

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
DIXIE LAND AND TIMBER CORPORATION (2-2278):
(Section 8(d) of The Securities
Act of 1933, as Amended.)

FILED

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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Samuel Binder
Hearing Examiner

Washington, D.C.
June 23, 1966

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Before: Samuel Binder, Hearing Examiner.

Appearances: Alan B. Levenson, Esq., John E. Taulbee, Esq.,
Leonard R. Steinsapir, Esq., and Robert H.
Werbel, Esq., appearing on behalf of the
Division of Corporation Finance, Securities
and Exchange Commission.

Clifford N. Sears, Esq., 236 Title Building,
Atlanta, Georgia, appearing on behalf of
Dixie Land and Timber Corporation.

Andrew Smith, Esq., 4708 Roswell Road, Atlanta,
Georgia, appearing on behalf of Mr. Ken Mason.

George H. Kasper, Jr., Esq., 942 Title Building,
Atlanta, Georgia, appearing on behalf of the
Trustees of the Bondholders, Messrs. Spears and
Smith.

Roy H. Phillips, Esq., Phenix City, Alabama,
appearing on behalf of Mr. J. W. Phillips, Sr.

This is a proceeding under Section 8(d) of the Securities Act of 1933, as amended, ("Act"^{1/}) to determine whether a stop order should issue suspending the effectiveness of a registration statement on Form S-1 filed by Dixie Land and Timber Corporation ("registrant", "respondent" or "Dixie") on September 22, 1964 covering a proposed public offering of 4,081,528 shares of registrant's authorized but unissued \$.25 par value common stock and 504 shares of registrant's treasury stock. The registration statement reflected that 1,000,000 of these shares were to be reserved for options, 60,960 shares were to be reserved for conversion of outstanding bonds and the balance, 3,021,072 shares, were to be offered at a public offering price of \$1.00 per share. Dixie also proposed to register 5,917,968 shares of its issued and outstanding \$.25 par value common stock and 762 units of its issued and outstanding 6-1/2% First Mortgage Bonds, for the purpose of informing certain purchasers of such securities "of the possible loss of the exemption [from registration] under the Securities Act of 1933 and the possible contingent liability for a refund to them of the price paid for their stock plus 7 percent interest from the date of purchase". The registration statement has not become effective.

1/ Section 8(d) of the Act, in pertinent part, provides:

"If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, the Commission may, after notice . . . and after opportunity for hearing . . . issue a stop order suspending the effectiveness of the registration statement. When such statement has been amended in accordance with such stop order the Commission shall so declare and thereupon the stop order shall cease to be effective."

On July 12, 1965 the Commission instituted these proceedings. The Commission's Division of Corporation Finance ("Division") alleged that Dixie's registration statement and prospectus contained materially false and misleading statements concerning the company's business and property, its financial condition, its subsidiaries, its earnings, its income, the market for its securities, its contingent liability for sales of unregistered securities, and the independence of its accountants. In addition the Division charged that Dixie's accountants failed to observe generally accepted accounting principles and to conform to generally accepted auditing standards.

The matter was set down for hearing to determine whether the charges made by the Division were true, to afford registrant an opportunity to rebut any evidence produced by the Division to support such charges, and to determine whether a stop order should issue suspending the effectiveness of its registration statement.

After appropriate notice, a hearing was held in Atlanta, Georgia before the undersigned hearing examiner at which the parties were afforded full opportunity to be heard and to present evidence and to file proposed findings and conclusions and briefs. The Division thereafter filed proposed findings and conclusions and a brief. The respondent filed a "Statement of Counsel for Registrant In Lieu of Proposed Findings and Conclusions and Brief of Registrant" ("statement"). The latter document dealt with events relating to Dixie's management, which occurred subsequent to the conclusion of

the hearing held herein. Registrant did not attempt in such document or otherwise to rebut the evidence presented by the Division or to refute the proposed findings and conclusions and brief prepared and filed by the Division. Counsel for Dixie in his statement for registrant informed the hearing examiner of the resignations of Mr. Ken Mason the president and chairman of the board of directors of Dixie ("Mason") and Mrs. E. D. Mason secretary and treasurer of the company in what he referred to as a ". . . disputed election, (unresolved at this time). . . ." In addition, counsel stated that respondent decided that the company "would not be active in the near ^{2/} future and it was unnecessary to pay further legal expense to complete 'Proposed Findings and Conclusions and Brief of Registrant.'" In addition, counsel for Dixie appended an excerpt from the minutes of the Financial and Executive Committee of respondent held on October 27, 1965 in Atlanta, Georgia stating that:

"Mr. Gordon Kiser made a motion that Mr. Sears [counsel for registrant] notify the S.E.C. that we have a change in management and will not answer their last correspondence (Proposed Findings and Conclusions and Brief of the Division of Corporate Finance); meaning that we wish to sell no more stock in Dixie; seconded by Shaw, motioned carried."

2/ The registrant has sold an undetermined number of shares of its common stock on a time subscription basis and, at least, to the extent that it continues to receive payments for such securities, it will be actively engaged in business.

The registrant urged the hearing examiner "to find and conclude the most effective method of protecting the investors in Dixie Land and Timber Corporation and the public interest and allow Dixie Land and Timber Corporation to either withdraw its registration or amend after the new management team decides on the future course of Dixie".

The following findings and conclusions are based on the record, the documents and exhibits therein and the hearing examiner's observation of the witnesses.

BACKGROUND

Registrant, a Georgia corporation, was organized in January 1959 "for the primary purpose of acquiring, owning, managing and operating timber and forest lands and ultimately, establishing and operating a tissue mill" and secondarily to acquire "other types of real property and other investments which appear to offer good potentials for income and/or capital appreciation".

Dixie sold to the public either for cash or on a time subscription basis at constantly ascending prices between April 15, 1959 and June 12, 1964 3,410,640 shares of its \$.25 par value common stock (adjusted for a four for one stock split) for approximately

^{3/}
\$1,748,000. During this period Dixie also exchanged 2,007,384 such shares for other securities, and "Assets and Timber Lands". Most of Dixie's shares thus issued were later sold to the public. During the period from November 29, 1962 to May 12, 1964 the registrant also sold either for cash or on a time subscription basis 880 of its 6-1/2% First Mortgage Sinking Fund Bonds for gross proceeds of \$88,000.^{4/}

3/ Dixie for a number of years had been offering its securities allegedly only to residents of Georgia under a claim that such sales were entitled to an exemption from registration pursuant to Section 3(a)(11) of the Act. According to a state prospectus covering securities registered with the Securities Commissioner of Georgia dated October 31, 1963 the company was offering at that time 92,944 shares of the company's \$1 par value common stock at \$3.40 per share and also offering 6-1/2% First Mortgage Sinking Fund Bonds (Series A). This prospectus stated that the company had made prior public offerings of its common stock as follows:

<u>Date Registered</u>	<u>Number Shares Subscribed</u>	<u>Offering Price</u>
April 15, 1958 (sic)	200,000	\$1.00
September 26, 1959	475,000	\$2.00
May 24, 1960	225,000	\$2.40
October 4, 1960	320,427	\$2.80
October 6, 1961	42,391	\$3.40
November 19, 1962	14,665	\$3.40

These shares were offered prior to a four for one stock split authorized for shareholders of record July 31, 1964.

4/ Note 10 to Dixie's Statement of Financial Condition June 30, 1964 stated in pertinent part that ". . . the company may have lost its exemption under the Securities Act of 1933." The uncontradicted evidence developed during this proceeding established that the "intrastate" exemption from registration under the Securities Act relied upon by registrant was not available, and that in addition all of Dixie's state prospectuses contained materially false and misleading statements principally relating (Continued)

Dixie had never shown a profit but had sustained substantial losses in each year of its operations. Nevertheless, Dixie's stock was offered to the public at constantly ascending prices ranging from \$1 per share in 1959 to \$3.40 per share shortly prior to the time it filed its registration statement with the Commission.^{5/} The price for Dixie's stock was arbitrarily fixed by Dixie's management.

During the period between April 15, 1959 and September 22, 1964, the date when registrant filed its registration statement and prospectus with the Commission, Dixie employed a series of state prospectuses in offering and selling its stock to the public. All of the state prospectuses used by Dixie contained false and misleading statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Specifically, Dixie's state prospectuses dated October 5, 1961, November 19, 1962 and October 31, 1963 present false and misleading statements concerning its financial condition and assets particularly in regard to "Land & Timber", "Machinery", "Survey Costs" and in addition such

4/ (Continued from page 5)
to its financial condition, including its assets, and relating to its income and earnings. Accordingly, the company had contingent liabilities under Sections 12(1) and 12(2) of the Securities Act and under Section 10(b) of the Securities Exchange Act. Registrant's failure to disclose its contingent liabilities attributable to its sales of securities in violation of the anti-fraud provisions of the Securities Acts constituted a material omission.

5/ See footnote 3, supra.

documents were materially misleading with regard to registrant's description of business and description of property. Moreover, Dixie's state prospectuses contained materially false and misleading statements regarding its subsidiaries. In addition, the state prospectuses contained false and misleading statements concerning the income of the company.

In essence, Dixie's registration statement and prospectus filed with the Commission repeated the same or substantially similar false and misleading statements as those which had appeared in the company's various state prospectuses.

From January 22, 1959, the date of its incorporation to September 22, 1964 the date when it filed its registration statement with the Commission, Dixie sustained operating losses each year.

According to a "Summary of Income" made part of its registration statement filed with this Commission, Dixie reported that it had losses for 1959 of \$15,881.82 (unaudited), had losses for 1960 of \$26,041.45 (unaudited), for 1961 it had losses of \$118,873.17, for 1962 losses of \$42,231.68, and for 1963 losses of \$58,281.43. For the six months ended June 30, 1963 the company reported losses of \$34,856.64 (unaudited) and for the six months ended June 30, 1964 it reported that it had losses of \$36,745.88. The net income (loss) per share of common stock for the following periods based on the shares outstanding or subscribed at the end of each period adjusted to indicate the four for one stock split were reported in the regis-

tration statement as follows: 1959 (\$.0169), for 1960 (\$.0057). These were unaudited figures. For 1961 the net income (loss) per share was reported as (\$.0248), for 1962 (\$.0079) and for 1963 (\$.0100). For the six months ended June 30, 1963 (unaudited) the loss figure per share for 1964 was reported as (\$.0062). However, this presentation of its "Summary of Income" by Dixie in its registration statement understated its losses substantially, as will be discussed more fully hereinafter.

Despite this business record on April 15, 1962 and again on April 15, 1963, when the registrant had a retained earnings deficit, Dixie declared and distributed "10% stock dividends" to its shareholders. The registrant was engaged in a stock selling campaign at the times it declared these stock dividends. In fact, registrant engaged in an almost continuous stock selling campaign from shortly after the date of its incorporation to the date it filed its registration statement with the Commission. Dixie mailed at least six communications to shareholders preceding or accompanying the distribution of the purported stock dividends, stating that "stock purchased now will participate in these dividends" that, while fractional shares would not be issued in connection with these "dividends," shareholders were given the opportunity to purchase additional portions of shares in order to round off their fractional shares; that the "dividend" denotes a "milestone in the progress of Dixie and we are looking forward to sending many more to our stockholders"; and that the

"dividend" is an "addition to your stock holdings that will prove of great value in the future."

These statements were designed to convey the impression of a profit-making dividend-paying company. At a minimum this literature should have pointed out that this action of the company did not represent a capitalization of earnings, that Dixie was in fact suffering losses at the time it declared its "stock dividends" and that the "dividends" represented merely a fractionating of the shareholders' existing equity interests. There was no basis for representing that these declarations of stock dividends denoted "a milestone in the progress of Dixie". In fact the use of stock dividends in these circumstances was simply a manipulative device to create a false appearance of profitable operations^{6/} and to persuade shareholders to buy additional shares of Dixie stock.

This course of conduct violated Section 17 of the Securities Act and Section 10 of the Exchange Act.

In a number of its state prospectuses, Dixie stated that:

"At the present time there is no established market for the common stock of the company."^{7/}

^{6/} In the Matter of MacRobbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962); In the Matter of Gob Shops of America, Inc., Securities Act Release No. 4075 (May 6, 1959). See also Chapter 7, Section B, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at page 204 (1965).

^{7/} See Dixie's state prospectuses dated October 4, 1960, October 6, 1961, November 19, 1962, and October 31, 1962. See footnote 4, supra.

Mason, the chief executive officer of Dixie, became aware in 1961 that registrant's stock was being offered through newspaper advertisements in Atlanta and was being sold at prices varying between \$1.10 per share and \$1.70 per share during periods when Dixie was offering its stock at \$2.80 per share and later when it was offering the stock at \$3.40 per share.^{8/} In fact, Mason personally purchased 3,000 shares at \$1.10 per share in April 1962 from Frank B. Stow, a Georgia attorney, who together with a former salesman for Dixie was engaged in selling Dixie stock at a time when the registrant's salesmen were selling its stock under a Georgia state prospectus at \$3.40 per share.

Dixie unsuccessfully sought to enjoin Stow and others from offering and selling its stock to the public at prices substantially lower than Dixie's price. Dixie alleged in its complaint, among other things that:

"That defendants, as a result of said misrepresentations to the stockholders of the petitioner have hereby created distress sales of said stock and have amassed thousands of shares of the stock of petitioner herein, for the purposes of reselling said securities and undercutting petitioner's authorized salesmen on the offering price of said stock."

"That defendants are advertising, soliciting, and offering for sale, to the general public, stock of Dixie Land and Timber Corporation at an unconscionable price of \$.90 - \$1.10 per share upon a continuing and repeated basis."

^{8/} See footnotes 2 and 3, supra.

"That your petitioner is unable to sell stock in Dixie Land and Timber to the general public, as provided by the Laws of Georgia, due to the unconscionable acts of said defendants. . . ."

Both Mason and Blasi the registrant's "sales manager" testified during the hearing that they did not consider themselves under an obligation to inform purchasers of the depressed market in the stock. Blasi testified:

"No sir, certainly didn't want that information out. We were trying to sell the Company stock at \$3.40 . . ."

"You can't go out and ask a guy \$3.40 per share of stock and tell him its less somewhere else. You knock yourself out."

Another stock salesman for the registrant who was offering its securities in late 1963 and early 1964 was aware that registrant's stock was being offered in newspapers in Atlanta, Georgia at prices substantially lower than the \$3.40 per share, offering price set forth in registrant's October 31, 1963 prospectus. He testified, however, that he never disclosed such fact to prospective purchasers of registrant's stock.

In addition to the employment of false and misleading state prospectuses, the registrant mailed communications to its stockholders concerning a pulp and paper mill it proposed to construct, and a report concerning this project prepared for Dixie by Stone & Webster Engineering Corporation and concerning a contract for machinery to be used in a tissue mill which it intended to operate. In addition, the respondent mailed other communications to members of the public

in an effort to sell its securities. The mails were customarily used by respondent in connection with the offer and sale of its securities. The registration statement was materially false and misleading because it failed to disclose Dixie's contingent liabilities by reason of its violations of the anti-fraud provisions of the Securities Acts.

THE FALSE AND MISLEADING CHARACTER OF
DIXIE'S REGISTRATION STATEMENT

The Division presented uncontradicted evidence that Dixie's registration statement and prospectus were materially false and misleading in the following respects:

1. Dixie represented that it had current assets of \$9,017.87 as at June 30, 1964 when in fact its current assets were overstated by 86% since it misclassified "Bond Expense" as a current asset.
2. Dixie represented that it had total assets of \$2,362,847.71 as at June 30, 1964 when in fact its total assets were overstated by approximately \$1,000,000 or about 73%.

The overstatement of total assets was attributable to four items:

- (a) Machinery, which was never delivered to registrant by the seller, was improperly classified as an asset as at June 30, 1964 in the amount of \$475,000. The seller had informed Dixie on October 15, 1962 that

the contract for such machinery had been cancelled because Dixie had not met payments due the seller under its contract.

- (b) Dixie failed to fully reserve or write off its investment in Georgia Development Enterprises, Inc. ("GDEI"), a subsidiary, in the amount of \$276,372.63, although such investment was "almost a hundred per cent loss".
- (c) Dixie made several misrepresentations regarding the asset "Land & Timber". One misrepresentation concerning this asset involved an overstatement of its acquisition costs by \$250,000. This overstatement was attributable to Dixie's inflation, without reasonable basis, of the book cost to it of a tract of land referred to in these proceedings as the Fulcher tract. Secondly, the title to the Fulcher tract was acquired by Dixie on September 19, 1960 and was transferred to Tennessee Land and Timber Corporation ("TILT") on September 20, 1963. Dixie's registration statement was false and misleading in that it reflected that as of June 30, 1964 Dixie still had title to the Fulcher tract when in fact TILT was and still is the owner of such property. The misstatements and omissions of material facts relating to the Fulcher tract so affected registrant's

"Description of Property" and "Description of Business" as to make such descriptions false and ^{9/}misleading.

- (d) Dixie failed to write off "Survey Costs" of \$22,240 attributable to a project involving the construction by Dixie of a kraft paper and liner board mill at Phenix City, Alabama, although this project had been abandoned by registrant.
3. In order to make Dixie's financial condition look better than it actually was so that the company could "sell more stocks . . .", Dixie's board of directors "authorized the transfer of \$253,745.20 from premium paid in on Capital Stock reflected in Capital Surplus to Earned Surplus to eliminate the operating loss from date of incorporation to August 31, 1963". Registrant's transfer of \$253,745.20 from premiums paid in on Capital Stock to Earned Surplus was improperly classified in its "Statements of Surplus" as a "Quasi-Reorganization" and was merely an improper debit to "Capital Surplus" to eliminate its existing "Earned Surplus" deficit resulting in a material understatement of its "Earned Surplus" deficit.
4. Dixie's "Summary of Income" reflected that for the year ended December 31, 1962 registrant had incurred a net loss

^{9/} The registrant's misrepresentations regarding this matter will be dealt with more fully hereinafter.

of \$43,231.68 and that for the six-month period ended June 30, 1964 it had incurred a net loss of \$36,745.88, when in fact such net losses were understated for the year ended December 31, 1962 by approximately \$22,000 and the net loss for the six-months period ended June 30, 1964 was understated by approximately \$430,000. The understatement for the year ended December 31, 1962 was related to the failure to write off the survey costs.^{10/}

5. Dixie understated its contingent liability to purchasers of its common stock and bonds in that registrant based its estimate of contingent liability on the statute of limitations applicable to sales of securities in violation of the registration requirements of Section 5 of the Securities Act and made no provision for contingent liability related to sales of Dixie's securities made in violation of the anti-fraud provisions of the Securities Acts.
6. Dixie represented that Hemrick & Co., the accountants who prepared the financial statements and textual portions of the registration statement and prospectus and who had executed "an opinion of independent certified public accountants" as part of the registration statement, had made their

10/ See page 14, supra.

examination ". . . in accordance with generally accepted auditing standards . . . and that the financial statements included in the registration statement were prepared in conformity with generally accepted accounting principles" when in fact such standards and ^{11/} principles were not employed.

THE EVIDENCE SUPPORTING THE DIVISION'S ALLEGATIONS

1. Current Assets

Registrant's improper classification of "Bond Expense" as a current asset had the effect of overstating total current assets by approximately 86% which rendered the total current asset figure included in the registration statement grossly misleading.

Generally accepted accounting principles require that current assets should include only those assets or resources which are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. ^{12/} By improperly classifying "Bond Expense" as a current asset Dixie violated generally accepted accounting principles.

11/ The Division also charged that Hemrick & Co. was not independent as required by the Commission's Rules (17 C.F.R. 210, 2-01). The evidence strongly supported this charge. Hemrick & Co. was not a party to this litigation, although David Hemrick, the sole proprietor of Hemrick & Co., and one of his employees, William Collier, were witnesses and admitted some of the facts on which the Division based its charge that Hemrick & Co. was not independent. This matter will be discussed more fully hereinafter.

12/ Chapter 3A, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at page 232 (1965); and Regulation S-X, Rule 3-13.

2. Total Assets

The evidence supporting the Division's allegations that Dixie had overstated its total assets by approximately \$1,000,000 may be described as follows:

(a) Machinery

The registrant's "Statement of Financial Condition" reflects that as at June 30, 1964 it classified as an asset "Machinery" in the amount of \$475,000 with a corresponding contract payable in the amount of \$322,000. On July 25, 1962 Penn Yan Paper Products Company ("Penn Yan"), a newly organized Georgia corporation, entered into a machinery contract and a land option agreement with registrant to furnish machinery to Dixie for a tissue plant in Bainbridge, Georgia for approximately \$475,000. Under the contract, Dixie agreed to make payments to Penn Yan as follows: Seventy-five thousand (75,000) shares of stock in registrant valued for purposes of the transaction at \$2 per share, ten tracts of land valued for the purposes of the transaction at \$150,561.25, and \$174,438.75 in cash. The first eight tracts described in the agreement were to be conveyed to Penn Yan "forty-five (45) days subsequent" to the date of the agreement. The cash involved was to be paid in twenty-four (24) consecutive monthly installments of \$3,000 each commencing "one (1) month subsequent to the date of the agreement and continuing on the same day of each month thereafter"

The contract had a default clause providing that if Dixie failed to make any payment due to Penn Yan under the contract when it became due and the failure continued for a period of 30 days then Penn Yan had the option of terminating the agreement and any consideration received by Penn Yan "should be applied against damages awarded to . . ." Penn Yan.

Dixie delivered to Penn Yan 75,000 shares of its common stock when the agreement was executed and it made one cash payment of \$3,000 in August, 1962. Dixie, however, made no further payments of any kind to Penn Yan nor did registrant transfer title to any of the properties it had agreed to convey to Penn Yan under the contract. On October 15, 1962, Charles DiCarlo, president of Penn Yan, informed registrant by letter that: "We are terminating this contract effective immediately per our option clause . . ." Mason, Dixie's chief executive officer, testified that he received this letter on October 8, 1962.

Milton Bach, a certified public accountant, who had been engaged by registrant to do auditing work for it during the years 1961, 1962 and 1963 testified that he personally had not seen DiCarlo's termination letter but "had this been known to myself or my associate, and had the terms not been altered past this point, I agree with you; yes, it would have been a mistake" to include the item "Machinery" as an asset in the amount of \$475,000 in the "Statement of Financial Condition" of registrant. Subsequent to canceling the July 25, 1962 machinery contract DiCarlo orally discussed with Mason the possibility

of amending the purported machinery contract or entering into a new machinery contract. However, Penn Yan and registrant never, in fact, entered into any new or amended machinery contract.

In footnote 2, to Dixie's "Statement of Financial Condition" Dixie stated that "The tissue mill machinery to be delivered upon completion of the building is estimated to cost \$475,000 . . . The amount due on the machinery \$322,000 will be renegotiated prior to the delivery of the machinery as the company considers the present contract voidable". This footnote compounded the misleading nature of the financial statement since it reflected that registrant had a contractual right to receive a shipment of \$475,000 in machinery when in fact the contract relating to such machinery had been cancelled due to Dixie's default in making payments.

It is concluded that Dixie's registration statement was materially misleading in that registrant improperly classified as an asset "Machinery" in the amount of \$475,000 as well as the corresponding contract payable in the amount of \$322,000 in its "Statement of Financial Condition" as at June 30, 1964.

(b) Georgia Development Enterprises, Inc. ("GDEI")

Registrant's "Statement of Financial Condition" reflects that as at June 30, 1964 Dixie classified as an asset, an investment in GDEI, a 96% owned subsidiary of registrant, in the amount of \$276,372.63. Registrant also included in its prospectus a "Statement of Income and Earned Surplus" of GDEI for the 12-month periods ended December 31, 1959,

1960, 1961, 1962, 1963 and the 6-month periods ended June 30, 1963 and 1964. The "Statement of Income and Earned Surplus" of GDEI reflected that it had sustained operating losses for each year reported (the five year and six month period ended June 30, 1964) and that for the six months ended June 30, 1964 GDEI had incurred a net loss on operations of \$154,217.75 with its only source of income being rental income in the amount of \$427.50. The "Statement of Financial Condition" of GDEI reflects that as at June 30, 1964 GDEI had total assets of \$18,299.29, total liabilities of \$58,208.69, and a stockholders' deficit of \$39,909.40.

GDEI's major asset consisted of "Notes Receivable - Druid DeKalb Corp." in the amount of \$22,000 with respect to which a reserve for discount was provided in the amount of \$7,900. Note 1 to GDEI's "Statement of Financial Condition" indicates that "The Company discounted this note after balance sheet date." However, registrant failed to disclose that as at July 31, 1964, one month prior to the date at which Hemrick & Co. issued its certificate, this receivable was, in fact, sold for \$14,100 and \$12,500 of the proceeds was immediately transferred to registrant.

After the aforementioned transactions had been consummated and prior to the date of Hemrick & Co.'s certificate, GDEI was left with approximately \$4,000 in total assets, \$3,000 of which consisted of a loan receivable from Seaboard Investments, Inc., which registrant failed to disclose was a wholly-owned corporation of the president

of registrant. Thus, prior to August 31, 1964, the date of Hemrick & Co.'s certificate, GDEI had no income producing assets; it had, as the president of registrant testified, "nothing except furniture and fixtures, a little money in the account."

William Collier, who "did the audit . . . with respect to Dixie Land and Timber Corporation for Hemrick & Co." and prepared part of the registration statement testified that registrant's investment in GDEI "is almost one hundred per cent loss", that registrant's asset investment in such company was overstated by approximately \$250,000, that "it is misleading" and that "it should be written off". Collier also testified without contradiction that he "would like to change this", and "was undecided about it" because "it is overstated. The loss should have been in there". After discussing the balance sheet presentation of this item with Hemrick, Collier told Dixie's president Mason, "It should be written off, but we wouldn't write it off at this time."

Mason had no objection to this obviously misleading manner of handling the balance sheet presentation of registrant's investment in GDEI.

David Hemrick, the proprietor of Hemrick & Co. testified that in his opinion GDEI had an actual value of only about \$18,000 as at June 30, 1964, that the asset investment in "Subsidiary Company" was "not worth" the amount at which it appears on registrant's "Statement of Financial Condition" and that "it is misleading".

Registrant completely disregarded the generally accepted accounting principle that requires an investment in shares of stock of a subsidiary company, such as registrant's investment in GDEI, to be carried at cost, reduced however by provisions for losses and adjusted to reflect a permanent decline in value. It is abundantly clear from the foregoing that there was overwhelming evidence of a permanent decline in the value of registrant's investment in GDEI and that registrant by not fully reserving or writing off its investment in "Subsidiary Company" at least as at June 30, 1964, violated generally accepted accounting principles.^{13/}

Dixie's registration statement is materially misleading for the reason that registrant failed to fully reserve or write off its \$276,372.63 investment in "Subsidiary Company" as at June 30, 1964.

(c) The Fulcher Tract

Registrant's "Statement of Financial Condition" reflected that as at June 30, 1964 it classified as an asset an investment in "Land & Timber" in the amount of \$1,353,243.50. Included in this item is the Fulcher tract valued at \$1,109,000. This property had been owned by Gordon Fulcher a non-resident of Georgia, prior to

^{13/} Chapter 3A, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at pages 259, 260 (1965) Montgomery's Auditing at pages 290, 291 (Eighth ed. 1957).

its acquisition by Dixie. Dixie employed John W. Phillips, Sr. to visit the Fulcher tract and to make an estimate of its value. Phillips estimated this property to be worth \$872,900. Thereafter and on September 19, 1960 Mason and Fulcher came to an agreement providing for the sale of the Fulcher tract to registrant for \$12,500 cash, a promissory note in the amount of \$45,000, the assumption of a first mortgage in the amount of \$350,000, the assumption of a second mortgage in the amount of \$240,000 and 192,292 shares of registrant's \$1 par value common stock, which were valued for the purposes of the transaction by Fulcher and Dixie at \$1 per share. The total consideration on this basis amounted to \$839,792.

At the time that this transaction was under consideration and thereafter Dixie was claiming an exemption from registration of its securities pursuant to Section 3(a)(11). However, Fulcher who was to receive Dixie stock as part of the consideration for transferring his land to Dixie was not a resident of Georgia. Accordingly, no Section 3(a)(11) exemption was available for the transaction. However, in order to mask the fact that Dixie was delivering its stock to Fulcher, a non-resident of Georgia, in partial payment for the tract of land, in violation of Section 5 of the Act, Mason, on

^{14/} Section 5 of the Act required that Dixie's securities be registered unless an exemption were available. In view of the sale of registrant's stock to Fulcher no exemption under Section 3(a)(11) was available. Nor did any other exemption from registration under the Act appear available.

behalf of Dixie, arranged to have a contract drawn on September 19, 1960 by which Fulcher would transfer title to a Georgia company called the First Continental Corporation ("First Continental"), which would ostensibly receive the agreed upon consideration.

On the same day and immediately after First Continental obtained title to the tract it assigned the title and the consideration to Dixie. First Continental's sole function, insofar as taking title was concerned, was to assist Dixie in making it appear that it was issuing stock to a Georgia corporation when in fact Dixie's stock was to be transferred immediately by First Continental to Fulcher.

Although Dixie and Fulcher had agreed upon a figure of \$839,792 for the acquisition of the Fulcher tract, and had also employed this figure in determining the amount of federal documentary tax stamps to be used in the transaction, the registrant inflated the value of this asset upon receiving it by approximately \$250,000 by setting up an asset value for such property at \$1,109,000 for balance sheet purposes. This was done on the basis of attributing a value of \$2.40 per share for registrant's stock. This price was an arbitrary figure, being employed by Dixie in "unloading" its stock to the public at the time that the Fulcher transaction was consummated.^{15/} However, both Mason and Fulcher had agreed that for the

15/ In its October 4, 1960 state prospectus which was being used at the time this transaction was consummated, Dixie represented that: "At the present time there is no established market for the stock of the company. . . ."

purpose of arriving at a price to be paid by Dixie to Fulcher, the stock of the company was to be valued at \$1 per share. The registrant's accountants were aware that the price agreed upon for the Fulcher tract was reached after bargaining between the parties on the basis of valuing Dixie's 192,292 shares of stock at \$1 per share. They nevertheless attributed a value of \$2.40 per share for Dixie's stock for balance sheet purposes. This served the purpose of making Dixie's assets look higher than they actually were, and it rendered the "Statement of Financial Condition", false and misleading.

A generally accepted accounting principle requires fixed assets to be carried at the cost of acquisition or construction in the historical accounts.^{16/} In these circumstances it was clear that registrant violated this generally accepted accounting principle by overstating the cost of the Fulcher tract for balance sheet purposes.

Early in 1963 the registrant commenced negotiations with Tennessee Industrial Land and Timber Corporation ("TILT") a Tennessee corporation for the sale to the latter of the Fulcher tract. These negotiations culminated on September 20, 1963 in the transfer through an intermediary of the Fulcher tract from registrant to TILT. This transfer was accomplished by having Dixie issue a warranty deed transferring title to the Fulcher tract to Talmadge Phillips, a resident

16/ Chapter 5, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Account Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at page 252 (1965).

of Tennessee, who on the same day transferred title to such property to TILT. TILT, in turn, paid a consideration for the tract to Phillips which in part consisted of 475,200 shares of TILT's stock. Phillips then transferred the entire consideration paid by TILT to Dixie.^{17/} Shortly thereafter, Phillips received 2,000 shares of TILT stock for his role in the transaction. Phillips had no interest in the transaction other than to receive 2,000 shares of TILT stock for his services in acting as a conduit. It is reasonable to infer that the purpose in having Phillips act as a conduit was to hide the fact that shares of TILT stock would be delivered to Dixie. TILT was claiming an "intra-state exemption" from the registration

17/ The specifics of the transaction whereby TILT acquired the Fulcher tract were as follows: On September 20, 1963 Dixie transferred title to the Fulcher tract to Talmadge Phillips. Phillips then transferred to Dixie \$1,500 in cash which he had previously received from TILT for this purpose; issued a personal note in the amount of \$834,000 to Dixie; and assumed an outstanding first mortgage on the tract in the amount of \$275,000. The reason Phillips issued his personal note in the amount of \$834,000 to registrant was that he was informed by Mosier the president of TILT that Dixie would accept in full satisfaction of this note the assignment of a \$240,000 note which would be issued to Phillips by TILT and the transfer of 475,200 shares of TILT common stock which TILT was to issue to Phillips. On September 20, 1963, Phillips and his wife executed a special warranty deed transferring title to the Fulcher tract to TILT. In accordance with the prior agreement between the parties to the transaction, namely Phillips, Mosier, and Dixie, TILT assumed the \$275,000 mortgage from Phillips and issued to Phillips a \$240,000 note secured by a second mortgage on the tract and 475,200 shares of TILT's common stock. Phillips then assigned TILT's \$240,000 note to Dixie and endorsed the 475,200 shares of TILT's stock to the registrant although he remained the record holder of the TILT stock. Shortly thereafter Phillips received 2,000 shares of TILT stock.

requirements of the Securities Act in connection with the delivery of its stock for the Fulcher tract. In order to disguise the fact that an exemption under Section 3(a)(11) of the Act was not available for the transaction since TILT, a Tennessee corporation, was delivering its securities to a Georgia corporation the stock was delivered to Talmadge Phillips, a resident of Tennessee to make it appear that such stock was being delivered to a resident of Tennessee. Although the records of Dixie reflected that it no longer had title to the Fulcher tract and although there was nothing in such records to indicate that Dixie had ever again acquired title to the Fulcher tract, Hemrick & Co. reinstated the Fulcher tract as an asset on registrant's books. According to Hemrick, the president of Dixie, had informed him that TILT "would not be able to make quarterly payments on the land" and without any other proof, Hemrick in the "Statement of Financial Condition" showed Dixie as the owner of the Fulcher tract.

The record on the other hand reflected that TILT had made all payments due on its mortgage obligations and never defaulted on any of the obligations it assumed in connection with the Fulcher tract. Furthermore, while the second mortgage note by its terms did not call for payment until September 1965 TILT made a payment of \$113,750 on this note in January 1965 and it was received and accepted by the registrant.

TILT has not disposed of the Fulcher tract since acquiring it in 1963.

Dixie's registration statement is materially misleading for the reason that the registration statement failed to disclose that on September 20, 1963 Dixie had transferred its largest asset, the Fulcher tract, to TILT.

During the hearing, Dixie stipulated that on September 20, 1963 it acquired beneficial ownership of 473,200 shares of the \$1 par value common stock of TILT which was held in the record name of Talmadge Phillips. As at October 31, 1963 TILT had 570,000 shares of its common stock issued and outstanding. As at December 31, 1964 TILT had approximately 730,000 shares of its common stock issued and outstanding of which Talmadge Phillips was the record owner of 513,575 shares. Between October 31, 1963 and December 31, 1964 registrant had beneficial ownership of between 70 and 80 per cent of the outstanding common stock of TILT. James M. Mosier, TILT's president testified that he knew that TILT shares issued in this transaction would be received by Dixie and that Dixie would have control of TILT.

The registration statement was materially misleading for the reason that Dixie failed to disclose that TILT was its majority-owned subsidiary.^{18/} In this connection, it should be pointed out that the registration statement stated that the company had only one subsidiary GDEI.

^{18/} Rule 405 under the Securities Act defines the term "majority-owned subsidiary" to mean "a subsidiary more than 50 per cent of whose outstanding securities representing the right, other than as affected by events of default, to vote for the election of directors, is owned by the subsidiary's parent. . . ."

Registrant's prospectus states in relation to the Fulcher tract that Dixie "is currently engaged in operating 37,000 acres of Company-owned timberland. . . ." that "Timberlands currently owned and operated by the Company consist of approximately 21,000 acres of mineral rights in conjunction with its timberlands. This tract contains deposits of coal and crab-orchard type stone".

Dixie's registration statement is misleading because the registrant omitted to disclose that the Fulcher tract is inaccessible and cannot be worked during approximately three months of the year due to conditions of ice, snow, sleet and rain. In addition, registrant failed to disclose that under the terms of a first mortgage held by Connecticut General Life Insurance Company, the latter required, as a condition of removal of timber or other products, the making of payments to it.^{19/}

(d) Survey Costs

Registrant's "Statement of Financial Condition", reflected that as at June 30, 1964, Dixie classified as an asset "Survey Costs" in the amount of \$22,240.35 which represented the total costs accumulated in registrant's "Paper Mill" account as at August 31, 1961. These costs related to funds expended by registrant for a survey of

^{19/} When TILT acquired title, its management was aware of the restrictions on the cutting and removal of timber and in this connection it entered into an agreement with Connecticut General on October 2, 1963.

the paper mill industry and a proposed paper mill plant. In this connection, the facts were that in August, 1960 Dixie had contracted with the Stone & Webster Engineering Corporation ("Stone & Webster) to make a feasibility report on a proposed \$28,000,000 pulp and paper mill to be located in Phenix City, Alabama. The report was extremely pessimistic about registrant's chances of successfully building and operating a kraft paper and liner board 20/ mill. Registrant's president testified that at the time of the Stone & Webster report, Dixie was considering the construction of a plant for the production of kraft paper and liner board. As a matter of fact Dixie, on October 20, 1960, mailed a letter to its stockholders stating that on the basis of the Stone & Webster report, registrant had selected a site "near Phenix City, Alabama" for the construction of "a paper mill". Mason testified, however, that in 1961 registrant had abandoned the project relating to a \$28,000,000 kraft paper and liner board mill at Phenix City, Alabama and decided to build a \$7,000,000 tissue plant in Bainbridge, Georgia, an entirely different project. He testified: "The site had been changed from Phenix City, Alabama to Bainbridge [Georgia] and the project had been changed".

20/ The state prospectus which was employed by Dixie did not inform the readers of the character of the Stone & Webster report.

During the course of its audit of registrant, Hemrick & Co.'s auditor noted that written across the face of registrant's paper mill ledger page was the notation "Abandoned Project". In addition, Hemrick & Co.'s auditor testified that: "The decision not to go in the kraft paper business had been made. I knew that". Since registrant's alleged asset "Survey Costs" consisted of expenditures made by Dixie in 1961 in connection with a proposed \$28,000,000 kraft paper liner board mill to be built in Alabama and this project had been abandoned and an entirely new and different project was planned, these "Survey Costs" were no longer a meaningful asset. It was clear that registrant had violated the generally accepted accounting principle that requires fixed assets to be carried at cost of acquisition or construction in the historical accounts, unless such cost is no longer meaningful.^{21/} Dixie's registration statement is materially misleading because the registrant improperly classified as an asset "Survey Costs" in the amount of \$22,240.35 in its "Statement of Financial Condition" as at June 30, 1964.

3. "Quasi-Reorganization"

Note 11 to registrant's "Statement of Financial Condition" as at June 30, 1964 states in part that: "On May 23, 1963 the

21/ Chapter 3A, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles for Business Enterprises at page 63 (1965).

directors authorized the transfer of \$253,745.20 from premium paid in on Capital Stock reflected in Capital Surplus to Earned Surplus to eliminate the operating loss from date of incorporation to August 31, 1963."

As we have noted hereinbefore this was merely an improper debit to "Capital Surplus" to eliminate Dixie's existing "Earned Surplus" deficit and resulted in a material understatement of its "Earned Surplus" deficit.

This accounting treatment had been taken at the request of Mason by Bach, James & Co. the accountants formerly employed by Dixie. However, Hemrick, Dixie's accountant who certified the financial statements contained in the registration statement, conceded that this presentation of Dixie's financial statement was a result of his independent judgment although it had originally been certified by another accounting firm.

This entry was considered initially by Hemrick as a "quasi-reorganization". In his testimony during the proceedings, Hemrick conceded that he had been mistaken and that "it was just a book-keeping entry, to adjust to surplus accounts." During the course of Collier's testimony, he was asked why he referred to this entry as a quasi-reorganization and he stated "I have admitted that we were wrong on that".

Sound accounting principles require that when accumulated deficit accounts are eliminated against invested capital accounts

this should be effected through formal action approved by stockholders,^{22/}
which establishes a new base line of accountability.^{23/}

Dixie's registration statement is materially misleading for the reason that registrant understated its "Earned Surplus" (Deficit) by \$253,745.20 and improperly classified its transfer of this amount from premiums paid in on Capital Stock to Earned Surplus deficit as a "Quasi-Reorganization."

4. Summary of Income

Dixie's registration statement under the heading of "Summary of Income" is false and misleading principally because of registrant's failure to reflect a loss on "Survey Costs" in the amount of \$22,240.35 and its failure to reflect losses on "Machinery", and on its subsidiary, GDEI.

The "Survey Costs" were attributed to a project which was abandoned prior to December 31, 1962. Registrant capitalized these costs and presented them as an asset instead of writing them off and charging this amount to profit and loss at least by December 31, 1962. The failure of registrant properly to write off the amount of \$22,240.35 and charge it to profit and loss at least by December 31, 1962 not only had the effect of overstating Dixie's total assets by

^{22/} The action taken here was approved by registrant's board of directors but not by its stockholders.

^{23/} Chapter 7A, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at page 210; Rappaport, SEC Accounting Practices and Procedures at Section 3.28 (2d ed 1961).

that amount but also had the effect of rendering the registrant's "Summary of Income" materially misleading by understating its reported loss for the year ended December 31, 1962 by \$22,240.35.

The registrant presented as assets the items "Machinery" and "Subsidiary Company" (GDEI) in the amounts of \$475,000 and \$276,372.63 respectively instead of properly writing them off and correspondingly charging the losses incurred to profit and loss at least as at June 30, 1964.

Registrant incurred a net loss on "Machinery" in the amount of \$153,000 which loss consisted of a \$3,000 cash payment on the contract with Penn Yan and 75,000 shares of stock given the latter in partial consideration on the contract which registrant valued for purposes of the transaction at \$2 per share. Although the machinery contract had been breached by registrant and terminated by Penn Yan as at June 30, 1964, Penn Yan retained possession of both the \$3,000 cash payment made to it by registrant and the 75,000 shares of stock in registrant transferred to it.

It is clear from the facts established in the record that registrant should have charged to profit and loss at least by June 30, 1964 the \$153,000 loss incurred in its breach of the machinery contract.

Registrant's investment in "Subsidiary Company" (GDEI) should have been written off and the loss incurred charged to profit and loss at least by June 30, 1964 in that GDEI had sustained operating

losses for every year reported; GDEI had sold all of its operating assets prior to the date of the subject registration statement; and as at the date of the subject registration statement GDEI had only \$4,000 in total assets, \$3,000 of which consisted of a loan receivable from Mason.

Registrant's "Summary of Income" is materially misleading for the reasons that the net loss for the year ended December 31, 1962 is understated by approximately \$22,000 and the net loss for the six-month period ended June 30, 1964 is understated by approximately \$430,000.

Generally accepted accounting principles require that income should not be materially overstated or understated.^{24/} Registrant violated this generally accepted accounting principle by materially understating the losses incurred for the year ended December 31, 1962 and for the six-month period ended June 30, 1964.

INDEPENDENCE OF HEMRICK & CO., THE CERTIFYING ACCOUNTANTS

25/

Hemrick & Co., certified public accountants, examined the financial statements included in Dixie's registration statement and rendered an unqualified opinion with respect thereto, subject

24/ Chapter 4, Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at page 74 (1965).

25/ The sole proprietor of Hemrick & Co. is David C. Hemrick, Jr.

only to the effect on registrant's financial position of contingent liabilities which might arise from possible past violations of Section 5 of the Securities Act by registrant. ^{26/} Hemrick & Co. stated in its "Opinion of Independent Certified Public Accountants" that "our examination was made in accordance with generally accepted auditing standards . . ." and that the financial statements included in the registration statement "were prepared in conformity with generally accepted accounting principles." ^{27/}

The Commission's order for hearing raised the issue, inter alia, whether the "registration statement is materially misleading for the reasons that Hemrick & Co. did not conduct its examination in accordance with generally accepted auditing standards or report that registrant's financial statements were not prepared in conformity with generally accepted accounting principles." ^{28/} In this connection, ^{29/} the Division charged, that Hemrick & Co. failed "to make adequate investigation of the transactions set forth [in the registration statement] under the captions "Financial Statements (Item 21)" and

^{26/} The Securities Act (Section 7, Schedule A(25)(26)) requires that financial statements be included in the registration statement which are certified by an independent public or certified accountant and the Commission's rules require such accountant to be, in fact, independent (17 C.F.R. 210.2-01).

^{27/} Hemrick & Co. also filed as Exhibit 4 to the registration statement a "Consent of Independent Certified Public Accountants".

^{28/} See page 5 of Division's "Statement of Matters to be Considered at the Hearing". This Statement of Matters was incorporated by reference as part of the Commission's order of July 12, 1965 initiating this proceeding.

^{29/} Ibid.

"Summary of Earnings (Item 67)". The Division also alleged that "the registration statement is further materially misleading for the reason that Hemrick & Co. was not independent."

As the preceding discussion in this decision pointed out, Hemrick & Co.'s examination was not made in accordance with generally accepted auditing standards and the financial statements included in the registration statement were not prepared in conformity with generally accepted accounting principles.^{30/}

There remains the problem of determining whether Hemrick & Co. was, in fact, independent.

The Commission has consistently held that the question of independence is one of fact to be determined in the light of all the pertinent circumstances in a particular case.

In this case, it should be noted that in addition to being retained by Dixie as independent accountants, Hemrick & Co. was employed to write the textual portion of the registration statement. David Hemrick did not, at first, want to write such portion but was persuaded by Mason to do so. Mason reviewed each page of the textual portion of the registration statement, which was written by Collier, an accountant in the employ of Hemrick & Co., and suggestions made by Mason were incorporated in the final draft.

^{30/} See, for example comments in footnotes, 12, 13, 16, 18, 20, 21, 22 and 23, supra and the text to which such footnotes relate.

An example of Hemrick & Co.'s failure to be independent, by catering to Mason's wishes to have the financial condition of the company appear better than the facts warranted was, shown in the following circumstances.

In the registration statement, under the heading "Description of Property" Hemrick & Co. wrote that: "The Company obtained control of a Georgia Corporation, Georgia Development Enterprises, Inc., and has exchanged 365,240 shares of 25¢ par value stock of Dixie Land and Timber Corporation for 182,620 shares of the \$1.00 par value common stock of Georgia Development Enterprises, Inc., this stock being sold originally for \$2.00 per share. The transaction resulted in the Company acquiring 96.755 per cent of the outstanding common stock of Georgia Development Enterprises, Inc. These shares have a book cost of \$219,142.30 as of June 30, 1964."

Additional statements describing Dixie's investment in GDEI were written by Hemrick & Co. under the heading "Description of the Business".

The "Statement of Financial Condition" and the textual portions of the registration statement, both of which were written by Hemrick & Co. on behalf of Dixie, made it appear that GDEI was an important asset to Dixie when Hemrick & Co. was well aware at the date of the Statement of Financial Condition, June 30, 1964, that the asset value of GDEI should have been written off. In this connection, it will be recalled that Collier after discussing with David Hemrick the balance

sheet presentation relating to GDEI (which involved an alleged investment amounting to \$276,372.63) told Mason "it should have been written off but we wouldn't write it off at the time"^{31/}.

Under the headings "Description of the Business" and "Description of Property", prepared for Dixie by Hemrick & Co., the registration statement sets forth that Dixie "is currently engaged in operating 37,000 acres of company-owned timber land . . ." and that "the company also operates approximately 21,000 acres of mineral rights in conjunction with some timber land. . . ."

This language referred to the Fulcher tract. It may be noted that the misleading character of Dixie's representations concerning this asset have been discussed at length hereinabove. Hemrick & Co.'s certification was dated August 31, 1964 and related to a Statement of Financial Condition of Dixie as at June 30, 1964. Neither at June 30, 1964 nor at August 31, 1964 did Dixie own the Fulcher tract, such title having been conveyed to TILT on September 20, 1963 as described hereinabove. Hemrick & Co., in representing that Dixie owned and operated the Fulcher tract, relied upon unverified information received from Mason to such effect when the records of

^{31/} In the Matter of Associated Gas and Electric Company 11 SEC 975, 1047 (August 4, 1942) the Commission in the course of its discussion of the question of the independence of the certifying accountants stated that: ". . . an accountant who consistently submerges his preference or convictions as to accounting principles to the wishes of his client is not in fact independent. . . ."

Dixie showed that as of September 20, 1963 the registrant had transferred title to the Fulcher tract to TILT. At the time of Collier's audit of the company there were no records showing that TILT had reconveyed the property to Dixie, and in fact it never transferred title to Dixie.

The basis for Collier's reentry of the Fulcher tract as an asset on Dixie's books was that Mason told Collier that TILT "would not be able to make quarterly payments on the land". Collier testified he was taking Mr. Mason's word for it without any further investigation or check as to TILT transferring title to Dixie.^{32/}

Collier also testified that when he undertook to audit registrant's books, Mason informed him "that the land [the Fulcher tract] had been reacquired and he would like it to be reentered on the books", and that: "He informed me I would have to". Mason's representations to Collier were false and Hemrick relied upon

^{32/} Both Collier and Hemrick also pretended that they had relied on a title search concerning the Fulcher tract made by Procter Upchurch; a Tennessee attorney. The record shows, however, that Hemrick & Co. did not receive the results of Upchurch's title search until September 5, 1964 and September 21, 1964, which was subsequent to August 31, 1964, the date when Hemrick & Co. issued its certification. Moreover, Upchurch's title search was inconclusive on the question of title when it was received since the title to the Fulcher tract was never formally transferred on the county records in the county in which the property was located, although a deed to the Fulcher tract was delivered by Dixie to TILT on September 20, 1963. The facts regarding this transaction have been fully described hereinabove and such facts were wholly inconsistent with the representations in Dixie's financial statement and the facts were inconsistent with the statements in the text of the registration statement prepared by Hemrick & Co.

unverified information. Moreover, it should be noted that had Hemrick & Co. been independent, in fact, Collier would not "have to" make the entries required of Hemrick & Co. by Mason.

Similarly, Collier was fully aware at the time he prepared the registrant's "Statement of Financial Condition" that there was no valid machinery contract in force between the registrant and Penn Yan, the seller of the machinery and that no machinery had ever been delivered to Dixie by Penn Yan. Nevertheless, Hemrick & Co. improperly certified to the fairness of registrant's presentation of \$475,000 as an asset entitled "Machinery". In this connection, the registration statement under "Description of the Business" and under "Description of Property" referred to the proposed tissue mill for which the machinery was acquired. In this connection, reference was made under "Description of Property" to a \$7,000,000 tissue mill at Bainbridge, Georgia, to a "tissue machine and a packing operation", and to the fact that the mill was designed for a daily capacity of 20 tons of bathroom tissue, paper napkins and paper towels. These statements all prepared by Hemrick & Co. emphasized the importance of this machinery as an asset of Dixie's. They helped to make Dixie look attractive as an investment. In truth, however, there was no machinery, for the contract for machinery had been breached by Dixie. Dixie's representations concerning machinery and its asset value were prepared by Hemrick & Co. and the accountants knew or should have

known that the statements in the registration statement regarding "Machinery" were extremely misleading. Considering the comparatively small size of Dixie's business the magnitude of this representation as well as others described herein was extraordinary.

Hemrick & Co. improperly classified "Bond Expense" as a current asset.

The evidence established that Hemrick & Co. in their accounting presentation overstated Dixie's total assets by approximately \$1,000,^{33/}000.

Hemrick & Co. also violated sound accounting principles by characterizing as a "Quasi-Reorganization" a mere debit to Capital Surplus to eliminate its existing Earned Surplus Deficit. The result was that registrant understated its "Earned Surplus" (Deficit) by \$253,745.20.

Of course, an accounting error in and of itself would not necessarily establish that Hemrick & Co., or any other accountant was not independent. In this case, however, the accountants conceded that they were aware when they were preparing the registration statement that GDEI, an asset purporting to involve \$276,372.63 should have been written off but that they nevertheless decided not to write it off. They conceded that they relied upon unverified statements of Mason which were incorrect, in presenting the financial facts

^{33/} The accounting facts in regard to "Total Assets" have been described in detail hereinabove.

concerning the Fulcher tract, Dixie's largest asset. Moreover, it appeared that they felt compelled by Mason to misrepresent the facts concerning the ownership of the Fulcher tract in the registration statement. They presented incorrect information in the registration statement crediting Dixie with machinery worth \$475,000 when there was no such machinery. Moreover, Dixie's net loss for the year ended December 31, 1962 was understated by approximately \$22,000 and the net loss for the six-month period ended June 30, 1964 was understated by approximately \$430,000.

It should be noted that the number, variety and magnitude of the accounting errors were extraordinary for such a comparatively short registration statement. It is unreasonable to believe that these very serious errors were due to chance or lack of technical ^{34/} accounting ability. A more reasonable inference is that these material misrepresentations of the financial facts were due principally to the fact that Hemrick & Co. was not independent in fact. Hemrick & Co. did not conduct its examination of registrant in

34/ It has been pointed out by Carman J. Blough in The Journal of Accountancy (December, 1946, p. 453) that:

"Technical accounting ability is essential for success in the field of public accountancy, but it is the quality of a certified public accountant's integrity and his independence more than his ability that determine the extent of his usefulness to society. No matter how highly skilled a certified public accountant might be, if he could not be depended upon to see that the financial statements which he certifies are honestly presented, whether his client likes it or not, he would be not only valueless in the public accounting profession, he would be a business menace. But a public accountant of only ordinary technical accounting ability, whose integrity and courage are unassailable, may be a tower of strength in his business community."

accordance with generally accepted auditing standards because it did not maintain an independent mental attitude in the performance of its examination and the preparation of its report and did not exercise due professional care in the performance of its examination and the preparation of its report.

In addition, Hemrick & Co.'s audit was not adequately planned and William Collier was not properly supervised particularly in regard to the presentation of the financial facts concerning the Fulcher tract and in regard to machinery. Sufficient competent evidential matter was not obtained by Hemrick & Co. through inspection, observation, inquiries and confirmation to afford a reasonable basis to render an opinion regarding the financial statements made a part of Dixie's registration statement. Moreover, Hemrick & Co.'s report was misleading in that it failed to state that the financial statements were not presented in accordance with generally accepted principles of accounting and failed to state that informational disclosures in the financial statements were not reasonably adequate.

35/ Report of the AIA Committee on Auditing Procedure, Generally Accepted Auditing Standards - Their Significance and Scope; Accounting Research Study No. 7, Inventory of Generally Accepted Accounting Principles For Business Enterprises at pages 11-12 (1965); Wixon, Accountant's Handbook at 28:19 (4th ed. 1957).

36/ Ibid.

37/ Ibid.

38/ Ibid.

Moreover, Hemrick & Co. failed to portray realistically the financial position of the registrant and subordinated its judgment to its clients wishes. Hemrick not only relied upon unverified information but consciously omitted and concealed material facts. Hemrick & Co. did not apply to its examination that critical and objective analysis which is the obligation of an independent public accountant.

There is no evidence that Hemrick & Co. profited financially or otherwise by handling the audit as they did. However, it would seem that accountants rarely do benefit from a failure to perform

39/ In the Matter of Miami Window Corporation, Securities Act Release No. 4503 (June 21, 1962).

40/ In the Matter of Morton I. Myers, Accounting Series Rel. 92 (July 20, 1962); In the Matter of F. G. Masquelette & Co., Accounting Series Rel. 68 (July 5, 1959); In the Matter of Associated Gas and Electric Company, 11 SEC 975, 1047 (1942); In the Matter of National Boston Montana Mines Corporation, 2 SEC 226, 294 (1937); In the Matter of Metropolitan Personal Loan Company, 2 SEC 803, 813 (1937); In the Matter of American Terminals and Transit Company, 1 SEC 701 (1936). See also Rappaport, SEC Accounting Practice and Procedure, at 22.33 (2d ed. 1963).

41/ In the Matter of American Terminals and Transit Company, 1 SEC 701, 707 (1963).

42/ In the Matter of Red Bank Oil Company, 21 SEC 695 (1946). See also In the Matter of South Bay Industries, Inc., Securities Act Rel. No. 4702 (June 11, 1964).

^{43/}
their functions properly.

Such circumstances, however, do not relieve Hemrick of its responsibility to investors and others who read the registration statement or the prospectus.^{44/}

43/ See Kostelanetz, "Accountants' Responsibilities and the Criminal Law," The New York Certified Public Accountant (July, 1943), p.401:

"It must be observed that derelictions by accountants are for the most part not a result of greed to share in the loot produced by fraud. On the contrary, accountants have been led astray by their desire to help their clients out of a particular embarrassment by stretching a point of auditing or accounting principle. Unless the affairs of the client improve, the accountants subsequently find themselves committed to the same intentional errors but to a greater degree, until a day of reckoning when third parties, usually creditors, stockholders, or the government, delve into the affairs of the client and discover the fraud . . . almost invariably the facts show that except for the retention of a particular client of doubtful value accountants have not profited by the scheme. . . ."

44/ As the Commission pointed out in the Matter of Touche; Niven, Bailey & Smart, et al (Release No. 78, March 25, 1957):
The responsibility of a public accountant is not only to the client who pays his fee, but also to investors, creditors and others who may rely on the financial statements which he certifies. The function of an independent public accountant has been described as follows by the executive director of the American Institute of Accountants:

". . . Whenever he certifies a financial statement the certified public accountant is potentially, at least, rendering a service to two or more parties whose interests may come into conflict--management and stockholder, borrower and lender, purchaser and seller. He may, and often does, serve simultaneously competitors in the same line of business, without fear on the part of either client that he will favor the one or the other. It is the peculiar obligation of the certified public accountant, which no other

(Continued)

Based on the evidence in this case and based on standards relating to the independence of accountants by the Commission, it is found and concluded that Hemrick & Co. was not independent, in fact, and that its representation in the registration statement that it was independent was misleading.^{45/}

44/ (Continued from page 46)

profession has to impose on its members, to maintain a wholly objective and impartial attitude toward the affairs of the client whose financial statements he certifies. The certified public accountant acknowledges a moral responsibility (and under the Securities Act this is made a legal and financial responsibility) to be as mindful of the interests of strangers who may rely on his opinion as of the interests of the client who pays his fee. This is at the same time a heavy burden and a proud distinction. It marks the certified public accountant as an individual of the highest integrity; a tough-minded technician whose judgment cannot be unbalanced by the strongest pressures, who stakes a hard-earned professional reputation on his ability to express a fair and just opinion on which all concerned may rely; in the broad sense, a highly useful servant to society as a whole.

" . . . The certified public accountant, therefore, in providing accounting statements which all concerned may accept as disinterested expressions, based on technically sound procedures and experienced judgment, may serve as a kind of arbiter, interpreter, and umpire among all the varied interests. Thereby he can eliminate the necessity for costly separate investigations by each party at interest, as well as endless doubts, delays, misunderstandings, and controversies which are so much sand in the economic machine." 61/

61/ John L. Carey, Professional Ethics of Public Accounting (1946), pp. 13-14."

45/ See In the Matter of Cornucopia Gold Mines, 1 SEC 364, 367 (1936).

REGISTRANT'S REQUEST FOR WITHDRAWAL

In a "Statement of Counsel for Registrant In Lieu of Proposed Findings and Brief of Registrant" the registrant "urges the Hearing Examiner to find and conclude the most effective method of protecting the investors in Dixie Land & Timber Corporation and the public interest and allow DL&T to either withdraw its registration statement or amend after the new management team decides on the future course of Dixie".

According to the statement of counsel filed on November 9, 1965 the "new management team" came into existence in October 1965 as a result of "a disputed election (unresolved at this time)" after the hearings in these proceedings had been closed.

The fact that the management changed subsequent to these hearings is irrelevant to the question whether a stop order should ^{46/} issue. ^{47/}

The registrant's request for withdrawal of its registration is not supported by competent evidence, and should not be granted.

From the period April 15, 1959 to June 12, 1964, registrant sold either for cash or on a time subscription basis, 3,410,640

^{46/} Moreover, as the Division has pointed out, since the election is disputed, there may be a serious question whether such election was valid. Further, the facts regarding the validity of this action were not made a part of the record in this proceeding and for that reason they cannot be considered in reaching a determination of the issues herein.

^{47/} In the Matter of Ultra-Sonic Corporation, 37 SEC 497,506.

shares of its \$.25 par value common stock (adjusted for a 4-for-1 stock split) for approximately \$1,748,000 and also during that time exchanged 2,007,384 shares of its \$.25 par value common stock (adjusted for a 4-for-1 stock split) for "Assets and Timberlands". During the period from November 29, 1962 to May 12, 1964 registrant also sold, either for cash or on a time subscription basis, 880 of its 6-1/2% First Mortgage Sinking Fund Bonds for gross proceeds of \$88,000. None of these securities were registered under the Securities Act. Further, these securities were sold by means of state prospectuses containing materially false and misleading statements.

The issuance of a stop order in this matter is necessary to inform purchasers of Dixie's securities on a time subscription basis who are still making payments for stock as well as former purchasers of Dixie's securities of contingent liabilities that registrant may have for sales of its securities to them in violation of the Securities Act and the Securities Exchange Act of 1934, as amended, and to serve as a warning to the investing public that the Commission has found that the registration statement is untrue and materially mis-
^{48/}leading and, therefore, unreliable.

48/ The Court of Appeals for the 10th Circuit stated in Oklahoma-Texas Trust v. Securities and Exchange Commission (100 F. 2d 888 10th Cir. 1939) that:

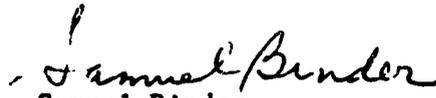
A stop order serves two purposes: First it suspends the effectiveness of the registration statement and the license of the issuer to use the mails and the facilities of interstate commerce for the purposes recognized by the act; second, it operates as a warning to the investing public that the Commission has found that the statement is untrue or mis-
leading and, therefore, unreliable.

A stop order suspending the effectiveness of registrant's registration statement should be issued.^{49/}

Accordingly, IT IS ORDERED pursuant to Section 8(d) of the Securities Act of 1933 that the effectiveness of the registration statement of Dixie Land and Timber Corporation be, and it hereby is suspended.

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

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


Samuel Binder
Hearing Examiner

Washington, D.C.
June 23, 1966 -

^{49/} The proposed findings and conclusions submitted have been considered. To the extent such proposals are consistent with this Initial Decision, they are accepted.