ADMINISTRATIVE PROCEEDING
FILE NO. 3-5175

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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| In the Matter of | : |
| LAWRENCE A. LUEBBE<br>(Benchmark Securities, Inc.) | : |
| | : |

# INITIAL DECISION

Washington, D.C.
September 23, 1977

Max O. Regensteiner
Administrative Law Judge

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APPEARANCES: Leonard H. Rossen, Michael K. Wolensky and Mark N. Zanides, of the Commission's San Francisco Branch Office, and Delores I. Smith, of the Los Angeles Regional Office, for the Division of Enforcement.

Lawrence A. Luebbe, pro se

BEFORE: Max O. Regensteiner, Administrative Law Judge

In these public proceedings instituted by the Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e) and (f) of the Investment Advisers Act of 1940, the issues to be considered are (1) whether Lawrence A. Luebbe ("respondent") engaged in misconduct as alleged by the Division of Enforcement and (2) what if any remedial action is appropriate in the public interest in the light of an injunction which has been entered against respondent and such misconduct as may be found herein.[1/]

The allegations as well as the injunction pertain to the offer and sale, during the period from July through October 1975, of general obligation bond anticipation notes issued by Reclamation District No. 2090, a California public agency. Respondent, who was then president of a registered broker-dealer, is charged with willfully violating and willfully aiding and abetting violations of antifraud provisions of the securities laws by recommending and selling such notes without having made a reasonable and diligent inquiry into the District's financial condition and in disregard of information regarding such condition and by making false and misleading statements concerning specified matters. On November 9, 1976, respondent was permanently enjoined, with his consent, from violating antifraud provisions in the offer or sale of the notes or any other security.[2/]

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1/ The order instituting the proceedings named three other respondents. The proceedings as to them have been disposed of on the basis of settlement offers accepted by the Commission and a default, respectively.

2/ S.E.C. v. Reclamation District No. 2090, Civil Action No. C-76-1231 RHS (N.D. Cal.). Respondent neither admitted nor denied the allegations of the complaint.

Following hearings, at which respondent represented himself, the parties filed proposed findings and conclusions and supporting briefs, and the Division filed a reply brief.

The findings and conclusions herein are based on the record and on observation of the witnesses' demeanor. Clear and convincing evidence is the standard of proof applied.[3/]

The Respondent

Respondent, who is 56 years old, has worked in the securities business since 1959, for the last 16 years on a full-time basis. After serving as branch manager of a broker-dealer for several years, he founded his own firm, MFAI Associates, in 1966 and has at all times been its president and sole shareholder. MFAI was registered as a broker-dealer from 1966 until the end of 1976, when it withdrew its registration. At the present time, MFAI is a "division" of another registered broker-dealer. The office out of which respondent operates is in his home, and his wife is the office supervisor.

Respondent was also for a number of years president and a director of a registered investment company. He was

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3/ The Commission has traditionally employed the "preponderance of the evidence" standard of proof. However, in its recent decision in Collins Securities Corporation v. S.E.C., C.A.D.C., August 12, 1977, the Court held that at least in cases involving alleged fraud and potentially severe sanctions, the higher "clear and convincing evidence" standard must be met. In the instant case, where there are no factual disputes of substance, the application of either standard yields the same results.

forced to resign from those positions in late 1976 because of the injunction against him. In addition, he has been secretary and a director of the investment company's management company and principal underwriter, which is registered both as an investment adviser and broker-dealer.[4/]

The District

The District, which was apparently created in 1955,[5/] encompasses about 983 acres in the Sacramento River Delta, some 55 miles east of San Francisco. It was formed by the owners of that land, pursuant to California's Water Code, with a view to raising funds for and engaging in reclamation and other projects. As of 1975, the District itself owned all but about 200 acres of the land within its boundaries. Thus, while it had the power to assess taxes on privately-owned land, its tax base was negligible.

In January 1975, the District authorized the issuance of $50 million in bond anticipation notes. As its name indicates, a bond anticipation note is a short-term note issued in anticipation of a bond issue. Such notes are normally retired with the proceeds of the bond issue. Alternatively, the bonds may be offered to the noteholders in exchange for the notes.

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4/ Respondent, who was also a shareholder of that company, states in his proposed findings that its ownership has recently been sold, but does not indicate whether he is still an officer or director. Section 9(a) of the Investment Company Act would appear to preclude such affiliation because of the injunction to the same extent it compelled him to resign his positions with the investment company.

5/ The information in the record concerning the District's history, operations and management is rather skimpy.

The District's notes, which carried interest at the rate of eight percent, were payable on April 1, 1976. By their terms, stated on the face of the notes, they were secured by revenues to be received or accrued by the District during the fiscal year ended June 30, 1975 and were to be paid from the proceeds of bonds to be issued by the District in accordance with an offer to purchase the bonds on file with the District's secretary. The notes further stated that notwithstanding the specified provisions for payment, they constituted a general obligation of the District and to the extent not paid from revenues or bonds would be paid from other available monies. 6/

It appears that out of the $50 million in notes which were authorized, only $5 million was actually issued. Those notes were issued to one James Dondich in exchange for property in Colombia, South America. About $1.22 million of the notes were sold to public investors. Dondich sold $400,000 face amount of notes at substantial discounts to National Municipal Bond Company ("National"), a municipal securities dealer of which one Roger Osness was a principal. National, which as a dealer exclusively in municipal securities

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6/ The opinion of bond counsel attached to each note stated the basis for payment somewhat differently. It stated that the notes were payable out of revenues to be received or accrued by the District during its 1975 fiscal year, "and more specifically" from the proceeds of bonds for whose purchase the District had a commitment, and that if "such revenues" were insufficient, the notes were payable from all available monies and constituted general obligations for which the District's full faith and credit was pledged.

was at that time not subject to registration under the Exchange Act,[7] in turn marketed $55,000 of the notes through MFAI.[8] In or about May 1975, the District also authorized the issuance of $1 million in general obligation negotiable promissory notes; these were subsequently sold, apparently to public investors.

The financial reports of the District to the State Controller for the fiscal years ended June 30, 1974 and 1975 (the latter filed on August 1, 1975) and its certified financial statements for the 1974 fiscal year showed, among other things, that the District had no revenues from taxes or assessments in either year; that in the earlier year, its total revenues were about $437,000, consisting almost entirely of a non-recurring prepaid rental item, and net revenues over expenditures amounted to about $174,000; and that in fiscal 1975 revenues totalled only about $43,000 and the District lost over $154,000 on operations.

When the notes and interest thereon became due in April 1976, the District defaulted. And the bond issue referred to in the notes never materialized. In June 1976, the District filed a petition under Chapter IX of the Bankruptcy Act,[9] alleging that it was unable to pay its debts as they matured.

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7/ The provisions of the Securities Acts Amendments of 1975 requiring the registration of broker-dealers dealing in municipal securities did not become effective until December 1, 1975.

8/ The record does not indicate how the balance of the $1.22 million face amount of the notes reached public investors.

9/ Chapter IX provides for the adjustment of debts of political subdivisions and public agencies.

For reasons which do not appear in the record, the petition was dismissed in April 1977.[10/]

Violations in Sale of Notes

During the period from July 10 to October 28, 1975, MFAI sold bond anticipation notes in the total amount of $55,000 to eight customers. Respondent personally sold notes totalling $20,000 to three customers during July. He knew that those persons were principally concerned with the safety of their investments. Yet he recommended these securities to them despite the fact that he had little information of a reliable nature about the District and in particular had no reliable financial data.

Two of respondent's customers testified at the hearing. Their testimony, which is undisputed, is credited. One of them advised respondent that he planned to retire in two years from his job as proofreader, had a maximum of $5,000 to invest, and wanted an investment that was secure. Respondent recommended a $5,000 note to him and stressed that it was a safe investment. The customer thereupon purchased the note. The other investor-witness and her husband, who together also invested $5,000 in a note, are both employed by the U.S. Postal Service, she as a clerk and he as a carrier. She testified that they advised respondent they were interested in investing for their retirement and needed a secure investment. Respondent

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10/ According to the Division's reply brief, on June 26, 1977 the Court reopened the Chapter IX proceeding upon the District's petition.

assured them the note was a good and safe investment. MFAI distributed to these customers and to others a flyer, under National's name, which contained some general information about the notes, but none about the District. The contents of the flyer are described in more detail below. As of the time of the hearing in April 1977, more than a year beyond the maturity date of the notes, the investors had not received any payment of interest or principal.

Such information as respondent had concerning the District came almost entirely from National and Osness. The latter had made a "cold" call on MFAI in late 1974 to interest that firm in selling municipal securities distributed by National. Discussions culminated in a contract between National and MFAI in December 1974 under which the latter would sell municipal bonds made available to it by National in return for an eight percent commission. Notwithstanding the extent of his reliance on Osness, respondent did not inquire into Osness's experience with the securities regulatory agencies and thus was not aware that Osness had been sanctioned by the Commission. 11/

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11/ In 1973 Osness, who had been an officer of a registered broker-dealer, was barred by the Commission from association with any broker-dealer, provided that after seven months he could apply for re-entry into the securities business in a supervised capacity on condition that he would handle only certain types of securities. Securities Exchange Act Release No. 10263 (July 3, 1973), 2 SEC Docket No. 3, p. 88. The Commission's order was based on a settlement offer submitted by Osness. In those proceedings, Osness was charged, among other things, with violations of antifraud provisions of the securities laws.

While National made several municipal securities available to MFAI, the latter offered only two to its customers: an industrial revenue bond and the District notes. In the case of the revenue bonds, respondent arranged through Osness to have sales cancelled and money refunded to MFAI customers who had bought the bonds, when respondent ascertained that as a result of weather-related problems there would be a delay in moving the industrial enterprise in question into the municipally-owned facility.

With respect to the District notes, Osness and an associate furnished respondent with three items of written information. One was a specimen copy of the note. The second item, which was furnished in quantity and as noted was distributed by MFAI to prospective purchasers, was the above-mentioned flyer. It stated that the notes were tax-exempt, were due on April 1, 1976, and were to be redeemed by full payment plus accrued interest or by the issuance of ten-year general obligation bonds bearing eight percent interest. It listed the name and address of the District's counsel, and it stated that the offering was subject to approval of legality by named bond counsel and that only $5 million of notes, out of the total $50 million issue, had been issued. The balance of the flyer consisted of a reproduction of the text on the face of the note. Thus, as noted by the Division, the flyer said nothing about the District's financial condition or tax base, the background of its management, its existing

debt structure or other matters of a material nature.

The final item which National provided to respondent was a one-page sheet entitled "Background Information." Osness informed respondent that this sheet had not been cleared for customer use. The sheet stated, among other things, that the District was engaged primarily in developing innovative concepts of aquaculture which were receiving world-wide attention and secondarily in developing recreational and educational facilities.

Prior to the time MFAI began to sell the notes, Osness, in answer to respondent's questions, orally gave him certain additional information concerning the District. Some of the information pertained to the District's present and proposed operations and the identity of its management. The financial information conveyed was, in respondent's words, "only general." Osness told respondent that the District's books, which he said he had seen, showed that its assets exceeded $100 million, including a substantial interest in land in South America, and its liabilities were less than $10 million. When respondent asked Osness to get him copies of "this," Osness said he would attempt to do so, but respondent received no copies before the sales began. Later Osness advised respondent that he had received "additional statements, the written ones," but that District officials had asked him not to divulge those and had indicated they would give them to

respondent directly. Osness said that, pursuant to respondent's request, he would arrange for a visit by respondent to the District and see to it that respondent received financial statements at that time. As it happened, respondent did not see the District until about October 1976. Beginning in early July 1975, respondent had some telephone conversations with the District's general manager concerning a visit. The latter at first promised to arrange for a prompt visit, but thereafter interposed a series of delays. Respondent obtained no written financial data until August 1976, when Osness furnished him with unaudited material purportedly emanating from the District.

At or about the time MFAI began selling the notes, respondent also contacted the District's counsel and bond counsel. The record does not indicate the nature of his discussions with the latter. Respondent asked district counsel whether the District had financial problems, and the latter responded that any organization can have financial problems. Counsel also informed respondent that the District was having problems with the county in which it was located regarding the intended land use, but further stated that "if that didn't work out they had alternate methods of operation." (Tr. 232) Respondent did not ask counsel how much money the District had made in the past year.

The crux of the case against respondent is that he recommended the District notes to his customers, caused MFAI

salemen to recommend them to their customers and assured customers these were safe investments even though he had failed to make a diligent and reasonable inquiry into the material facts concerning the District, in particular its financial condition, and thus had no adequate basis for such recommendations and representations. As the Court of Appeals for the Second Circuit pointed out in an oft-quoted statement, a securities salesman

> ". . . cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation." 12/

While there may be significant differences under the securities laws in the treatment to be accorded transactions in municipal as distinguished from corporate securities, 12a/ the Commission made clear many years ago that the duty of diligent inquiry encompasses dealers who recommend the purchase of municipal securities to their customers. 13/ That duty is particularly apparent and important where the issuing agency is as obscure as the one involved here.

In one of its recent decisions, the Commission, dealing with a situation closely analagous to that presented here, said:

> "A professional who recommends the unknown securities of obscure issuers is under a duty to investigate and to see to it that his recommendations have a reasonable basis. In prior cases we pointed out that a salesman cannot recommend the equity securities of such issuers without reliable financial data. This proposition is even more compelling when we deal, as here, with debt securities." (Footnotes omitted) /14/

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12 / Hanly v. S.E.C., 415 F.2d 589, 597 (C.A. 2, 1969).

12a/ See, e.g., Doty and Peterson, The Federal Securities Laws and Transactions in Municipal Securities, 71 Northwestern University Law Review 283 (1976).

13/ Walston & Co., Inc., 43 S.E.C. 508 (1967).

14/ Willard G. Berge, Securities Exchange Act Release No. 12846 (September 30, 1976), 10 S.E.C. Docket 600, 602.

Addressing itself to the contention of respondents in that case that they properly relied on the advice of the presidents of their respective broker-dealer firms that the issuer's financial condition was satisfactory, the Commission went on to state:

> ". . . oral assurances . . . could not be used as a substitute for the concrete financial data called for in situations such as this . . . no salesman can recommend an unknown or little known security unless he has himself seen reliable financial data that supply him with a reasonable basis for his recommendation. This is especially true of debt securities. Having no current financial data, respondents could not possibly have had an adequate basis for recommending [the] notes." (Footnote omitted) 15/

Respondent contends that at the time he began to sell the notes, he did have financial information concerning the District, in the form of Osness's statements regarding the District's assets and liabilities. He urges that it was only a technicality that he did not have at that time copies of the written financial material on which those statements were based, and that when he received such material in August 1976 it bore out the accuracy of Osness's statements. These arguments are without merit. Even aside from the propriety of respondent's almost exclusive reliance for information on National and Osness, about whom he knew very little, 16/

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15/ Ibid.

16/ See Cortlandt Investing Corporation, 44 S.E.C. 45, 51 (1969):

> "While in an appropriate case an employee may be entitled to to rely upon his own employer for information respecting a security he undertakes to sell, a higher standard of care is required of those engaged in the securities business who would place reliance upon market letters or other materials or information respecting a security which was prepared or supplied by another broker-dealer."

oral information regarding an issuer's financial situation is, as noted above, not a substitute for review of reliable written financial data. Indeed, respondent's inability to obtain such data should have served as a "red flag." Moreover, the oral information which respondent received from Osness amounted at best to the bottom lines of a balance sheet. It revealed nothing concerning the District's revenues, income (or loss) from operations, or its tax base. Respondent's assertion that in the case of a general obligation note or bond, the public agency's total assets, not only its taxing capacities, are subject to the security holders' claims appears to be unfounded.[17/] Moreover, the little information which respondent had concerning the District's assets should have served as a "red flag" rather than satisfying him that the notes represented sound investments for his customers. Osness told him that the District had substantial land holdings in South America. The nature of this purported asset should have raised questions in respondent's mind regarding the legitimacy of the District's operations or at least the quality of its management.[18/]

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17/ The District's notes by their terms subjected only the District's "available monies," not its assets, to the claims of noteholders.

18/ The Division maintains that the District never obtained title to the South American property. There is no evidence in the record to that effect. The record does, however, raise serious questions as to the legitimacy and value of this asset. According to the financial data which Osness furnished to respondent in August 1976, the District's total assets at June 30, 1975 were almost $108 million, including a 350,000-acre ranch in Colombia valued at $96 million. A footnote to the list of assets stated, however, that the ranch was "not listed in capital assets on accountant's report as it was not recorded as of June 30, 1975," but that it would be included in the 1976 accounting (continued)

Respondent also argues that at the time MFAI began to sell the notes, it was not yet possible to get a current audited financial report for the District since the District's fiscal year had ended only a short time before then. The argument misses the point, which is that it was respondent's obligation not to offer or sell the notes in the absence of reliable financial information.

The fact that under the terms of the notes they were payable from the proceeds of bonds to be issued by the District does not affect the conclusions expressed above.[19/] The District's financial condition and particularly its ability to service any bonds issued were of course critical to its ability to sell a bond issue. Respondent had no reliable information bearing on these basic matters.

The order for proceedings alleges, and the Division contends, that respondent, in addition to his failure to make a diligent investigation, made false and misleading statements of material facts. Aside from stressing the safety of the investment, respondent said little to his customers about the District or its notes. He did, however, distribute the flyer. And

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18/ (continued)
period. The financial report for fiscal 1975 filed by the District with the State of California showed total assets at June 30, 1975 of only $3.4 million, including land carried at $927,321. Among the obvious questions which come to mind are: why would Dondich exchange land with a $96 million value for $5 million in notes? And why would a California reclamation district want to own land in far-away South America?

19/ The flyer, somewhat inconsistently with the terms of the notes, stated that the notes were to be redeemed by full payment plus accrued interest from the date of purchase or by the issuance of ten-year general obligation bonds.

that contained some materially misleading statements.[20] In particular, it was misleading to state that the notes were secured by revenues to be received or accrued during the 1975 fiscal year when, at the time MFAI and respondent sold the notes, that year had already been completed and the District had had only minimal revenues and had lost over $150,000 on its operations. Further, the representation that the notes, as general obligations of the District, would be paid from any other available monies if not paid from revenues or bonds, was misleading in the absence of disclosure concerning the District's financial condition and its negligible tax base.

Based on the above findings, it is concluded that respondent willfully violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[21]

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20/ Certain of the alleged misrepresentations are not clearly established by the record which contains little or no information about such matters as the District's operations and the reason why the proposed issue of general obligation bonds never materialized.

21/ The term "willfully" within the meaning of Section 15(b) of the Exchange Act and Section 203(f) of the Investment Advisers Act means intentionally committing the acts which constitute the violations. It does not require an awareness that the law is being violated. See Tager v. S.E.C., 344 F.2d 5, 8 (C.A. 2, 1965); Lipper v. S.E.C., 547 F.2d 171, 180 (C.A. 2, 1976); Roman S. Gorski, 43 S.E.C. 618, 621 (1967).

Public Interest

The remaining issue concerns the remedial action which is appropriate in the public interest. The Division, stressing the seriousness of respondent's misconduct and his "misbegotten notion" of his responsibilities to customers as reflected in his testimony, recommends that he be barred from association with any broker-dealer, with the proviso that after one year he be permitted to return to the securities business in a non-supervisory capacity upon a showing of adequate supervision. 22/ For the reasons discussed below, I conclude that a somewhat less stringent and more discriminating sanction will adequately protect the public interest.

Both the Division and respondent place some emphasis on respondent's actions in connection with termination of MFAI's sales of the notes and subsequent thereto. As indicated previously, MFAI's last sale of District notes took place on October 28, 1975. The Division asserts that the termination of sales was due to the fact that National went out of business in November 1975. However, I credit respondent's testimony that it was attributable rather to his increasing concern about the legitimacy of the District's operations. That concern was fueled by the fact that

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22/ The Division's proposed sanction would also bar respondent from association with a municipal securities dealer. Such a sanction cannot be imposed in these proceedings, however, since the order for proceedings did not encompass Section 15B of the Exchange Act relating to municipal securities dealers. The Division did not recommend the imposition of any sanctions under the Investment Advisers Act.

the visit to the District which had been promised him and the related furnishing of financial statements to him were continually put off. The final straw was that respondent was advised that the District's general manager was away on an extended trip and that no one else at the District could answer his questions. In early November 1975, respondent wrote to both the county attorney's office and the state attorney general's office seeking information about the District. In addition, he contacted the Commission's San Francisco office to express his concern.

Respondent's recognition, albeit belated, that sales should not continue, and his communications to the authorities, are entitled to some consideration as mitigating factors. On the other hand, that effect is largely dissipated by respondent's failure to advise the customers who had purchased the notes of the fact that he had terminated sales because of his serious concern about the District. Moreover, his communications to those persons after the District had already defaulted on its obligations smack of obfuscation, to put the best face on them. In early April 1976 he requested certain information from each customer on behalf of the District and added that "on receipt of this information from you, the District should be sending your interest payments and the anticipated 10-year General Obligation Bond." When he wrote this, respondent knew that the District was in default. And he had no basis, except apparently a further representation by Osness, for making such a statement. Respondent's

argument that he was merely advising the customers of the District's obligations under the terms of the notes and not that it "would" take the indicated action can only be characterized as disingenuous. Moreover, even if the communications could be read that way, they would still have been misleading since there was no disclosure that respondent had no reasonable basis for believing that the District could or would belatedly comply with its obligations.

The concern expressed by the Division regarding respondent's understanding of his responsibilities to customers in connection with the recommendation of securities seems well founded. Even today, respondent continues to insist that he had an adequate basis for recommending the notes. And he testified that he had not considered making restitution to the note-purchasers, because "these were the risks involved in securities." (Tr. 331) Respondent went on to explain that if he reimbursed those customers, he would also have to reimburse others whose investments had declined in value. These statements reflect a fundamental misconception of the principles involved here. While every securities investor assumes the risk of a decline in the value of his investment, the securities laws were designed in part to relieve him of the risk that his broker would recommend an investment without a reasonable basis for doing so.

Finally, in the assessment of the action that is appropriate and necessary in the public interest and for the protection of

investors, certain factors that weigh in respondent's favor need to be considered. Thus, his actions to make customers whole in connection with the revenue bonds were commendable. Moreover, in his 18 years in the securities business, during which his experience has been confined largely to the retail sale of mutual fund shares, he has not been the subject of any other disciplinary action. The rather impressive character testimony presented in his behalf is also entitled to some consideration. Giving due regard to all pertinent facts and circumstances, I conclude that a relatively brief suspension of respondent from the mutual fund business, coupled with exclusion for at least nine months from other areas of the securities business, will appropriately protect the public interest from future harm. 23/

Accordingly, IT IS ORDERED that Lawrence A. Luebbe is hereby barred from being associated with a broker or dealer, provided that

(1) After three months he may become so associated for the sole purpose of engaging in the offer and sale at retail of redeemable securities issued by investment companies registered under the Investment Company Act of 1940; and

(2) After nine months he may apply to the Commission for permission to become so associated on a basis not so restricted,

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23/ Cf. Bruce W. Zimmerman, Securities Exchange Act Release No. 12690 (August 5, 1976), 10 SEC Docket 175, rehearing denied, Securities Exchange Act Release No. 12790 (September 13, 1976), 10 SEC Docket 458.

but only in a non-supervisory position and upon a showing of adequate supervision.[24/]

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

Max O. Regensteiner
Administrative Law Judge

Washington, D.C.
September 23, 1977

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