order for Proceedings Richards and Harty are charged with wilful violation of Section 5 of the Securities Act of 1933 (Securities Act), and singly and in concert, with wilful violations of the antifraud provisions of both the Securities Act and the Securities Exchange Act of 1934 (Exchange Act). [2/] The violations allegedly took place between January 18, 1975, and April 28, 1976 in connection with the Regulation A offering of stock of Chemex Corporation (Chemex), a company which is attempting to develop a cure for cancer.

An extended hearing was held in Denver, Colorado in March, 1977 with a concluding session in May of that year. Thereafter, extensive findings and briefs were filed by the Divison of Enforcement and counsel for Richards and Harty.

[1/] Institutional Securities of Colorado, Inc., United Securities Corporation and Abraham Goldberg have defaulted. SEA Rel. No. 13,341 (March 8, 1977); SEA Rel. No. 13,493 (May 2, 1977). William C. Armor and James Kent Kinniburgh have entered into settlements. SEA Rel. No. 13,110 (Dec. 27, 1976); SEA Rel No. 13,372 (March 14, 1977).

[2/] §17(a) of the 1933 Act and §10(b) and Rule 10b-5 of the Exchange Act.

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

The Standard of Proof and Scienter

Respondents contend that the "clear and convincing" standard of proof of the Collins case [3/] should be applied here. The Division merely argues that, if such a standard is applicable, it has been met.

In the Collins case the standard was restricted to fraud violations. Here, violations of the registration provisions are charged as well. I have, nevertheless, concluded that the "clear and convincing" standard is also applicable to the latter charges. The alleged registration violations depend upon a finding that fraud has been committed in connection with the Regulation A offering circular. This fraud vitiates the exemption. Since the same alleged misconduct is involved in both the independent antifraud violations and the fraud which causes the loss of the exemption, the same standard should be applied.

A leading comment contends that the "clear and convincing" standard means "highly probably true", and this meaning is adopted here. [4/]

[3/] Collins Securities Corp. v. S.E.C., 562 F. 2d 820 (D.C. Cir. 1977).

[4/] McBaine, Burden of Proof: Degrees of Belief, 32 Calif. L. Rev. 242, 246, 253-254 (1944).

Respondents argue under the Hochfelder case [5/] that scienter in the sense of intent to defraud or manipulate is a prerequisite to findings of fraud. However, as the Division points out, there is no such requirement in connection with Section 17(a) of the Securities Act in court or in administrative proceedings, and the Commission has stated that, even with respect to §10(b) of the Exchange Act and Rule 10b-5, scienter is not essential in administrative proceedings. Steadman Security Corporation, 12 SEC Docket 1041, 1043, 1050-1051, (June 29, 1977); Shaw, Hooker & Co., 13 SEC Docket 1171, 1173-1174 (January 3, 1978).

The Charges

The heart of the charges against Richard and Harty is that they, singly and in concert, wilfully violated anti-fraud provisions of the Federal securities laws in the Chemex offering by:

(1) withholding from public distribution Chemex shares while placing a substantial portion of that stock into accounts which Richards and Harty controlled and accounts controlled by the issuer.

(2) reselling some of the shares to member of the investing public at prices in excess of the offering price.

(3) using a misleading offering circular which failed to disclose the above plan to distribution and failed to disclose that, by virtue of such plan, the true public offering price was considerally higher than the designated price of 10¢ per share.

The order also charges as fraud a failure to disclose certain consulting fees.

[5/] Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1967)

Respondents' motions to dismiss the charges were denied by Commission order, dated February 23, 1977. The order stated at p. 4:

> "Respondents are charged with withholding a substantial portion of the Chemex offering from public distribution, placing the withheld stock in accounts which they and control person of the issuer controlled, immediately reselling some of the stock to the public at prices in excess of the offering price, and using an offering circular which failed to disclose these facts. These allegations do not break new ground. Taken as a whole they spell out a pattern of fraudulent conduct similar to that which we have dealt in several prior cases." 6/

It should be noted at the outset that the pattern referred to by the Commission did not occur here. Except for limited instances, the stock purchased by insiders and friends of the issuer and by relatives and friends of the respondents was not sold until more than six months after the offering was closed.

The situation presented is atypical in other respects.

(1) Chemex has proved to be of continuing interest to investors. As of the end of January, 1978 its stock was quoted at $5.25 bid, $6 ask. Accordingly, at least as of this date, the public has not been left holding the bag.

(2) Chemex is fortunate in having the services in its research department of Dr. Russell T. Jordan, a scientist of impeccable credentials

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6/ The Order for Proceedings does not state that the shares were immediately resold. Section II, Paragraph B (3).

(3) Demand for Chemex stock during the Regulation A offering and thereafter may be attributable in part to Dr. Jordan's reputation and to the earlier phenomenal record of Vipont Chemical Company, a local company which was also attempting to develop a cancer cure and also employed Dr. Jordan.

(4) A large proportion of the Chemex resales was made through a broker-dealer who was not in the underwriting group and who is not charged as a respondent in the proceeding.

This case, however, has certain typical "hot issue" elements. Thus, there is no real dispute that large portions of the Regulation A offering were placed in the hands of a favored few, i.e., relatives, friends and business associates of the respondents and of principals of the issuer. One facet of the Division's argument is that this, in itself, without disclosure, is a violation of the antifraud provisions. 7/ It is as to this contention that counsel for respondent Harty (Br. 14) states:

> "No matter how the staff clothes the manipulative aspects of its case, it comes down to no more than the view, that it is somehow a violation of the antifraud provisions for an issue to be allocated unfairly."

It is clear that the promoters and Richards and Harty knew or could reasonably have expected that the Chemex

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7/ The Division Brief states at pp. 8-9:

> "Thus, a distribution is not complete if any part of the offering remains in the hands of broker-dealer or in the hands of persons (such as for example officers, directors, partners, employees and favored friends of broker-dealers, underwriters or issuers) who are not generally members of the public."
>
> As noted above, the Chemex offering circular failed to disclose this plan of distribution and was therefore a false and misleading offering circular."

offering would be a "hot issue", and that it is further clear enormous profits were obtained by the insiders- apparently attributable only to their ability to obtain an allocation of Chemex stock through association and friendship with the promoters of the company or with Richards and Harty.

There is no doubt that the distribution was "unfair" in the sense noted, but the leading cases cited by the Division do not establish that unfairness alone violates the antifraud provisions.

For example, in Holman [8/] there was much more than inequity in the distribution. The period of retention by certain of the controlled insider purchasers was so short that it was apparent that they did not represent true demand but were merely being interposed between the broker-dealer and the public to take a profit without risk to them. Under these circumstances, it could be concluded that the market was being artificially stimulated with manipulative effect.

In Strathmore Securities Inc., 43 S.E.C. 575 (1967), shares in an offering were transferred to insiders who were not the actual purchasers and who did not pay for the stock, with a view to their subsequent repurchase by registrant and distribution to the public. The action was apparently taken

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8/ R.A. Holman & Co., Inv. v SEC, 366 F. 2d 446, 450 (2d Cir. 1966). aff'g R.A. Holman & Co. Inc., 42 S.E.C. 866 (1965).

to close out an offering and to make it appear successful when it had been a failure. 9/

In Atlantic Equities Company, 43 S.E.C. 345 (1967), fraudulent representations were involved and shares were withheld in an offering and then distributed through contrived transactions at artificially inflated prices.

In Lewisohn Copper Corp., 38 S.E.C. 226 (1958), a Regulation A offering was represented to have been sold out by October 20, 1955 when "more than half of the issue was sold to a few broker-dealer firms for their own accounts or for the accounts of members of their families" (p. 234). A substantial amount of this stock was resold at prices in excess of the offering price in a period ending on January 12, 1956. It was in this context that the Commission stated (p. 234):

> "A distribution of securities comprises 'the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public.'"

The Commission declined to hold, despite the urging of the Division, that the distribution continued into July, 1956 (pp. 234-235).

I grant the request of counsel for Harty that official notice be taken of certain testimony, set forth in his brief, contained in the transcripts of the "Hot Issue" Hearings. 10/

9/ Cf. SEC v. Manor Nursing Centers, Inc. 458 F. 2d 1062 (2d Cir. 1972).

10/ The Hot Issues Securities Market, Comm. File 4-1148

Generally these hearing tend to show that:

(1) Allocations in a "hot issue" underwriting were frequently made on the basis of business considerations, such as the potential of the account.

(2) "Directed" stock frequently accounted for high percentages of a "hot issue" offering, and frequently these people were the first to unload.

(3) Large portions of "hot issue" offerings were placed in discretionary accounts (the ultimate controlled account).

Counsel for Harty notes that as a result of the hearings the Commission amended Form S-1 to require a statement of the extent to which the principal underwriters intended to place the securities being offered in discretionary accounts. 11/

As counsel further notes, the Commission in Securities Act Releases 5274 and 5275 (July 26, 1972) urged the National Association of Securities Dealers (NASD) to improve standards with respect to what constituted a bona fide public offerings and indicated that, failing action by the self-regulatory organization, it might take action itself. Now, six years later, the NASD has not taken such action nor has the Commission.

Counsel contends that under these circumstances it would be inappropriate for the Commission to conclude

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11/ SA Rel. No's. 5395, 5396 (June 1, 1973); [73' Transfer Binder] Fed. Sec. L. Rep. CCH ¶¶'s 79,383, 79,383.

in an administrative proceedings (dealing with events that took place 2 1/2 years after the above releases) that placing the offering in the hands of the "favored few" or even that placing an offering in controlled accounts, without more, violates the antifraud provisions. 12/

I agree not only for these reasons, but because I find no authority for the proposition that such actions by themselves constitute violations.

However, the Division also asserts that the "thrust" of its case is "that there was a pre-arranged plan among insiders of the issuer, Chemex (Tomlinson, Larsen and Hamilton) and respondents Harty and Richards to withhold from distribution the shares of Chemex issues pursuant to a Regulation A offering. The plan was accomplished through an issuer-directed distribution." (Division Reply Brief, p. 2). It charges an alleged scheme "to represent that securities are being sold at a price which is purportedly the market price while failing to disclose restrictive and manipulative practices such as assuring that large blocks of stock are locked up with holders who are withholding the shares from sale." (Division Reply Brief, p. 16). In citing and discussing as support for

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12/ Counsel argues that the proper course for the Commission to follow is rule-making, citing SEC v. Chenery Corp., 332 U.S. 194 (1947). Counsel states at p. 53 of his brief: "An economic analysis and not a morality that abhors speculative profits is called for."

the last quoted proposition certain cases, [13/] the Division further appears to clarify its charges to assert an agreement or arrangement between the insiders and the issuer's promoters to withhold insider purchases from sale and to sell only pursuant to pre-arrangement. The Division argues that a like arrangement existed between Harty and Richards and their customers.

In order to be involved in what, if true, are clearly violations, Harty and Richards must be participants therein or must have been in a position where they knew or should have known that such a scheme was afoot and, nevertheless, continued to collaborate with the schemers. See Haight & Company, 44 S.E.C., 481, 497 (1971).

These questions, i.e., was there such a scheme, and, if so, to what extent were Harty and Richards involved, present factual issues. After identifying the principal persons involved in these matters, the factual discussion which follows focuses on these issues.

Respondents

1. Lloyd G. Harty is around 42 years old and has worked in the securities industry for a total of approximately 17 years since 1955. During that period

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13/ Otis & Co. v. SEC, 106 F. 2d 579 (6th Cir. 1969); Canusa Gold Mine Limited, 2 SEC 548 (1937); In Otis and Canusa there were agreements not to sell large blocks of stock.

of time, Harty has been employed with eight different wholesale and/or retail over-the-counter broker-dealer firms as a registered representative, trader, head trader, office manager, manager of retail sales and manager of retail department.

Harty was employed as a registered representative, sales manager and manager of the retail department of M.S. Wien & Co., a registered broker-dealer, from September or October 1974 until about January 31, 1975. Harty was fired by Wien on that date.

Harty was employed as a registered representative at Institutional Securities of Colorado, Inc. from about April 22, 1975 through April 1976.

Harty is a leading over-the-counter saleman in Denver.

2. Stanley Richards is around 53 to 55 years old and has been employed in the securities industry continuously since 1958 with the exception of about a two year period. During the period of time since 1958, Richards has been employed with six different retail over-the-counter broker-dealer firms as a registered representative, trader, head trader and partner.

Richards generates around $100,000 a year in net commissions and is one of the top over-the-counter salesmen in Denver.

Richards worked as a registered representative and trader at Institutional Securities of Colorado, Inc. from March 1973 through all relevant periods of time alleged in the Order for Public Proceedings.

Others Involved in the Proceeding

1. Institutional Securities of Colorado, Inc. (ISOC), a corporation, having its principal place of business in Denver, Colorado, was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act continuously from April 27, 1971 through all periods of time material to this proceeding.

2. Abraham Goldberg (Goldberg) was from April 1971 until about September 15, 1974 an officer, a director and a shareholder of ISOC. From about September 15, 1974 until at least June 30, 1976, Goldberg was the President, a director and a shareholder of ISOC.

3. United Securities Corporation (United), a corporation having its principal place of business in Casper, Wyoming, was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act continuously from September 25, 1970 until at least June 5, 1975.

4. William C. Armor, Jr. (Armor), a resident of Casper, Wyoming and Stuart, Florida, was one of the founders of United in 1970 and was employed with United as a sales-

man during 1974 and 1975. Armor is a millionaire. He is the owner of Armor Oil Company, a company engaged in oil and gas leasing and drilling ventures, and is active in real estate development. He was formerly the president of Great Plains Life Insurance Company. From January 1974 to January 1975, Armor spent only 30% of his time as a salesman for United.

5. Vipont Chemical Company (Vipont) was incorporated in the State of Wyoming on May 7, 1968, is located in and does business out of Lander, Wyoming. Vipont has been continuously engaged in the investigation and testing of a drug designated as "Compound X". Vipont entered into an agreement with Colorado State University located in Fort Collins, Colorado, to carry out the investigation and testing of Compound X, especially in the treatment of equine sarcoid, which is a connective tissue tumor found in the skin of horses. Vipont made an offering of 925,000 shares of its common stock to the public pursuant to an offering circular dated May 4, 1971 with an offering price of 50¢ per share. The offering was made pursuant to a claimed Regulation A exemption from registration.

The over-the-counter market price of Vipont reached a high of $14 within a period of approximately one year

after the closing of the offering. During the period from October 1, 1974 through April 1, 1975 which included the period of the Chemex offering, the lowest quotations were $3 bid $3 3/8 ask and the highest quotations were $3 1/2 bid and $4 1/4 ask.

As of January 30, 1978, when Chemex was quoted at $5.25 bid and $6 ask, Vipont was quoted at $1.13 bid $1.63 ask. 14/

Aside from Dr. Russell T. Jordan who was President of Vipont and resigned to become Director of Research for Chemex, the persons controlling and managing Vipont are not the same as those controlling and managing Chemex.

6. Chemex Corporation (Chemex) was incorporated in the State of Wyoming on June 3, 1975 and is located in and does business out of Riverton, Wyoming. Chemex was formed to conduct research, either directly or indirectly, to attempt to identify the mechanism of action by which certain constituents of elements of larrea divaricata (a perennial evergreen shrub also known as the creosote bush) may have some inhibitory affect on the growth and development of cancerous cells. On June 10, 1974, Chemex and Vipont entered into an agreement under

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14/ Official notice is taken of these quotations as requested by counsel for Harty.

which Chemex's research was to be conducted by and directed from the research facilities of Vipont at Fort Collins, Colorado. The research program was to be under the control and direction of Dr. Russell T. Jordan, President of Vipont. On about June 11, 1975 Chemex entered into an agreement with the University of Nevada at Reno, Nevada to conduct Chemex's research.

Chemex made an offering of 3,000,000 shares of its common stock to the public pursuant to an offering circular dated January 17, 1975 with an offering price of 10¢ per share. The offering was made pursuant to a claimed Regulation A exemption from registration and was purportedly closed on February 18, 1975. No registration statement has been filed with the Commission nor has ever been in effect with respect to Chemex's common stock.

7. Dr. Russell T. Jordan (Jordan) who resides at Fort Collins, Colorado, holds a Ph.D degree in microbiology and virology. He is a scientist with impressive and impeccable credentials. At least from the summer of 1974 and until the middle of June 1975. Jordan was the President and the Chairman of the Board of Vipont and, for a short period of time, was in charge of the Chemex research agreement of June 10, 1974. In mid-June, 1975, Jordan left Vipont and became the Director of Research of Chemex and has from that point been in charge of

Chemex's research program.

8. John L. Larsen (Larsen), a resident of Riverton, Wyoming, is and has been since June 3, 1974 the Vice President, a director and owns 1,125,000 shares of stock of Chemex, or 18.75% of the outstanding stock.

Larsen has been associated with numerous companies that have raised money from the public through the issuance of securities. Thus, Larsen was associated with U.S. Energy Corp. which had a public offering in 1970 in which Harty and Richards were involved. Larsen was associated with Ruby Mining Company which had a public offering through B.J. Leonard & Co. when Richards was employed there.

9. Emery Tomlinson (Tomlinson) is a businessman from Riverton, Wyoming. He may be regarded as a promoter of Chemex, having been involved in its early development and in arranging for the underwriting. He is presently a financial consultant of Chemex. His wife, Allyn Mae Tomlinson, owns 1,125,000 shares of Chemex stock. This is 18.75% of the outstanding stock.

10. Charles Hamilton (Hamilton) is a Wyoming attorney who represented Chemex and was its president.

11. Gary D. Garrison (Garrison), who is 36 years of age, has held a number of important jobs with large brokerage firms. He was one of the founders of ISOC and

from April 1971 until September 1974 was its President, a director and shareholder. From September, 1974 to around March 20, 1975 he was Chairman of the Board of Directors and a shareholder of ISOC. From the latter date until around June 1976 he was a shareholder of ISOC.

On June 24, 1976, Garrison entered a plea of guilty in the U.S. District Court in Colorado to an indictment charging him with fraudulent statements made in connection with a bank loan (18 U.S.C. §1014). He was granted immunity by the Justice Department with respect to his testimony in the administrative proceeding against Harty and Richards.

Background and the Offering

Sometime in 1972 Tomlinson and certain other persons purchased a Las Vegas, Nevada corporation named Chapparral for $5,000. Chapparral was engaged in developing cosmetics from the creosote bush. Most of the assets of this company, certain formulae, a mixing machine, and some bottles of cosmetics were abandoned. A file was, however, discovered which they considered "junk" (Tr. 1651). It contained clippings relating to the curative effects of tea made from the creosote bush and certain research being conducted at various universities, including the University of Nevada.

These clippings in the "junk" file aroused the curiosity of Tomlinson and his associates and lead to the eventual formation of Chemex in 1975. Prior to incorporation of

Chemex, trips were made to Reno, Nevada to the university to discuss the research being done there. In May 1974 Richards accompanied Tomlinson, Hamilton and Larsen on one of these trips and advised them that he would be interested in doing an underwriting for such a venture if Jordan or the university would do the research.

Richards had in early 1973 been employed by Garrison at ISOC at the suggestion of Tomlinson, Larsen and Hamilton. Prior to his employment by Wien in mid-1974, Larsen and Hamilton talked to Harty about participating in the proposed underwriting and he expressed an interest stating that he could handle at least a third of a $500,000 offering.

When the offering was made on January 17, 1975, United Securities Corporation, a Wyoming broker, in which, Armor, a long-time personal friend of Hamilton, was employed as a salesman, was named as the underwriter and the participating dealers were M. S. Wien (Harty) and ISOC (Richards). The offering was for 3,000,000 shares at 10¢ a share.

The proposed offering had been presented to the owners of United by Armor. Harty had brought the offering to Wien and Richards had proposed it to ISOC.

Allocations among the selling group were as follows:

a.	United	-	1,700,000 shares
b.	Wien	-	950,000 shares
c.	ISOC	-	350,000 shares

The over-the-counter market in Chemex commenced on February 19, 1975, and on that first day the market rose from a bid of 25¢ to a bid of 37 1/2¢ per share. On February 20, 1975 the bid rose to 48¢ per share and by March 6, 1975 the bid was 68¢ per share.

It is clear that the Chemex offering was a "hot issue" and that the participants were well aware of the fact. The Division produced a number of public investors who testified that they were unable to obtain shares in the quantities they desired. The fact that United, a firm which had little underwriting experience and success, was selected as underwriter is a further indication that the promoters had no doubt that the offering could be easily sold. There is testimony that both Tomlinson and Richards expected from an early date that a "hot deal" would result.

In fact, the offering was largely a dispensation of largesse by the three participating firms, rather than a sale of stock.

Thus, United's Wyoming office sold mainly to persons who were referred to it by the issuer and its promoters. The Denver office of United, which normally did the bulk of the firm's underwriting business, sold only 25,000

shares. Among the persons who purchased Chemex from the Wyoming office in the offering were the following:

Name	No. of shares
Jordan (Chemex's research director)	100,000
Lloyd Larsen (brother of Larsen)	125,000
Leslie W. Larsen (brother of Larsen)	125,000
Jan A. Lucero (daughter of Tomlinson)	110,000
Eric Tomlinson (son of Tomlinson- includes 50,000 shares for Eric, Inc., his company)	150,000
Farrell Brough (business partner of John Benesch of Riverton, Wyoming)[15/]	75,000
Earl E. Coleman, Jr. (friend and business associate of Hamilton)	75,000
Daniel L. Colgan (business partner of Tomlinson)	140,000
Michael D. Colgan (brother of Daniel Colgan)	140,000
Harry S. Harnsberger (Riverton, Wyoming lawyer and friend of Larsen, Tomlinson and Hamilton)	140,000
Cleo Arguello (Harnsberger's secretary)	10,000
Total ——	1,190,000

A number of these persons borrowed money to purchase the stock, and all of them may be considered "issuer-directed" in the sense that the promoters of the issuer referred them to Armor at United and Armor willingly sold to them. While Hamilton told Armor prior to the offering that a number of friends would be interested in purchasing Chemex, the record does not indicate that there was any understanding on Armor's part that such prospects would be preferred in that shares would be set aside for them to the exclusion of others.

15/ Benesch is president of the American National Bank of Riverton, Wyoming which loaned $10,000 to Jordan to purchase his stock.

The testimony of Phillipart, an NASD examiner at the time, that Kinniburgh, an official of United, admitted to him the stock was "issuer directed" is not credited. Phillipart did not include Kinniburgh's statement in his detailed NASD resport, and Kinniburgh denies having made it.

Bell's testimony concerning the statement by Gibson, another official of United (now deceased), that the company had "directed" most of the stock is not sufficiently probative both because of the indefinite nature of the quoted term and because the time the statement was made despends upon supposition on Bell's part.

In its More Definite Statement the Division alleged that Jordan, both Larsens and Eric Tomlinson were controlled accounts of the issuer. Loans to permit the purchases of their Chemex shares were arranged by the Chemex promoters for Jordan and the two Larsens. Eric Tomlinson, who was quite young, was Tomlinson's son, and his motorcycle business was financed by his father. In the sense that these accounts would probably be quite responsive to the issuer's wishes, they may be considered "controlled".

There is no direct evidence that the promoters extracted any agreement from these persons respecting the future sale of their stock or brought any influence to bear at any time concerning resale. Certain circumstantial evidence on this point is discussed later.

The Division in its More Definite Statement alleged that Harty sold Chemex in the offering to the following controlled accounts: 16/

Name	No. of shares
Fred and Patricia Simpson (Harty's brother-in-law and sister)	100,000
Louise Smith (Harty's mother-in-law)	10,000
Joan Ramsden (nominee for his mother)	10,000
Richard and Frances Teadonno (Harty's brother-in-law and sister)	121,000
Jeffco Associates (account 1/2 owned by Harty's wife and 1/2 owned by Fred Simpson)	100,000
Arthur Murphy (an account in which Harty directs the purchases and sale of securities)	30,000
Total —	371,000 17/

The Division contention as to control by Harty is accepted, insofar as it means that these persons generally were beholden to Harty for past favors and must have expected that future favors would depend upon their being agreeable. Harty loaned Teodonno the money to buy his stock. There is, however, no evidence except as to the Murphy and Jeffco Associates accounts, which he directly controlled, that any influence was brought to bear by Harty concerning the later disposition of these shares. There is no evi-

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16/ Harty's sales were actually consummated through United. He was fired from Wien in the midst of the distribution process, because he did not share his bonanza with other salesmen in the office. Harty had also falsely denied to a representative of Wien that he had placed stock with his relatives.

17/ A number of other accounts to whom Harty sold were "favored accounts", but they were not asserted by the Division to be "controlled" and are thus basically irrelevant to the discussion herein.

dence that there was any agreement or understanding between Harty and the Simpson's, Teodonno's, Smith or his mother concerning the future sale of their Chemex stock.

Richards is alleged to have sold Chemex in the offering to the following controlled accounts:

Name	No. of shares
C. William Alexander (Richards' brother-in-law)	50,000
John B. Milne (a wealthy businessman, who had jointly owned a small company with Richards)	75,000
Michael DiSalle (an old friend of Richards, who borrowed money from Milne to make the purchase - the loan was arranged by Richards)	50,000
Lad Felix (a friend of Richards who had experienced financial reversals and who borrowed money from Milne for the purchase)	125,000
Total ——	300,000

Richards merely used the name of his brother-in-law, Alexander to mask the fact that the account was that of Goldberg, a principal of the firm. Alexander was to receive a small percentage of the profits. Contrary explanations by Richards and Alexander at the hearing are not credited. Richards and Goldberg clearly controlled this account.

Mr. Milne is a man of considerable wealth, and there is no evidence that his account is controlled by Richards.

DiSalle, a man of modest means, was able to make his purchase through a loan arranged by Richards from Milne,

who was formerly a business associate of Richards. Under such circumstances, and in the expectation of possible future favors, he could probably be expected to do Richards' bidding with respect to the disposition of his stock and in this loose sense may be considered to be "controlled". Felix was down on his luck financially, received his loan from the same person and may generally be regarded in the same category.

Thus, the total Chemex shares which may loosely be considered under Richards' "control" amounted to 225,000.

There is no evidence- in fact the testimony is directly to the contrary- that any agreement or understanding between Richards and either Milne, DiSalle or Felix was reached concerning the later resale of the Chemex shares which he apportioned to them, nor is there any evidence that Richards brought any influence to bear upon them respecting resale of their shares.

In pursuing its "scheme to defraud" theory the Division relies heavily upon the manner in which, and circumstances surrounding, the disposition of Chemex shares during November, 1975 through June, 1976 by "issuer-directed" customers through a Denver broker, Charles Snow. 18/

18/ First Colorado Investments and Securities, Inc. (First Colorado).

Snow opened First Colorado in late November, 1975. From late November 1975 through June 30, 1976, Snow purchased approximately 600,000 shares of Chemex stock primarily from the Wyoming residents who had purchased their shares in the original underwriting from United. These shares were purchased by Snow at substantial discounts from the current market prices in claimed block-bid transactions. The Chemex purchases and resales represented gross proceeds of several hundred thousand dollars to Snow's firm.

Prior to actually engaging in any securities transactions there were long distance telephone calls from Snow to Tomlinson. From November 19, 1975 to February 22, 1976 there were 40 telephone calls from Snow's firm to Tomlinson's telephone number and as of March 10 these calls totalled 67. The Division did not attempt by analysis or otherwise to show a relationship between the timing of the calls and particular tranasactions in Chemex shares. Snow stated that he made some of these telephone calls and that, in addition, there were telephone calls from Tomlinson to him. Snow testified that the purpose of these calls was to discuss the stock market with Tomlinson and also to some degree to talk to Tomlinson and Tomlinson's wife about Chemex.

Snow denied ever receiving instructions from Tomlinson during these telephone calls concerning the numerous transactions Snow's firm was effecting with the Wyoming people who were friends of Tomlinson. Snow stated that during this period of time Tomlinson himself had no transactions in securities with Snow's firm.

Snow sent each of the Wyoming people with whom he dealt a form letter which was returned to Snow's firm signed by most of these individuals stating that Snow and his firm had an option to purchase each of these individuals' Chemex shares. Snow also sent to these same individuals a subsequent letter which they also signed stating that Snow's firm did not have an option on these shares and that each transaction was separately negotiated.

Witnesses Daniel Colgan, Richard Van Norman, and Harry S. Harnsberger, members of the Wyoming group who sold Chemex to Snow, testified that they dealt with Snow independently of Tomlinson and that they separately negotiated each transaction.

The Division contends that this evidence establishes that Tomlinson was orchestrating the resale of the Chemex stock for manipulative purposes pursuant to a pre-arranged scheme. The aborted option agreements may be viewed as an attempt to justify the substantial discounts which Snow was obtaining which was abandoned as unsupportable

in favor of the subsequent letter to the effect that each transaction was separately negotiated. Under this theory, both of these letters were designed as a form of cover-up. Snow's explanation of the "option" letter was that the employee who drafted it did so because of his prior experience as an NASD official. The subsequent letter was an attempt by Snow's lawyer to correct an obvious error. Those who signed the option letter stated they gave neither it nor the replacement letter any thought, merely signing them because they thought Snow needed them for his records.

Tomlinson and Larsen, the principal promoters of Chemex, were not called as witnesses by either side.

While the circumstances here are exceedingly suspicious, proof of the charged pre-arranged manipulative scheme must, as noted, be "clear and convincing". In order to find as the Division proposes, it would be necessary to view all of the direct testimony in point as perjured. 19/ While I suspect that there may be some animus on the part of the Wyoming group against what is probably viewed as "government interference", I am not prepared to find, in effect, that these perons, who appear to be reputable citizens, have all given perjured testimony.

Another problem is tying the alleged scheme in with the respondents. In this respect the Division.

19/ In fact, in the overall case the Division asserts that the testimony of 12 of the 46 witnesses is "incredible" and ask for conclusions directly contrary to their testimony.

replies primarily upon the following evidence:

1. About 6 months after the offering a United salesman sold Chemex short and was at first unable to cover his short position. Richards told the saleman that he would not be able to cover the short.

2. Richards commented to Garrison with respect to the Snow sales of Chemex and the fact that he appeared to be covering them, that Tomlinson must be selling and that Tomlinson and the Wyoming group had cheated him (Richards) for the last time. 20/

3. The fact that many shares sold by Harty and Richards were also held over 6 months before resale. 21/ Apparently, the argument is that parallel conduct cannot be explained by other factors, or fortuitiously, and is therefore indicative of guilt.

In respect to Harty the following may be pointed out with respect to the Arthur Murphy account which he controlled. Murphy has an auto-dealership in California. Some of the proceeds from this account were credited to automobiles leased by Jordan and Tomlinson.

Generally, it may be noted that both Richards and Harty are sophisticated and experienced securities saleman and were involved in the Chemex underwriting at early stages.

20/ Richards denied having made such a statement. His denial is not credited.

21/ It should be pointed that all sales by Chemex customers of Harty and Richards were not deferred until the 6 month period had elapsed.. Harty customers, Arthur Murphy, Bob Wilson, Jeffco Associates, Robert Neher, Harty's mother and Richard Teodonno, made sales substantially before the 6 month period was up, and Michael DiSalle, one of Richards' customers, made a substantial sale in June, 1975.

The above statements by Richards are sufficiently vague to be subject to a number of possible interpretations and explanations. However, even if they are viewed in their worst possible light, they do not establish that Richards knew or should have known at the time of the offering of a pre-arranged scheme pursuant to which the insiders held their stock off the market and agreed to sell only with the approval of the promoters. 22/ There is, of course, even less evidence against Harty.

Under the circumstances, to hold Richards and Harty to be parties to such an illegal scheme would be essentially, as counsel for Richards argues, to rely upon guilt by association. Sufficient involvement by Richards and Harty in the allegedly improper activities of Snow- which themselves were not appropriately established- has not been proven clearly and convincingly.

The Division argues that the case of Leo Glassman, 8 SEC Docket 735 (1975), a recent Commission decision involving "hot issues", is to be regarded as an "aberration". (Div. Reply Br. 19). There the Commission stated that certain circumstances were "suspicious" but

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22/ Nor do they sufficiently establish such a pre-arranged scheme on the part of the promoters.

found the evidence insufficient to establish violations of antifraud provisions. The case involved accounts which were clearly controlled by those making the distributions and the person who was subject to such control, in effect, acknowledged that he did not resell without their approval. See Leo Glassman, Initial Decision (March 25, 1975), p. 7, File No. 3-3758. In this last sense Glassman is a stronger case than that presented here. The Glassman decision must be viewed as to taking the position that withholding through the use of "controlled" accounts and even the later exercise of that "control" in the resale of "hot issue" stock is not a per se violation.

It would appear that in such circumstances a manipulative purpose or clear manipulative effect would have to be shown. No such purpose or effect has been shown in this case, and until the Glassman decision is modified by the Commission, it must be regarded as a governing precedent.

Failure to Disclose Consulting Fees to Dr. Jordan

The Chemex Regulation A Offering Circular stated that the company had entered into a research agreement with Vipont Chemical Company and that "a substantial portion of the net proceeds of this offering will be reserved to fund the research". (Div. Ex. 1, p.4).

It identified Dr. Jordan as the President of Vipont.

In fact, Dr. Jordan acted as a consultant to Chemex during its organizational stage, while the offering was in progress and until he went to work for Chemex as Research Director in June of 1975. He was paid no more than $24,000 during this period of time. This included expenses as well as a consulting fee. These services were rendered for $20.00 an hour, which is much less than his usual fee. Dr. Jordan assisted in preparing the technical portions of the Offering Circular. The Offering Circular does not disclose his fees, but does include an estimate of the expenses of the offering, and a portion of Dr. Jordan's fees and expenses are properly attributable to these expenses.

The Division argues that failure to disclose the above consulting fees was an omission of material fact in violation of the antifraud provisions. It urges that investors should have known that the Jordan arrangement gave rise to a possible conflict of interest for him. The Division further argues in reply to the contention of Richards and Harty that they were unaware of these fees that their close association with the principals of Chemex makes it clear that they knew or should have known of these fees. Regardless of what conclusion is reached on this last proposition, as counsel for both

Richards and Harty point out, non-disclosure is not a violation unless a material fact was omitted.

The standard for materiality has recently been stated by the Supreme Court as follows:

> "What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. 23/

All eight investor witnesses in the proceedings who were asked the question stated that it was of no particular significance to them whether Dr. Jordan received consulting fees or not.

I have concluded that the charged omission was not material.

Conclusions

While certain aspects of the situation presented hardly inspire faith in the fairness and integrity of the underwriting and distribution process for public issues, no fraud has been clearly and convincingly shown. The remedy for the problem of the "favored few" reaping huge profits to the exclusion of the ordinary public investors and the ever present possibility that those favored will return the favor by permitting themselves to be used for manipulative purposes appears to be, as counsel for Harty argues, in the area of rulemaking.

23/ TSC Industries Inc. v. Northway Inc., 426 U.S. 428, 449 (1976)

Since the alleged registration violations are based upon establishment of the fraud violations, the registration violations also have not been sufficiently shown.

Accordingly, IT IS ORDERED that the charges against Harty and Richards contained in the Commission's Order for Public Proceedings, dated October 14, 1976, are hereby dismissed.

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

Pursuant to Rule 17(f), this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen (15) days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17 (c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review

as to a party, the initial decision shall not become final with respect to that party. 24/

Edward B. Wagner
Administrative Law Judge

Washington, D.C.
August 14, 1978

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