

ADMINISTRATIVE PROCEEDING  
FILE NO. 3-2990

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

**FILED**

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SECURITIES & EXCHANGE COMMISSION

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In the Matter of  
FOX-RAFF & COMPANY, INC.  
ROBERT L. RAFF  
File No. 8-13645

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INITIAL DECISION  
(Private Proceedings)

Washington, D.C.  
November 9, 1972

Sidney L. Feiler  
Administrative Law Judge

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APPEARANCES: Floyd L. Newland, Esq., Karr, Tuttle, Koch, Campbell,  
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Robert L. Raff

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Washington, 98104, for the Division of Enforce-  
ment

BEFORE: Sidney L. Feiler, Administrative Law Judge

These are private proceedings instituted by order of the Commission pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934, as amended ("Exchange Act"), to determine whether certain allegations set forth in the order are true and, if so, what, if any, remedial action is appropriate in the public interest.<sup>1/</sup>

The order for the proceedings sets forth allegations of the Division of Trading and Markets (now known as the Commission's Division of Enforcement ) that during the period from on or about July 31, 1970 to on or about March 12, 1971, Fox-Raff and Company ("registrant") willfully violated, and Robert L. Raff, president, director, and largest stockholder of the registrant willfully aided and abetted violations of the net capital rule.<sup>2/</sup>

It is also alleged that from on or about February 5, 1971, registrant willfully violated, and Raff willfully aided

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<sup>1/</sup> Sally E. Lang who was an officer, stockholder, and employee of the registrant during the relevant period also was named in the order for proceedings, but the Commission has accepted an offer of settlement submitted by her. (Sec. Exch. Act Rel. No. 9489, February 14, 1972).

<sup>2/</sup> Section 15(c)(3) of the Exchange Act and Rule 15c3-1 thereunder. The composite effect of these provisions, as applicable here, is to forbid the use by a broker or dealer of the mails or of the means and instrumentalities of interstate commerce to effect any transaction in or to induce or attempt to induce the purchase or sale of any securities (with certain exceptions) otherwise than on a national securities exchange when his aggregate indebtedness to all other persons exceeds 2,000 percent of his net capital or he does not have or maintain net capital of not less than \$5,000.

and abetted violations of applicable record keeping requirements.<sup>3/</sup>

It is further alleged that during the period from on or about January 22, 1971 to on or about March 12, 1971, registrant willfully violated, and Raff willfully aided and abetted violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder<sup>4/</sup> by making false and misleading statements of material facts and omissions of material facts concerning the registrant's past and present financial condition, including its earnings and losses, and its ability to execute customers' orders; registrant's violation of the Commission's net capital rule; falsification of registrant's books or records; and the risk that the Commission, the National Association of Securities Dealers ("NASD") or state authorities might take some action against registrant based on those activities.

Other allegations in the order for the proceedings are that registrant and Raff failed reasonably to supervise with a view to preventing the aforementioned violations by persons who were subject to their supervision and who committed such

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3/ Pursuant to the provisions of Section 17(a) of the Exchange Act and Rules 17a-3 and 4 thereunder, as relevant here, every registered broker or dealer is required to accurately make and keep current certain blotters, ledgers, and a record of proof of money balances of all ledger accounts and to preserve these and other records.

4/ The composite effect of these provisions, as applicable here, is to make unlawful the use of the mails or interstate facilities in connection with the purchase or sale of any security by means of a device or scheme to defraud or to make any untrue or misleading statements of material facts, or to engage in any act, practice, or course of conduct which operates or would operate as a fraud or deceit upon any person.

violations. It is also stated that on March 8 and 11, 1971 these respondents were permanently enjoined by the United States District Court for the Western District of Washington from violating Sections 10(b), 15(c)(3) and 17(a) of the Exchange Act and Rules 10b-5, 15c3-1, 17a-3 and 17a-4 thereunder.

Pursuant to notice, a hearing was held in Seattle, Washington. All parties were represented by counsel. Testimony was given by witnesses presented by the Division. A written stipulation was entered into (Div. Ex. 8) in which the respondents conceded the truth of the allegations in the order for the proceedings. After the conclusion of the evidentiary hearing, the Division filed proposed findings of fact, conclusions of law, and a brief in support thereof. The registrant did not submit any findings or a brief, but later submitted a memorandum from its counsel summarizing the current financial condition of registrant and citing certain factors in mitigation (Registrant's Exhibit 1). A memorandum and brief was filed on behalf of Raff addressed primarily to the sanction that might be appropriate as to him. The Division filed a reply brief.

On the basis of entire record, including his evaluation of the testimony of the witnesses, the undersigned makes the following:

## II. FINDINGS OF FACT AND LAW

### A. The Respondents

At all times here relevant, the registrant was registered with

the Commission as a broker dealer, pursuant to Section 15(b) of the Exchange Act. It was also a member of the NASD, a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act.

At all times here relevant, Robert L. Raff was the president, director and the largest stockholder of registrant. This relationship commenced prior to January 10, 1968 and continued until February 10, 1971 when Raff resigned his positions with the Company. He retained a stock interest in the registrant but is now no longer associated with the registrant in any way (Registrant's Ex. 1).

The registrant is now the subject of proceedings for an arrangement under Chapter XI of the Bankruptcy Act in the United States District Court for the Western District of Washington, said proceedings having been initiated on December 27, 1971.

#### B. Violations of the Exchange Act

As previously mentioned, during the course of the hearing the parties and their counsel submitted a signed Stipulation of Facts in which registrant and Raff, for the purpose of this proceeding only, admitted the matters of fact in the order for these proceedings. They also admitted certain facts relating to the obtaining by the respondents of a subordinated loan from Mrs. Theodora Burnett (Division Ex. 8). The details of the Burnett loan will be discussed later herein.

The balance of the evidence received at the hearing related to the obtaining of a subordinated loan by respondents from a customer, Gordon S. Giovanelli. Giovanelli had known Raff personally for a number of years and had maintained an account at the registrant since November 1968. On July 24, 1970 Giovanelli purchased through registrant \$200,000 in face value King Resources Company 5½ percent convertible subordinated debentures due 11-1-88, at a total price of \$74,750. The registrant had been suffering severe operating losses for several months in mid-1970 and had a net capital deficiency of \$320,537 on August 12, 1970. It ceased operation for several days until it was able to correct the situation by obtaining subordinated loans (Division Ex. 1). One of those approached was Giovanelli whom Raff asked for a loan of the King Resources debentures for 30 to 60 days. The loan was made.<sup>5/</sup>

In late September or early October 1970, Giovanelli asked Raff to sell the debentures. Raff agreed to do so, but departed on a month-long trip to the South Pacific shortly thereafter without causing Giovanelli's order to be executed. This matter was discussed extensively by Giovanelli with a representative of registrant in Raff's absence and with Raff, on the latter's return. Some guarantee or commitment was made

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<sup>5/</sup> The actual Subordination Agreement had a one-year term with a provision that it could not be changed in any way if the effect thereof would be to reduce the net capital of registrant below the amount required by the rules of the Commission.

to Giovanelli although the three witnesses who testified with relation to the arrangement all differed as to the details. In any event Raff caused registrant to issue a check to Giovanelli on November 27, 1970 for the amount of his purchase price of the King Resources debentures, \$74,750. This check was presented twice for payment but was not honored. When Giovanelli protested to Raff the latter told him that he would get him \$55,000 and pay the balance in a few days. Raff then instructed Sally Lang, who was in charge of the Operations Department of the registrant, to borrow the money to pay Giovanelli. The loan was made and Giovanelli was paid (Div. Ex. 2). The payment was made on December 9, 1970.

As previously noted, the registrant had had net capital problems from mid-1970. At this time it was filing weekly financial reports with the Seattle Regional Office of the Commission. The next report after the Giovanelli payment on December 9 was due on December 11. The additional loan made to cover the payment to Giovanelli had an adverse effect on the registrant's financial position and this would have been obvious if it had been so noted on the books of the Registrant. Instead, Miss Lang charged the check to an expense account and then, after a discussion with Raff and upon his instructions, entered it as a receivable (Tr. 112-115). Thus on statements of net capital computed as of December 11 and December 18, 1970, the registrant showed an excess of net capital over requirements (Div. Exs. 5 and 6). The King Resources debentures of Giovanelli



had been listed as part of subordinated inventory as of December 4, 1970. They were sold out of Giovanelli's account between December 7 and December 16, 1970 ; the amounts received were credited to his account (Div. Ex. 7) and a corresponding reduction was made in reported subordinated inventory.

It has been argued that registrant was entitled to an offsetting credit for monies received into the Giovanelli account because of the payment to him of \$55,000. However, it is not the purpose of this proceeding to adjudicate the respective rights of Giovanelli and the registrant, but the handling of this transaction illustrates the mishandling of the books and records of the registrant under the direction of Raff.

Another effort was made by the registrant to bolster its financial statement in preparation for its required filing on December 11, 1970. It has been stipulated that Miss Lang, at the request of Raff, telephoned a Mrs. Theodora Burnett on that day and requested her to make a subordinated loan of her securities (valued at about \$83,250), and held for her by the registrant. This loan was needed to put registrant in compliance with the Commission's net capital rule. Miss Lang told Mrs. Burnett that the loan would only be needed for twenty-four hours and that she would be paid \$1,000. Miss Lang assured Mrs. Burnett that the one-year term specified in the subordination agreement submitted to her would not interfere with the short term arrangement. Mrs. Burnett agreed to make the loan.

At the time the subordinated loan was made, Mrs. Burnett was not given any financial information about the current condition of the registrant, losses it had sustained, and various violations it had committed of the net capital and other rules. The loan from Mrs. Burnett continued to be outstanding until June 24, 1971 when the registrant ceased doing business and returned the borrowed securities to Mrs. Burnett.

During the last ten days of January 1971, Raff directed that Miss Lang cause the records of the registrant to show, and the Commission would be informed, that as of the weeks ending January 22 and 29 the registrant had received subordinated capital in the form of securities valued at \$46,421 from a Frank Potocnik. In fact, while there was an oral understanding between Raff and Potocnik, a written subordinated agreement was not executed until February 5, 1971, two days after the securities were physically delivered to the firm. The agreement with Potocnik was rescinded on or about February 12, 1971 and his securities were returned to him.

It is concluded that the registrant's activities in making transactions while it was undercapitalized were violative of the net capital rule and that the methods used by the registrant to record the entry of the payments made to Giovanelli and the entry of subordinated capital allegedly received from Potocnik were violative of the record keeping provisions of the Exchange Act and other applicable rules, including those dealing with

the preservation of records.<sup>6/</sup> These violations were willful.<sup>7/</sup>

It is further found that registrant willfully violated the anti-fraud provisions of the Exchange Act in its dealings with Mrs. Burnett and obtaining a loan from her based on incomplete and misleading information. Raff played a key part in arranging for and carrying out all the above violations. It is concluded that he willfully aided and abetted those violations.

### III. CONCLUDING FINDINGS, PUBLIC INTEREST

The Commission, pursuant to the provisions of Section 15(b)(5) of the Exchange Act, so far as it is material herein, is required to censure, suspend for a period not exceeding twelve months or to revoke the registration of any broker or dealer if it finds that such action is in the public interest, and such broker or dealer, subsequent to becoming such, has been permanently enjoined from certain acts and practices in connection with his activities as a broker or dealer; or has willfully

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<sup>6/</sup> The requirement that records be kept includes the requirement that said records be accurate. Lowell Niebuhr & Co., Inc., 18 S.E.C. 471 (1945); Carter Harrison Corbrey, 29 S.E.C. 283 (1949); See Morris Luster, 36 S.E.C. 298 (1955). Weiss, Registration and Regulation of Brokers and Dealers (1965), pp. 43-44, and cases cited in Footnote 19 therein.

<sup>7/</sup> Tager v. SEC, 344 F. 2d. 5, 8 (2nd Cir. 1965), affirming, Sidney Tager, Sec. Exch. Act Rel. No. 7368 (July 14, 1964); Accord Harry Marks, 25 S.E.C. 208, 220 (1947); George W. Chilian, 37 S.E.C. 384 (1956); E.W. Hughes & Company, 27 S.E.C. 629 (1948); Hughes v. SEC, 174 F. 2d 969 (C.A.D.C. 1949); Shuck & Co., 38 S.E.C. 69 (1957); Carl M. Loeb, Rhoades & Co., 38 S.E.C. 843 (1959); Ira Haupt & Company, 23 S.E.C. 589, 606 (1946); Van Alstyne, Noel & Co., 22 S.E.C. 176 (1946); Thompson Ross Securities Co., 6 S.E.C. 1111, 1122 (1940); Churchill Securities Corp., 38 S.E.C. 856 (1959). See generally Loss, Securities Regulation, (1961 Ed.), Vol. II, pp. 1309-1312 (1969 Supp.), Vol. V, pp. 3368-3374.

violated any provisions of the Exchange Act or any rule or regulation thereunder; or has failed reasonably to supervise with a view to preventing such violations by others subject to his supervision.

The Commission also, pursuant to the provisions of Section 15(b)(7) of the Exchange Act, may censure, bar, or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer, if it finds that such sanction is in the public interest and that such person has committed any of the violations mentioned above or has been enjoined from any act or practice specified above.

Furthermore, pursuant to Section 15A of the Exchange Act, it may expel or suspend a member of a registered securities association from membership therein who is subject to a sanction imposed by the Commission.

It has been found that the registrant, willfully aided and abetted by Raff, willfully violated the anti-fraud provisions of the Exchange Act, the net capital rule thereunder, the record keeping provisions and the preservation of record rules. In addition, registrant and Raff failed reasonably to supervise with the view to preventing the aforementioned violations through persons who were subject to their supervision and who committed such violations. Also, these respondents have been permanently enjoined from violating provisions of the Exchange Act and applicable rules thereunder. The NASD has imposed substantial sanctions on Raff for violations of its rules.<sup>8/</sup>

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The Division maintains that in view of the serious violations found, substantial sanctions should be imposed and Raff should be barred from association with any broker or dealer. It is argued on behalf of Raff that he did not controvert the allegations in the order for the proceedings, but stipulated as to the underlying facts; that the violations committed by him are all related to his hope and desire to keep the registrant alive and to serve the best interests of its employees and clients. It is urged that a period of suspension be imposed rather than a bar order which, it is claimed, would be punitive and permanently prevent him from engaging in the securities business and not serve the public interest.

The violations found were most serious and relate to key provisions of the Exchange Act. Raff made incomplete and misleading statements to those from whom he sought subordinated loans and thereby placed the assets of those persons under substantial risk. In addition, Raff directed that entries should be made in the registrant's books and records which made them inaccurate, incomplete, and misleading. As a result, the efforts of Commission staff to monitor compliance of the registrant with the net capital and other rules were thwarted and registrant carried on business as usual when remedial measures were required. Under these circumstances, the undersigned concludes that an order barring Raff from association with any broker or dealer is

required in the public interest.<sup>9/</sup>

The registrant is also responsible for the violations found since Raff was its chief officer and employee. However, it must be noted that the violations were either committed personally by Raff or directed and authorized by him. He is no longer associated with the registrant in any way. (Registrant's Ex. 1).<sup>10/</sup> All claims of customers of the registrant have been or are in the process of being paid pursuant to court order. Efforts are being made to realize on other assets of the registrant so that operations may be continued. Under all these circumstances, the undersigned concludes that it is not necessary in the public interest to revoke the registration of the registrant, but that a period of suspension would be appropriate.<sup>11/</sup> Accordingly,

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<sup>9/</sup> Such an order is a bar to continuance in the securities business. However, the Commission, upon an appropriate showing, may modify such an order by imposing conditions designed to protect the public interest. It has said: "The bars that are imposed by such order do not, however, necessarily mean that respondents are permanently excluded from the securities business; under the Exchange Act and applicable rules they are not precluded from applying for permission in the future to reenter that business upon an appropriate showing." (Pennaluna & Company, Inc., Sec. Exch. Act Rel. No. 8892, p. 3 (May 27, 1970).

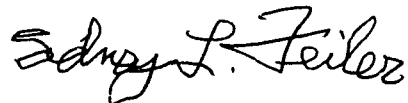
<sup>10/</sup> The Commission has considered the disassociation of a registrant from a primary wrong-doer as a mitigating factor. (Security Planners Associates, Inc., Sec. Exch. Act Rel. No. 9421, p. 6 (Dec. 17, 1971); Competitive Capital Corporation, Sec. Exch. Act Rel. No. 9184, p. 5 (May 25, 1971); Walston & Co., Inc., Sec. Exch. Act Rel. No. 8165, p. 4 n. 3 (Sept. 22, 1967).

<sup>11/</sup> Of course, after the period of suspension if registrant intends to continue in business it must be in full compliance with applicable rules.

IT IS ORDERED that Robert L. Raff is barred from association with any broker or dealer.

IT IS FURTHER ORDERED that the registration of Fox-Raff & Company, Inc., as a broker-dealer is suspended for a period of sixty days. Its membership in the National Association of Securities Dealers, Inc., is also suspended for sixty days.

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. This initial decision pursuant to Rule 17(f) shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(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.<sup>12/</sup>



Sidney L. Feiler  
Administrative Law Judge

Washington, D.C.  
November 6, 1972  
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<sup>12/</sup> All contentions and proposed findings and conclusions have been carefully considered. This initial decision incorporates those which have been accepted and found necessary for incorporation therein.